Stressed Assets Funding (Restructuring & Alternative Fund Raising options)

By Dr. Anil Yadavrao Gaikwad

RBI Prudential Norms For Income Recognition, Asset Classification And Provisioning Pertaining To Advances

In line with the international practices and as per the recommendations made by the Committee on the Financial System (Chairman Mr. M. Narasimham), the Reserve Bank of India had introduced, in a phased manner, prudential norms for Income Recognition, Asset Classification and Provisioning for the advances portfolio of the banks so as to move towards greater consistency and transparency in the published accounts.


Non Performing
Assets

RBI PRUDENTIAL NORMS FOR INCOME RECOGNITION, ASSET CLASSIFICATION AND PROVISIONING PERTAINING TO ADVANCES

What is a Non Performing Asset (NPA)?

- An asset, including a leased asset, becomes non performing when it ceases to generate income for the bank. A non performing asset (NPA) is a loan or an advance where;
- Interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan.
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- The installment of principal or interest thereon remains overdue for two crop seasons for short duration crops.

RBI PRUDENTIAL NORMS FOR INCOME RECOGNITION, ASSET CLASSIFICATION AND PROVISIONING PERTAINING TO ADVANCES

Categories of NPAs

- Banks are required to classify nonperforming assets further into the following three categories based on the period for which the asset has remained nonperforming and the realisability of the dues:

1. **Substandard Assets**
2. **Doubtful Assets**
3. **Loss Assets**

- Non-performing assets (NPAs) are a key concern for banks in India. They are the best indicator of the health of the banking industry.

- The increase in NPAs shows the necessity of provisions, which bring down the overall profitability of banks. Therefore to improve the efficiency and profitability of banks, NPAs need to be reduced and controlled. A high degree of NPAs suggests high probability of a large number of credit defaults that affect the profitability and liquidity of banks.

Issues relating to high level of NPA of Indian Banks

- The NPA issue has been afflicting the performance of banks for the last couple of years and the question being asked is whether or not the worst is over.
- NPAs would broadly come under two buckets, which however are difficult to distinguish. The first is on account of the recognition of the quality of the asset (the AQR norms were introduced in 2016) which pertains to the past while the second refers to new NPAs being generated.
- The sudden upsurge in the NPAs for banks in the last 2-3 years can be largely attributed more to the recognition aspect. It was widely believed that the NPA level had peaked in March 2018.
- Subsequently there was a tendency for the ratios to show some moderation. This was also observed for provisions (where it may be assumed that upwards of 80% are on account of NPA) that were made in the last two quarters.

Issues relating to high level of NPA of Indian Banks

- As per CARE Ratings - While it cannot be said with any certainty that declining NPA ratios in Q2-FY19 indicate a turnaround, a thumb rule can be that two successive quarters of declining NPA ratio can give confidence that the ratio will not increase in the coming quarters.

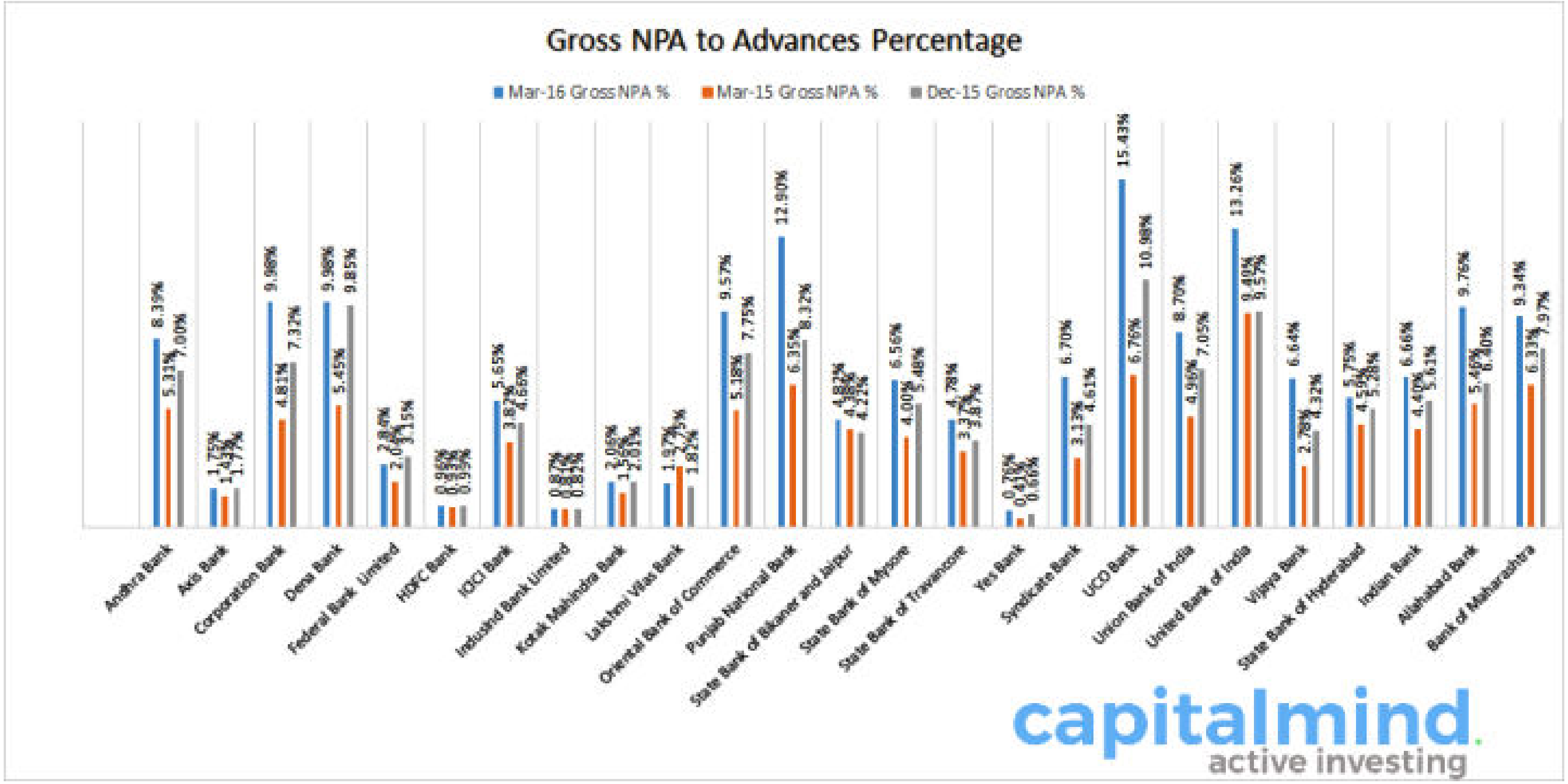
Issues relating to high level of NPA of Indian Banks

Gross NPA ratio (%)

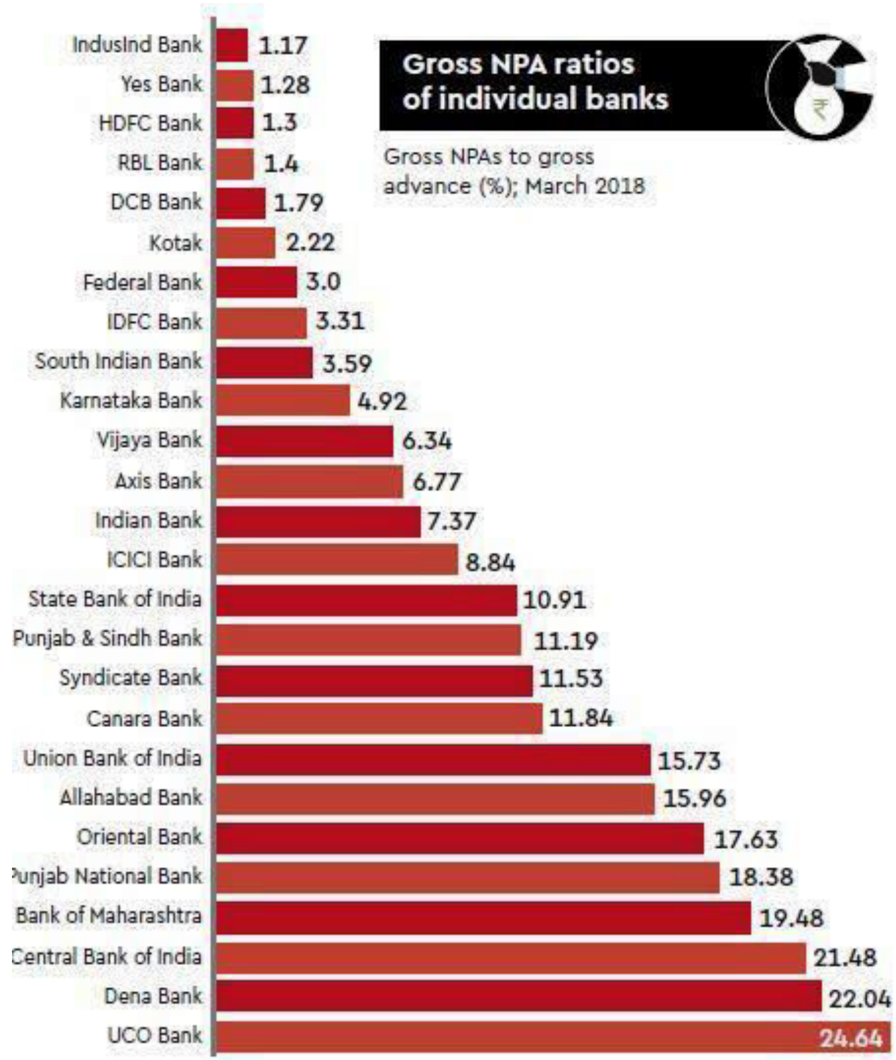
Company Name	201609	201612	201703	201706	201709	201712	201803	201806	201809
Andhra Bank	11.49	11.88	12.25	13.33	13.27	14.26	17.09	16.69	16.36
AU Small Finance Bank Ltd.	2.43	2.75	1.89	2.98	3.08	2.83	2.01	2.17	2.03
Axis Bank Ltd.	4.17	5.22	5.04	5.03	5.90	5.28	6.77	6.52	5.96
Bank Of Baroda	11.35	11.40	10.46	11.40	11.16	11.31	12.26	12.46	11.78
Bank Of Maharashtra	14.08	15.08	16.93	18.59	18.54	19.05	19.48	21.18	18.64
Canara Bank	9.81	9.97	9.63	10.56	10.51	10.38	11.84	11.05	10.56
City Union Bank Ltd.	2.69	2.98	2.83	3.05	3.07	3.30	3.03	3.02	2.85
DCB Bank Ltd.	1.75	1.55	1.59	1.74	1.80	1.89	1.79	1.86	1.84
Dena Bank	13.79	14.79	16.27	17.37	17.23	19.56	22.04	22.69	23.64
Dhanlaxmi Bank Ltd.	6.86	7.59	4.78	5.62	6.11	6.96	7.35	8.94	7.81
HDFC Bank Ltd.	1.02	1.05	1.05	1.24	1.26	1.29	1.30	1.33	1.33
ICICI Bank Ltd.	6.12	7.91	8.74	8.84	8.79	8.55	9.90	9.65	9.30
IDFC Bank Ltd.	5.96	7.03	2.99	4.13	3.92	5.62	3.31	3.24	1.63
Indian Overseas Bank	21.77	22.42	22.39	23.60	22.73	21.95	25.28	25.64	24.73
IndusInd Bank Ltd.	0.90	0.94	0.93	1.09	1.08	1.16	1.17	1.15	1.09
Karur Vysya Bank Ltd.	2.29	2.66	3.58	4.27	4.83	5.94	6.56	7.44	7.70
Kotak Mahindra Bank Ltd.	2.49	2.42	2.59	2.58	2.47	2.31	2.22	2.17	2.15
Oriental Bank Of Commerce	12.36	13.80	13.73	14.83	16.30	16.95	17.63	17.89	17.24
Punjab National Bank	13.63	13.70	12.53	13.66	13.31	12.11	18.38	18.26	17.16
RBL Bank Ltd.	1.10	1.06	1.20	1.46	1.44	1.56	1.40	1.40	1.40
State Bank Of India	7.14	7.23	6.90	9.97	9.83	10.35	10.91	10.69	9.95
Syndicate Bank	7.72	8.69	8.50	9.96	9.39	9.62	11.53	12.59	12.98
Federal Bank Ltd.	2.78	2.77	2.33	2.42	2.39	2.52	3.00	3.00	3.11
Jammu & Kashmir Bank Ltd.	11.33	11.84	11.20	10.79	10.87	10.08	9.96	9.83	9.00
Karnataka Bank Ltd.	3.64	4.30	4.21	4.34	4.13	3.97	4.92	4.72	4.66
Lakshmi Vilas Bank Ltd.	2.70	2.78	2.67	3.78	5.50	5.66	9.98	10.73	12.31
South Indian Bank Ltd.	3.96	3.98	2.45	3.61	3.57	3.40	3.59	4.54	4.61
Union Bank Of India	10.73	11.70	11.17	12.63	12.35	13.03	15.73	16.00	15.74
Vijaya Bank	7.07	6.98	6.59	7.30	7.06	6.17	6.34	6.19	5.86
Yes Bank Ltd.	0.83	0.85	1.52	0.97	1.82	1.72	1.28	1.31	1.60
Set of 30 banks	**7.73**	**8.15**	**7.87**	**9.07**	**8.98**	**9.02**	**10.16**	**9.95**	**9.41**

