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Management of Non-Performing Assets by Banks

Chapter Objectives

This chapter will enable you to develop an understanding of the following:

1 *Non-performing assets*
2 *Tools available to banks to manage their NPAs*
3 *One-time settlement*
4 *Lok Adalats*
5 *Debt recovery tribunals*
6 *Corporate debt restructuring*
7 *Willful Defaulters*
8 *The SARFAESI Act*
9 *Asset reconstruction company*
10 *CIBIL*

INTRODUCTION

The quality of assets held by banks and financial institutions is a critical indicator of the health of the financial system. A high quality of assets reflects the level of bank's credit risk and efficiency in allocation of resources to productive sectors. The quality of assets has been deteriorating in case of both banks and financial institutions which has become an area of grave concern. While credit growth is one of the drivers of economic growth, NPAs are value destroyers of the economy. Non-performing assets alone do not reflect the bad quality of assets of the banking system. Banks and financial institutions restructure some default loans by extending the repayment period or reducing the interest rate. Hence a new broad category in the form of stressed assets consisting of NPAs, restructured loans and written -off assets has come into existence. According to an RBI report, the stressed assets ratio (ratio of stressed assets to gross advances) stood at 12.2 per cent at the end of June 2016, of which 8.6 per cent of loans are gross non-performing assets (GNPAs) and an additional 3.6 per cent are restructured loans. The total stressed asset stock in India as on March 2017 excluding state financial corporations, mutual funds, and the insurance sector is around ₹8,00,000 crore and this works out to 9.6 per cent of the GDP. Due to banks being saddled with high non-performing assets and low demand for credit from the corporate sector, the credit growth in financial year 2016–17 of 5.08 per cent is the lowest since 1953–54. The large amount of NPAs predominantly originate from the industrial sector. But retail loans, infrastructure loans and agriculture loans account for bulk of the addition to NPAs.

The Narasimham Committee report notes, 'No other single indicator reflects the quality of assets and their impact on banks' viability, than the NPA figure in relation to advances'. Non-performing assets (NPAs) are loans given by a bank or a financial institution wherein the borrower defaults or delays interest or principal payments. According to the RBI norms, any interest or loan repayment delayed beyond 90 days has to be identified as a non performing asset. Non-performing assets are categorized into sub-standard, doubtful and loss assets for which provisions have to be made in the lender's books. Under the prudential norms laid down by the RBI, income should not be recognized on NPAs on an accrual basis but should be booked only when it is actually received in respect of such accounts. Any NPA would migrate from sub-standard to doubtful category after 12 months. It would get classified as a loss asset if it is irrecoverable or marginally collectible. With effect from March 31, 2016 an asset would be classified as doubtful if it remained in the sub-standard category for 12 months. The banks should make full provision for loss assets, 100 per cent of the unsecured portion of the doubtful asset and 20 per cent to 100 per cent of the secured portion depending upon the period for which the asset has remained doubtful. If the asset has remained doubtful for one year, the provisioning requirement is 25 per cent; if doubtful up to three years, the provisioning requirement is 40 per cent and for more than three years, it is 100 per cent with effect from March 31, 2005 (refer Annexure 14.1).

- An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank.

The Gross NPAs of the scheduled commercial banks has increased in absolute terms on account of hardening of interest rates and higher housing loans at floating interest rate charges. The NPAs of the new private sector banks and foreign banks have increased due to their higher exposures in real estate and housing sectors. The share of priority sector, especially agriculture sector's share in total NPAs has increased.

Although the NPA ratio in the priority sector was consistently higher than the NPA ratio in the non-priority sector, deterioration in asset quality during 2016–17 was primarily on account of the non-priority sector. There has been a steady deterioration on in asset quality of industry and infrastructure which account for about half and one third of the total credit and total industrial credit respectively

TOOLS AVAILABLE TO BANKS TO MANAGE THEIR NPAs

The provisions of Indian laws do not facilitate speedy and effective enforcement of securities. The Sick Industries Companies (Special Provisions) Act, 1985 was enacted to provide a framework for the rehabilitation and revival of sick industrial companies through the board for industrial and financial reconstruction so as to enable inter alia release of public funds that are locked up in such companies. This act was not only unable to provide a speedy and efficient mechanism for rehabilitation and revival of the sick companies, but also provided companies with a 'safe haven' for defaulting.

