

# **Effective Implementation of Insolvency and Bankruptcy Code**

**A Collective Stakeholders  
Responsibility**



*Launched on the occasion of ASSOCHAM INSOL India  
Conference on Insolvency held on 28-29 April 2017 in New  
Delhi with the Society of Insolvency Practitioners of India as  
Knowledge Partner and Edelweiss as Summit Partner.*



## FOREWORD



The new insolvency law is creating a lot of excitement and anxiety in the industry, as it throws both opportunities as well as challenges. The code establishes an Insolvency Regulator, The Insolvency and Bankruptcy Board of India (IBBI) to exercise regulatory oversight over insolvency professional agencies and the Adjudicator, the National Company Law Tribunal with designated insolvency benches; and Information utilities – the repositories and depositories of information to facilities quick access to information and timely resolution.

In this backdrop, recognizing the importance of Insolvency and Bankruptcy Code in the financial architecture of the country, ASSOCHAM is organizing International Conference on "New Corporate Insolvency Regime" on 28- 29 April, 2017, New Delhi in partnership with INSOL India, SIPI and supported by Insolvency and Bankruptcy Board of India and United Nations Commission on International Trade Law (UNCITRAL). This International Conference provides for learning from eminent speakers and think tanks in the insolvency regime, in terms of practical aspects and challenges.

ASSOCHAM-SIPI-Edelweiss have brought out the knowledge paper with the objective to highlight the issues and challenges being faced by various stakeholders.

We hope that this study would help the regulators, market participants, government departments, and other research scholars.

D S Rawat

Secretary General, ASSOCHAM

## PREFACE



Insolvency lawmaking is unique since bankruptcy reaches to some of the most fundamental policy debates on substantive values in a society, its political system and economy. It involves three levels of policy: 1) meta-policy issues; 2) master policy issues for insolvency; and 3) insolvency-specific and collateral policy issues. Meta-policy issues reach to fundamental ways in which societies define their values and their institutions. Master policy issues countries confront are – liquidation verses restructuring; universalism versus protectionism; and state versus market. The third level of policy making is insolvency specific – substantive provisions to be incorporated in the law.

In all lawmaking a gap opens up between law on the books and law in action. There are several key policy choices that influence the probability of effective implementation, both substantive and institutional. Insolvency and Bankruptcy Code 2016 contains many new concepts and principles as a result of shift in past policies and new policy choices. The wisdom behind these choices will be tested in the implementation of law. The key to the impact of the legislation therefore, lies in its implementation.

Every stakeholder has a role in effective and efficient implementation of insolvency law. The degree of role of stakeholders may vary but the importance of each is no less than that of the others. It is with this recognition that the stakeholders of Insolvency and Bankruptcy Code must approach the new insolvency regime. All stakeholders have a duty to contribute to the success of the law by adopting best practices and applying it in its true spirit. All stakeholders should benefit from its implementation. If one limb of the insolvency system advances rapidly by adopting the best practices but the other stays slow and unsure, it will adversely impact the overall functioning of the law. This will be possible only if we compliment each other's efforts.

This report capsules the role and approach expected from each stakeholder. Every section of the report demands expansion going forward. I hope this will be a useful precursor to deeper work required on its various dimensions.

As an independent think tank for the insolvency industry, Society of Insolvency Practitioners is committed to constantly assist the policy makers and the industry in the development of the law and best practices. I am thankful to ASSOCHAM for inviting SIPI as Knowledge Partner for producing this report. I thank INSOL India and Edelweiss for their invaluable contributions in crafting this report.

**Suman Batra**

Chairman

Society of Insolvency Practitioners of India

Chief Mentor, INSOL India

Chairman, ASSOCHAM National Council of Insolvency and Bankruptcy

## 2ND FOREWORD



2016 brought about many landmark legislations and amendments in many legislations with the sole aim of easing business as part of economic reforms. The Insolvency and Bankruptcy Code was one of these.

From the time the Insolvency and Bankruptcy Bill was introduced in the Lok Sabha on December 21, 2015, the Insolvency and Bankruptcy Code has made unprecedented headway in its enactment and implementation. The framework required for restructuring and liquidation processes for the incorporated companies and limited partnerships has been put in place including relevant rules and regulations, the last one being regulations in relation to information utilities under the Code.

Under the Code, after obtaining membership of an Insolvency Agency, insolvency professionals have to register themselves with the Insolvency and Bankruptcy Board of India. Successful functioning of the Code depends upon the insolvency professionals and how they manage to work out the various provisions of the Code. Integrity and knowledge of the Code shall be the guiding factor for them.

The report being published is an attempt to bring forth the challenges the professionals would face and meet during the course of implementation of the Code.

The Insolvency and Bankruptcy Board of India (the regulator under the Code) has to play a pro-active role in implementing the Code and guide to establish not only a robust insolvency regime, but also to ensure that requisite training is provided to the professionals.

INSOL India is lending its might and playing a crucial role in tapping the opportunities, building not only the new discipline of insolvency profession but also that of associated service providers and development of insolvency industry. Mindful of this responsibility, INSOL India, together with its knowledge arm SIPI, has associated itself with ASSOCHAM to fulfill its catalytic role in implementing the Code and the present report is a step in that direction.

INSOL India is making inroads into academic institutions to get insolvency included in the curriculum or syllabus as a core or allied subject. It is associating itself with various universities, organisations and NGOs for wider dissection and dissemination of the topic, with a view to achieving a better insolvency system – one of the best in the world.

The report in your hand would not only give an insight into the challenges before us, but also make us think of meeting them and ultimately transforming insolvency into a viable opportunity, bringing hope from hopelessness.

A.S. Chandhiok

President, INSOL India.

## 3RD FOREWORD



Aggregate stressed assets in the banking system comprising Non-Performing Assets (NPAs) and restructured loans have reached alarming level of 14-15% of total advances as on March 31, 2017. Reserve Bank of India (RBI) and the Central Government have been taking several initiatives to help banks manage the stress effectively. This is not the first time that the banking sector encountered NPA problems; history shows that every time such problems happened, new institutions or instrumentalities were set up to support the banking system. The 1980s gave birth to Board for Industrial and Financial Reconstruction and 1990s created Debt Recovery Tribunals. However, NPA issue became acute by FY 2001 when gross NPA reached close to 14% of the total banking credit. The year 2002 is considered a watershed year when a three-pronged strategy was put together, namely, (a) empowering banks to enforce security through SARFAESI Act, (b) introduction of Corporate Debt Restructuring mechanism and (c) introduction of Asset Reconstruction Companies(ARCs) to acquire the toxic assets off the balance sheets of the banks. All these measures together with an uptick in the economy helped in bringing down the NPA issue to a nominal level of less than 2% by FY 2008.

The type and nature of stressed loans this time is different. There had been a trend of aggressive lending by Indian banks during the boom period 2004-08. This trend continued even after 2008 melt down on the strong perception that the global economic crisis would not impact Indian economy significantly. Capital intensive sectors like steel, cement, power, aviation & shipping/ship-building, construction and real estate continued to receive bank funding for their aggressive expansion plans. More than 60% of the stress currently in these sectors. There was excessive leveraging and overinvestment in this phase of high GDP growth. Banking system again faced a situation similar to or worse than 2001. Once again RBI introduced several tools such as conversion of debt into equity by banks of the borrower under stress, restructurings over a period of 20-25 years and the concept of sustainable debt and flexible restructuring. While the jury is still out if these measured have worked, the most significant measure is passing of Insolvency and Bankruptcy Code. The Code is likely to help both borrowers and lenders to arrive at the most appropriate resolution where possible and faster liquidation of the unviable entities.

ARCs have also come of age. Financial year ended March 2017 witnessed several significant steps taken by the Government and RBI for revitalizing ARCs; all the restrictions for raising capital by way of equity and Security Receipts have been removed. Today ARCs are can raise any amount of capital for ramping up the business. It is expected that NPAs worth over Rs.2 lakh crore will be acquired by the ARC system catalyzing an investment of Rs 30-40000 crore in cash/ structured transactions mobilized through sponsors, investors and stress funds.

Edelweiss is delighted to be associated with this Knowledge Report initiated by ASSOCHAM and Society of Insolvency Practitioners of India.

Siby Antony

MD & CEO, Edelweiss Asset Reconstruction Company Ltd.

# CONTENTS

Background -----	06
Implementing IBC -----	10
Collective Responsibility and Duty -----	13
Role of Asset Reconstruction Companies -----	22
About ASSOCHAM -----	28
About SIPI -----	30
About INSOL India -----	31
About Edelweiss -----	32

COLLECTIVE

# BACKGROUND

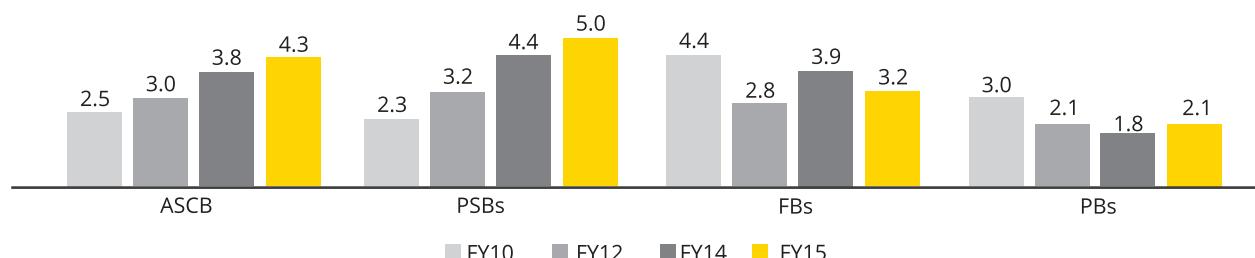


In May 2014, the National Democratic Alliance formed government in India under the leadership of Prime Minister Narendra Modi after a landslide victory in the general elections. The first task of Modi Government after assuming power was to rejuvenate the economy and the mood of the nation after a low period under the UPA-II. A large investment was needed to brighten up the market mood. A number of urgent measures were required to regain investor confidence and make India once again attractive for foreign investors. This could not be done without improving India's ranking on World Bank's Ease of Doing Business. Soon after assuming office, Prime Minister Modi announced that India would strive to be among the top countries in terms of ease of doing business within three years. A massive exercise was started to address the causes responsible for India's low ranking. It was at once realised that an efficient insolvency law is a prerequisite to all of this. Recognising the urgency, the government initiated steps to reform the insolvency law on priority. An overhaul of the insolvency framework was an immediate beneficiary of this exercise and a new

law in the form of the Insolvency and Bankruptcy Code, 2016 (IBC) was passed by the Parliament on 11 May 2016 to provide the framework of corporate insolvency and bankruptcy of natural persons. IBC received Presidential assent on 28 May 2016 and was notified in the official gazette on the same day.