NPA STATUS OF THE BANKS

Bank-wise NPA



NPA STATUS OF THE BANKS



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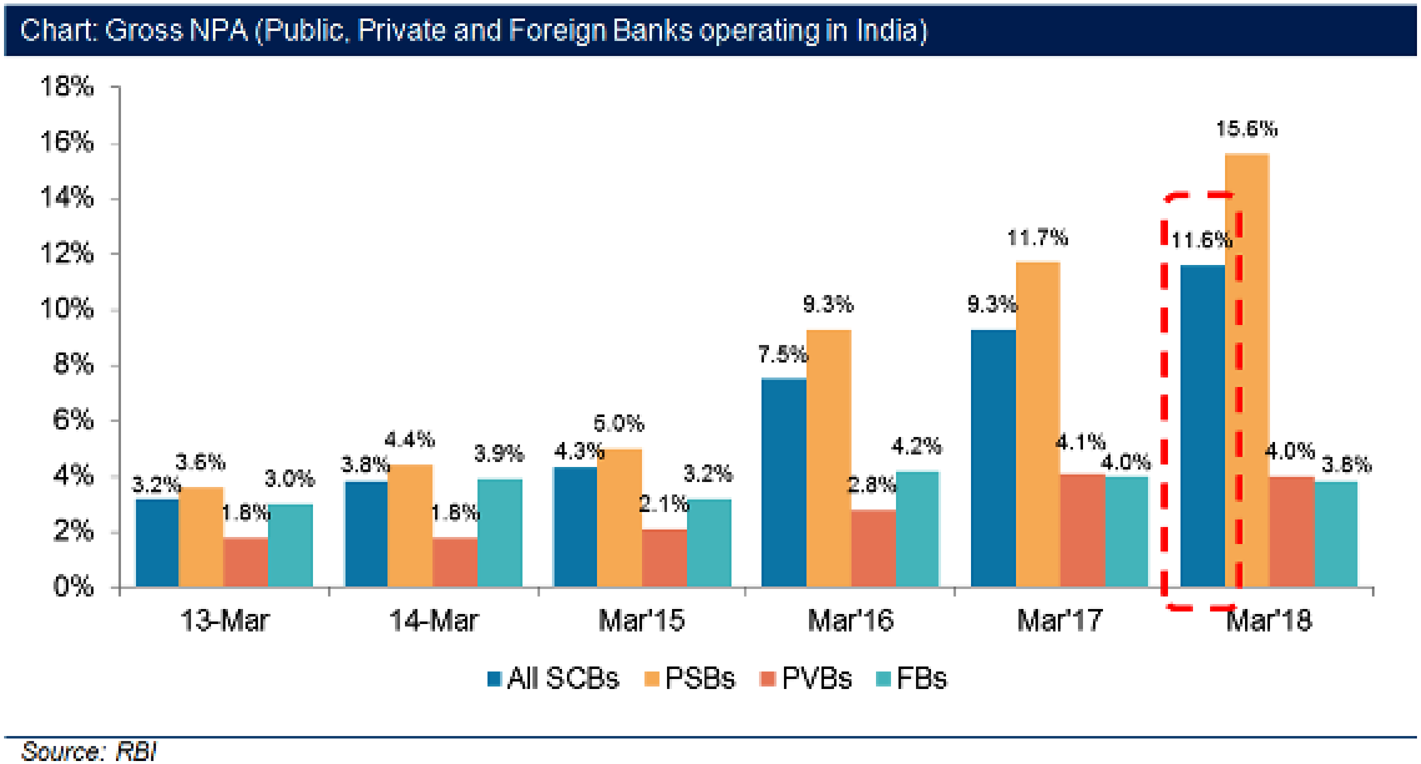
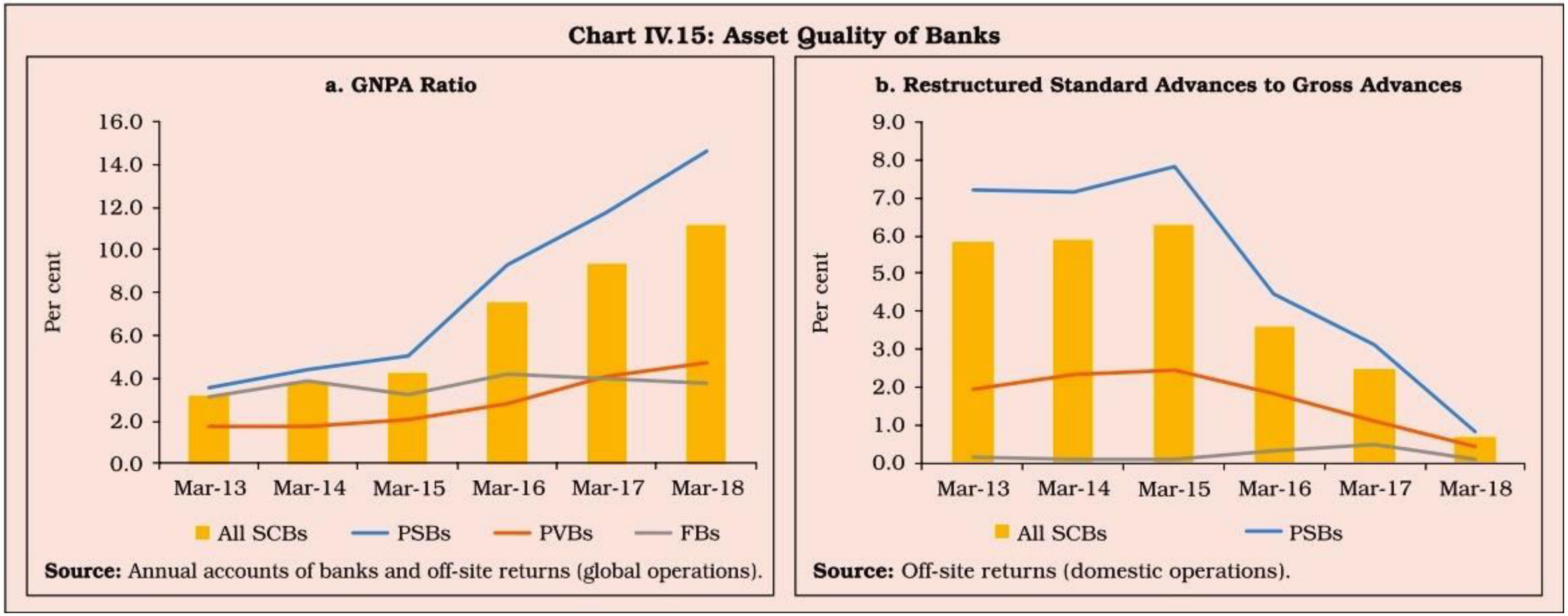


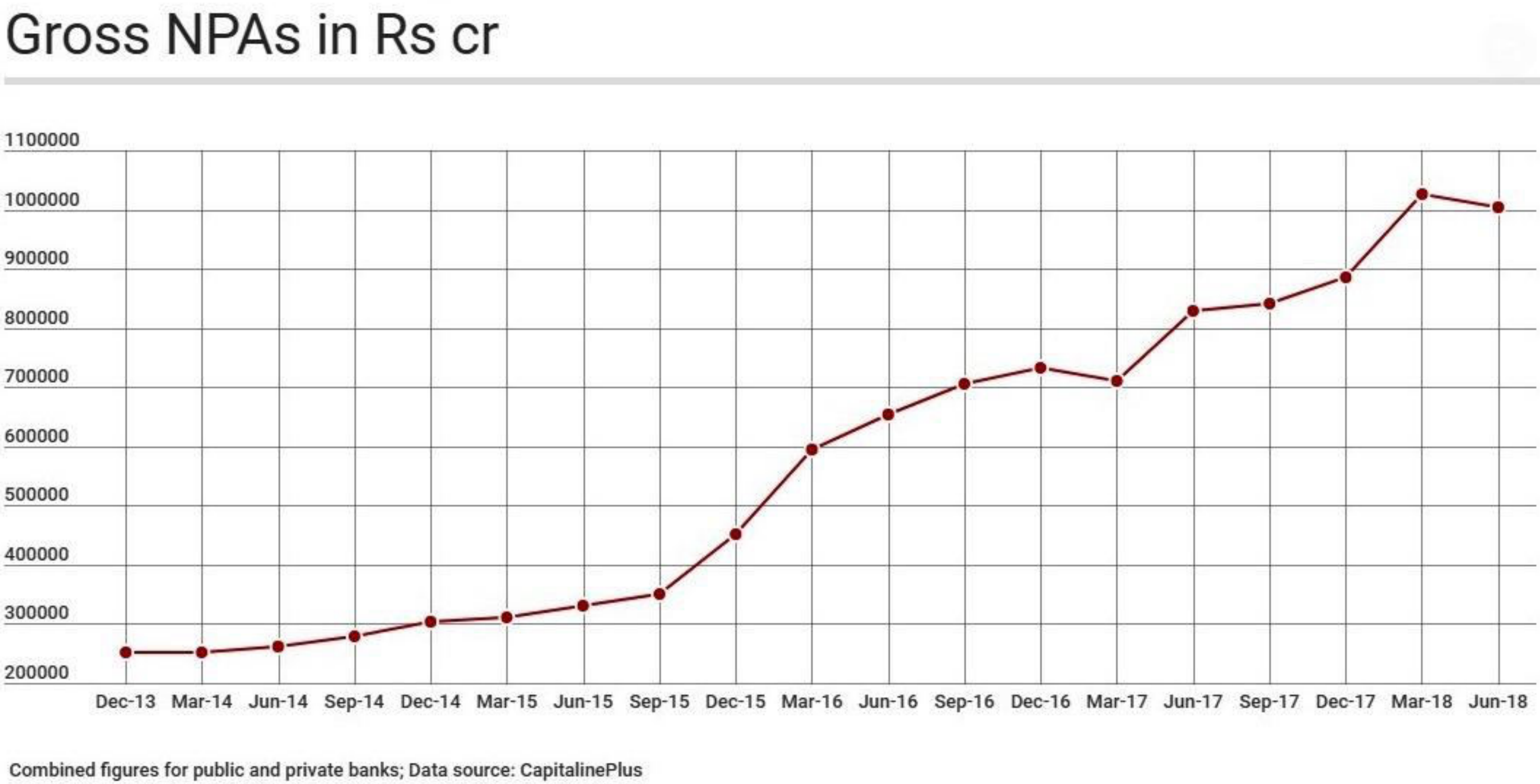
Gross NPA – Type of Bank Wise

Issues relating to high level of NPA of Indian Banks



NPA STATUS OF THE BANKS

These seven charts throw more light on the bad loans crisis that has engulfed the nation's banking sector:



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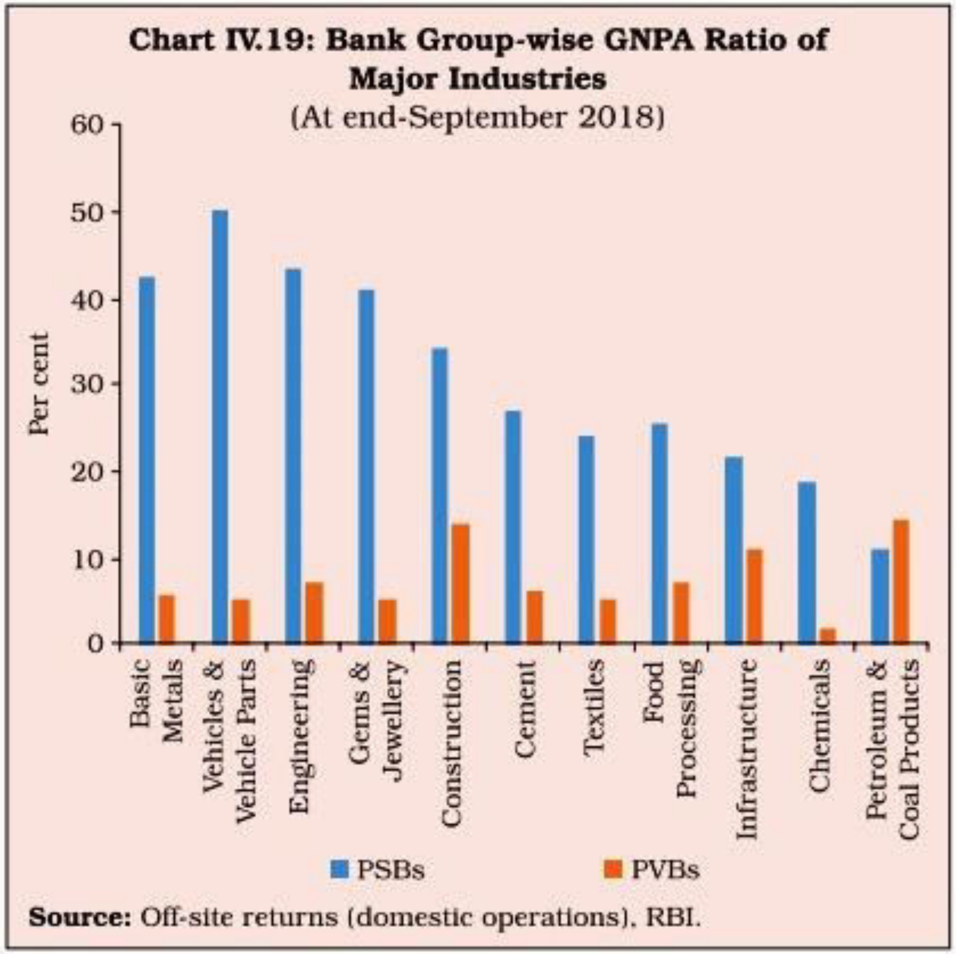
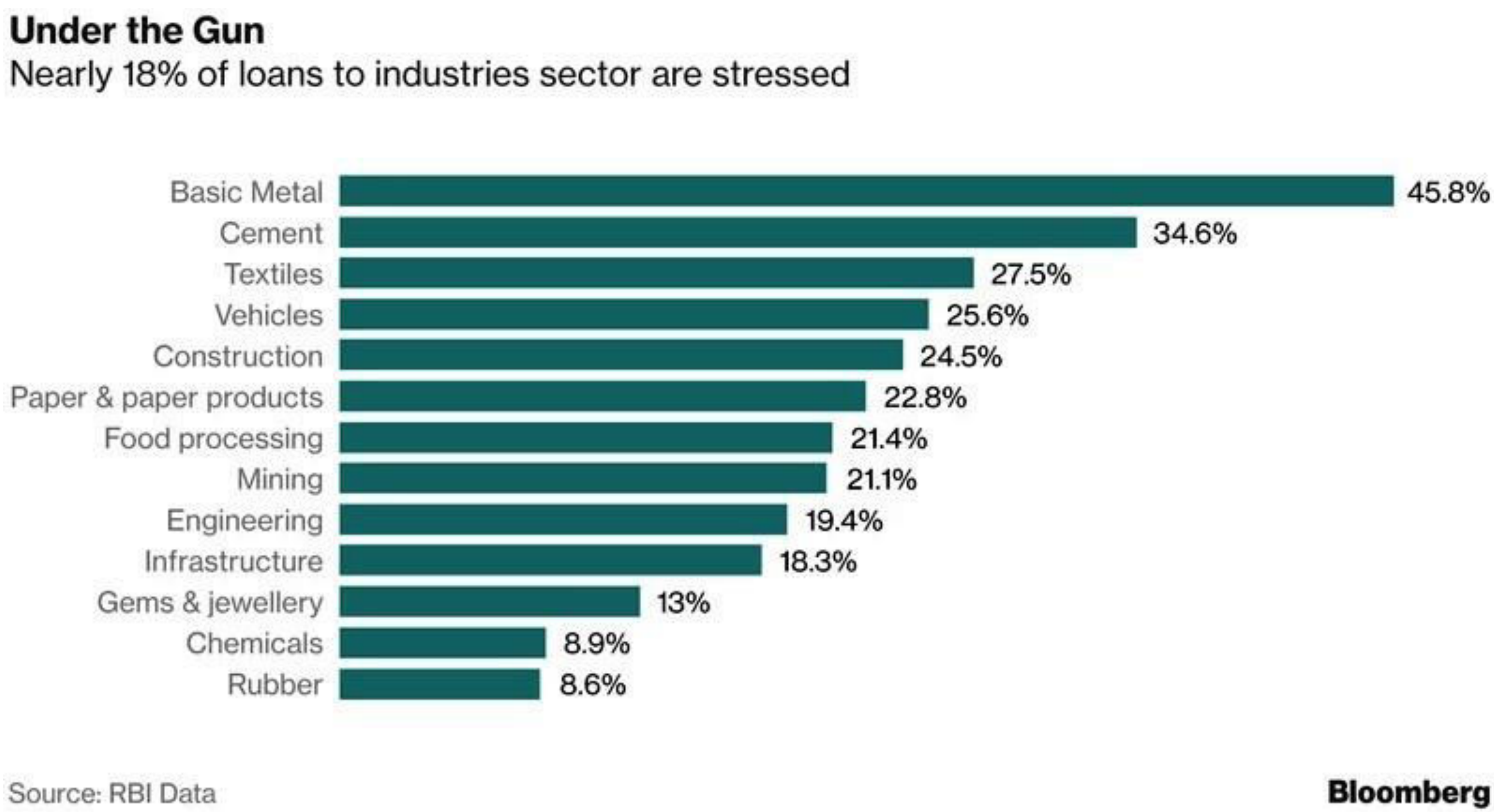