Now banks and financial institutions saddled with bad loans have multiple options like direct settlement across the table, legal recourse in the form of approaching the high court or debt recovery tribunals, enforcement of the new securitization law (where securities pledged with them could be attached and subsequently sold), and lastly selling it to asset reconstruction companies (ARCs).

Among the various channels of recovery available to banks for dealing with bad loans, the amount recovered as percentage of amount involved was the highest under the SARFAESI Act, followed by Lok Adalats during 2012–13. NPAs recovered through this Act accounted for about 80 per cent of the total amount of NPAs.

However, there was a deceleration in the recovery of NPAs during 2015–16 on account of a reduction in recovery through the SARFAESI channel by 52 per cent, while recovery through Lok Adalats and DRTs increased.

One Time Settlement/Compromise Scheme

Banks have been advised to devise one-time compromise settlement schemes for resolution of NPAs. The RBI issued guidelines for this scheme in March 2000. This scheme covers NPAs classified as doubtful and NPAs classified as sub-standard, which have subsequently become doubtful or less. This scheme covers actions under the SARFAESI Act and also cases pending before courts/DRTs/BIFR, subject to consent decree being obtained from them but does not cover cases of willful default, fraud and malfeasance. As per this scheme, for NPAs upto ₹10 crore, the minimum amount that should be recovered should be 100 per cent of the outstanding balance in the account. For NPAs above ₹10 crore, the CMDs of the respective banks should personally supervise the settlement of NPAs on a case-to-case basis. The RBI has allowed the board of directors to evolve policy guidelines regarding one-time settlement of NPAs as a part of their loan recovery policy. The amount arrived for settlement is to be paid in lumpsum. If not, borrowers should pay at least 25 per cent upfront and the balance within one year with interest at the existing PLR.

The Reserve Bank issued a new set of guidelines for all public sector banks to go in for one-time settlements of chronic NPAs of ₹10 crore and less in the small and medium enterprises (SME). The revised guidelines cover all NPAs in the SME sector which have become doubtful or loss or sub-standard.

Lok Adalats

They were constituted under the Legal Services Authority Act, 1987. They have been setup to help banks to settle disputes involving accounts in 'doubtful' and 'loss' category with an outstanding balance of ₹20 lakh.

Lok adalats help in resolving disputes between the parties by conciliation, mediation, compromise or amicable settlement and thereby reduce burden on courts. They were conferred adjudicial status and every award of the Lok Adalat shall be deemed to be a decree of a civil court and no appeal can be made

- Lok Adalats help banks to settle disputes involving accounts in 'doubtful' and 'loss' category with an outstanding balance of ₹20 lakh.

Box 14.1

Public sector banks will have to furnish details of their non-performing loans to the finance ministry while setting business goals.

These banks will have to provide information on the source of change in the net NPAs.

Source: The Economic Times, July 12, 2005, p. 11.

to any court against the award made by the Lok Adalat. They are generally presided over by two or three senior persons including retired senior civil servants, defense personnel and judicial officers.

Debt recovery tribunals (DRTs) have now been empowered to organize Lok Adalats to decide on cases of NPAs of ₹10 lakh and above. Banks were advised to participate in the Lok Adalats convened by various DRTs/DRATs for resolving cases involving ₹10 lakh and above to reduce the stock of NPAs.

A large number of cases involving small amounts were successfully resolved through these fast-track courts.

Despite being a popular method, banks find difficulty in bringing the parties together when the Lok Adalat meets.

Debt Recovery Tribunals

- DRTs help in expeditious adjudication and recovery of debts due to banks and FIs.

They were setup under The Recovery of Debts due to Banks and Financial Institutions Act, 1993, also popularly called as the RDB Act. This act provides for the establishment of tribunals for expeditious adjudication and recovery of debts due to banks and FIs and for matters connected therewith and incidental thereto. Under the act, two types oftribunals are set up: (i) Debt Recovery Tribunals (DRTs), and (ii) Debt Recovery Appellate Tribunals (DRATs). The order passed by a DRT is appealable to a DRAT but no appeal shall be entertained by the DRAT unless the applicant deposits 75 per cent of the amount due from him. However, the DRAT may waive or reduce the amount of such deposit. DRTs have been empowered to decide on cases of advances of ₹10 lakh and above. Recoveries valued below ₹10 lakh are sent to civil courts, while those abovr ₹10 lakh are referred to the DRTs. After the enactment of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests Act (SARFAESI Act), borrowers could become first applicants before the DRTs. Earlier only lenders could be applicants.