There were others reason for urgency in insolvency reform. Although the Indian banking sector remained largely insulated from the severe impact of the global financial crisis that shook banking sectors worldwide following the collapse of Lehman Brothers in 2008, macroeconomic conditions deteriorated in India over the past few decades causing rise in the non-performing assets. "Undercapitalised projects; b) continued focus on expansion by optimistic promoters who believed that India is decoupled from global trends; c) undercapitalised banks leading to delayed recognition of stressed situations and a consequent debt trap; and d) policy paralysis contributed to growth of stressed assets in the banks.

**Trend in gross NPAs (%) across bank groups FY10-15**

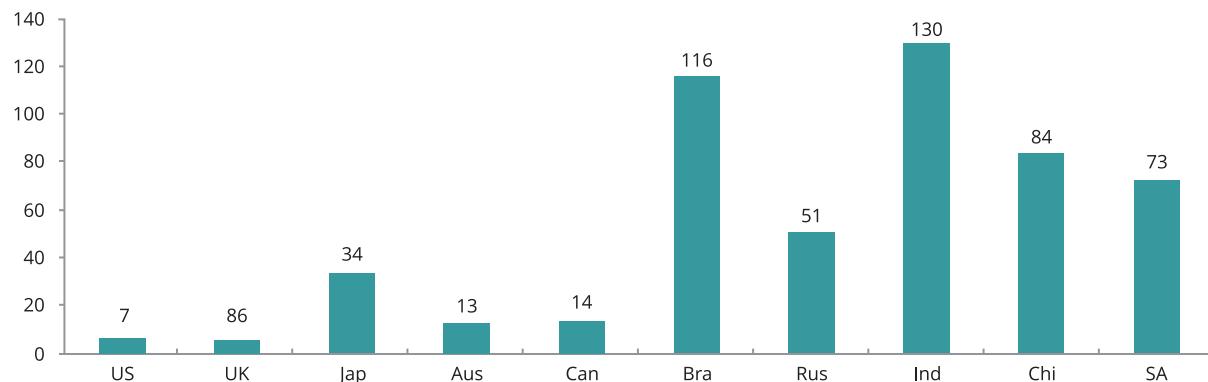
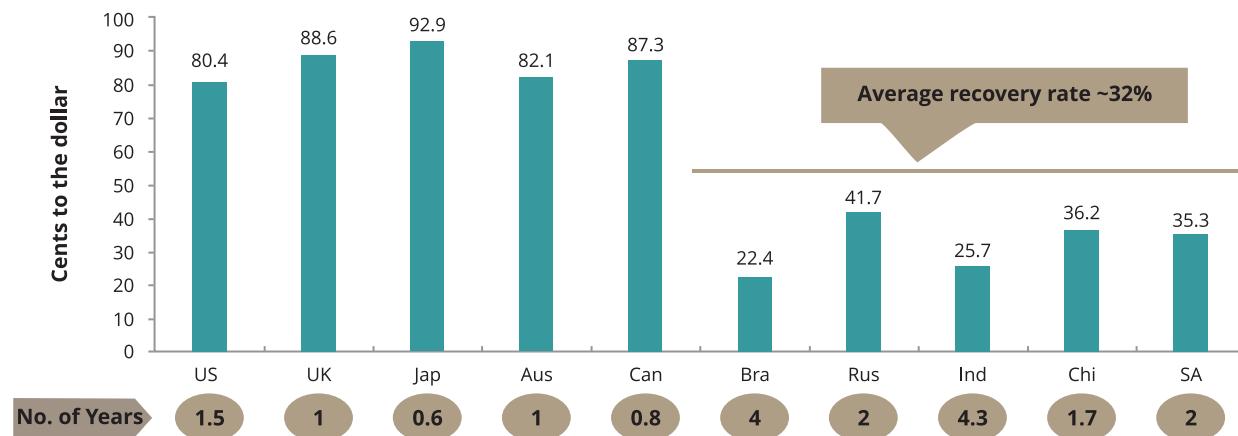


Source: RBI Financial Stability Report

Non-performing assets (NPA) assumed an alarming proportion in 2014 impacting availability of credit needed to inject energy in the economy. A fragmented and fractured insolvency framework operating at that time was of little help in resolving NPAs. Although banks were able to repossess fixed assets and enforce security interest by invoking the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) there was not much they could do to restructure or liquidate these assets in the absence of an efficient insolvency law. The restructuring and liquidation proceedings were cumbersome and marred by lengthy court processes. Average life of cases recommended for restructuring took between 4 to 8 years and those recommended for winding up even longer, while it is only 1.7 years in high-income OECD countries. Even as of October 31, 2015, only about 955 (out of 4,636) and 163 (out of 545) cases of court and voluntary winding up were resolved within 5 years. A significant number of such cases were pending for more than 20 years. The outcomes were obviously poor.

The recovery rate (cents on the dollar) in India is 25.7 as opposed to 71.9 in high-income OECD countries. India continued to fare badly in the World Bank's Ease of Doing Business ranking for many consecutive years, with Closing a Business (now called as Resolving insolvency) in India being one of the key negative indicators. In 2010, India ranked at number 133 in the list of 189 countries with its Closing a Business ranking at 138. In 2016, the ranking moved up to 130 but in Resolving Insolvency, India continued to score poorly having been slotted at 136.

The NDA realised that to revitalise the economy cosmetic efforts will not suffice, path-breaking measures were needed. Reforming insolvency law was placed on the top of the list of reforms chalked by the government. This led to the setting up of the Bankruptcy Law Reforms Committee (BLRC) in August 2014 to make suitable recommendations. BLRC rolled out the marathon undertaking swiftly.



In the meanwhile, the risks to India's banking sector increased mainly on account of a further deterioration in asset quality and low profitability. The gross non-performing assets rose sharply to 7.6 per cent in September 2015 largely reflecting re-classification of restricted advances to NPAs following an asset quality review initiated by the Reserve Bank of India (RBI). Public sector banks continued to hold the highest level of stressed advances ratio at 14.5 per cent, whereas, both private sector banks and foreign banks recorded stressed advances ratio at 4.5 per cent.

The banking sector's gross non-performing assets showed a sharp year on year increase of 79.7 per cent in March 2016. Among the major sub-sectors within the industrial sector, 'basic metal and metal products' accounted for the highest stressed advances ratio as of March 2016 followed by construction and textiles on the other hand, annual slippages of major sectors/sub-sectors in December 2015 show that the textiles industry had the highest number of standard accounts slipping into the NPA category at 8.8 per cent, followed by the cement industry at 8.0 per cent. In terms of outstanding amounts, the iron and steel industry saw the highest slippages at 7.8 per cent followed by textiles at 6.4 per cent.

### **Corporate Debt Restructuring & Joint Lenders Forum) mechanisms**

As it was getting difficult for the lenders to arrive at a common approach to tackle issues from growing stressed loans, RBI introduced the Corporate Debt Restructuring (CDR) Mechanism in the year 2001 which was a voluntary non-statutory system based on Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA) and the principle of approvals by super-majority of 75% creditors (by value) which makes it binding on the remaining 25% to fall in line with the majority decision. The CDR Mechanism covered multiple banking accounts, syndication/consortium accounts, where all banks and institutions together had an outstanding aggregate exposure of Rs.100 million and above.

RBI introduced Joint Lender's Forum (JLF) mechanism in the year 2014 and laid guidelines to deal with issues stemming from elevated stressed loans. JLF was introduced to recognize stressed assets early and come up with a corrective action plan (CAP) within 45 days.

These systems were not so successful and the progress was slow, and not so steady. The issues faced by the lenders were that there the CDR group & the JLFs formed were slow in their execution and were taking too long to resolve issues; even when consensus was achieved, execution was hit by other road blocks like lack of clarity, responsibility & accountability. There were conflicting opinions among the lenders regarding the method of resolution. The conflict among the lenders was also due to the different security positions. There were delays in banks getting approvals from their respective boards for Restructuring. The banks generally did not have enough resources to oversee the restructuring cases. ARCs have to a certain extent resolved this problem by acquiring from lenders and achieving aggregation of debt. The ARC by way of aggregation of debt hold majority of debt thereby integrating the interests of the lenders with respect to a particular borrower.

In this background, the enactment of IBC and its prompt implementation assumed greater necessity and importance.