Sector-wise Stressed Assets

NPA STATUS OF THE BANKS



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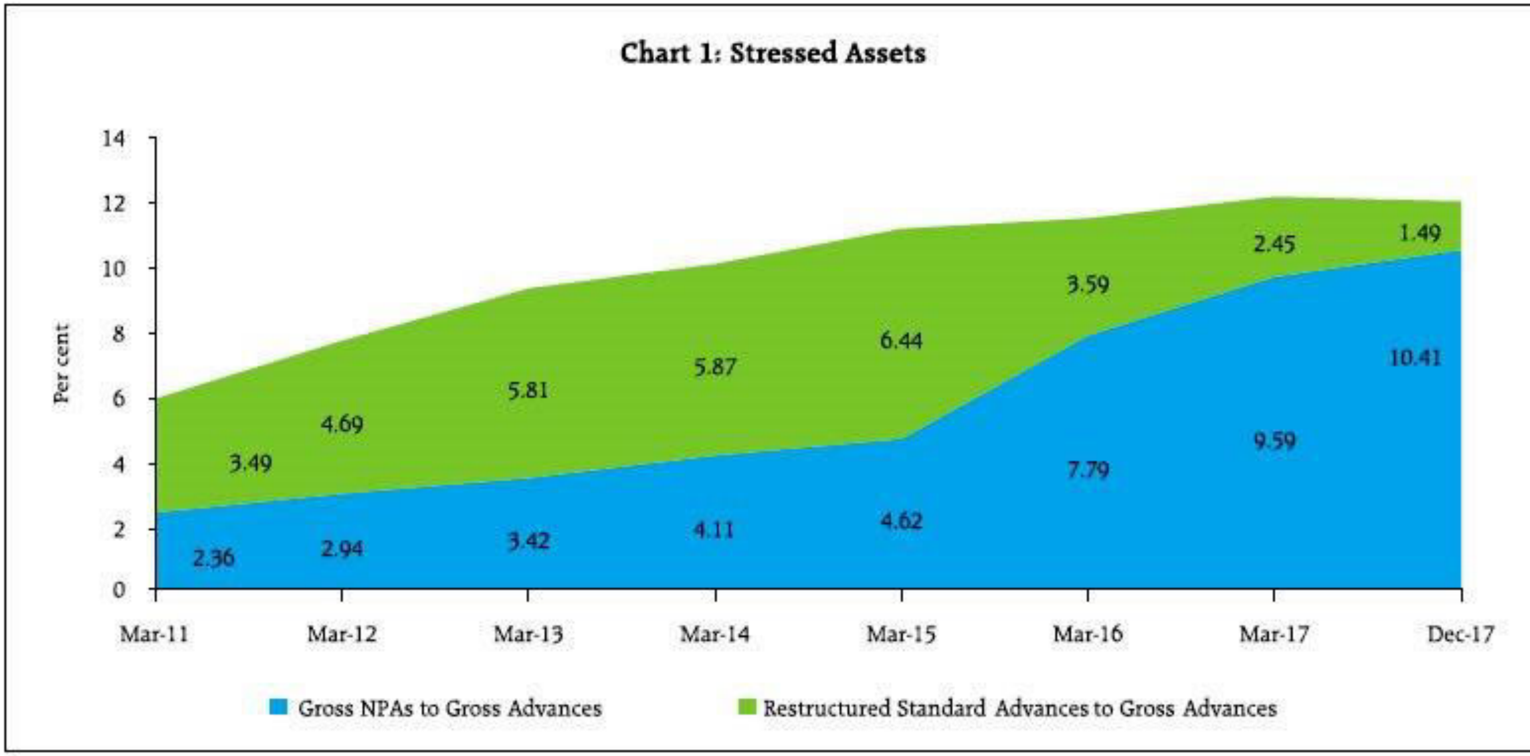
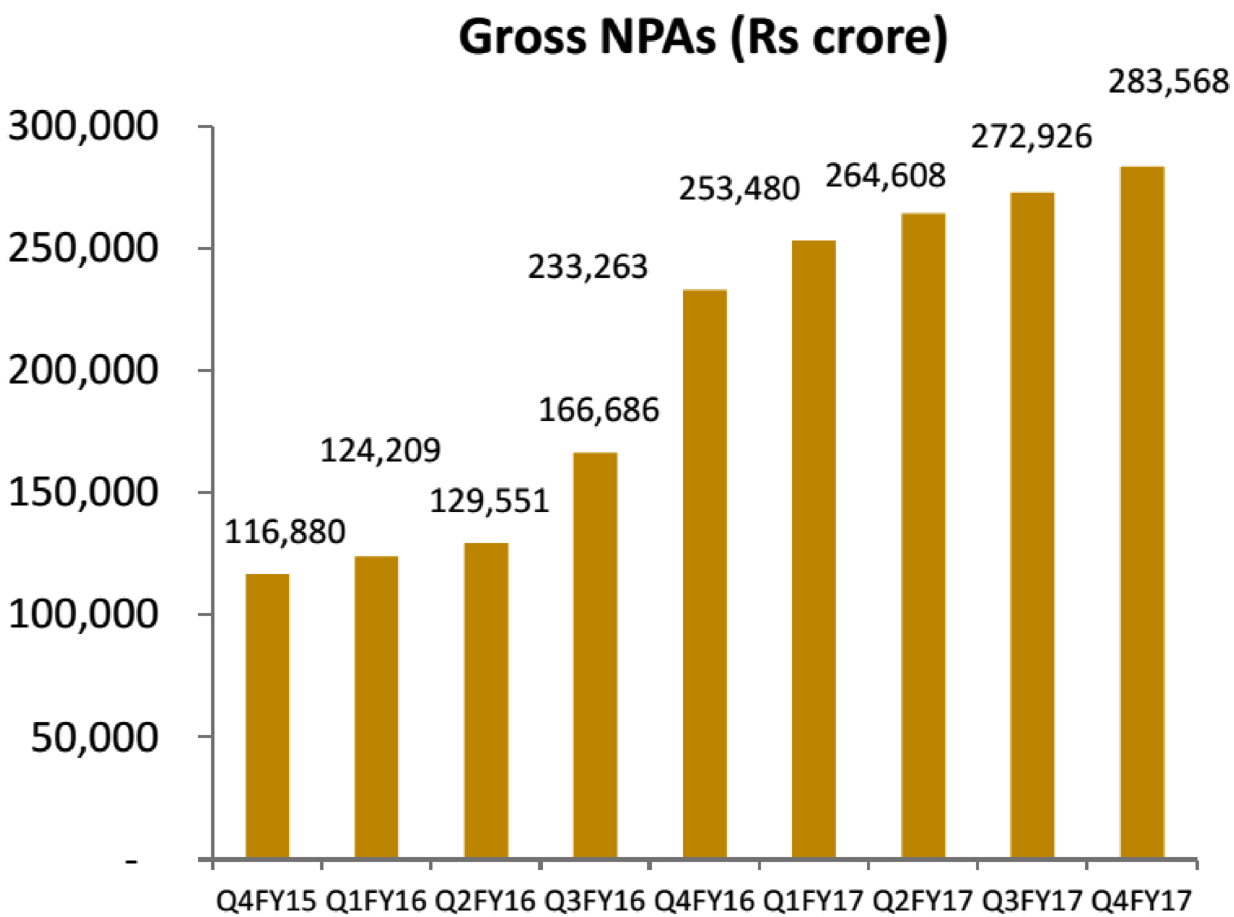
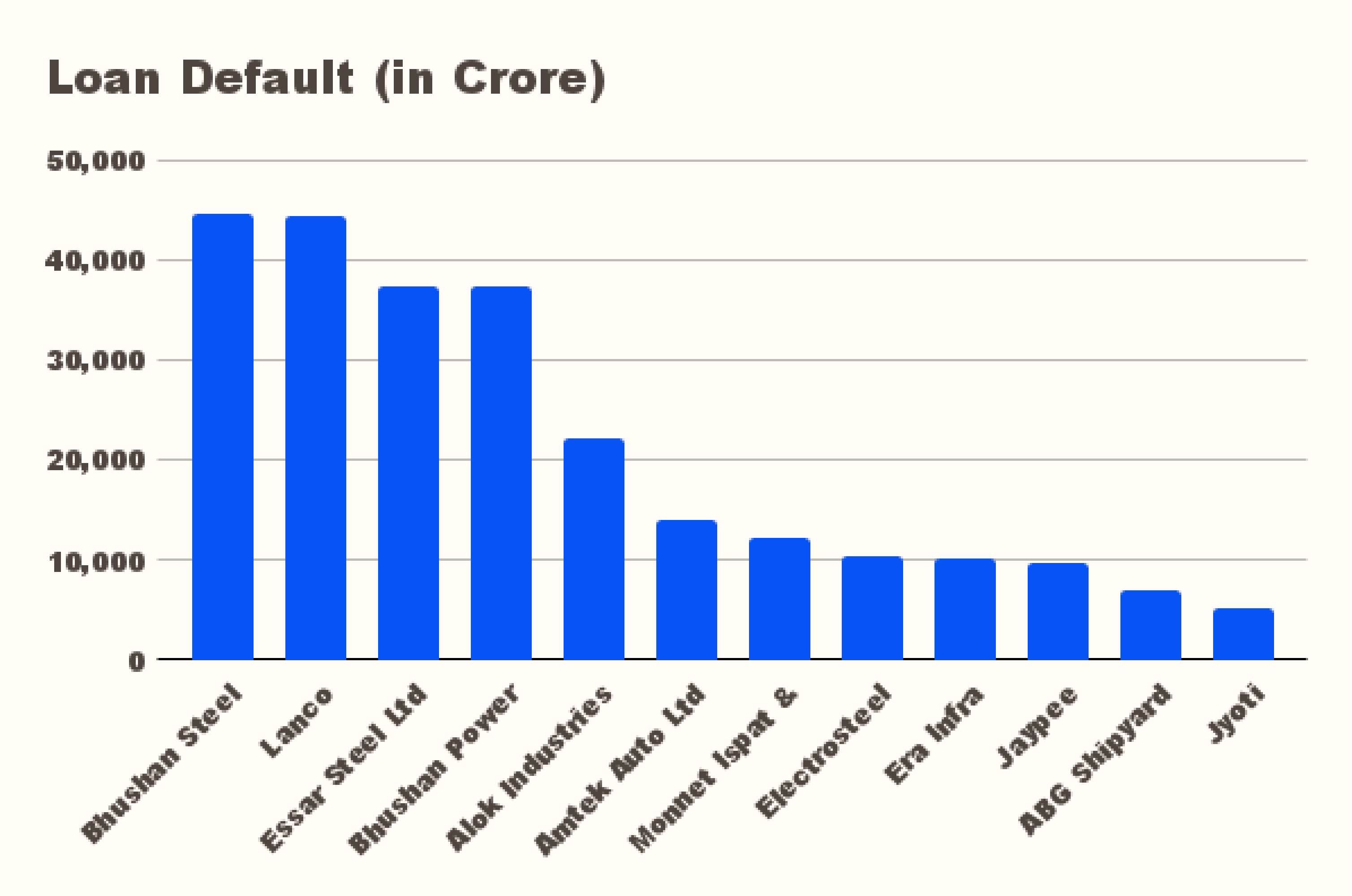


Increase in Stress Assets from 2015 onwards

NPA STATUS OF THE BANKS



NPA STATUS OF THE BANKS
Top 12 Defaulters



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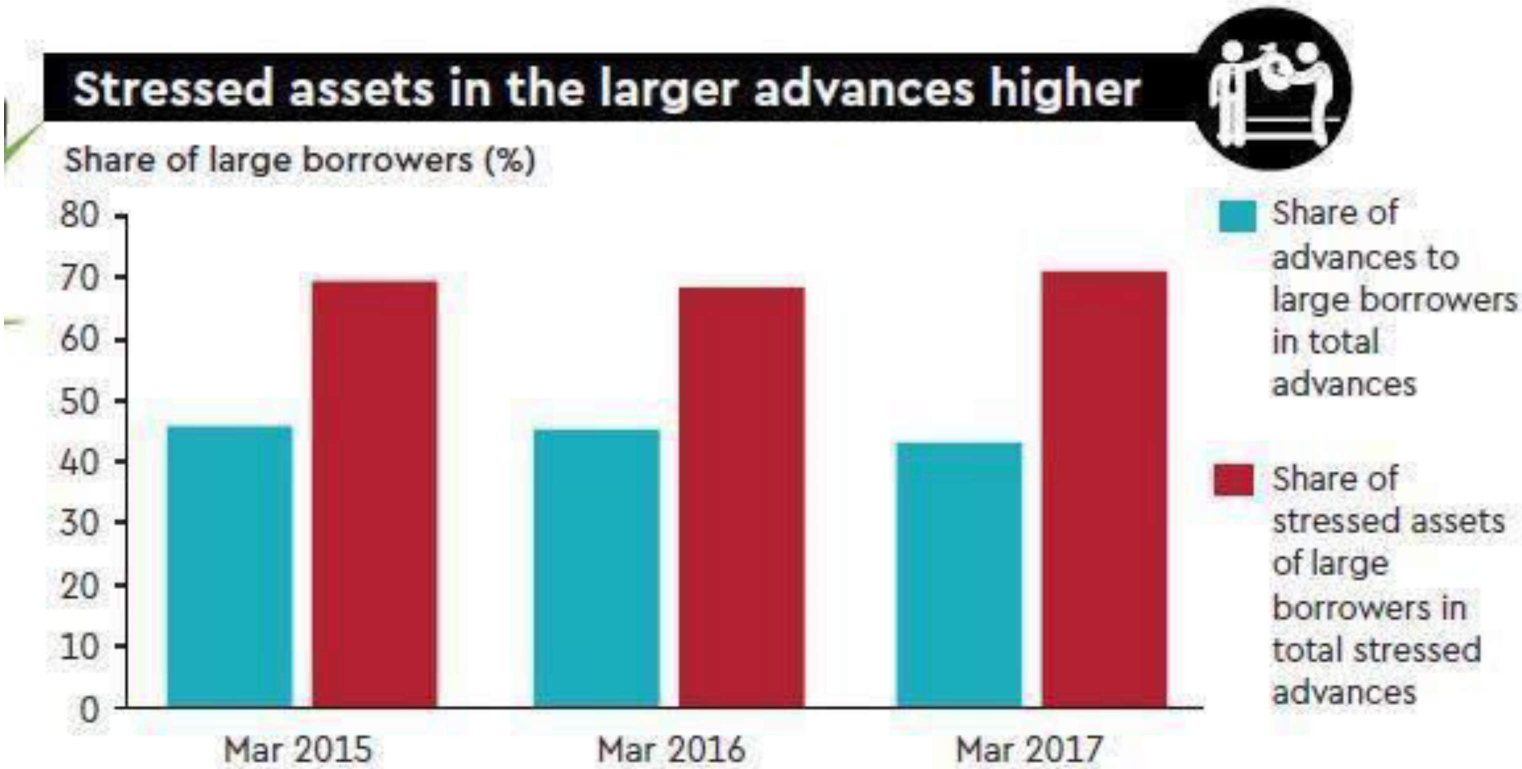

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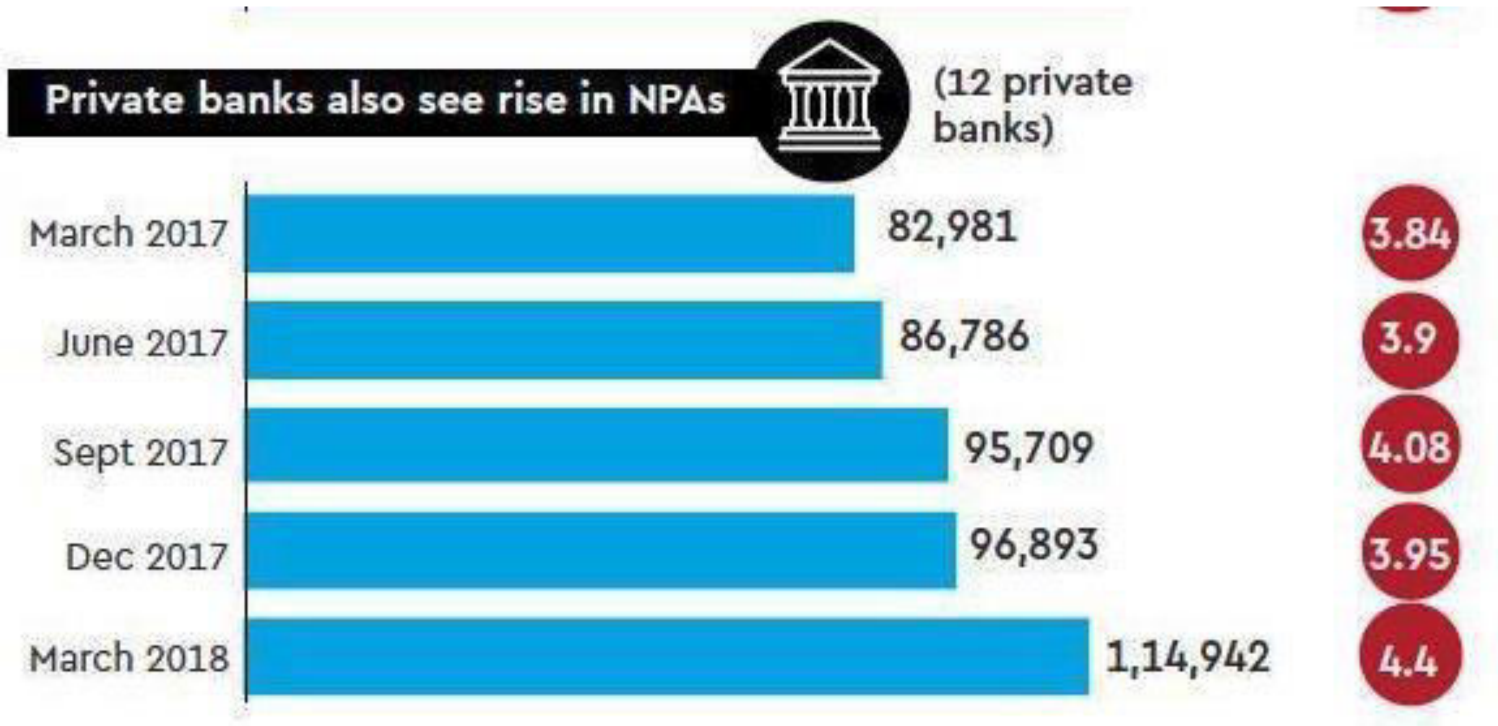