The central government sets up the tribunals and provides them with a presiding officer, two recovery officers and other employees. The presiding officer is a judge of the rank of district and sessions judge. The presiding officer is the sole judicial authority to hear and pass any judicial order. Most cities have one DRT, while Mumbai and Delhi have three tribunals and Chennai and Kolkata two each. The number of cases decide the formation of a tribunal.

Every bank and financial institutions can initiate the procedure of recovery by making an application under Section 19 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993, to the tribunal, within the local limits of whose jurisdiction the defaulter company is located. If there are other banks whose loan to the same company has become bad, the latter can join the recovery suit. After receiving a valid application, the DRT takes up the case and listens to arguments from the contesting parties. The parties to the suit or proceedings can be represented by an agent, including a lawyer, in which case the application must be accompanied by a duly executed *Vakalatnama*.

DRTs have become more active as they have been vested with new powers such as power to attach defendant's property/assets before judgement, penal provisions for disobedience of the tribunal's order or breach of any terms of the order and appointment of receiver with powers of realization, management, protection and preservation of property. At present, there are 29 DRTs and 9 DRATs but they have hardly made a dent on the recovery process. Defendants challenge the validity of the act in the high court which hinders the functioning of the DRTs.

Corporate Debt Restructuring (CDR)

CDR Mechanism

- Applies to outstanding multiple banking accounts/ consortium accounts of ₹20 crore and above.

CDR:

- For restructuring Corporate Debt of Viable entities

The scheme of CDR was institutionalized in 2001–02 to provide a timely and transparent system for restructuring of corporate debts of ₹20 crore and above with the banks and financial institutions. The corporate debt should be outside the purview of the Board for Industrial and Financial Reconstruction (BIFR), DRTs, or other legal proceedings. The objective of the scheme is to enable corporates affected by certain internal/external factors to restructure their debt through an orderly and coordinated debtor—creditor agreement and inter-creditor agreement which results in preserving their viability and minimizing losses to creditors/other stakeholders. This scheme enables speedy disposal of restructuring proposals of large corporate borrowers engaged in any type of activity and availing finance from more than one bank/FI/under multiple banking/syndication/consortium system of lending. CDR is a non-statutory mechanism which is a voluntary system based on Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA). The Inter-Creditor Agreement would be a legally binding agreement amongst the creditors, with necessary enforcement and penal clauses, wherein the creditors would commit themselves to abide by the various elements of CDR system.

The eligibility criteria has been broadened to include recovery suit-filed cases by the creditors against the company provided the proposal to restructure is supported by 75 per cent of the lenders by value and 60 per cent of creditors (by number); large erstwhile BIFR cases to be decided by CDR Core Group on a case-to-case basis provided that the lending institutions complete all the formalities in seeking the approval from BIFR before implementing the package; cases involving frauds or diversion of funds without malafide intent may be admitted for restructuring with the approval of the Core Group only.

Reference to Corporate Debt Restructuring System could be triggered by (i) any or more of the creditor who have minimum 20 per cent share in either working capital or term finance, or (ii) by the concerned corporate, if supported by a bank or financial institution having stake as in (i) above.