# IMPLEMENTING IBC



The government moved at an unprecedented pace to operationalize IBC. In less than six months after the enactment of IBC, most of the subordinate legislation was finalised and the corporate insolvency law made majorly operational before the end of the year 2016. It became fully operational by the end of March 2017. Most institutions part of the new eco system became functional and filing of insolvency applications started.

IBC is largely a sound piece of legislation. It consolidates and amends the laws relating to the reorganization and liquidation of corporations, and bankruptcy of natural persons. It seeks to achieve insolvency resolution of a corporate entity in financial distress and, failing that, its liquidation, in a time bound manner. IBC contains many new principles and concepts that are a fundamental change from the repealed reorganisation and winding up law, substantially as well as procedurally. It introduces a shift from the "debtor in possession" regime under the Sick Industrial Companies (Special Provisions) Act, 1985 (since repealed) to a "creditor in control" regime, making it a creditor-friendly legislation. The law establishes a new discipline of insolvency professionals. Insolvency professional is appointed as resolution professional on commencement of insolvency proceedings displacing the debtor from the management and control of assets, and becomes responsible for management of the debtor's enterprise as a going concern. The role of court has been reduced significantly with insolvency professional serving as an extended arm of the NCLT. Creditors have been provided with greater role and powers in the corporate insolvency resolution process through creditors' committee.

IBC is a shift from balance sheet to cash flow test. Unlike the subjective and often contentious entry test of erosion of net worth under SICA, IBC prescribes an objective test, that of payment default in respect of a debt. An application for commencement of corporate insolvency resolution process can be filed upon the occurrence of a payment default in respect of a debt of at least INR1 lakh before the NCLT.

IBC stands apart and different from DRT/ SARFAESI because, there is less or practically no interference

from borrowers/ promoters by way of litigation due to the moratorium on the borrower when an application under IBC is admitted. DRT and SARFAESI mechanisms are characterized by interference by way of litigation (even if frivolous) by the borrower, thereby delaying the recovery, frustrating the financial creditor and diminishing the asset value given as security. Resolution under IBC happens in a time bound manner as opposed to DRT. IBC seeks to promote entrepreneurship and availability of credit for revival. IBC also seeks to promote re-organisation of the company in a systematic manner, failing which the liquidation of the concerned entity is invited.

#### *Stakeholders under the IBC*

While dealing with stressed assets, lenders in the past could not take into account workman dues, dues of the government etc. There was an arbitrary approach of only trying and recovering their dues, which, more often than not, left other stakeholders high & dry.

The Insolvency & Bankruptcy Board of India (Liquidation Process) Regulations, 2016 defines "Stakeholders" as the stakeholders entitled to distribution of proceeds under Section 53; therefore the Stakeholders as per Section 53 include; (a) the Insolvency Resolution Process Costs & Liquidation Costs undertaken by the Applicant; (b) Workmen dues & the debts of the Secured Creditor. (c) Wages & unpaid dues owed to employees for a period of 12 months preceding the liquidation commencement date. (d) Financial debts owed to unsecured creditors. (e) Dues to the Government (Central & State) debts including the amount to be received on account of the consolidated fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the period of two years preceding the liquidation commencement date & dues owed to Secured Creditor for any amount unpaid following the enforcement of security interest. (e) Any remaining debts & dues (f) Preference shareholders (g) Equity shareholders/ partners. For the successful implementation of the Code; it is imperative that every stakeholder as listed under Section 53 of the Code are considered while implementing of the Resolution Plan so that every stakeholder's claim is considered on equitable grounds.

The success of IBC will depend on how effectively it is implemented. As IBC was being operationalised, NPAs of 39 listed banks surged to 4.38 rupees trillion for the quarter ended 31 December 2016, from 3.4 trillion rupees at the end of September 2016. The aggregate net profit of the 39 listed banks fell 98% to 307 crore rupees in the 2016 December quarter from 16,806 crore rupees in the year earlier. The 24 public sector banks were the worst performers, having reported an aggregate loss of 10,911 crore rupees in the 2016 December quarter compared to a profit of 6,970.8 crore rupees in the year-ago quarter. Such was the surge in bad loans that provisions towards these wiped out the profits of 12 out of the 39 listed banks. Out of the 27 banks that reported a quarterly profit, six saw profits plummet more than 70% from a year-ago period. The effectiveness of IBC will be tested in bringing the scale of NPAs down.

IBC is an important reform for India and its implementation has to be planned carefully. The focus of the government in initial stages has been more on expeditious operationalisation rather than effective implementation. The popular perception is that the government is more focused on the benefits the provisions of legislation and their operationalisation will produce in improving India's ranking on in the World Bank's Ease of Doing Business index. In 2010, India ranked at number 133 in the list of 189 countries in 2010 and climbed up only to 136th spot in 2016 despite a number of reforms and measures in other areas impacting ease of doing business. The successful implementation of IBC will depend on a number of factors including meticulous transition planning. A new discipline of Insolvency Professionals has been created by IBC. Adequate number of skilled and trained insolvency professionals is not available in the market. Educating the market players and building capacity of the newly set up institutions is key to effective implementation of IBC. A mammoth exercise is needed, as the nuances of the insolvency law are not widely understood in India. Indians are quick learners and there is no doubt that in a very short time the market will have immensely competent players operating in the new insolvency system.

Many new institutions have been established or developed. Implementation and institution building are as important as – indeed arguably more consequential than – formal lawmaking. It is a dangerous illusion that the legal framework and institutions of an effective insolvency system can be done cheaply. Effective bankruptcy systems require the careful design, infrastructural expenditure, and political will comparable to major infrastructural projects in transportation or energy or defence. This is especially so in circumstances where there is rapid economic development and social dislocation in a society that had previously invested little in legal institutions. Failure of governments to act boldly and decisively can lead not only to incapacity but instability in society and ultimately the market.

## COLLECTIVE RESPONSIBILITY AND DUTY



IBC is an important reform for India and its implementation has to be planned carefully. The new insolvency system will need to mature quickly, commensurately with economic development in the country. India does not have a great track record on implementation of laws. IBC presents an opportunity to alter that image and exhibit that India can deliver prompt and effective implementation. But, it will be unjust to load the government with the entire responsibility for making IBC successful. While the government must charter the course of its implementation, the onus to make IBC successful rests with all the key stakeholders, including its consumers and beneficiaries. Each stakeholder will need to play an enthusiastic and constructive role in potent implementation of IBC to ensure its success.

The favourable outcomes of IBC will not only result in unlocking of the flow of capital but also lead to the development of a robust corporate debt market. Access to finance is the biggest constraint to growth and has to be considered in the context of the overwhelming need for macro-financial stability.

To make the new insolvency system robust and at par with global standards, the new institutions established under IBC will have to function guided by the statement of objectives outlined in IBC; the policy makers will need to quickly plug the gaps in law and regulations on an on-going basis; and stakeholders will need to adopt the global best practices with speed. The bar must be set high right at the start.

India must aspire to compete with the best insolvency system on the strength of its unique characteristics. Its success can propel India as an attractive choice of jurisdiction for resolving insolvency. All stakeholders must make the success of IBC a common goal and a national aspiration. A few suggestions on approach and measures needed by key stakeholders to achieve this goal are outlined below.

## GOVERNMENT OF INDIA

The scale and pace of reforms undertaken in insolvency law by the Modi Government prove political will is critical to drive reforms. The government must sustain the momentum built on the implementation of IBC. In the world of insolvency, developments are rapid and many. The luxury of pause is absent. The government will have to stay constantly on its toes.

The biggest stumbling block to success of any insolvency law is the stigma associated with it. The society must recognize that businesses do fail and unfortunate promoters are not to be penalised for failure. Insolvency law provides confidence to risk taking entrepreneurs and investors that in the event of a financial difficulty the system will offer them a fair and reasonable opportunity to resolve the insolvency by providing a second chance. By providing legitimacy to bona fide failure, insolvency law disassociates stigma from failure.

Unfortunately, this fundamental principle is not articulated in statement of objectives of IBC. Efforts are needed to educate people so that the society can forgive those who fail. Without legitimizing bona fide failure, the insolvency law will not serve its purpose. This is necessary to encourage those who have failed honestly to try again, while providing a robust and effective remedy against the small minority abusing their creditors. India should take this issue head on and come out with a plan to address the same. The government should draw a systemic plan to disassociate stigma from failure and create an environment where bona fide failure is perceived as legitimate. Linked with the need to address the issue of stigma is the case for fresh start. Honest failure is an inevitable part of a dynamic market economy. India's radical liberalization of the insolvency regime should mean a fresh start for many, backed by a very tough regime for those whose conduct of their financial affairs is irresponsible or reckless.

Absence of cross-border insolvency provisions in IBC has turned out to be a disappointment. It was

widely expected that India would adopt the UNCITRAL Model Law on Cross-Border Insolvency or offer an alternate framework to deal with cross-border issues. The Indian common law regime is ill equipped to deal with the cases of cross border insolvency. Provisions made in the IBC are inadequate to deal with cross border insolvency. A law is urgently needed to facilitate greater co-operation between courts of various States, fair and efficient administration of cross-border insolvencies that protects the interests of creditors as well as the debtor, and other objectives. Judicial involvement and devotion in regulating economic aspects is nothing but a natural corollary to its economic development. In the absence of statutory framework for cross border insolvency, courts in India will always struggle to deal with the insolvency issues. Access, recognition, relief and co-operation are the key tenets of the cross border insolvency law, by a combined action of which the law ultimately aims for recognition of foreign insolvency proceedings, foreign decisions and access of foreign liquidators/ administrators to local court proceedings. The UNCITRAL Model Law is the most widely accepted blue-print to effectively deal with cross-border insolvency issues while ensuring the least intrusion into each country's internal insolvency and bankruptcy laws.