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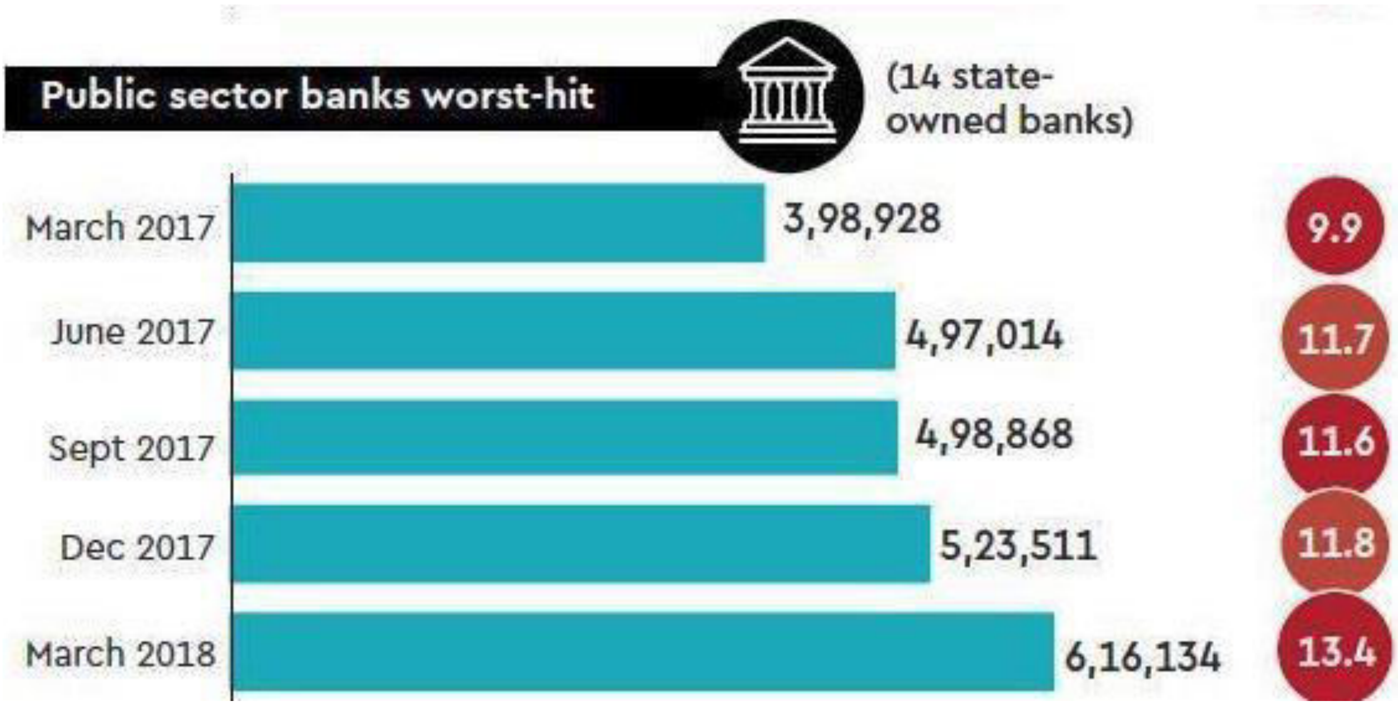

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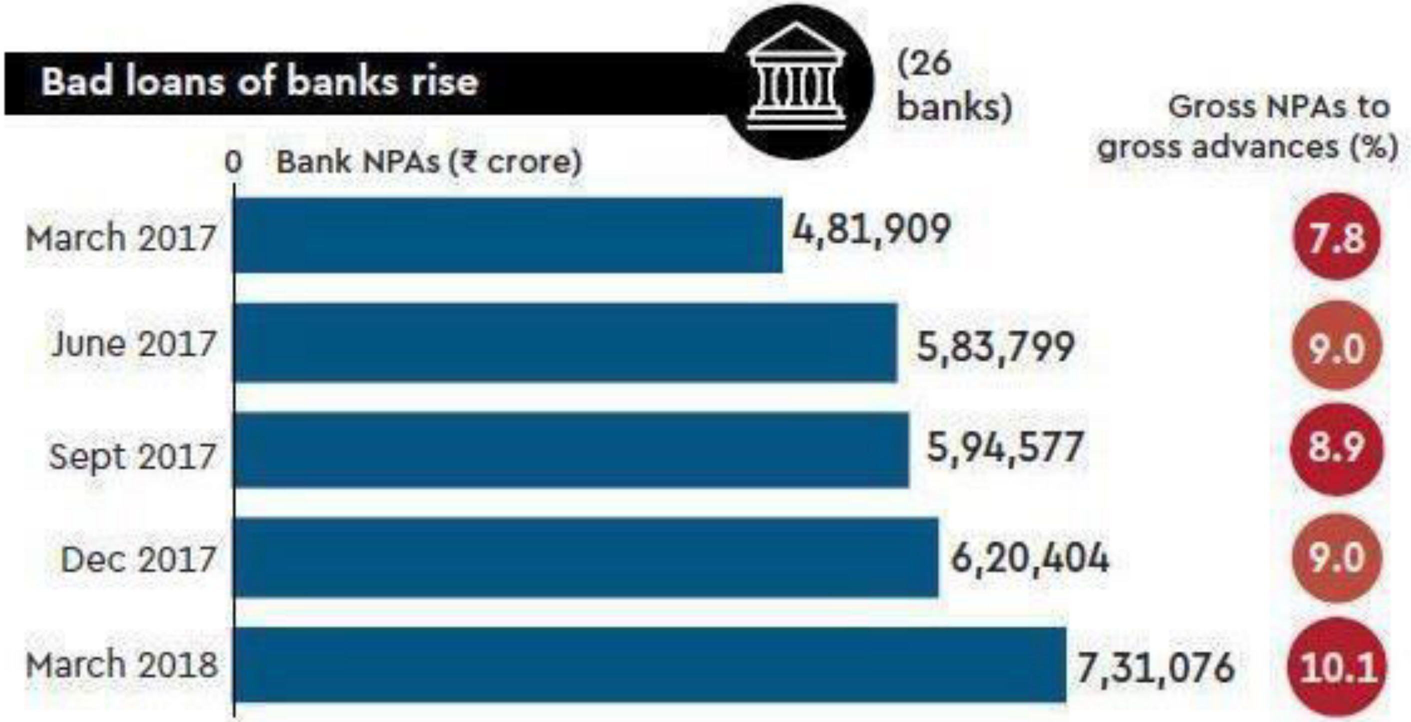

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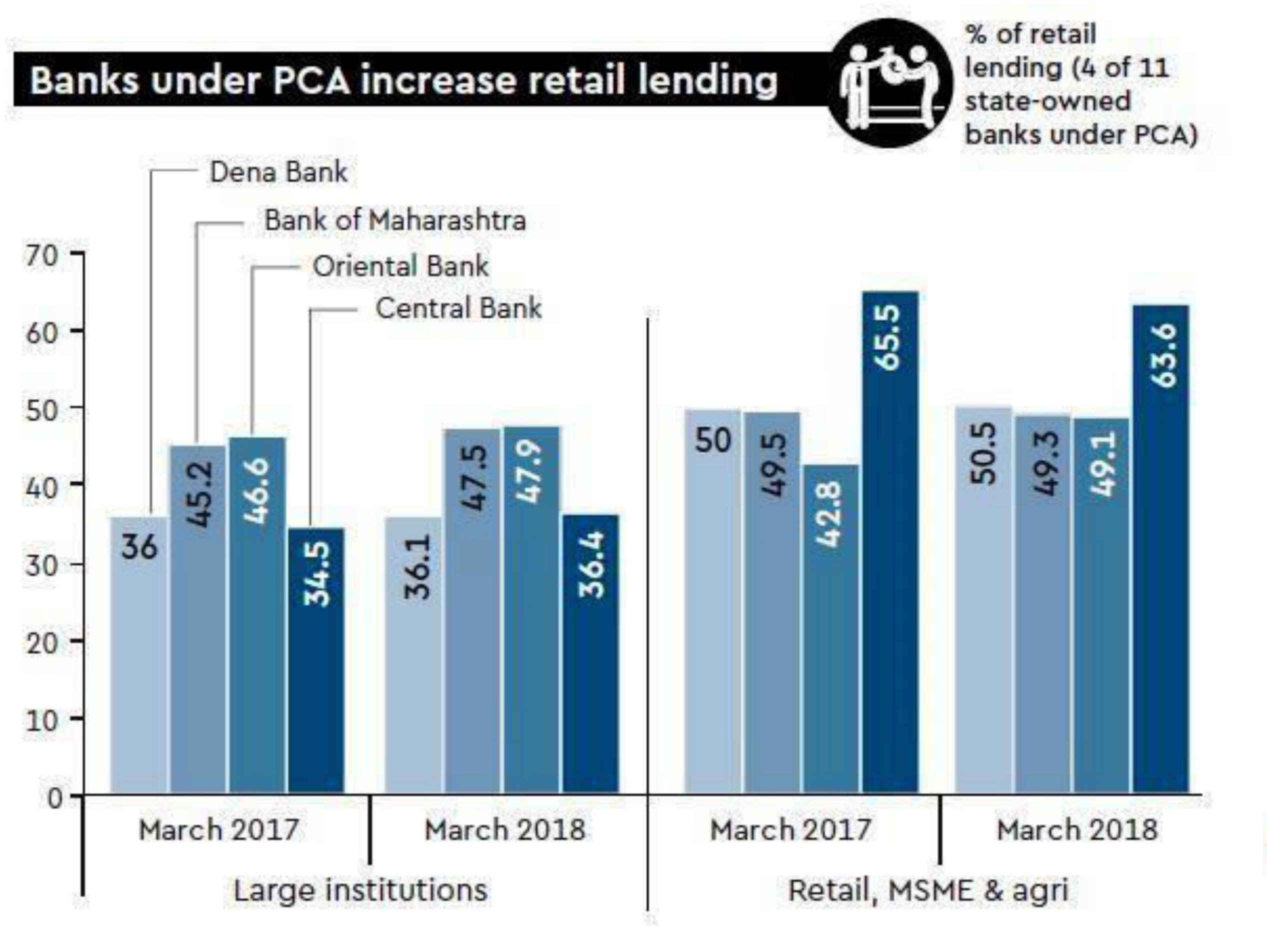
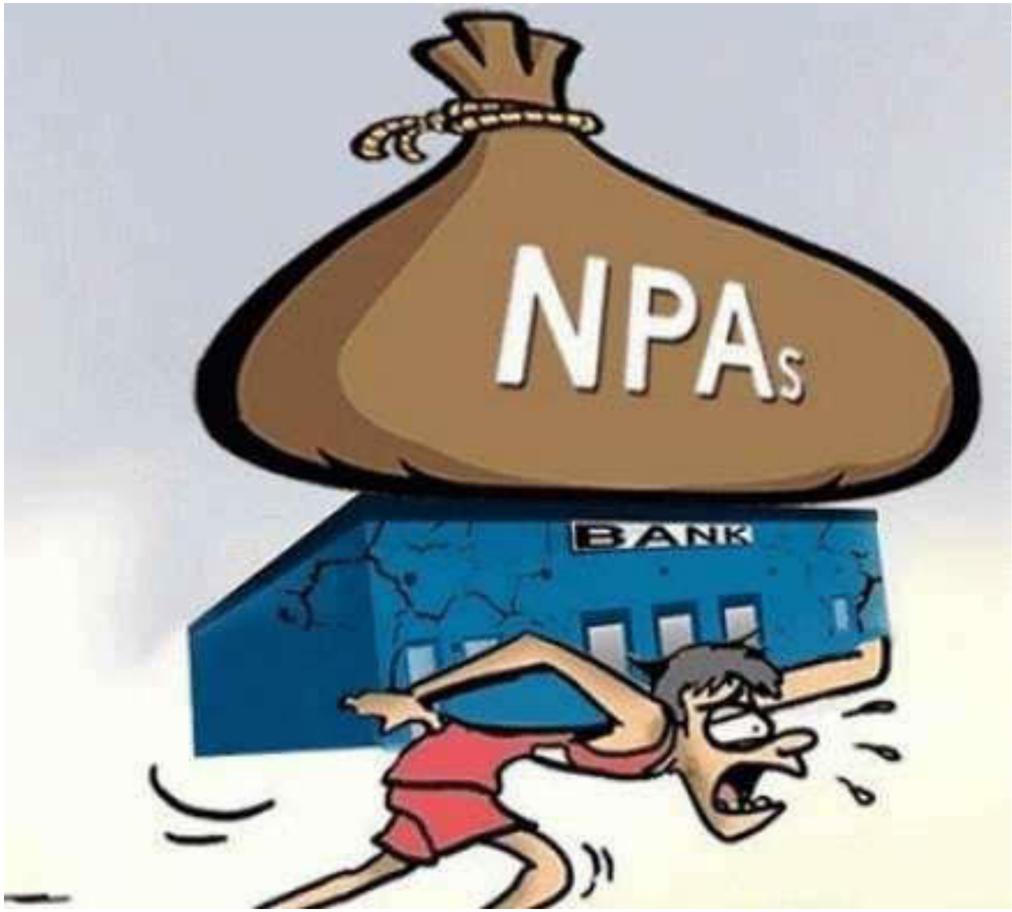