CDR has a three-tier structure consisting of the CDR Standing Forum and its core Group (the policy-making body), CDR Empowered Group (the functional group deciding on the restructuring of cases referred to CDR mechanism) and the CDR Cell (the secretariat to the CDR system). The CDR Standing Forum is the representative general body of all financial institutions and banks participating in CDR system. Its function is to lay down policies and guidelines, and monitor the progress of corporate debt restructuring. It also provides an official platform for both the creditors and borrowers (by consultation) to amicably and collectively evolves policies and guidelines for working out debt restructuring plans in the interests of all concerned. The CDR Core Group, which is carved out of the CDR Standing Forum, lays down the policies and guidelines to be followed by the CDR Empowered Group and CDR Cell for debt restructuring. It also prescribes the PERT chart for processing of cases referred to the CDR system and decides on the modalities for enforcement of the time frame. The CDR Empowered Group looks into each case of debt restructuring, examines the viability and rehabilitation potential of the Company and approves the restructuring package within a specified time frame of 90 days, or at best within 180 days of reference to the Empowered Group. The CDR Empowered Group takes into consideration parameters such as return on capital employed (ROCE), debt service coverage ratio (DSCR), gap between the internal Rate of Return (IRR) and the Cost of Fund (CoF), and the extent of sacrifice to decide on the acceptable viability benchmark levels applied on a case-by-case basis. The decisions of the CDR Empowered Group shall be final. If restructuring of debt is found to be viable and feasible and approved by the Empowered Group, the company would be put on the restructuring mode. If restructuring is not found viable, the creditors would then be free to take necessary steps for immediate recovery of dues and/or liquidation or winding up of the company, collectively or individually. The CDR Standing Forum and the CDR Empowered Group are assisted by a CDR Cell in all their functions. The lead institution/major stakeholder to the corporate works out a preliminary restructuring plan in consultation with other stakeholders and submits it to the CDR Cell within one month. The CDR Cell will prepare the restructuring plan in terms of the general policies and guidelines approved by the CDR Standing Forum and place for consideration of the Empowered Group within 30 days for decision. The Empowered Group can approve or suggest modifications but ensure that a final decision is taken within a total period of 90 days. However, for sufficient reasons the period can be extended up to a maximum of 180 days from the date of reference to the CDR Cell.

The guidelines allow accounts to be categorized as standard, sub-standard or doubtful for restructuring and independent consultants to help in preparing the restructuring plan. The main features of the guidelines are the introduction of two types of restructuring under the CDR System. Accounts which are classified as 'standard' and 'sub-standard' would be restructured under the first category (Category I) whereas accounts classified as 'doubtful' would be restructured under the second category (Category II).

The Category 1 CDR system is applicable only to accounts classified as 'standard' and 'sub-standard.' If the account has been classified as 'standard'/'substandard' in the books of at least 90 per cent of creditors (by value), the same would be treated as standard/substandard, only for the purpose of judging the account as eligible for CDR, in the books of the remaining 10 per cent of creditors. There would be no requirement of the account/company being sick, NPA or being in default for a specified period before reference to the CDR system. However, potentially viable cases of NPAs will get priority. This approach provides the necessary flexibility and facilitates timely intervention for debt restructuring.

One of the most important elements of Debtor-Creditor Agreement is 'stand still' agreement binding for 90 days, or 180 days by both sides. Under this clause, both the debtor and creditor(s) shall agree to a legally binding 'stand-still' whereby both the parties commit themselves not to take recourse to any other legal action during the 'stand-still' period. This would be necessary for enabling the CDR System to undertake the necessary debt restructuring exercise without any outside intervention, judicial or otherwise. However, the stand-still clause will be applicable only to any civil action either by the borrower or any lender against the other party and will not cover any criminal action.

Additional finance, if any, is to be provided by all creditors of a 'standard' or 'substandard account' irrespective of whether they are working capital or term creditors, on a pro-rata basis. In case for any internal reason, any creditor (outside the minimum 75 per cent and 60 per cent) does not wish to commit

Restructuring of Debt Through

- Financial restructuring
- Business restructuring
- Operational restructuring

Hierarchy under CDR

- CDR Standing Committee: It is Representative general body of all financial institutions and participants. It formulates guidelines through CDR Core group.
- CDR Empowered Group: It considers, evaluates and decide on all cases of requests of restructuring, submitted to it by CDR Cell.
- CDR Cell: CDR Cell, in conjunction with lead banks, works out on the detailed restructuring package. The package is submitted to CDR Empowered Group for review

Financial Restructuring means

- Increasing the tenure of the loan repayment period.
- Reducing the Rate of Interest.
- One time Settlement with the borrower.
- Conversion of Debt into Equity (including convertible instruments with form similar to equity)
- Converting un-serviced interest cost/working capital loans into Term loan.

additional financing, that creditor will have an option in accordance with the provisions. Such creditor can either (a) arrange for its share of additional finance to be provided by a new or existing creditor, or (b) agree to the deferment of the first year's interest due to it after the CDR package becomes effective. The providers of additional finance, whether existing creditors or new creditors, shall have a preferential claim, to be worked out under the restructuring package, over the providers of existing finance with respect to the cash flows out of recoveries, in respect of the additional exposure.