Recognising this, three prior reform committees that looked into insolvency law reform in India – the N.L. Mitra Committee, the Eradi Committee and Irani Committee recommended that India adopt cross border insolvency law in some form or the other. Adoption of the UNCITRAL Model Law is a necessity and not an option. Most sophisticated economies have well developed cross border insolvency laws. India should match up soon.

The importance and contribution of research in development of commercial laws is not fully recognised in India. Research is an inseparable part of insolvency framework. It is imperative that an independent research foundation, adequately funded by public and private sector, is set up as part of architecture of new insolvency system. This could reside in one of the national law schools headed by a scholar of repute. Academics, thinkers and practitioners will have to be provided a role in

this structure.

Stakeholder engagement in policy making is critical. It is about the country's financial sector, businesses and insolvency professional getting together and making it successful. The government should develop a sincere and robust system of continuous stakeholder engagement at all levels of

## NATIONAL COMPANY LAW TRIBUNAL

As adjudicator of issues arising from IBC, NCLT represents one of the most significant limbs of the insolvency law. The approach of NCLT will have a far-reaching bearing on the outcome of IBC. The exigencies of the insolvency law and its economic goals require the adjudication of issues arising out of the proceedings to be resolved by NCLT not on the basis of technical questions of law, but after considering the policy intentions and unique principles on which the law is based. NCLT must oversee the process of resolution in a way that is non intrusive. NCLT members handling insolvency cases are expected to encourage consensual resolution among the parties where possible, and otherwise undertake timely adjudication of issues with a view to reinforcing predictability in the system through consistent application of the law. Adversarial proceedings should be kept limited.

NCLT must ensure that IBC is not converted into a debt recovery proceedings. Insolvency proceeding is not a remedy to recover individual debts of creditors. For that, other effective laws exist as part of the creditor/debtor regime. Insolvency proceedings are a collective debt collection mechanism through which an insolvent debtor's assets are pooled together for the benefit of all the creditors, by reviving the debtor or liquidating it, depending on which of the two procedures maximizes the returns for them. It is not a remedy to pursue individual rights of a creditor, whatever its size. Insolvency proceedings are meant to benefit the entire body of creditors, while giving due consideration to revival prospects of the debtor. It will be unfair to

use insolvency proceedings as the possible weapon against the capable defaulters unable to temporarily service their debt obligations. In order for insolvency law to work for creditors and debtor, it is important that players in the judicial arena change their attitude towards creditors who prefer this mechanism over other possible debt collection measures. The judge's role should remain as that of an umpire; to decide whether or not the petition is awfully submitted before the court, and not to determine the legitimacy of one's choice of procedure or collect debt for a creditor.

The insolvency resolution system will only be effective if NCLT has the necessary capacity to provide the most efficient, timely and fair outcome to those for whose benefit an insolvency regime exists. The capacity to handle the sometimes complex commercial issues involved in insolvency cases is often not only a question of knowledge and experience of specific law and business practices, but also a question of that knowledge and experience being current and regularly updated. On going training is the key. NCLT members should participate in the Judicial Colloquium organised by INSOL International.

The adequacy of the legal infrastructure and in particular the resources available to courts dealing with insolvency cases, may be a significant influence on the efficiency with which insolvency cases are handled and the length of time required for insolvency proceedings. NCLT will have a challenging task of resolving large number of insolvency cases apart from other corporate cases. Pending cases in the Company Law Board have moved to the NCLT. BIFR has been dissolved. Cases pending before it have been abated but the applicants have the right to file fresh applications before the NCLT. Approximately 700 pending cases in BIFR (as of 2015) may move to the NCLT as well. Further, an influx of new cases is also expected in the very near future, leading to a major concern as to whether the NCLT will be able to cope with the projected caseload unless it has adequate infrastructure.

It is important that independence of NCLT is recognised by reducing its dependence on the executive for its day-to-day functioning. In India, the judiciary is an independent institution. While

being dependent on the executive in a number of matters, it enjoys freedom to make decisions in matters of administration of justice without having to rely on the executive. The judiciary is dependent on the executive for availability of infrastructure and resources. It is important to ensure that no collateral damage is caused to IBC due to the difference in opinion on the needs of NCLT.

## INSOLVENCY AND BANKRUPTCY BOARD OF INDIA

IBC places considerable responsibility on IBBI in its role as regulator as well as for carrying out other functions.

Global standards demand that the insolvency regulatory body should be independent; set standards that reflect the requirements of the legislation and public expectations of fairness, impartiality, transparency and accountability; and have appropriate powers and resources to enable them to discharge their functions, duties and responsibilities effectively. IBBI must set the bar high from the start and constantly raise the standards so that market is vying to match its pace rather than the reverse of it.

IBBI should be respected by its constituents rather than feared. It should evolve an open door policy so that it is accessible to market players. The regulator will need well-considered industry feedback so that it could evolve policies and update regulations from time to time. Experience under IBC and new developments will have to be analysed on an on-going basis. Well-represented stakeholders committees can serve as effective bridge between the market and regulator.

The legislature has chosen IBBI to regulate the insolvency profession, its member associations and information utilities. There is no concept of self-regulation. The regulatory approach adopted by policy makers appears to be based on the premise that the Indian insolvency industry is not mature and sophisticated enough to self-regulate and therefore the government must assume the regulatory role. While that may be a fair point to an extent, it is equally important to appreciate that

the insolvency industry is expected to grow rapidly (and surely, the government would also take necessary measures in that direction) and therefore, it should be ensured that insolvency profession should be left to self-regulate itself not too far ahead in future. IBBI should develop regulations and leave it to insolvency agency to implement them diligently. Proper reporting by insolvency agency would be required. IBBI should audit them and as stated, step in whenever its intervention becomes necessary.

It is important that a regulator is aware of the impact of its regulatory actions and decisions. This helps drive improvement and enhance system and process internally. It also demonstrates the effectiveness of the regulator to those it is accountable toward and helps to build confidence in the regulatory system. The regulatory decisions, actions and interventions of the regulator should be evaluated through performance indicators. This creates awareness and understanding of the impact of the regulator's own actions and helps to communicate and demonstrate to stakeholders the added value of the regulator.

## INSOLVENCY PROFESSIONALS AND INSOLVENCY PROFESSIONAL AGENCIES

A key component of an effective and efficient insolvency system is the role undertaken by the insolvency practitioners. IBC has created a new discipline of insolvency professionals that will have a central role to perform in the insolvency process. This is a historical decision. Although proposed by the Irani Committee, the discipline finally found its way through IBC.

In administering the resolution outcomes, the role of insolvency professional encompasses a wide range of functions and duties. Insolvency professional will be called upon to sort out difficult situations. In some cases, his main task will be to try to rescue a business. In other, he will have to sell the assets of the person or company who owes money (the debtor); collect money due to the debtor; agree creditors' claims (if there is enough money to go round); and distribute the money collected after paying costs. Insolvency

professional's work involves dealing with many competing interests. A robust insolvency system seeks to achieve the appropriate balance between the debtor and its creditors, rehabilitation and liquidation, as among creditors, while preserving their negotiated right and ensuring that preferential transactions are appropriately managed and misfeasance is effectively addressed. Insolvency professionals must stay mindful that they have an important role in getting this balance correct and in effecting the insolvency proceeding in a timely manner and should arguably be a key driver of the process.

Well-qualified and respected insolvency professionals command respect from all of the enterprise's stakeholders. The complexity of the majority of insolvency and restructuring assignment's demand that those who are involved in such actions are appropriately qualified. These qualifications should include a good knowledge of the law (not only insolvency law, but also relevant commercial, financial, labour and business law) as well as adequate experience in commercial and financial matters, including, to some degree, accounting. An individual should possess good interpersonal skills, an ability to communicate clearly and to reconcile the different positions of stakeholders. They need good management skills. They will be required to balance commercial reality with legal requirements in order to preserve the entitlements of stakeholders, such as creditors, as well as to recognize issues relating to the public interest, where appropriate.

Equally important to the knowledge and experience requirement are the personal qualities of those who seek to be insolvency professionals. These include qualities such as integrity, impartiality, and independence. Integrity should require that the individual have a sound reputation and no criminal record or record of financial wrongdoing. They should be financially securable to finance their overhead and other operational costs.

It is also critical that the insolvency practitioner be and be able to demonstrate that he/she is independent from vested interests, whether of an economic, familial or other nature. While regulations should provide for a disclosure process,

such requirement should not result in having to disclose what are likely trivial matters, but those which an informed person would find troublesome and result in a loss of trust and confidence in the insolvency system.

The success or failure of IBC will depend on the quality of insolvency profession. It is critical that no stone is left unturned by IBBI to provide a world-class framework for insolvency profession, drawn from international best practices that are suitable for Indian dynamics.

## DEBTORS

The businesses will need to swiftly reconcile with the new "credit in control" insolvency system. The promoters should offer their full cooperation in handing over the management, control of affairs and assets to the insolvency professional appointed as resolution professional. The promoters sincerely interested in revival of enterprises should not see their displacement as a threat but as an opportunity to focus on putting together a resolution plan free from distraction of managing the business.

They should take creditors in confidence before filing insolvency proceeding.

The directors and officers have to be mindful of liabilities arising from wrongful, fraudulent and preferential transactions when in the pre-insolvency period.