NPA STATUS OF THE BANKS

Beyond Control

NPA STATUS OF THE BANKS

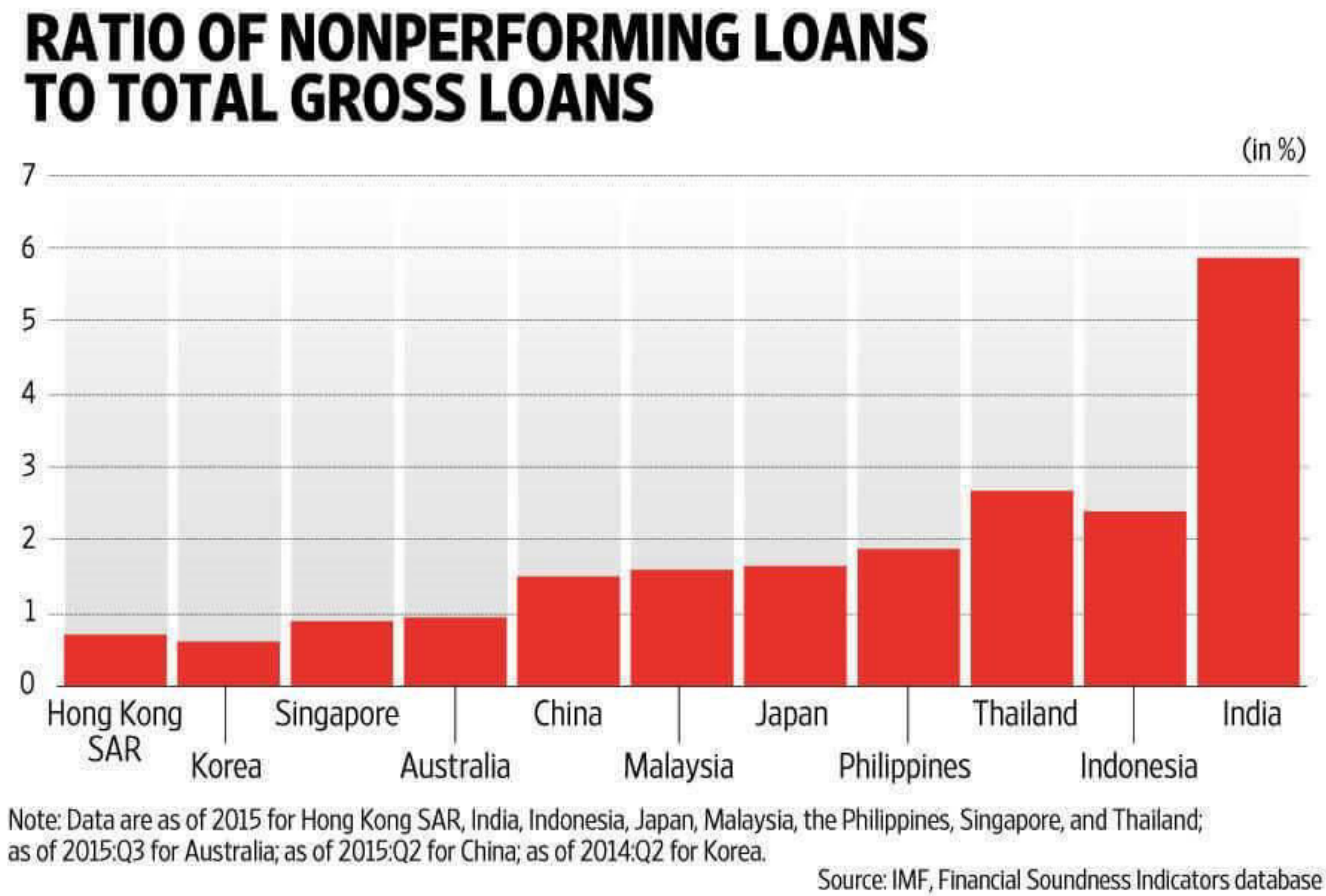
NPA STATUS OF THE BANKS



NPA STATUS OF THE BANKS

Trying to Recover

NPA STATUS OF THE BANKS



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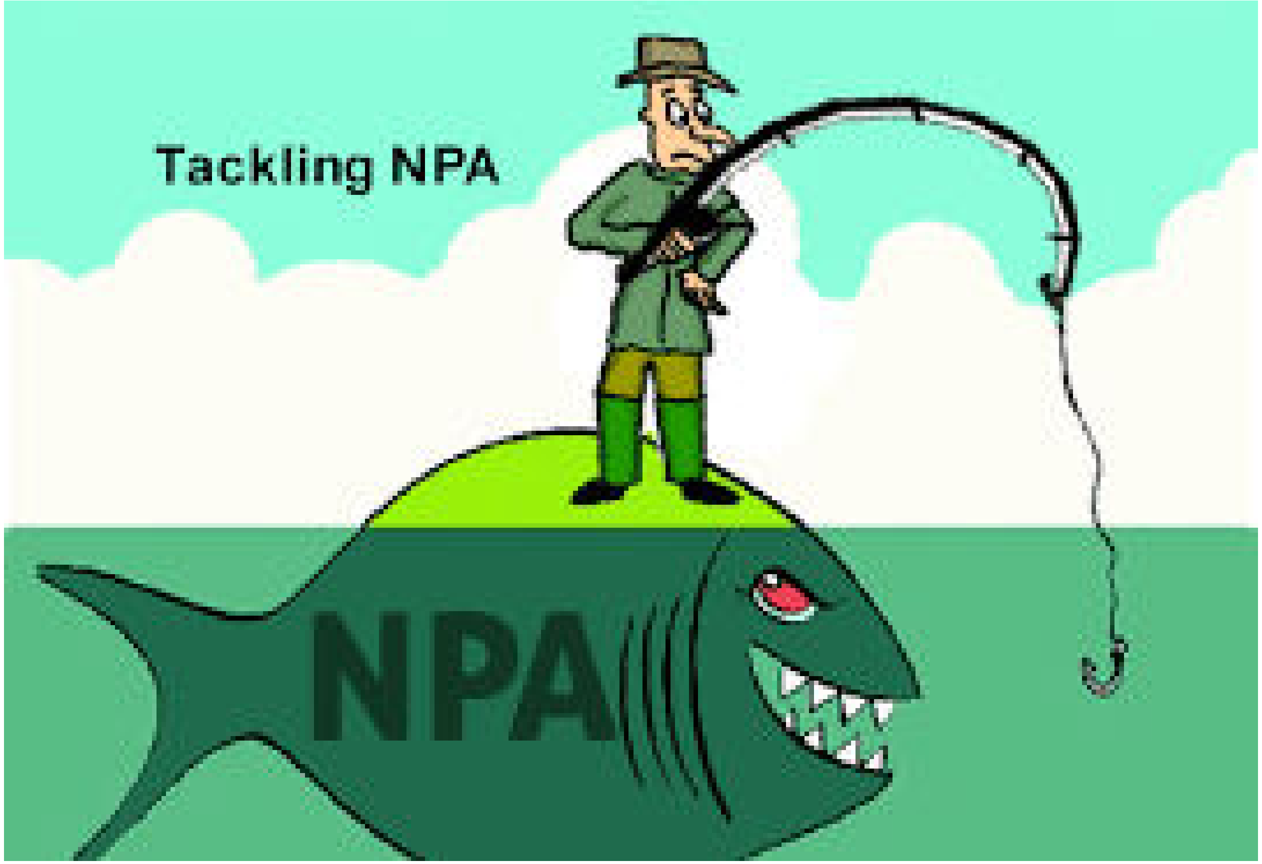


HISTORICAL BACKGROUND OF REHABILITATION

Pre-Independence Position

- Before 1947, the Indian economy was predominantly agricultural economy.
- There was dearth of private players in the market.
- Industrial Units or Producers were almost negligible though the demand was much higher.
- Only Industries survived who served the interests of the Britishers.
- Market was unorganized
- The shortage of power was main hurdle in success of a unit.
- No Banks or FIs were in existence to finance the industrial projects.
- Money lenders, they charged exorbitant rates of interest
- No promotion of Industry by Government
- Also there were no proper implementation of any policy in regard to the efforts of the Government in the revival and rehabilitation of sick industries.

HISTORICAL BACKGROUND OF REHABILITATION

Post-Independence Period

Prior to 1985

- The Government undertook rapid industrialization of basic and heavy industries to convert India from agricultural to industrial economy.
- However, large numbers of units were turning sick due improper management.
- To check the growth of the sick units, the Government adopted strategies to takeover of the sick industrial units and restrict the problem if unemployment, labour unrest and social unrest.
- The Government also took the initiative of taking over the management of sick industrial undertakings for a brief period and returning it back to the owners once the sickness is removed.
- The Government in its aim of preventing the growth of sickness was given support by various agencies such as RBI, IFCI, IDBI etc.

INTRODUCTION OF SICA

- In 1981 Committee of Experts under the Chairmanship of Mr. T. Tiwari was set-up by Govt. to examine and recommend the remedies for increasing Industrial sickness.

- Based on the recommendations of the Committee, the Government of India enacted a special legislation namely, the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) commonly known as the SICA.

INTRODUCTION OF SICA, 1985

Main Objective of SICA

- To determine sickness and expedite the revival of potentially viable units or closure of unviable units.
- By revival, idle investments in sick units will become productive and by closure, the locked up investments in unviable units would get released for productive use elsewhere.
- To securing the timely detection of sick and potential sick companies and expeditious enforcement of the measures
- The Board of experts named the Board for Industrial and Financial Reconstruction (BIFR) was set up under Section 3 of SICA in January, 1987 and functional with effect from 15th May 1987.
- The Appellate Authority for Industrial and Financial Reconstruction (AAIRFR) was constituted in April 1987.
- Government companies were brought under the purview of SICA in 1991 when extensive changes were made in the Act including, inter-alia, changes in the criteria for determining industrial sickness.

INTRODUCTION OF SICA

SICA applies to companies both in public and private sectors owning industrial undertakings:-

- Pertaining to industries specified in the First Schedule to the Industries (Development and Regulation) Act, 1951, (IDR Act) except the industries relating to ships and other vessels drawn by power and;
- Not being "small scale industrial undertakings or ancillary industrial undertakings" as defined in Section 3(j) of the IDR Act.
- **The criteria to determine sickness in an industrial company are :**
  - The accumulated losses of the company to be equal to or more than its net worth i.e. its paid up capital plus its free reserves
  - The company should have completed five years after incorporation under the Companies Act, 1956
  - It should have 50 or more workers on any day of the 12 months preceding the end of the financial year with reference to which sickness is claimed.
  - It should have a factory license.

BOARD OF INDUSTRIAL AND FINANCIAL RECONSTRUCTION (BIFR)

The role of BIFR as envisaged in the SICA (Sick Industrial Companies Act) is:

- Securing the timely detection of sick and potentially sick companies;
- Speedy determination by a group of experts of the various measures to be taken in respect of The sick company;
- Expeditious enforcement of such measures

PREPARATION AND SANCTION OF SCHEME FOR REVIVAL UNDER SICA

If the company found sick under SICA BIFR may grant time to the sick company to enable it to make its net worth positive and bring the company out of sickness, without any external financial assistance.

PREPARATION AND SANCTION OF SCHEME FOR REVIVAL UNDER SICA

If it is found infeasible for company to make its networth positive without any external financial assistance, or if the BIFR decides that the company can not make its net worth positive within a reasonable time, then the Board appoints an operating agency under section 17(3) of the Act, then the operating agency is required to prepare and submit a schedule in respect of the referred company by providing any or more of the following measures:

- Financial Reconstruction of the sick industrial company;
- The proper management of the sick industrial company by change in, or takeover of, the management of the sick industrial company;
- Amalgamation with another company or vice-versa;
- Sale or lease of its undertaking;
- Rationalization of its staff;
- Any other preventive or remedial measures; and
- Incidental or consequential measures.

PREPARATION AND SANCTION OF SCHEME FOR REVIVAL UNDER SICA

The revival package may vary from case to case depending on the nature of the problem and may include :-

- Additional financial assistance if required
- Postponement of recovery of loan already lent by banks and financial institutions,
- Change in management, amalgamation,
- Sale of redundant assets,
- Lease of assets or any other suitable measure.
- The revival package should be submitted to the BIFR within a time limit of 90 days or such extended period as may be granted by the BIFR.

APPROVAL OF REHABILITATION SCHEME

- On submission of the revival package by the operating agency and after Board of Director heard the stake holders (Banks, FIs, Govt Bodies Etc.) and After careful examination of all the aspects, the BIFR will sanction the revival scheme with or without any modifications.

- However, SICA was repealed in year 2003 vide “THE SICK INDUSTRIAL COMPANIES (SPECIAL PROVISIONS) REPEAL BILL, 2003” by the houses of parliament.

HOW BANK CAN RECOVER MONEY FROM STRESSED ASSETS ?

- The banks and financial institutions (FIs) were facing numerous problems in recovery of defaulted loans on account of delays in disposal of recovery proceedings.

- The Government, therefore, enacted the *Recoveries of Debts due to Banks and Financial Institutions (RDDBFI) Act, 1993* and The **Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI)** for the purpose of expeditious recovery of non-performing assets (NPAs) of the banks and FIs.

INTRODUCTION OF SARFASI ACT IN 2002

- To provide a structured platform to the Banking sector for managing its mounting NPAs and keep pace with international financial institutions, “The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002” was put in place to allow banks and FIs to take possession of securities and sell them.

- The **Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI)** empowers Banks / Financial Institutions to recover their non-performing assets without the intervention of the Court.

INTRODUCTION OF SARFASI ACT IN 2002

The Act provides three alternative methods for recovery of non-performing assets, namely: -

- Securitisation
- Asset Reconstruction
- Enforcement of Security without the intervention of the Court

The provisions of this Act are applicable only for NPA loans with outstanding above Rs. 1.00 lakh.

INTRODUCTION OF SARFASI ACT IN 2002

- NPA loan accounts where the amount outstanding is less than 20% of the principal and interest are not eligible to be dealt with under this Act.

- Non-performing assets should be backed by securities charged to the Bank by way of hypothecation or mortgage or assignment.

- Security Interest by way of Lien, pledge, hire purchase and lease not liable for attachment under Sec. 60 of Civil Procedure Code 1908 (CPC), are not covered under SARFASI Act.

THE SARFASI ACT EMPOWERS THE BANK

- To issue demand notice to the defaulting borrower and guarantor, calling upon them to discharge their dues in full within 60 days from the date of the notice.

- To give notice to any person who has acquired any of the secured assets from the borrower to surrender the same to the Bank.

- To ask any debtor of the borrower to pay any sum due or becoming due to the borrower.

- Any Security Interest created over Agricultural Land cannot be proceeded with.

THE SARFASI ACT EMPOWERS THE BANK

A borrower / guarantor aggrieved by the action of the Bank can file an appeal with Debt Recovery Tribunals (DRT) and then with The Debt Recovery Appellate Tribunal (DRAT), but not with any civil court. The borrower / guarantor has to deposit 50% of the dues before an appeal with DRAT.

If the borrower fails to comply with the notice, the Bank may take recourse to one or more of the following measures:

- Take possession of the security
- Sale or lease or assign the right over the security
- Manage the same or appoint any person to manage the same

THE SARFASI ACT EMPOWERS THE BANK

The Act provides three alternative methods for recovery of NPAs, namely:

1. **Securitisation:** It means issue of security by raising of receipts or funds by Securitisation Company (SC) or Assets Reconstruction Company (ARCs).

THE SARFASI ACT EMPOWERS THE BANK

- **Asset Reconstruction:**
  - The SCs/ARCs for the purpose of asset reconstruction should provide for any one or more of the following measures:
  - The proper management of the business of the borrower, by change in, or take over of, the management of the business of the borrower
  - The sale or lease of a part or whole of the business of the borrower
  - Rescheduling of payment of debts payable by the borrower
  - Enforcement of security interest in accordance with the provisions of this Act
  - Taking possession of secured assets in accordance with the provisions of this Act.
- **Settlement of dues payable by the borrower**

THE SARFASI ACT EMPOWERS THE BANK

Exemption from registration of security receipt:

- The Act also provides, notwithstanding anything contained in the Registration Act, 1908, for enforcement of security without Court intervention:

(a) Any security receipt issued by the SC or ARC, as the case may be, under section 7 of the Act, and not creating, declaring, assigning, limiting or extinguishing any right, title or interest to or in immovable property except in so far as it entitles the holder of the security receipt to an undivided interest afforded by a registered instrument; or

(b)Any transfer of security receipts, shall not require compulsory registration.

THE SARFASI ACT EMPOWERS THE BANK

The Guidelines for SCs/ARCs registered with the RBI are:

- Act as an agent for any bank or FI for the purpose of recovering their dues from the borrower on payment of such fees or charges
- Act as a manager between the parties, without raising a financial liability for itself;
- Act as receiver if appointed by any court or tribunal.

THE SARFASI ACT EMPOWERS THE BANK

Some broad guidelines pertaining to Asset Reconstruction are as follows:

- Acquisition of Financial Assets
- Valuation procedure for assets having realisable value, which could be reasonably estimated and independently valued;
- Plan for realisation of asset acquired for reconstruction

CORPORATE DEBT RESTRUCTURING (CDR) SYSTEM 2004

- Companies sometimes are found to be in financial troubles for factors beyond their control and also due to certain internal reasons.

- For the revival of such businesses, as well as, for the security of the funds lent by the banks and FIs, timely support through restructuring in genuine cases was required.

- With this view, a CDR system was established by RBI with the objective to ensure timely and transparent restructuring of corporate debts of viable entities facing problems, which are outside the purview of BIFR, DRT and other legal proceedings.

CORPORATE DEBT RESTRUCTURING (CDR) SYSTEM

- In particular, the system aimed at preserving viable corporate/businesses that are impacted by certain internal and external factors, thus minimising the losses to the creditors and other stakeholders.
- The system has addressed the problems due to the rise of NPAs. Although CDR has been effective, it largely takes care of the interest of bankers and ignores (to some extent) the interests of borrower's stakeholders.
- The secured lenders like banks and FIs, through CDR merely, address the financial structure of the company by deferring the loan repayment and aligning interest rate payments to suit company's cash flows. The banks do not go for a one time large write-off of loans in initial stages.

INTRODUCTION OF JOINT LENDERS FORUM 2014

RBI circular dated the February 26, 2014 dealing with Framework for Revitalising Distressed Assets in the Economy – Guidelines on Joint Lenders' Forum (JLF) and Corrective Action Plan (CAP) also allows the banks to form a Joint Lenders Forum (JLF) outside CDR and grant reliefs and concession to a deserving Sick Company. In case if the Reliefs and concessions involve deep restructuring, JLF can refer the case to CDR cell for consideration.

Introduction of Strategic Debt Restructuring (SDR) in 2015

- This gave power to the Banks for converting loan dues to equity shares based on certain conditions.

ASSET RECONSTRUCTION COMPANY

ARC - MEANING

- Asset Reconstruction company means acquisition by any securitization company or reconstruction company of any right or interest of any bank or financial institution in any financial assistance for the purpose of realization of such financial assistance.
- Asset Reconstruction company is a company registered under section 3 of the Securitization & Reconstruction of financial assets & Enforcement of security interest (SARFAESI) Act 2002.
- It is regulated by RBI as a Non – banking Financial company

Continued…

- RBI has exempted ARCs from the compliances under section 45- 1A (Requirement of registration & net owned fund) , Section 45 – 1B (Maintenance of liquid assets) , Section 45 – 1C (Creation of reserve fund) of the Reserve Bank Act, 1934.
- ARC Functions like an AMC within the guidelines issued by RBI.
- The ARC transfers the acquired asset to one or more trusts at the price at which the financial assets were acquired from the originator.