The lenders who wish to exit from the package would have the option to sell their existing share to either the existing lenders or fresh lenders, at an appropriate price, which would be decided mutually between the exiting lender and the taking over lender The new lenders shall rank on par with the existing lenders for repayment and servicing of the dues since they have taken over the existing dues to the exiting lender In order to bring more flexibility in the exit option, One Time Settlement can also be considered, wherever necessary, as a part of the restructuring package. If an account with any creditor is subjected to One Time Settlement (OTS) by a borrower before its reference to the CDR mechanism, any fulfilled commitments under such OTS may not be reversed under the restructured package. Further payment commitments of the borrower arising out of such OTS may be factored into the restructuring package.

Difference Between CDR and SDR:

Corporate Debt Restructuring (CDR)

- The reorganization of a company's outstanding obligations by reducing the burden of the debts on the company by decreasing the rates paid and increasing the time the company has to pay the obligation back.
- It has a three tier structure which includes CDR Cell, Empowered Group and a Standing Forum. The Standing Forum is the top tier which decides on the restructuring.

SDR

- SDR scheme allows banks to convert their outstanding loans into equity in a company if even restructuring has not helped.
- A consortium of lending institutions namely Joint Lender's Forum is formed which will decide on the conversion of debt into equity
- GTL Infrastructure Limited, a telecom tower company GTL Infrastructure owes its lender more than ₹5000 crore.

There have been instances where the projects have been found to be viable by the creditors but the accounts could not be taken up for restructuring under the CDR system as they fell under 'doubtful' category. Hence, a second category of CDR is introduced for cases where the accounts have been classified as 'doubtful' in the books of creditors, and if a minimum of 75 per cent of creditors (by value) and 60 per cent creditors (by number) satisfy themselves of the viability of the account and consent for such restructuring. It will not be binding on the creditors to take up additional financing worked out under the debt restructuring package and the decision to lend or not to lend will depend on each creditor bank/FI separately. In other words, under the proposed second category of the CDR mechanism, the existing loans will only be restructured and it would be up to the promoter to firm up additional financing arrangement with new or existing creditors individually. The other conditions are similar to conditions applicable to category I.

CDR is a popular mechanism among lenders as it avoids delays in multiple lender arrangements and increases transparency in the process. A recent review of the operation of the scheme by the RBI revealed that nearly one-third of the units assisted under the scheme improved their financial position. Banks and financial institutions have restructured more than ₹1,00,000 debts through financial restructuring, business restructuring and operational restructuring. Financial restructuring includes extension of loan maturity, reduction of interest rates, write-off principal or debt to equity/convertible bond swap. Business restructuring comprises of sale of assets or business units, spin-off business division or mergers and amalgamations. Operational restructuring includes changes in company management, asset sales, special audits and divestiture and/or liquidation of non-viable and non-core assets.

Banks have also successfully used the threat of invoking the SARFAESI Act to recast troubled companies via the CDR mechanism and relieve the stress in their asset books. Under this arrangement, a company's debt is recast if 75 per cent of the lenders (in terms of value) agree to do so. The lenders normally compromise on the interest rates and stretch the maturity profile of debt while borrowers too sacrifice in terms of converting part of their debt into equity, offering high collaterals and pumping in fresh money.

The RBI issued guidelines on the CDR mechanism for small and medium enterprises (SMEs) on 9 September 2005. A small-scale industry is defined as one with investment in plant and machinery not exceeding ₹ one crore, while medium enterprises are those with an investment not exceeding ₹10 crore. According to the RBI norms:

- The CDR package would be available to all corporate and non-corporate SMEs irrespective of their level of dues with banks and even if they have banking facilities from only one bank.
- The repayment schedule should not exceed 10 years and banks should consider a proposal only if they are of the view that the unit could be viable in seven years.
- Accounts involving willful default, fraud and malfeasance would not be eligible for restructuring under these guidelines. Banks will also refrain from restructuring loans of companies categorized as loss accounts.
- If the borrowers outstanding is fully covered by tangible security, the rescheduling of instalments of principal amount would not result in down-grading the account to substandard category. However, tangible security is not required when the outstanding is ₹5 lakh.
- If the bank writes off or makes provision on the interest component in terms of present value, the restructured account need not be downgraded to sub-standard category.
- The provision made towards interest sacrifice should be created by debit to profit and loss account and held in a distinct account. For this purpose, the future interest due as per the bank's current

prime lending rate should be discounted to the present value at a rate appropriate to the risk category of the borrower (*i.e.*, current PLR plus the appropriate term premium and credit risk premium for the borrower category) and compared with the present value of the dues expected to be received under the restructuring package, discounted on the same basis.
- The sacrifice made by banks on such SME accounts would have to be recomputed on each balance sheet date till satisfactory completion of all repayment obligations and full repayment of the outstanding.
- Banks should also provide for the shortfall in provision or reverse the amount of excess provision held in the distinct account.

The success of CDR depends on successful turnaround of the company, which requires a disciplined approach and board oversight function. Even though it has been a popular recourse amongst the lender community, lenders have faced difficulties in its successful implementation due to lack of adequate expertise, time and resources to run the distressed company. Also, a significantly discounted price expected by potential buyers, given the 'fire sale', unsustainable levels of debt and lack of reliable information to make a value assessment have made it difficult for lenders to find new promoters

Willful Defaulters

A large number of defaulters strategically defaulted on their repayment obligations on realizing that the legal machinery was ineffective in taking any steps against them. As per the RBI guidelines on detection of willful defaults, a willful default occurs when a borrower defaults in meeting its obligations to the lender when it has a capacity to honour the obligations or when funds have been utilized for purposes other than those for which finance was granted.

The RBI publishes a list of borrowers with outstanding aggregating ₹1 crore and above and against whom suits have been filed by banks and financial institutions for recovery of their funds as on March 31 every year. The banks have to submit a list of willful defaulters to the SEBI also so as to prevent their access to capital markets. The RBI has also advised public sector banks to examine all cases of willful default of ₹ one crore and above and file criminal suits in such cases. A willful defaulter does not get any new loans from FIs. Also, promoters are not allowed to raise resources for floating new ventures for five years from the date of the Reserve Bank publishing their names in the list of willful defaulters.

- A willful defaulter is a borrower who defaults in meeting his obligation to the lender when he has the capacity to honor the obligations or when he has utilized funds for purposes other than those for which finance was granted.

Banks and financial institutions are required to form a committee of higher functionaries headed by the executive director for classification of borrowal accounts as willful defaulters, and create a redressal mechanism in the form of a committee headed by the chairman and the managing director to be carried out through two distinct processes, namely, (i) identification of default as 'willful' based on the prescribed norms through a committee approach, and (ii) suitably advising the borrower about the proposal to classify him as willful defaulter, along with the reasons thereof. The concerned borrower would be provided reasonable time for making representation against such decision to the committee members. A final declaration as 'willful defaulter' would be made only after a view is taken by the committee on a specific representation.

SARFAESI Act

The government enacted the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest SARFAESI Act, 2002 for enforcement of security interest for realization of dues without the intervention of courts or tribunals. This act is a step towards bringing down the level of risk in the system and encouraging banks to lend.

SARFAESI Act Deals with
- Securitization
- Asset Reconstruction
- Security Enforcement

Objectives of SARFAESI Act
- To strengthen the creditors' rights of recovery.
- To pave the way for speedy NPA recovery.
- To empower ARCs for asset reconstruction and recoveries.

The act deals with the following aspects: (i) securitization, (ii) asset reconstruction, and (iii) security enforcement. These three concepts have been interwoven to deal effectively with the problem of NPAs. Securitization is conversion of a financial or non-financial asset into securities. These assets may be healthy or unhealthy (non-performing). Asset reconstruction is a financial tool for corporate debt restructuring and financial rehabilitation through rebundling, takeovers or sale. Enforcement of security interest confers the right on lenders to foreclose a non-performing loan.