## LENDERS

In India, consortium lending is a common form of lending, where a couple of banks form a consortium and lend to a particular borrower for a project or several banks individually lend to a borrower and then nominate one of the participating banks as lead bank. Generally, a single lender would not hold more than 10-20 % of the total debt. As such either consortium or Multiple

banking with a lead try to achieve consensus on various issues of the lenders. This is usually a time consuming exercise.

### Committee of Creditors [CoC] under the IBC

CoC is an important stakeholder in the insolvency and bankruptcy code, in a way the most important one. A CoC is constituted by the Resolution Professional after identifying all the creditors, both financial and operational. The CoC shall comprise of all financial creditors of the corporate debtor. CoC is formed with financial creditors, although large operational creditors may attend CoC meeting without voting rights. Since each decision of the CoC is carried through 75% majority vote, which is binding on the corporate debtor and all its creditors, the primary responsibility of the success of IBC largely rests on major secured and unsecured financial creditors. This casts a huge responsibility on financial creditors along with the Resolution Professional to ensure absolute fairness of the proposed workout plan under the IBC.

### Procedure under the Code:

The procedure in case an application is filed for CIRP process (by a financial creditor) before the Adjudicating Authority can be summarized as follows: (a) application before the relevant Adjudicating Authority by a Financial Creditor for initiating the Corporate Insolvency Resolution Process (CIRP); (b) admission or Rejection of such Application by the Adjudicating Authority; (c) on Admission of such Application, confirming the appointment the proposed Insolvency Resolution Professional (IRP) in the Application; & declaring moratorium by an order; the date of admission shall be the date of the Insolvency Commencement Date; (d) The IRP then calls out for claims from the other Creditors (both financial and operational); (e) The Committee of Creditors is formed once claims are received by all Creditors; (f) If there is a Resolution Plan in place; then there is an approval of the Resolution Plan by the Committee of Creditors (75 % the voting share of the Financial Creditors) within 180 days from the Insolvency Commencement Date; (g) Implementation of the Resolution Plan; (h) If there is no Resolution Plan or if no approval on Resolution Plan; then the decision

of liquidating the Corporate Debtor is undertaken; During liquidation, a decision is taken by the Financial Creditor to either be part of the Liquidation proceedings or to opt itself out, enforce its security outside liquidation and appropriate the IRP costs; (i) Final liquidation of the Corporate Debtor.

### **Meetings of the COC**

The first meeting of the COC takes place within seven days (7) of the constitution of the committee of creditors. The COC in the first meeting by a majority vote of not less than 75 % of the voting share of the financial creditor either resolve to appoint the IRP as the Resolution Professional (RP) or to replace the IRP by another RP. The members of the COC may meet in person or by such electronic means as may be specified. All such meetings of the COC shall be conducted by the RP. A meeting of the committee shall quorate if members of the committee representing atleast 33% of the voting rights are present in person or by video conferencing or other audio and visual means.

### **Voting by the COC:**

The creditors of such COC shall vote in accordance with the voting share assigned to him based on the financial debts owed to such creditor. The RP shall determine the voting share to be assigned to each creditor in the manner specified by the Board.

Approval of the CoC required under the Code for the following actions:

Under section 28 of the Code, the following actions require the approval of the CoC namely (a) to raise interim finance; (b) Create any security interest over the assets of the corporate debtor; (c) Change the capital structure of the corporate debtor; (d) Record any change in ownership interest of the corporate debtor; (e) give instructions to financial institutions maintaining accounts of the corporate debtor for a debit transaction from any such accounts in excess of the amount as may be decided by the committee of creditors in their meeting; (f) undertake any related party transaction; (g) amend any constitutional documents of the corporate debtor; (h) delegate its

authority to any other person; (i) dispose of or permit the disposal of shares of any shareholder of the corporate debtor or their nominees to third parties; (j) make any change in the management of the corporate debtor or its subsidiary; (k) transfer rights or financial debts or operational debts under material contracts otherwise than in the ordinary course of business; (l) make changes in the appointment or terms of contract of such personnel as specified by the committee of creditors; or (m) make changes in the appointment or terms of contract of statutory auditors or internal auditors of the corporate debtor.

The CoC shall vote & approve any such actions by the RP; if the RP performs any such action without the approval of the CoC (being 75 % o the voting shares), the same shall be void & the COC may report to the Board of any such action taken by the RP without the approval of CoC

### **CoC & the Resolution Plan**

Under Section 30 (2) of the Code, the RP has to examine every resolution plan received by him to confirm that it provides for payment of insolvency resolution process costs in a manner specified by the the Board in priority to the repayment of other debts of the corporate debtor; that it provides for the repayment of the debts of operational creditors in such manner as may be specified by the Board which shall not be less than the amount to be paid to the operational creditors in the event of a liquidation of the corporate debtor under Section 53; that the plan provides for the management of the affairs of the corporate debtor after the approval of the Resolution plan; that the plan provides for implementation and supervision of the Resolution Plan. That it does not contravene any of the provisions of the law for the time being in force; that it conforms to such other requirements as may be specified by the Board. The RP shall thereafter present to the CoC for its approval such resolution plans which confirm the conditions as provided in Section 30 (2) of the Code. The CoC may approve a Resolution Plan by a vote of not less than 75 % of voting share of the financial creditors. The plan as approved by the COC shall be presented by the RP to the Adjudicating Authority. If the Adjudicating Authority is satisfied that the

Resolution Plan as submitted by the COC meets the requirements as provided in the Code (section 30 (2)); it shall by order approve the Resolution Plan which shall be binding on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the Resolution Plan. If the Adjudicating Authority is of the view that the Resolution Plan does not confirm to the requirements as provided in Section 30, then it may be order reject the Resolution Plan. After order of Approval of the Resolution Plan by the Adjudicating Authority the moratorium order passed by the Adjudicating Authority ceases to have effect. The CoC may inform the RP about its decision to liquidate the Corporate Debtor anytime before confirmation of the Resolution Plan and in such cases, the RP shall inform the Adjudicating Authority and the Adjudicating Authority shall pass order of liquidation under Section 33.

### **CoC instrumental to the Success of IBC**

As the Code envisages that any action with respect to the borrower (termed as Corporate Debtor) under the Code, needs the consent/vote of at least 75% of the voting share of the financial creditors [CoC]. The CoC can ensure success of the IBC as the lenders would be in a position to identify early insolvency symptoms of a borrower, therefore quick actions can be taken to either revive the corporate debtor or liquidate them.

If the CoC decide to revive the Corporate Debtor, they can approve a definite plan tailored to revive the Corporate Debtor or; if the CoC decide to salvage the value of asset, they may do so by deciding to liquidate an unviable company even before completion of the mandatory six month period stipulated by the Code. The CoC can ensure that the strict timelines as provided in the Code are adhered to, thus providing some light at the end of the tunnel. The CoC formed can ensure faster decision making process as compared to the JLFs. The IRP costs can be regulated as the applicant fixes the expenses to be incurred on or by the IRP. The CoC ratifies such expenses of the IRP which is later reimbursed to the applicant. The amount so ratified by the COC shall be treated as the Insolvency Resolution Costs which in a way regulates the IRP costs.

Therefore the introduction of the concept of CoC under the IBC Code, helps in the smooth functioning and implementation of the Code. This should help lenders achieve recovery in an organized structured method or take a decision to avoid further loss in the value of the secured assets by choosing liquidation, in cases where there is very limited probability of revival. The Code envisages a "Creditor in Control Regime" with the CoC playing a vital role. It will be interesting to see how the underlying intentions of the Code to promote 'entrepreneurship' & 'helping stressed assets' situations are achieved by the creditors & corporate debtor.

### **ARCs & the IBC Code:**

Asset Reconstruction Companies (ARCs) are assignees of secured debt of banks/financial institutions including NBFCs. There are two distinct advantages an ARC has over other creditors, namely, (a) ability to aggregate debt from all or majority lenders and (b) the necessary expertise to turn around stressed and distressed assets or companies. Since timelines are very critical in an insolvency and bankruptcy process, aggregation of debt by an ARC and ability to build consensus among various stakeholders will be important. ARCs have over a period developed these strengths. The in-house personnel with industry specific expertise can help ARCs to understand the workings of a particular industry and take appropriate steps in reviving the sick, NPA industries. With an ARC in the driver's seat driving the Resolution plan, ARCs can also ensure that the stakeholders' claims are considered and evaluated while implementing the plan; ARCs can achieve a Resolution plan where every stakeholder's claim is considered on equitable grounds.

### **INDIAN INSTITUTE OF CORPORATE AFFAIRS**

IICA was conceived under the Ministry of Corporate Affairs as a world class centre of excellence and think tank to advise the government on various issues impacting corporate functioning, and for holistic treatment of matters impacting on corporate functioning and provide instruction and capacity building in the subject to a wide range of

stakeholders drawn from the government, regulators, professionals and public. It is visualised as a State-of-the-art Knowledge Management system for creation, collation and dissemination of knowledge.

IICA should step forward to play an active role in the development of the insolvency industry.

*As founder member of IICA Governing Board member I am pained to see that insolvency no longer figures in the institute's focus areas. While IICA was being conceived we spent weeks and months on the drawing board and insolvency figured prominently in the vision document. A number of activities were carried out during my term. I hope IICA will carve out a place of pride for itself in the development of insolvency system.*

**Suman Batra**

## INSOL India

INSOL India is the only independent body of insolvency practitioners in India. The uniqueness of INSOL India lies in representing the diversity of stakeholders across the broad spectrum of insolvency. Recently restructured to adapt to the needs of the new insolvency eco-system, INSOL India has a crucial role to play in the development of the insolvency industry in the country. In existence since 1997 and being involved in policy and market developments over the past two decades, INSOL India has a deep familiarity with country's commercial law landscape. The organisation has a long established association with its parent body, INSOL International that it can tap to channelize expertise and know-how into the country.