Continued…

- ARC has been set up to provide a focused approach to Non – Performing Loans resolution issue by –

1. Isolating Non – Performing Loans from the financial system.
2. Facilitating development of market for distressed assets.

- Now in India, Asset Reconstruction company are in both Public as well as Private Sector

PRIMARY GOAL OF ARC

- An Asset Reconstruction Company's primary goal is to manage & to make profitable those assets which have been underperforming or become formally classified as Non- Performing Asset belonging to companies who have been unable to generate sufficient timely revenue to service their outstanding obligations.
- An ARC have the responsibility under the SARFESI Act to function as intermediaries between the promoter & the trust.
- An ARC are created to manage & recover NPA acquired from the banking system.

FUNCTIONS OF ARC

ARC perform the following functions :

- Acquisition of Financial assets
- Rescheduling of Debts.
- Change or takeover of management
- Enforcement of security interest
- Settlement of dues payable by the borrower.

ARCs are allowed to raise funds from QIB in order to raise cash to make an upfront payment required to buy discounted debts.

BENEFITS OF ARC

- The Major objective of ARC is to acquire & rapidly liquidate Non- Performing Assets.
- Clean books of Accounts by reducing NPA
- It deals with Larger portfolio , it can mix up good assets with bad ones & make a sale.
- ARC improve the recovery & reduce NPA.
- Acquisition of interest.

HOW DOES ARC ACTUALLY WORK?

- ARC functions more or less like a mutual fund . It transfers the acquired assets to one or more trusts at the price at which the financial assets were acquired from the originator.
- Then, the trusts issue security receipts to QIB . The trusteeship of such trusts shall vest with the ARC . ARC will get only management fee from the trusts.
- ARC will have the obligation to help companies in times of stress to review the activities of Non – Performing assets.

Continued…

- NPA is transferred to ARC along with any security which is pledged while taking loan.
- ARC will issue security receipts for fixed interest rate & will raise money.
- Security Receipt – It means a receipt or other security by a securitization or reconstruction company to any QIB , pursuant to the scheme, evidencing the purchase or acquisition by the holder of an undivided right, interest in the financial asset involved in securitization.
- The Securitisation Company or Reconstruction Company shall invest in the security receipts issued by the trust set up for the purpose of securitisation, an amount not less than 5% under each scheme :

FIRST ARC IN INDIA

ARCIL – Asset Reconstruction company India (Limited)

- Set up in 2002, ARCIL India First & among the leading asset reconstruction companies in the country.
- ARCIL resolved over Rs. 780 billion worth of Non-Performing Assets acquired from banks & Financial Institutions.
- ARCIL is sponsored by prominent banks & F.I. such as SBI , IDBI, PNB .
- ARCIL is also an associate member of Indian Bankers Association.

OTHER ARC IN INDIA

- ACRE – Asset care & Reconstruction Enterprise Limited
- ASREC (India) Limited
- Reliance Asset Reconstruction Company Limited
- PHOENIX ARC Private Limited
- INVENT Assets Securitisation & Reconstruction Private Limited

FOREIGN INVESTMENT IN ARCs

- Government decided to permit Foreign Direct Investment (FDI) in equity.
- Foreign Investment Promotion Board (FIPB) to consider applications from persons / entities eligible to invest in India in equity capital.
- FDI will be permitted, But investments by FII will not be permitted.

MINIMUM REQUIREMENT

Every ARC seeking the Bank's registration under Section 3 of the Act, shall have a minimum Owned Fund of Rs. 2 Crore. (Provided that every ARCs seeking the Bank's registration under Section 3, or carrying on business on commencement of the Securitisation Companies and Reconstruction Companies (Reserve Bank) (Amendment) Guidelines and Directions, 2004, shall have a minimum Owned Fund not less than fifteen percent of the total financial assets acquired or to be acquired by the Securitisation Company or Reconstruction Company (irrespective of whether the assets are transferred to a trust set up for the purpose of Securitisation or held in its own books) on an aggregate basis, or Rs. 100 crore, whichever is less;)

ELIGIBILITY CRITERIA FOR REGISTRATION

- Every ARC has not incurred losses in any of the 3 preceding financial year;
- Any of the directors has not been convicted of any offence involving moral turpitude;
- The board of directors of such securitisation company does not consist of more than half of its total number of directors who are either nominees of any sponsor or associated in any manner with the sponsor or any of its subsidiaries;

DOCUMENTS / INFORMATION CHECKLIST

- Certified Copy of up-to-date Memorandum & Articles of Association of the company
- Certified copy of Certificate of Incorporation.
- Board resolution to the effect that the company has not accepted any deposit.
- Board resolution to the effect that none of the directors are disqualified to be appointed as directors as per the provisions of the companies Act, 2013
- All Information about the sponsor

Contd…

- All Information about the management
- A Certified copy of Auditor Certificate
- Last 3 years audited balance sheet along with directors & auditors report.
- Statement of owned funds.
- Information about related parties.

APPLICATION TO RBI

- Every ARC shall make an application for registration to the RBI. The forms & manner of application are to be prescribed by the RBI.
- A Securitisation Company or Reconstruction Company shall commence business within six months from the date of grant of Certificate of Registration by the Bank;
- A Securitisation Company or Reconstruction Company, which has obtained a certificate of registration issued by the Bank under Section 3 of the Act, can undertake both securitisation and asset reconstruction activities;

Continued…

- The RBI shall conduct inspection of books of accounts of the company for the purpose of considering the application for registration.
- Every ARC seeking the Bank's registration under Section 3 of the act, shall have a minimum owned fund of Rs. 2 crore
- ARC shall commence their business after obtaining the Certificate of Registration under SARFAESI Act, 2002

DISCLOSURES IN THE BALANCE SHEET

Every Securitisation Company or Reconstruction Company, prepare the following schedules & Annex them to its balance sheet -

- The names and addresses of the banks / financial institutions from whom financial assets were acquired and the value at which such assets were acquired from each such bank / financial institutions;
- Value of financial assets acquired during the financial year either on its own books or in the books of the trust;
- Value of financial assets realized during the financial year;

Continued…

- Value of Security Receipts pending for redemption as at the end of the financial year;
- Details of related parties as per Accounting Standard and guidance notes issued by the Institute of Chartered Accountants of India and the amounts due to and from them;
- The accounting policies adopted in preparation and presentation of the financial statements shall be in conformity with the applicable prudential norms prescribed by the Bank.

INTERNAL AUDIT

Every ARC shall put in place an effective Internal Control System providing for periodical checks and review of the asset acquisition procedures and asset reconstruction measures followed by the company and matters related thereto.

SUBMISSION OF AUDITED BALANCE SHEET

All the ARC were advised to furnish a copy of audited balance sheet along with the Directors' Report / Auditors' Report every year within one month from the date of Annual General Body Meeting, in which the audited accounts are adopted, starting with the balance sheet as on March 31

QUARTERLY STATEMENT TO BE SUBMITTED BY ARCs REGISTERED WITH RBI

Quarterly Statement on owned Funds, assets acquired, securitized & assets realized during the year, value of financial assets unresolved as at the end of the year, value of security receipts pending for redemption etc. are to be submitted by ARCs registered with RBI within 15 days of close of the quarter to which it pertains

PERMISSIBLE BUSINESS

- AN ARC shall commence / undertake only the securitisation and asset reconstruction activities and the functions provided for in Section 10 of the Act.
- A Securitisation Company or Reconstruction Company shall not raise monies by way of deposit.

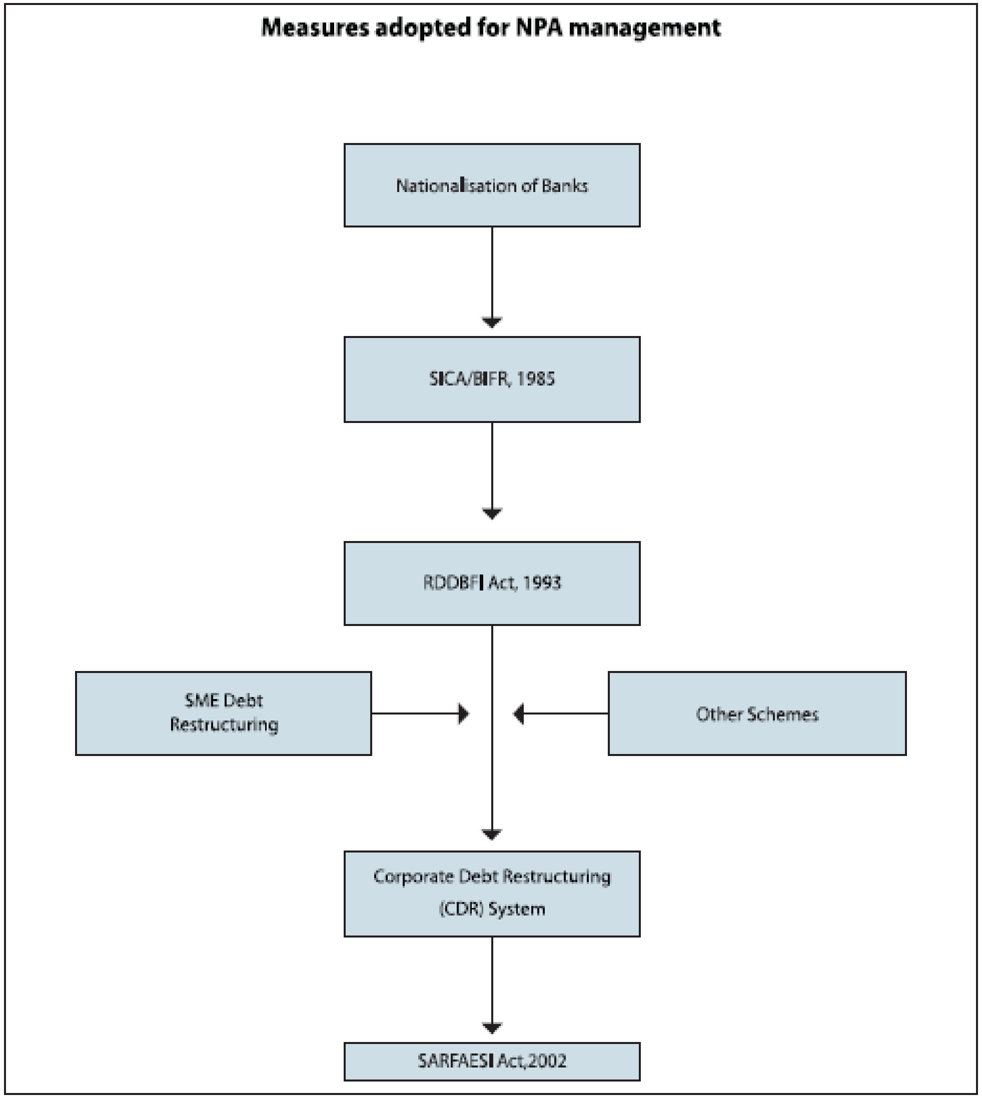
APPROVAL OF RBI FOR CHANGE IN MANAGEMENT

- Every ARC shall obtain prior approval of the reserve bank for any substantial change in its management or change of location of its registered office or change in its name.
- The decision of the Reserve Bank whether the change in management of a ARC is a substantial change in its management or not, shall be final.

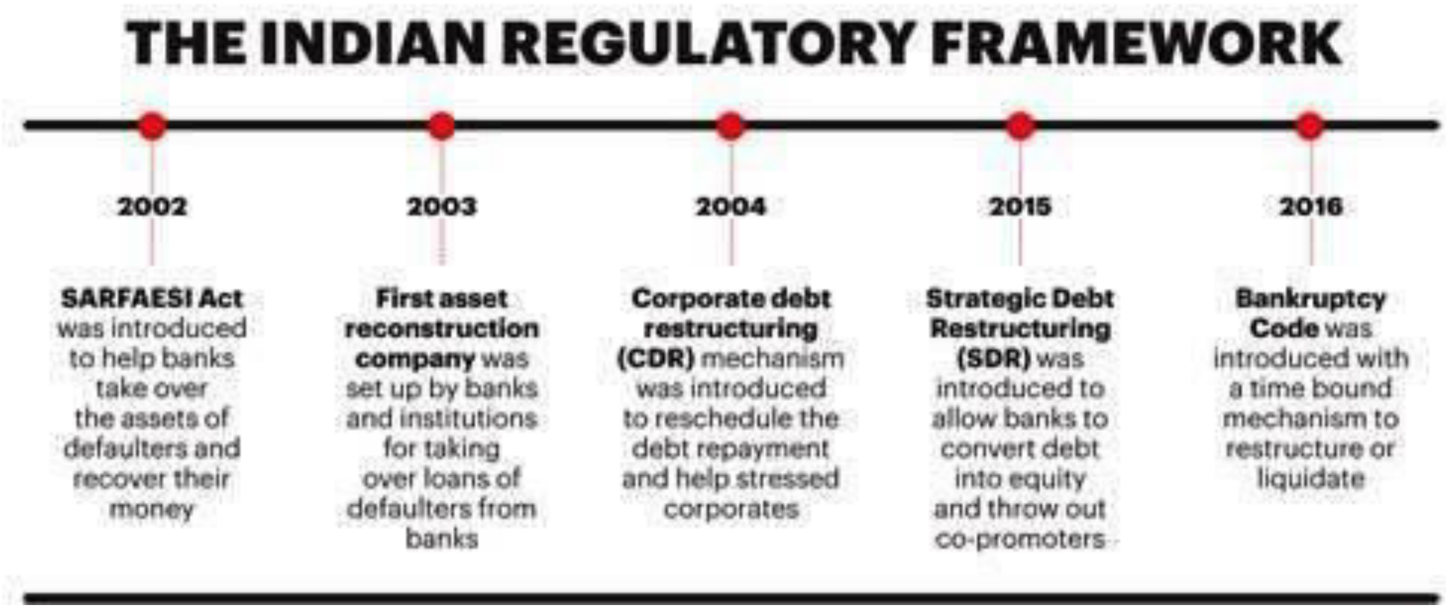
CANCELLATION OF CERTIFICATE OF REGISTRATION

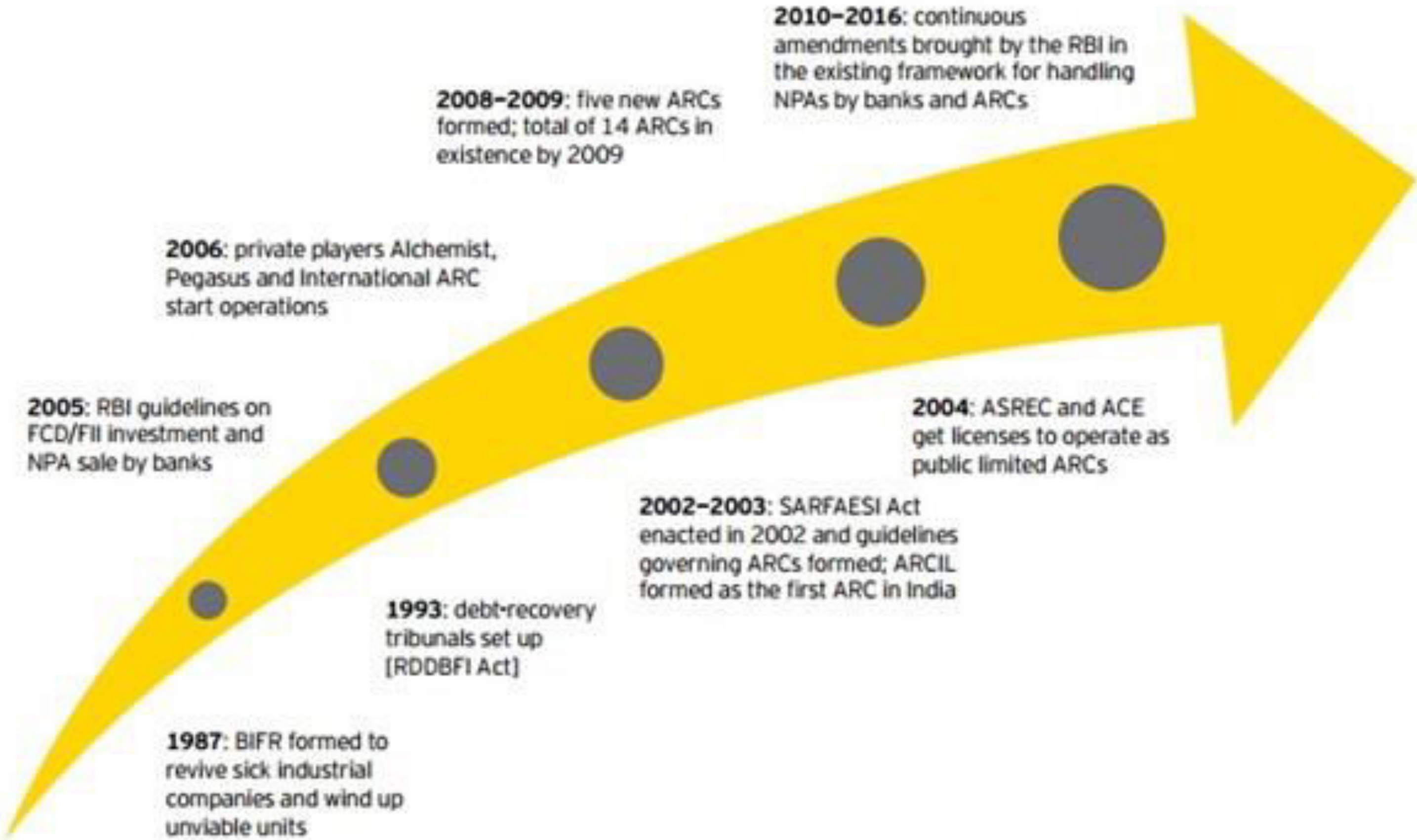
- The order of cancellation should specify clearly the grounds for cancellation & normally the ARC/ SC should given a hearing before cancellation.
- However, the aggrieved ARC/ SC may appeal to the Central Government against such cancellation or rejection of registration within 60 days of the date of order of the RBI.
- In case of rejecting an appeal such company shall given a reasonable opportunity of being heard.