The act has defined certain key terms relating to the above three concepts. Section 2 (1) (2d) defines a 'secured creditor' as a bank or a financial institution and including a debenture trustee appointed by the said bank/financial institution and an ARC/SC, in whose favour security interest is created for due payment by a borrower of any financial assistance. The term 'security interest' is defined as covering any right, title, interest of any kind upon property created in favour of the secured creditor. The definition of 'financial asset' includes claims to debt or receivables, secured or unsecured, any debt or receivable secured by mortgage, charge, hypothecation of movable property or any beneficial interest in property. The term 'securitization' is defined as acquisition of financial assets by any securitization company or reconstruction company from any organization whether by raising of funds by such securitization company or reconstruction company from qualified institutions buyers by issue of security receipts representing undivided interest in such financial assets or otherwise. 'Obligor' is defined as a person liable to the originator to pay a financial asset or discharge any obligation is respect of the financial asset. Originator is the owner of the financial asset which is to be acquired by an SC/ARC and security receipt or security issued by an SC/ARC to a qualified institutional buyer pursuant to a scheme evidencing acquisition by the holder of an undivided right, title or interest in the financial asset. 'Securitization company' is a company formed and registered under the Companies Act, 1956 for the purpose of securitization/asset reconstruction respectively.

The act permits a secured creditor whose debt has become an NPA to issue a notice to the borrower requiring the borrower in writing to discharge his dues within 60 days. In case the borrower fails to discharge his liability within 60 days of issue of the notice, the act permits the secured creditors to enforce their security interest provided that in case of financial asset held by more than one financial creditor or joint financing of the financial asset by secured creditors, not less than 75 per cent of the secured creditors agree. The secured creditor is entitled to take one or more of the following measures as mentioned in Section 13 (4) of the ordinance:

- Take over possession of the secured assets of the borrower including right to transfer by way of lease, assignment or sale.
- Take over the management of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale.
- Appoint any person as a manager (such person could be the ARC if they do not accept any pecuniary liability) to manage the secured assets the possession of which has been taken over by the secured creditor.
- Require at any time by notice in writing to any person who has acquired any of the secured assets from the borrower and from whom any money is due or may became due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

- Only secured creditors can refer to SARFAESI.

The secured creditors are required to get valuation of the assets taken over under Section 13 (4) of the act. They can then sell off the assets through any of the following routes:

- By obtaining quotations from persons dealing in such assets or otherwise interested in buying the assets.
- By inviting tenders from the public.
- By holding public auctions.
- By private treaty.

The bargaining power of lenders has improved after the enactment of SARFAESI Act.

The act does not apply to unsecured loans, loans below ₹1,00,000 nor to loans where the remaining principal due is less than 20 per cent of the amount advanced.

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act has given banks and FIs a much needed tool to recover bad debt. Along with this came the corporate debt restructuring (CDR) package, where both lenders and borrowers sit across the table and recast stressed debt for the benefit of both the parties. This is the classic carrot and stick approach—if borrowers are not willing to come to the discussion table, the SARFAESI sword hangs over their heads.

The act also introduces another global trend to the Indian credit market; the establishment of ARC to recover distressed assets. The banks can now clean up their books by selling assets to ARCs at a discounted price or taking over the assets of a defaulter and selling them to recover their dues without resorting to long-winded legal procedures. The first ARC ARCIL acquired 8.3 per cent of gross non-performing bonds during 2005–06. ARCIL took over ₹20,000 crore of sticky assets from the Indian financial system by March 2006. Banks can also generate funds locked in the existing assets through securitization, *i.e.*, issuing bonds against the security of assets. Moreover, the act no longer allows any reference to be made to the Board for Industrial and Financial Reconstruction (BIFR)—a traditional haven for promoters of sick companies. However, the act suffers from certain ambiguities such as the problem of stamp duty and larger powers granted to creditors.

The SARFAESI Act later got into legal wrangles before the supreme court on the issue of Mardia Chemicals. Mardia Chemicals challenged the provisions of the act in the supreme court. The supreme court, in its judgement dated April 8, 2004, upheld the constitutional validity of the act and its provisions except a subsection (2) of Section 17 under Section 17 of the ordinance, the borrower has no right of appeal when notice is issued u/s.13(2) upto the stage when measures have been taken u/s.13(4). The supreme court declared Section 17 (2) as unconstitutional and violative of Article 14 of the Constitution of India.

The Apex Court struck down Section 17 (2) of the said act which requires pre-deposit of 75 per cent of the amount claimed by the secured creditor. However, in reality, the court transposed these powers to be vested with DRTs who, in turn, could impose conditions as they deem fit and proper having regard to the facts and circumstances of the case. In other words, DRTs can play a significant role in disciplining willful defaulters by specifically requiring them to furnish security in the form of deposit of such sums as they deem proper before proceeding to stay the action initiated by the secured creditor, having regard to the conduct of the borrower. As such, the decision of striking down Section 17 (2) would not majorly dilute the legislative intent in disciplining the defaulters.