INSOL India has a dynamic executive committee and board representing the leadership of insolvency industry. INSOL India must play the leadership role to develop the discipline of

insolvency professionals. While guarding its independent character, INSOL India should actively support and compliment the government and IBBI efforts in developing suitable insolvency policies, codes and best practice guidelines. INSOL India is best suited to serve as a bridge between INSOL International and India.

## SOCIETY OF INSOLVENCY PRACTITIONERS OF INDIA

Society of Insolvency Practitioners is the first independent think tank dedicated to the cause of insolvency and development of the soft infrastructure of insolvency industry. It has an important role to play in assisting the stakeholders in developing best practices by studying the systems operating in other parts of the world and reconciling them with the Indian dynamics. SIPI can undertake research and provide constant and prompt feedback to policymakers on the legal and regulatory evolution needed to keep pace with the market developments.

SIPI also serves a special purpose vehicle of INSOL India to deliver its technical, educational and capacity building programmes. The main role of the think tank is to undertake research and develop best practices and standards for the insolvency industry. SIPI offers assistance in the development of the capacity in stakeholders forming part of the insolvency system through conferences, workshops, seminars and publications.

## ROLE OF ASSET RECONSTRUCTION COMPANIES



## GENESIS OF ARCs

A banking system with high level of NPAs can act as a serious hindrance in economic growth with valuable capital and resources of the banking system being engaged in recovery and resolution of NPAs. The high level of NPAs also result in lower availability of capital owing to provisioning and losses as well as highly conservative and risk averse approach to lending which further extenuates credit crunch in the economy. The nature of solution adopted to tackle NPAs often depends on the severity and systemic nature of the NPA problem as well as institutional, legal, and market conditions. Governments have resorted to both "stock" (a one-time cleansing of balance sheet) and "flow" (preventing substantial accretion) solutions at various points of time.

The fallout of the Asian Crisis, poor economic conditions as well as the slow, inefficient and tedious legal resolution process prevalent in India, saw NPAs in the banking system grow to as high as ~15% in early 2000's. The year 2000-01 was a watershed year in stress management in India with introduction of 2 key resolution mechanisms to handle the precarious NPA situation, i.e. Corporate Debt Restructuring (CDR) mechanism and the introduction of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). The genesis of Asset Reconstruction Companies (ARCs) in India owes its origin to enactment of the latter. In addition to paving the way for establishment of ARCs, the SARFAESI Act also permitted banks and financial institutions to enforce their security interests outside the traditional court process. ARCs were established under the supervision and guidance of Reserve Bank of India to acquire, manage, and recover illiquid NPAs, unlocking value trapped in them with necessary resolution expertise via an institutional platform.

ARCs set up under the SARFAESI Act were akin to Asset Management Companies (AMCs) which had been globally utilized to transfer, manage and resolve illiquid bad loans. Different countries have

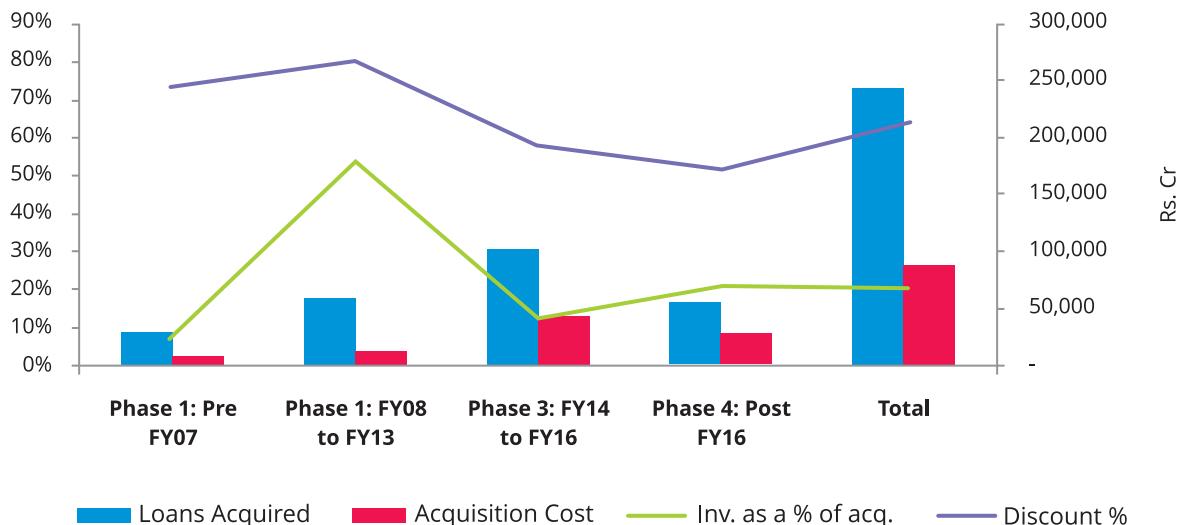
tried out varying models of ownership of AMCs. The options range from asset workout departments or units of banks, bank-owned subsidiaries or affiliated companies, private companies and government owned AMCs.

Generally, AMCs were set up and funded as publicly owned government entities to offer a "stock" solution by bringing about a government funded expensive overhaul of their respective banking system. However, India followed a different model by allowing ARCs to be setup as private/public entities under license of Reserve Bank of India to be utilized more as a "flow" solution. This model is adopted essentially where there is absence of crisis but nature and size of NPAs could undermine the efficiency of the banks and it relies for success on participation by willing sellers and buyers and strong regulatory inducements in the absence of direct financial support from the government.

ARCs act as debt aggregator by acquiring NPAs from the banking system, manage and recover illiquid NPAs by putting them on resolution path. In the process, ARCs help unlock capital of the banking system held in NPAs thereby helping banks to focus on core activities as also help put the underlying assets held as security (industrial and other assets) back to productive use at sustainable values through the resolution.

## PERFORMANCE OF ARCs

The growth of ARCs in India has been primarily in 4 phases, the current one being the 4th phase and amongst the most exciting in terms of possibilities it presents to the industry. ARCs have been doing a lot of work to ensure that the banking system is relieved from the structural NPA problem which they are currently facing. Approximately, Rs. 244,000 Cr worth of Gross NPA have been sold to ARCs, however the current stock of stress in the Indian Banking system is estimated at ~Rs. 1180,000 Crores as on 31st March 2017 (being ~15% of gross advances, 9.8% NPA and 4.2% restructured assets) provides a huge array of opportunity for the industry.



#### a. Phase 1: Pre FY 2007

7 ARCs formed largely promoted by banks and transfer of NPAs to these ARCs on low cash investment, prominent among them was Arcil. Large part of NPA debt of sponsor banks was transferred to the ARCs promoted by them.

#### b. Phase 2: Between FY 2008 to FY 2013

Banks preferred sale on cash basis with largely written off accounts being sold with underlying assets being closed assets or assets mired in litigation. SRs market largely dormant. The number of ARCs who have been granted certificate by RBI stood at 14.

#### c. Phase 3: Between FY 2014 to FY 2015

Noticeable shift post September 2013, after RBI's initiative to revitalize the ARC Infrastructure created for NPA resolution process. Post September 2013, there had been a surge in sale of NPAs by banks with most sales under the 5:95 structures. The pricing also saw upward movement since several loans were sold in early stages of stress. Post Aug-15, the minimum capital investment of ARCs was raised to 15% which increased skin in the game for ARCs and saw an approach of cherry picking assets being adopted by ARCs.

#### d. Phase 4: Between FY 2016 to FY 2017

Decline in NPA sales on account of two main

reasons, one the price mismatch between the expectation of ARC and the banks in the 15:85 structured sales and two, resource constraints on the part of ARCs. Post Mar-16, amendments and relaxation of shareholding limits in ARCs as well as increase in permitted FDI investment limits in ARCs provided a fillip to sourcing capital. Some ARCs like Edelweiss ARC and ACRE announced foreign collaborations and also achieved highest levels of annual capital investment by ARCs. The number of ARCs who have been granted certificate by RBI stands at 23 as on Mar-17. Significant capital raised and ready for deployment by existing players and several new high profile players expected to commence business in Fy2018.

While ARCs are an important means to help banks manage NPAs, at its heart, ARC business is a resolution business and not a recovery business. ARCs do not have any magic spell for reviving a non performing asset. Process of resolving a stressed asset requires aggregation of debt outstanding to various banks, arrangement of capital, rightsizing the business and bringing in a strategic partner. This requires a period of 3-5 years, first few years to resolve the issues and then the balance period for consolidation and growth. It is pertinent to note that out of total acquisition cost of ~Rs. 62,550 Cr as on Mar-15, ~Rs. 43,000 Cr were issued post FY2014. As on Mar-15, redemptions by ARCs stood at ~Rs. 12,600 Cr vis-à-vis acquisition cost of ~Rs. 19,300 Cr pertaining to SRs issued prior to FY2014. Redemptions are expected to pick up pace with

resolution of stock of SRs issued post FY 2014. Therefore the performance of ARCs in resolution needs to be seen in light of these facts and the true test of effectiveness lies in the coming 2 years.