MEASURES ADOPTED FOR NPA MANAGEMENT



Action by Govt. over the years




2010–2016: continuous amendments brought by the RBI in the existing framework for handling NPAs by banks and ARCs
2008–2009: five new ARCs formed; total of 14 ARCs in existence by 2009
2006: private players Alchemist, Pegasus and International ARC start operations
2005: RBI guidelines on FCD/FII investment and NPA sale by banks
2004: ASREC and ACE get licenses to operate as public limited ARCs
2002–2003: SARFAESI Act enacted in 2002 and guidelines governing ARCs formed; ARCIL formed as the first ARC in India
1993: debt-recovery tribunals set up [RDDBFI Act]
1987: BIFR formed to revive sick industrial companies and wind up unviable units

BUSINESS ENVIRONMENT UNDER NEW INSOLVENCY LAWS IN INDIA

PURPOSE OF IBC

- The resolution of stressed assets in the past involved the simultaneous operations of several statutory instruments. These includes :-

1. The Sick Industrial Companies Act, 1985 (SICA)
2. The securitisation and reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFSI)
3. The Recovery of Debt Due to Bank and Financial Institutions Act, 1993, etc.

- All of these multiple legal system use to result in huge piling up of NPA and creditors had to wait for years at end to recover their dues. The Bankruptcy Code is an efforts at a comprehensive reforms of the fragmented regime of corporate insolvency framework in order o all credit to flow more freely in India and instilling faith in investors for speedy disposal of their claims.
- The code has unified the law relating to enforcement of statutory rights to creditors and streamlined the manner in which a debtor company can revived to sustained its debt without extinguished the rights of creditors.

BACKGROUND FOR INTRODUCTION OF INSOLVENCY AND BANKRUPTCY CODE, 2016 (“IBC”)

- Before the enactment of the Insolvency and Bankruptcy Code, 2016, there was no single legal framework in India that dealt with insolvency and bankruptcy.
- The provisions relating to insolvency and bankruptcy were scattered over many legislations viz:
  - For Companies
    - Sick Industrial Companies (Special Provisions) Act, 1985 (dealing with the sick industrial companies),
    - The Recovery of Debt Due to Banks and Financial Institutions Act, 1993,
    - The Securitization and Reconstruction of Financial Assets and Enforcement of security Interest Act, 2002 and
    - The Companies Act, 2013
  - For individuals
    - The Presidency Towns and Insolvency Act, 1909 and
    - The Provincial Insolvency Act, 1920

Jurisdiction

- High courts were handling the Liquidation proceeding of companies
- District courts or High courts, as the case may be, were handling bankruptcy insolvency proceedings of individuals and partnership firms.
- Multiple Jurisdictions were existed under various statutes for Debt Recovery & Insolvency Resolution.
- Cumbersome Procedure for Rehabilitation of Business or to Exit from the Business

OBJECTIVE OF IBC

- To consolidate and amend various laws relating to reorganization and insolvency resolution of Corporate persons /partnership /individual;
- To provide Adjudicating Authority - National Company Law Tribunal (NCLT) for corporate persons and Debt Recovery Tribunal (DRT) for firms and individual, for resolution of insolvency, liquidation and bankruptcy.
- To Complete the Insolvency Process in time bound manner
- Maximization of value of assets of persons
- To promote Entrepreneurship
- To make availability of credit and balance the interest of all the stakeholders in rehabilitation/restructuring of business process
- Introduction of insolvency professionals (**“IP”**) to ensure more professionalism and to bring efficiency in resolution proceedings.
- To establish the Insolvency and Bankruptcy Board of India (**“Board”**) for regulation of IP, Insolvency Professional Agencies (**“IPA”**) and Information Utilities(**“IU”**)

ROLE OF INSOLVENCY PROFESSIONAL

- **Insolvency professional (IP)** is a person enrolled, under section 206 of IBC, with an insolvency professional agency as its member and registered with the Board as an insolvency professional under section 207.
- IPs play a key role in the management and administration of the entire insolvency resolutions, fresh start, liquidation and bankruptcy process. [section 208 of IBC]

ROLE OF INSOLVENCY PROFESSIONAL AGENCY

- Insolvency professional agency can be any person registered with the Board under section 201 as an insolvency professional agency;
- IPA is :
  - to promote the professional development of and regulation of IPs;
  - to promote service of competent insolvency professionals to cater to the needs of debtors, creditors, and such other persons, as may be specified;
  - to promote good professional and ethical conduct amongst insolvency professionals;
  - to protect interest of debtors, creditors, and such other persons, as may be specified.

THE ROLE OF INFORMATION UTILITY

- Information Utility (IU) is a person who is registered with the Board as an Information Utility under section 210 of IBC.
- The purpose of IU is to manage submission and transmission of data pertaining to insolvency and provide such services as may be specified including "core services" to any person, if such person complies with the terms and conditions as may be specified by regulations.
- Core Services as defined under section 3 (9) 0f IBC are as under:
  - accepting electronic submission of financial information in such form and manner as may be specified;
  - safe and accurate recording of financial information;
  - authenticating and verifying the financial information submitted by a person; and
  - providing access to information stored with the information utility to persons as may be specified;

PERSONS COVERED UNDER IBC

- Sole Proprietorship or Individual
- Partnership
- Limited Liability Partnership (LLP)
- Private Company
- Public Company
- One person Company

APPLICATION OF IBC PROVISIONS

- Part II of IBC Relating to Insolvency Resolution And Liquidation For Corporate Persons

- Part III of IBC Relating to Insolvency Resolution And Bankruptcy For Individuals And Partnership Firms

ADJUDICATING AUTHORITY

- For Corporate Person - National Company Law Tribunal (**NCLT**)
- For Individuals And Partnership Firms - Debt Recovery Tribunal (**DRT**)

WHO CAN FILE APPLICATION FOR CORPORATE INSOLVENCY PROCEEDING?

- **Corporate Debtor**

"Corporate Debtor" means a corporate person who owes a debt to any person. [section 3 (8) of IBC]

- **Financial Creditor**

"Financial Creditor" means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to. [section 5 (7)of IBC]

- **Operational Creditor**

"Operational Creditor" means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred. [section 5 (20) of IBC]

RELEVANT TERMS USED IN IBC

- **Debt** means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt. [**section 3 (11) of IBC**]
- **Claim** means— (a) a right to payment, whether or not such right is reduced to judgment, fixed, disputed, undisputed, legal, equitable, secured or unsecured; (b) right to remedy for breach of contract under any law for the time being in force, if such breach gives rise to a right to payment, whether or not such right is reduced to judgment, fixed, matured, unmatured, disputed, undisputed, secured or unsecured. **[section 3 (6) of IBC]**
- **Operational debt** means a claim in respect of the provision of goods or services including employment or a debt in respect of the repayment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority. **[section 5 (21) of IBC]**

RELEVANT TERMS USED IN IBC

- **Financial debt** means a debt along with interest, if any, which is disbursed against the consideration for the time value of money and includes— (a) money borrowed against the payment of interest; (b) any amount raised by acceptance under any acceptance credit facility or its de-materialised equivalent; (c) any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument; (d) the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian Accounting Standards or such other accounting standards as may be prescribed; (e) receivables sold or discounted other than any receivables sold on nonrecourse basis; (f) any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing; (g) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price and for calculating the value of any derivative transaction, only the market value of such transaction shall be taken into account; (h) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by a bank or financial institution; (i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clauses (a) to (h) of this clause. **[section 5 (8) of IBC]**

PROCESS FOR INSOLVENCY RESOLUTION/LIQUIDATION OF A CORPORATE DEBTOR

Application To Be filed before NCLT by (a) Financial Creditor [section 7 of IBC] , Operation Creditor [section 9 of IBC] and (d) Corporate Debtor [section 10 of IBC] for insolvency resolution and liquidation of Corporate Debtor.

- **Timeline**

  Ideally corporate insolvency resolution process should be completed in 180 days. If it is fast track, it should be completed in 90 days. (Section 12 & 56 of IBC)

- **Moratorium**

  Once the application is admitted, a moratorium will be declared till the completion of the resolution process. During the moratorium, no suits or proceedings can be filed or if filed, be proceeded against the corporate debtor/company; the company cannot transfer its assets; no action under SARFAESI be taken. If an order for approval of resolution process or for liquidation of the company is passed, the moratorium will cease to exist. (Section 14 of IBC)

- **Public Announcement**

  Public announcement of the corporate insolvency resolution process made in such manner as may be directed in the rules. [Section 15 of IBC]

- **Interim Resolution Professional (IRP)**

  NCLT to appoint Interim Resolution Professional (IRP) within 14 days from the Insolvency Commencement date i.e. the date of admission of an application for initiating corporate insolvency resolution process by the Adjudicating Authority under sections 7, 9 or section 10, as the case may be. [Section 16 of IBC]

- **Affairs to vest in IRP**

  From the date of his appointment, the affairs of the company will vest in the IRP; directors' powers will be suspended; staff will report to the IRP; financial institutions will act as per the instructions of the IRP. IRP may execute documents in the name of the company and he may take actions as may be specified by Board; he can have access to books of account and other relevant records of the company [Section 17 of IBC].

- **Action by IRP**

  IRP will collect information with regard to the assets, finances and operations of the company for determining the financial position; receive claims submitted by creditors; constitute creditors committee; take control of the assets of the company. IRP will try to ensure that the company remains a going concern and will try to run the business by appointing professionals, raising interim finance (any financial debt to be raised by the resolution professional during the insolvency resolution process period) etc. [Section 18 of IBC].

- **Committee of Creditors (COC)**

  Committee of creditors will take decisions based on majority which shall not be less than 75%.

  COC will hold first meeting within 7 days of constitution of COC.

  They may confirm the IRP as Resolution Professional (RP) in the first meeting or propose another name as RP which will be decided by NCLT on confirmation from Board. [Section 21 of IBC].

- **Resolution Professional**

  RP will do the acts/functions what IRP could do as per above.

  RP may file application for avoidance of transactions. Such transactions include transfers made by the company one year preceding the filing of application by the company for resolution. The filing of application by RP for avoidance will have no effect on the proceedings.

- **COC Decisions**

  COC decisions are final and overriding with regard to
  - raising interim finance.
  - creation of security interest,
  - changing capital structure,
  - record any change in ownership interest of the company,
  - for debiting any account maintained by financial institutions,
  - related party transactions,
  - amending constitutional documents,
  - disposal of shares by any shareholder of the company,
  - Management change etc.

- **Information Memorandum (IM)**

  RP will prepare an information memorandum containing relevant information (financial position etc.) as may be specified by Board (in rules).

- **Resolution Plan**

  Based on the IM, the company may submit a resolution plan to RP.

  RP will submit the resolution plan to COC. COC may approve the plan.

  The COC approved resolution plan will be submitted to NCLT.

- **Approval of resolution plan by NCLT**

  If NCLT approves the resolution plan, the same is binding on the company, its employees, creditors, guarantors and other stakeholders. NCLT may reject the resolution plan if the same is not in accordance with section 30 (2) of IBC.

- **Appeal**

  An appeal may be filed against the order of NCLT as above before NCLAT and then with Supreme Court from the order of NCLAT. [Section 61, 62 of IBC]

- **Liquidation Process and Distribution of Sale Proceeds**
  - If NCLT rejects the resolution plan, liquidation order will be passed by NCL.
  - COC can decide the liquidation of the company before NCLT passes an order on the resolution plan, NCLT shall bound to pass an order for liquidation.
  - Similarly, if the order approving the resolution plan is contravened by the concerned corporate debtor, any person other than corporate debtor, whose interest are prejudicially affected by such contravention , may file an application before NCLT for liquidation on which NCLT may pass an order for liquidation of corporate debtor. [Section 33 of IBC]

- **RP As the Liquidator**
  - When an order for liquidation is passed, RP shall act as liquidator and all the powers of the board of directors and key managerial personnel shall vest in the liquidator.
  - The liquidator shall act as per the overall instructions of the NCLT and do all things as are required (section 35 of IBC).

Liquidation Estate

- The assets of the company will be known as liquidation estate
- The liquidator shall hold the assets as fiduciary for the benefit of the creditors.
- The assets mentioned in section 36(4) of IBC are not considered as part of liquidation estate which are as under :
  - assets owned by a third party which are in possession of the corporate debtor, including-

    (i) assets held in trust for any third party;

    (ii) bailment contracts;

    (iii) all sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund;

    (iv) other contractual arrangements which do not stipulate transfer of title but only use of the assets; and

    (v) such other assets as may be notified by the Central Government in consultation with any financial sector regulator;

Continued..

- assets in security collateral held by financial services providers and are subject to netting and set-off in multi-lateral trading or clearing transactions;
- personal assets of any shareholder or partner of a corporate debtor as the case may be provided such assets are not held on account of avoidance transactions that may be avoided under this Chapter;
- assets of any Indian or foreign subsidiary of the corporate debtor; or
- any other assets as may be specified by the Board, including assets which could be subject to set-off on account of mutual dealing between the corporate Debtor and any creditor

- **Claims**

  Within 30 days from the date of commencement of liquidation process, the liquidator shall collect claims from creditors. The creditors may withdraw or vary their claim within 15 days of submission.[Section 38 of IBC]

- **Disposal of Claims**

  The liquidator may after verification of the claims, accept or reject the claims and the aggrieved party may approach NCLT against the decision of the liquidator[Section 39, 42 of IBC].