## IMPORTANCE OF ARCS AS AN EFFECTIVE TOOL FOR RECONSTRUCTION

It was perceived that India had a decoupled economy post the global financial crisis of 2008. Indian Banks followed an easy liquidity policy in the years immediately following 2008 with large capital disbursements to certain sectors like power, steel, utilities and infrastructure. This period also coincided with tendency of the banks for rolling over troubled loans and deferring the problem at hand. This period of easy availability of liquidity, less stringent underwriting, excess capacity creation and unsustainable restructuring created a bed rock for stress in the financial system which got accentuated especially in wake of sluggish economic growth. The underlying stress had a lead time and the impact of decision making at the time is now visible after a lag of few years. This is now evident with stress in the system as high as 15% of gross advances as on Mar-17. The current stress situation is precarious. Firstly, the companies have become too large to fail and hence, systemically it is important to resolve these NPAs. Many of the NPAs are in core sectors like steel, utilities, and infrastructure. If these are not resolved, then it will be difficult for India to provide requisite infrastructure for growth.

NPAs with exposure greater than Rs. 5 crore, mainly in industrial sector, account for more than 85% of Gross NPAs of the system. Resolution of these assets would largely be through operation of industrial assets over long time frame. This requires in-depth skills for operational and financial restructuring either with the same promoters or change in hand. Recycling and improvement in capital efficiency is the overarching objective in any NPA resolution architecture, be it restructuring or liquidation / foreclosure particularly in growing economies needing more capital. Productive use of assets leverages the growth opportunities. The NPAs in Indian system have considerable going concern value. The challenge is to extract value

from the underlying NPAs by adopting appropriate resolution strategies. Quicker resolution benefits all stakeholders. The early stage resolution allows the value capture as the borrower may still have "going concern" value. A right kind of environment needs to be created for accelerated flow of NPAs to the ARCs well in time, so that value maximization in terms of capacity enhancement, employment generation and with sick units coming back to operations, contribution to state exchequer in terms of taxes and revenue can take place. This has to be reinforced with creating a legal and economic environment conducive for time bound workout based resolution and finally an effective foreclosure framework which could operate as credible "threat" for recalcitrant borrowers.

The basic principle behind reconstruction is that all Non-Performing Assets are not bad assets. If projects are technically feasible and products have market prospects, other issues namely promoter/management and financial management are addressable. ARCs look to bring fresh perspective to revival of assets through aggregation of debt to gain control on restructuring and/or enforcement, provide financial support necessary for restart of operations & working capital and handholding of management team/company through the revival phase. ARCs can act as a catalyst in resolution process by allowing quick decision making and single window approach.

Under Governor R. Rajan's stewardship banks were incentivized to sell fresh NPAs to ARCs for revival. The banks also responded effectively and majority of assets sold are fresh NPAs with potential to resolve and revive. ARCs system has worked well to absorb the NPA sales put forth by banks and assisted them in the process. Several large projects, which would have gone down the drain, if they continued to remain NPA in the books of the Bank, have been sustained and are in consolidation phases. If these assets get revived over a period of next 2-3 years, this will be significant improvement for the banking system. Very large assets, even with debt over 4,000 Crores, have been absorbed by the ARC system, and are now under restructuring / consolidation.

ARCs can bring debt under a single umbrella (debt aggregation) and provide resolution to multiple issues by bringing various stakeholders on a single table. This includes providing additional working capital finance to such companies. ARCs can provide a practical approach to restructuring, where restructuring is mapped to sustainable debt and possible cash flows. ARCs also offer a more flexible and dynamic approach to resolution of any issues during the restructuring/reconstruction period.

Faster decision making and execution assists the borrower companies to adapt to any changes in the business environment. Sale of non-core assets can also be expedited, since NOCs from multiple banks are not required and single window approach is adopted. ARCs can also provide their acumen and connect with international/domestic investors and strategic partners to ensure that the companies in their portfolio are revived at the earliest. ARCs are specialized agencies and their focus on such activities is much higher than the NPA management cells of many public sector banks.

### EXPECTED SCENARIO POST APRIL 2017

The Financial Sector Stability Report, December 2016 revealed that the risks to the banking sector remained elevated due to continuous deterioration in asset quality, low profitability and liquidity. The business growth of scheduled commercial banks (SCBs) remained subdued with public sector banks (PSBs) continuing to lag behind their private sector peers. Total stressed assets in the system defined as sum total of Gross NPAs and Restructured Loans are expected at ~15% as on March 31, 2017. In addition to the extent of the problem, the situation is serious in the context of systemic importance of a number of very large NPAs in core sectors like steel, utilities, and infrastructure. Resolution and revival of many of these companies are important for sustainable growth of industry and infrastructure of the country.

The size of NPA problem and the glare around it has its own unintended consequences. Banks in India are reluctant to grow credit on one side while stressed companies are unable to avail fresh credit

to fund its revival plan on the other side. This aspect is likely to hurt the economy for a longer time.

The situation faced by the banks and stakeholders today with stress being ~15% of gross advances is similar to the stress prevalent in the early 2000's. Like the far reaching amendments made in 2000-01, similar urgency has been noted and the Government and the Regulators have taken significant initiatives in the recent past to improve NPA management in Banks. A few important changes introduced/proposed include (a) Joint Lender Forum (JLF) and Corrective Action Plan to expedite asset resolution process, (b) SDR to allow banks to take 51 per cent or more equity by converting their debt for enabling them to effect management change, (c) Encouraging banks to sell NPAs to professionally managed ARCs, who could resolve and revive assets, (d) Scheme for sustainable structuring of stressed assets (S4A), (e) Strengthening of credit risk management at banks and Asset Quality Review (AQR), (f) Increasing accountability of promoters and (g) Enactment of Insolvency and Bankruptcy Code.

These recent reforms, especially the enactment of Insolvency and Bankruptcy Code are steps in the right direction and have the potential to transform the pace of reconstruction and resolution in India's stressed and distressed market, however it is likely to take a couple of years to get stabilized as a law. Notwithstanding, the ARC system will continue to remain as an effective NPA resolution system.

Amendments and relaxation of shareholding limits in ARCs as well as increase in permitted FDI investment limits in ARCs capital have provided significant avenues for fund raising. Government of India and Reserve Bank of India have on various occasions emphasized on the need for a vibrant ARC industry and significant changes have been brought about in SARFAESI Act and Insolvency law to protect the interests of the creditors and lenders.

Recent amendment in minimum requirement of net owned funds by ARCs of Rs. 100 Cr as well as circular on provisioning requirements by banks for assets in which SRs held by selling bank is more than 50% all point towards the need felt by banks for increased capital participation by ARCs. This has

made sure that only serious ARCs participate in the business.

The economic and legal climate is conducive for the industry which is seen by the slew of high profile entrants like Ambit-JC Flowers, AION Capital, KKR, SSG, etc and increased capital raising activity by existing players like Edelweiss Asset Reconstruction Company, JM Financial Asset Reconstruction Company, Kotak Bank etc.

### SOME SUGGESTIONS FOR IMPROVING EFFECTIVENESS OF ARCS

#### a. Debt aggregation

The Indian banking landscape necessitates debt-aggregation. It is common to encounter a borrower having multiple lenders with different security classes and structures. Thus, aggregation is key to improve leverage over the borrower and ARCs may act as a perfect vehicle for this. However, because of multiple and consortium banking arrangement with attendant inter-creditor issues, debt aggregation gets delayed resulting in opportunity loss to the economy in terms of capacity generation, employment creation, realization of overdue revenues, etc. Banks not following a consortium approach is a major issue which leads to delay of 12-18 months for debt aggregation. ARCs have to resort to a time-consuming process of dealing with each bank separately often at differing commercial terms. ARCs have had to endure long period of effort to aggregate enough debt to control resolution of the accounts. Incentive structure has to be introduced for banks where 100% debt is sold at the same time by all banks to an ARC.

#### b. Limit on conversion of debt into equity

The ARCs are not on par with the banking system when it comes to equity conversion. While RBI has given sweeping powers to banks in form of SDR and even in case of normal debt conversion, ARCs are restricted to maximum 26% of equity share in a particular company. To bring level playing field as well as to give more teeth to ARCs against promoters of companies having good potential but low promoter intent to revive, similar power should be given to ARCs as to banks. At least 51%

conversion should be allowed to ARCs while reconstructing an asset.

#### c. Availability of working capital lines to stressed assets

The companies under reconstruction require working capital lines and often the non-fund based requirements are high. The selling banks cannot lend, while non-bank entities, such as private equity or NBFC, demand very high interest along with priority in repayment over existing debt. Further the banking system is completely against any new exposure including non-fund based to these companies, even if they have come out of their structural issues. This leaves the responsibility of providing working capital finance on the ARCs and even non-fund based limits have to be raised against 100% cash margins thus putting more pressure on the resources of stressed asset and impacting the viability.

#### d. Stamp duty costs and requirement for registration of transaction documents

While there have been changes in the SARFAESI Act exempting applicability of stamp duty, the respective States have to pass necessary legislations to give effect to the same. Further, the registration fee for such transaction documents is very high in many States, increasing the cost for the ARCs and finally the borrower.

## ABOUT ASSOCHAM



[www.assocham.org](http://www.assocham.org)

### EVOLUTION OF VALUE CREATOR

ASSOCHAM initiated its endeavour of value creation for Indian industry in 1920. Having in its fold more than 400 Chambers and Trade Associations, and serving more than 4,50,000 members from all over India. It has witnessed upswings as well as upheavals of Indian Economy, and contributed significantly by playing a catalytic role in shaping up the Trade, Commerce and Industrial environment of the country.

Today, ASSOCHAM has emerged as the fountainhead of Knowledge for Indian industry, which is all set to redefine the dynamics of growth and development in the technology driven cyber age of 'Knowledge Based Economy'.

ASSOCHAM is seen as a forceful, proactive, forward looking institution equipping itself to meet the aspirations of corporate India in the new world of business. ASSOCHAM is working towards creating a conducive environment of India business to compete globally.

ASSOCHAM derives its strength from its Promoter Chambers and other Industry/Regional Chambers/Associations spread all over the country.

### VISION

Empower Indian enterprise by inculcating knowledge that will be the catalyst of growth in the barrierless technology driven global market and help them upscale, align and emerge as formidable player in respective business segments.

### MISSION

As a representative organ of Corporate India, ASSOCHAM articulates the genuine, legitimate needs and interests of its members. Its mission is to impact the policy and legislative environment so as to foster balanced economic, industrial and social development. We believe education, IT, BT, Health, Corporate Social responsibility and environment to be the critical success factors.

### MEMBERS – OUR STRENGTH

ASSOCHAM represents the interests of more than 4,50,000 direct and indirect members across the country. Through its heterogeneous membership, ASSOCHAM combines the entrepreneurial spirit and business acumen of owners with management skills and expertise of professionals to set itself apart as a Chamber with a difference.

Currently, ASSOCHAM has more than 100 National Councils covering the entire gamut of economic activities in India. It has been especially acknowledged as a significant voice of Indian industry in the field of Corporate Social Responsibility, Environment & Safety, HR & Labour Affairs, Corporate Governance, Information Technology, Biotechnology, Telecom, Banking & Finance, Company Law, Corporate Finance, Economic and International Affairs, Mergers & Acquisitions, Tourism, Civil Aviation, Infrastructure, Energy & Power, Education, Legal Reforms, Real Estate and Rural Development, Competency Building & Skill Development to mention a few.

## **INSIGHT INTO 'NEW BUSINESS MODELS'**

ASSOCHAM has been a significant contributory factor in the emergence of new-age Indian Corporates, characterized by a new mindset and global ambition for dominating the international business. The Chamber has addressed itself to the key areas like India as Investment Destination, Achieving International Competitiveness, Promoting International Trade, Corporate Strategies for Enhancing Stakeholders Value, Government Policies in sustaining India's Development, Infrastructure Development for enhancing India's Competitiveness, Building Indian MNCs, Role of Financial Sector the Catalyst for India's Transformation.

ASSOCHAM derives its strengths from the following Promoter Chambers: Bombay Chamber of Commerce & Industry, Mumbai; Cochin Chambers of Commerce & Industry, Cochin: Indian Merchant's Chamber, Mumbai; The Madras Chamber of Commerce and Industry, Chennai; PHD Chamber of Commerce and Industry, New Delhi.

Together, we can make a significant difference to the burden that our nation carries and bring in a bright, new tomorrow for our nation.

### **D. S. Rawat**

Secretary General  
d.s.rawat@assocham.com

## **The Associated Chambers of Commerce and Industry of India**

ASSOCHAM Corporate Office:  
5, Sardar Patel Marg, Chanakyapuri, New Delhi-110 021  
Tel: 011-46550555 (Hunting Line) Fax: 011-23017008, 23017009  
Email: [assocham@nic.in](mailto:assocham@nic.in) Website: [www.assocham.org](http://www.assocham.org)

## ABOUT SIPI



[www.sipi-india.in](http://www.sipi-india.in)

Society of Insolvency Practitioners is the first independent think tank dedicated to the cause of insolvency and development of soft infrastructure of insolvency industry.

SIPI also serves a special purpose vehicle of INSOL India to deliver its technical, educational and capacity building programmes.

Another role of the think tank is to undertake research and develop best practices and standards for the insolvency industry. SIPI offers assistance in the development of the capacity in stakeholders forming part of the insolvency system through conferences, workshops, seminars and publications.

SIPI is chaired by Sumant Batra, Chief Mentor, INSOL India.

SIPI is a society registered in New Delhi under the Societies Registration Act, 1860. Order for approval of name of SIPI was granted by the government under the Emblems and Names Act, 1950 by order dated 29.1.2009.

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15, Birbal Road, Jangpura Extension, New Delhi-110014, India

**Committed to building the stature  
and prestige of insolvency, restructuring  
and turnaround profession.**

## ABOUT INSOL INDIA



[www.insolindia.com](http://www.insolindia.com)

INSOL India was conceived on September 27, 1997 at a get together of lawyers and judges hosted by Arun Jaitley, Senior Advocate, presently, Union Minister of Finance, Defence and Corporate Affairs at the instance of Justice D.P. Wadhwa, the then Judge, Supreme Court of India. Justice Wadhwa was the only member of INSOL International from India at that time. A committee comprising of Arun Jaitley and Suman Batra drafted the Charter of INSOL India setting down, amongst others, the aims and objectives of INSOL India, the categories and eligibility criteria of membership. Justice Manmohan Sarin, then a Judge of High Court of Delhi was unanimously nominated as the first President of INSOL India and Suman Batra as the Founder Secretary of INSOL India.

The formation of INSOL India fulfilled the long cherished desire of the members of the legal fraternity, chartered accountants, company secretaries and other persons, bodies and institutions in India, to have an association to promote closer co-operation, exchange of ideas, dissemination of information and an empathetic understanding of law of insolvency and related laws.

The organisation grew formidably under the leadership of its successive Presidents.

### PAST PRESIDENTS

Justice Manmohan Sarin

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Justice A.K. Sikri

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Justice Sanjay Kishan Kaul

### PAST PATRONS

Justice D.P. Wadhwa

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Arun Jaitley

# 2016

INSOL India went through a major restructuring in June 2016 after enactment of the Insolvency and Bankruptcy Code in May 2016. Its vision, mission and goals were re-chalked to align with eco-system proposed under the new law. A new governing structure was approved that complimented the needs of INSOL India in its new avatar of an organisation aspiring to play leadership role in the dynamic and vibrant insolvency industry expected to develop rapidly in the country.

**AN INDEPENDENT LEADERSHIP BODY REPRESENTING PRACTITIONERS AND OTHER ASSOCIATED PROFESSIONALS SPECIALISING IN THE FIELDS OF RESTRUCTURING, INSOLVENCY AND TURNAROUND.**

**AN ASSOCIATION WITH AN ARCHITECTURE THAT FACILITATES KEY STAKEHOLDERS TO COME TOGETHER AND SHARE EXPERIENCES WHILE PRESERVING THEIR INDEPENDENCE.**

**SHARING KNOWLEDGE, PROMOTING BEST PRACTICES AND PROVIDING A FORUM FOR DEBATE ON KEY ISSUES FACING THE INDUSTRY AND PROFESSION.**

# ABOUT EDELWEISS



[www.edelweissfin.com](http://www.edelweissfin.com)

The Edelweiss Group is one of India's leading diversified financial services companies providing a broad range of financial products and services to a substantial and diversified client base that includes corporations, institutions and individuals. Our products and services span multiple asset classes and consumer segments across domestic and global geographies. Starting from an initial capital of INR 10m to capitalize on the capital market opportunity in the post liberalization era, today Edelweiss is an INR 52.75 billion diversified financial services conglomerate with offices spread across India and overseas. The Group has businesses across the Credit, Investment & Advisory as well as the Insurance spectrum enabling clients to Create, Grow as well as Protect their wealth and assets. Edelweiss serves over 1 million clients through 6900 employees in around 249 offices. Edelweiss has an asset base of over INR 37,000 crores and has successfully completed 21 straight profitable quarters and ranks in the top 200 most profitable companies in India.

## We have Evolved into a Diversified Business Model

CREDIT	NON CREDIT	INSURANCE
<p>Present Across:</p> <p><b>Retail</b></p> <ul style="list-style-type: none"><li>- Retail Mortgage</li><li>- Agri &amp; Rural Finance</li><li>- Loan Against Shares</li><li>- SME &amp; Others</li></ul> <p><b>Wholesale</b></p> <ul style="list-style-type: none"><li>- Structured Collateralized Credit</li><li>- Wholesale Mortgage</li></ul> <p><b>Distressed Assets</b></p>	<p>Strong product franchise serving diverse client needs:</p> <ul style="list-style-type: none"><li>- Wealth Management</li><li>- Asset Management</li><li>- Capital Markets</li><li>- Agri Services &amp; Others</li><li>- Balance sheet</li><li>- Balance sheet management</li><li>Unit &amp; Liquidity Management</li></ul>	<p>One of the fastest growing life insurance companies</p>

## Awards & Accolades

**Ranked amongst India's Best Corporate Brands 2016** *The Economic Times Consumer Survey*

**Ranked amongst India's Most Promising Brands 2015** *The Economic Times Consumer Survey*

**Ranked amongst the 100 Most Valuable Brands of India 2015** *World Consulting & Research Corporation (WCRC)*

**EdelGive recognised for its efforts towards Women** *Empowerment at the FICCI CSR Awards 2016*

**EdelGive recognised for its efforts towards optimally channelising CSR Budgets** *CNBC TV18 Financial Inclusion Awards 2016*

**Best Corporate Governance – India** *CFI.co Corporate Governance Awards 2016*

**Best Life Insurer - Edelweiss Tokio Life Insurance** *Outlook Money Awards 2016*

**Best Equity Capital Markets House and Best Broker Award** *FinanceAsia Country Awards 2016*

**Ranked #3 in four categories - best local brokerage, best execution, best overall sales trading and best overall for roadshows and company visits** *AsiaMoney Brokers Poll 2016*

*99 percent of success is built on failure*

Charles F. Kettering

[www.assocham.org](http://www.assocham.org)

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