- **Distribution of Sale Proceeds**

  The proceeds from the sale of assets shall be distributed in the priority of

  - costs of insolvency resolution process
  - workmen's dues and dues of secured creditors on pari passu basis
  - unpaid dues of employees other than workmen
  - financial debts due to unsecured creditors
  - government dues and debts due to secured creditors which are unpaid following enforcement of security interest remaining debts and dues.[Section 53 of IBC]

- **Certain Transaction Not Valid**

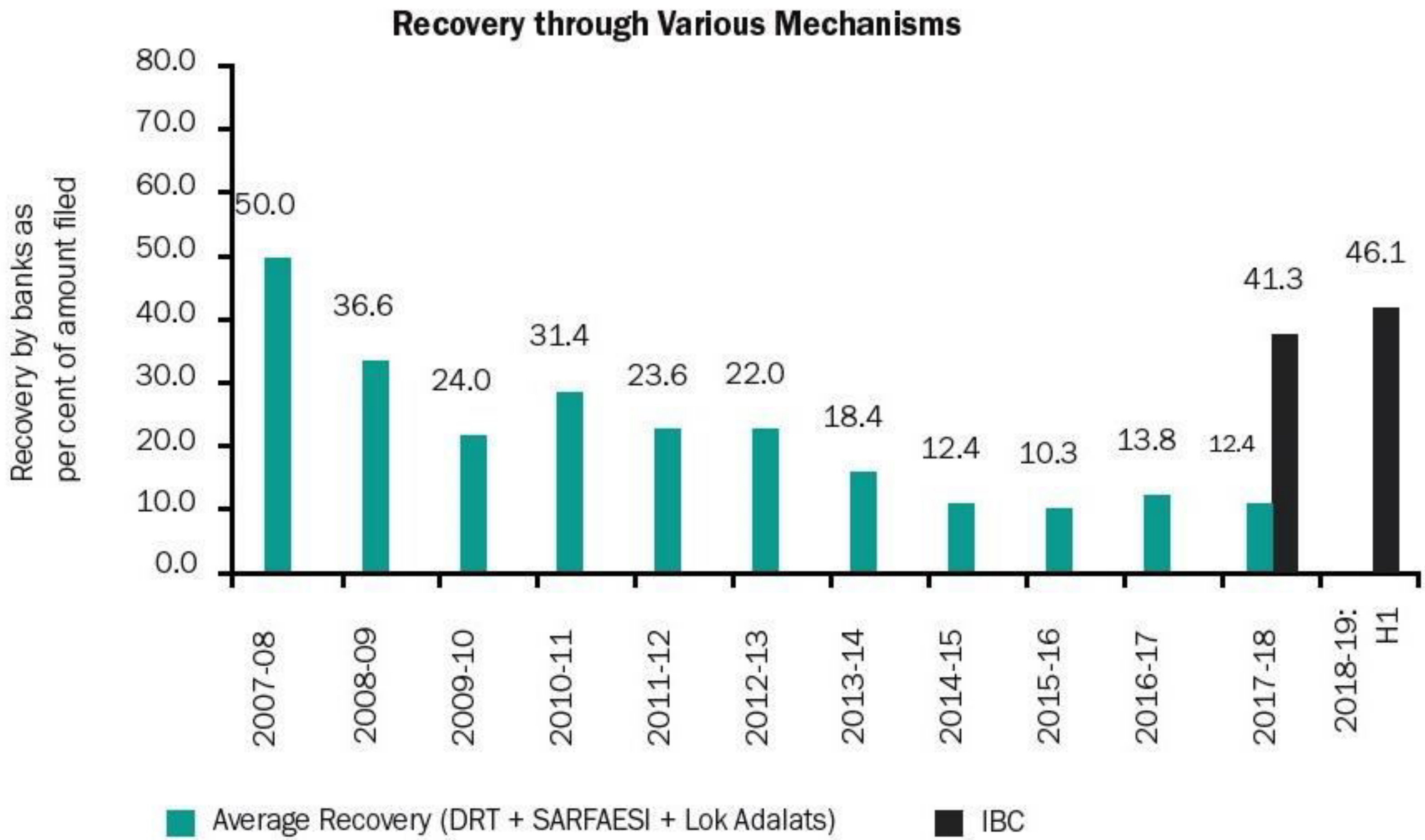
Preferential transactions will be avoided by the order of NCLT.

- Any transfer of property made (i) in favour of related parties (as defined in Section 5 (24) of IBC) two years preceding the commencement of insolvency resolution process; and (ii) in favour of any other person one year preceding the commencement of resolution process, where such parties or persons stood guarantee/surety or extended credit for antecedent financial debt or operational debt or other liability of the company, such transfers shall be avoided for which the RP or the liquidator will make an application to NCLT.

Undervalued transactions will be avoided by the order of NCLT.

- Any transfer of property made (i) in favour of related parties two years preceding the commencement of insolvency resolution process; and (ii) in favour of any other person one year preceding the commencement of resolution process, where property transferred by way of gift or transfer for a value significantly less than the value of the consideration provided by the company, such transfers shall be avoided for which the RP or the liquidator will make an application to NCLT.
- In both the above cases, NCLT may pass an order that the property so transferred shall be vested in the company as if no transfer took place.

Effectiveness of IBC



Note: Data on average recovery (DRT + SARFAESI + Lok Adalats) is not available for 2018-19:H1

Source: RBI and IBBI.

Options for funding of Stressed Assets

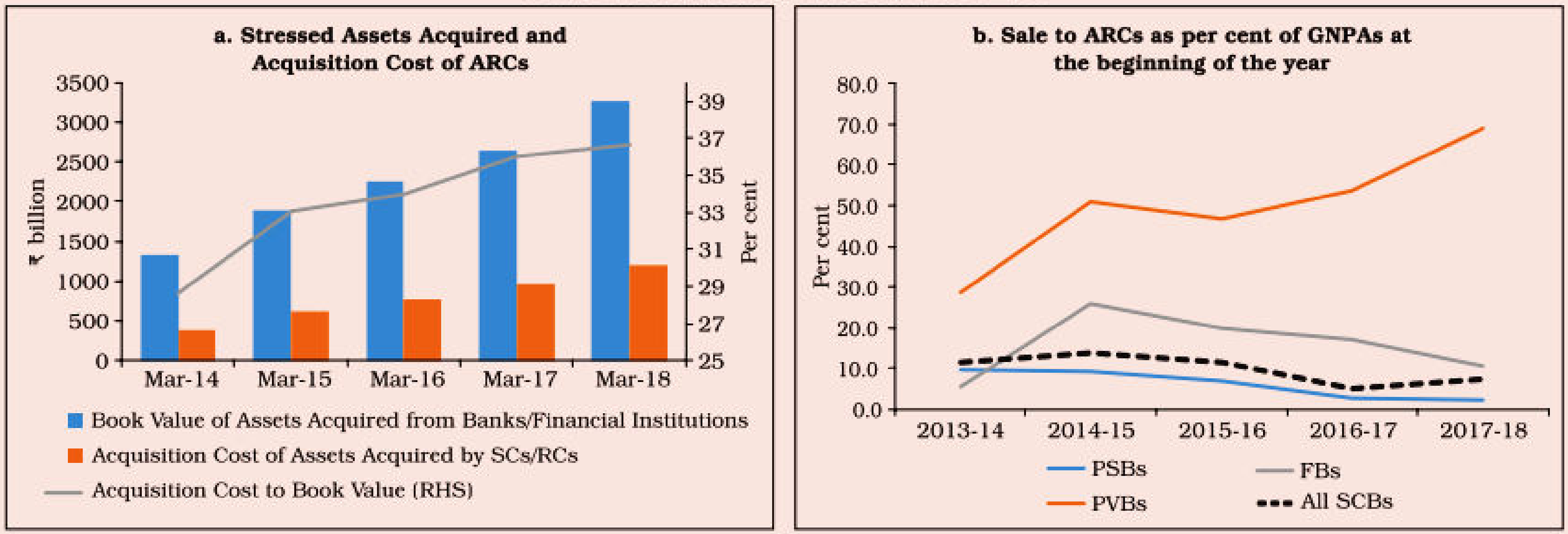
- Restructuring of the Debts
- Acquisitions by ARCs
- Private Equity / Private Funding
- Indian Stressed Asset Funds
- Foreign Stressed Assets Funds
- Special NBFCs and Investment Companies

Modifications in RBI Guidelines

- RBI vide is circular No. RBI/2017-18/131 DBR.No.BP.BC.101/21.04.048/2017-18 dated the February 12, 2018 issued revised framework for Resolution of Stressed assets in Line with Insolvency and Bankruptcy Code 2016

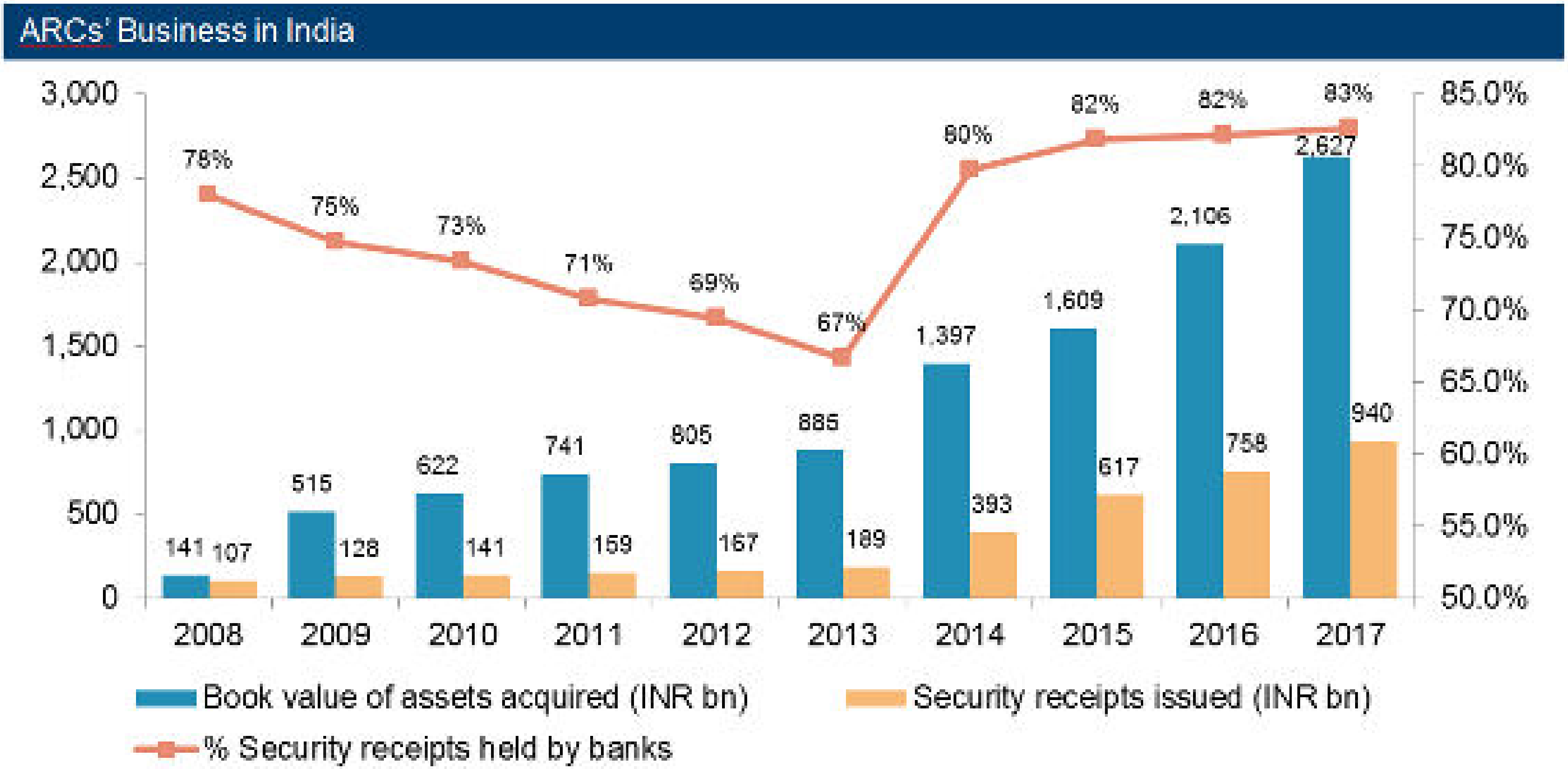
Options for funding of Stressed Assets

Chart IV.20: Stressed Asset Sales to ARCs



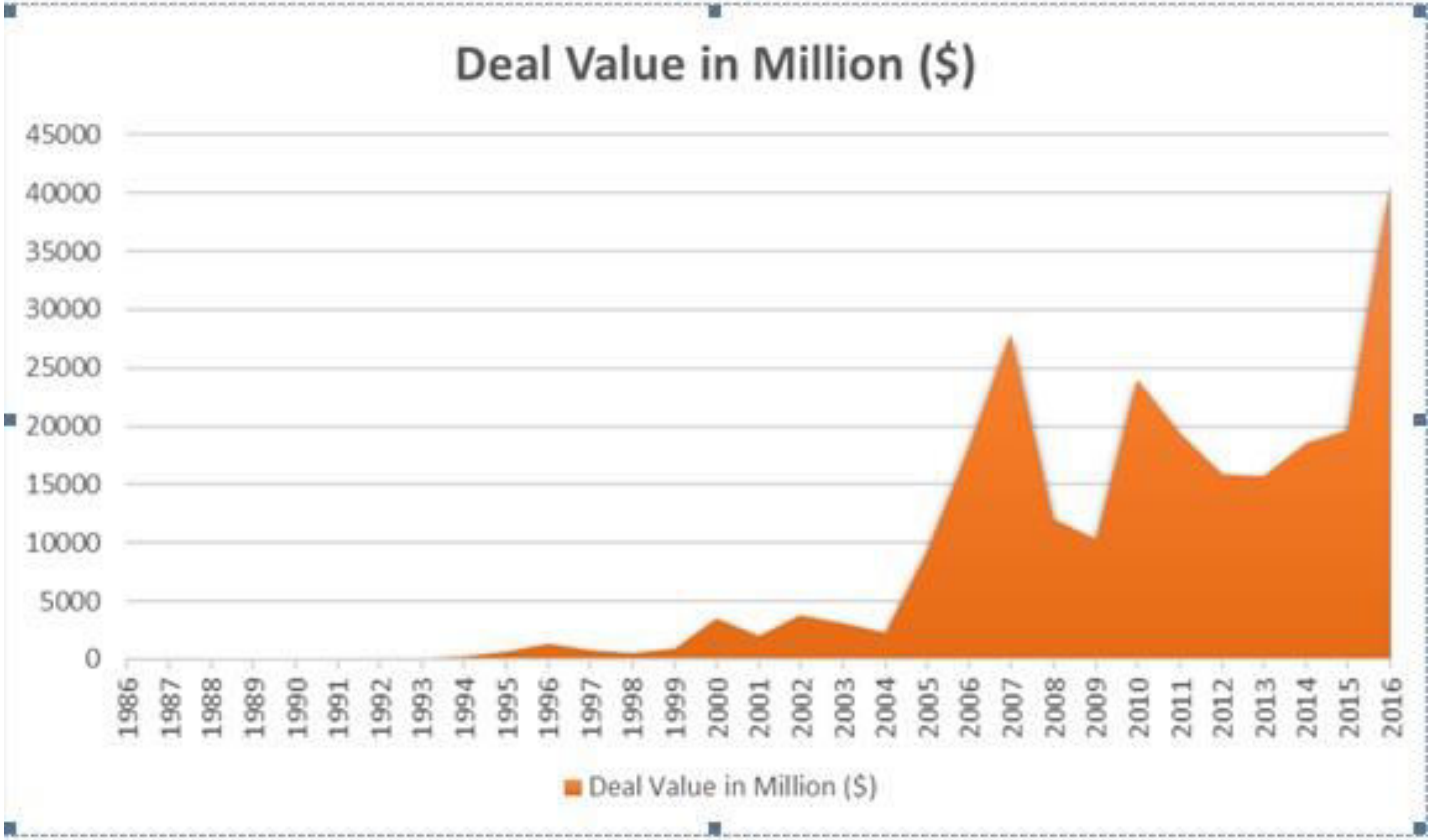
Source: Quarterly statements submitted by ARCs and off-site returns (domestic operations), RBI.

Investment by ARCs



Source: RBI

Options for funding of Stressed Assets



Options for funding of Stressed Assets

- **SOME OF THE TOP INVESTORS IN THE INDIAN DISTRESSED ASSETS MARKET INCLUDE,**

- **Temasek Holdings Pte. Ltd –** The Singapore-based firm describe themselves as an equity-only investor wanting to invest in the business of non-performing assets.

- **Infrastructure Leasing & Financial Services Ltd (IL&FS) –** Created a pool with the Lone Star Fund so as to invest almost $2.5 billion in distressed asset purchases.

- **WL Ross & Co –** The US-based firm which also holds a large share in OCM India Ltd, expressed their wish to invest in the textile industry distressed assets.

- **SREI Alternative Investment Managers Ltd –** This Kolkata-based firm is reported to have set aside Rs. 2000 crores in order to invest in debt instruments and assets by buying them.

- **TPG –** The private equity firm has already invested $1.5 billion in India's distressed assets and are looking to invest more as they see a great investment opportunity in India.

Options for funding of Stressed Assets

DISTRESSED ASSET FUNDS

Brookfield & SBI
Launch date: Jul '16
Value: **$1,040 mn**

Piramal Group & Bain Capital
Launch date: Aug '16
Value: **$1,000 mn**

Lone Star & IL&FS
Launch date: Feb '17
Value: **$550 mn**

CPPIB & Kotak Mahindra
Launch date: Jan '16
Value: **$525 mn**

Srei Alternative Investment
Launch date: Feb '16
Value: **$300 mn**

JM Financial
Launch date: Jul '16
Value: **$300 mn**

Source : Company reports   Compiled by BS Research Bureau

Dr. Anil Yadavrao Gaikwad