The Enforcement of Security Interest and Recovery of Debt Laws (Amendment) Act, 2012

The provisions of this Act (except Sections 8 and 15(b)) have came into effect from January 15, 2013. The provision of sections 8 and 15(b) of the Act came into effect from May 15, 2013. This Act amends the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and the Recovery of Debts Due to Banks and Financial Institutions Act, 1993. The major features of the Act are as follows:

- The Act includes 'multi-state cooperative banks' in the existing definition of bank in the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 so that the measures for recovery through the Debt Recovery Tribunals are now available to multi-state cooperative banks.
- It provides for conversion of any part of debt into shares of a borrower company.
- The Act allows secured creditor to accept the immovable property in full or partial satisfaction of the claim against the defaulting borrower in times when they connot find a buyer for the securities.
- It enables the secured creditors or any person to file a caveat sot that before granting any stay, the secured creditor or person is heard by the Debt Recovery Tribunal.
- It empowers Central Government to require by notification, registration of all transactions of Securitization, reconstruction or creation of security interest on or before the date of establishment of Central Registry, within prescribed time period and on payment of prescribed fee.
- The Central Government is enabled to exempt a class or classes of banks or financial institutions from the provisions of this Act on grounds of public interest.
- It permits multi state cooperative banks with respect to debts due before or after the commencement of the Act, to opt to initiate proceedings either under the Multi State Cooperative Societies Act, 2002 or under the Recovery of Debts due to Banks and Financial Institutions Act, 1993.

Asset Reconstruction Companies

The SARFAESI Act, 2002 paved the way for setting up asset reconstruction companies (ARCs) under Section 30 of the act. ARC is setup to help the banks and financial institutions to clean up their balance sheets. Asset reconstruction company is also known as securitization company (SC) or reconstruction company (RC) which tries and resurrects bad loans into good ones.

ARC is an important constituent of the financial system because of the following reasons:

- Isolates non-performing loans from the balance sheets of banking and financial institutions and thereby enable them to focus on their core activities.
- Facilitates development of market for distressed assets.

Benefits of Sale of NPAs to ARCs

- Enables banks/FIs to remove NPAs from the loan books.
- Enable banks/FIs to focus on their core activities.
- Fuster implementation of resolution strategy by ARCs.
- Reduces expenditure of banks/FIs on NPA maintenance.

An ARC is registered under the Companies Act and regulated by the RBI as a non-banking financial company [u/s. 451 (f) (iii) of RBI Act, 1934].

The functions of an ARC are specified in RBI Notification No. DNBS 2/CGM (CSM) 2003, dated April 23, 2003 and they are as follows:

- Acquisition of financial assets (as defined u/s.2 (L) of the SARFAESI Act.
- Change or take over of management/sale or lease of business of the borrower (as per the guidelines to be issued by the RBI in this behalf).
- Rescheduling of debts.
- Enforcement of security interest (as per Section 13 (4) of the SARFAESI Act, 2002.
- Settlement of dues payable by the borrower.

The SARFAESI Act vests the RBI with the powers to register such companies and frame regulations for their functioning, covering areas, such as, registration, owned fund, prudential norms, capital adequacy, aggregate value and type of assets to be acquired. Based on the recommendations of the two working groups constituted by the RBI to address the above issues, guidelines and directions have been issued to securitization or reconstruction companies on April 23, 2003. Following are the main features of the SCs/RCs:

- SCs/RCs seeking registration with the RBI are required to have a minimum owned fund of ₹2 crore. This has now been raised to 15 per cent of the assets acquired or ₹100 crore whichever is less.
- Such SCs/RCs can undertake both securitization and asset reconstruction activities. While SCs/RCs not registered with the RBI can carry out the business of securitization and asset reconstruction outside the purview of the SARFAESI Act, they would not be able to exercise the powers of enforcement provided for in the SARFAESI Act.
- SCs/RCs registered with the RBI would confine their activities to the business of securitization and asset reconstruction and such other activities as permitted under the SARFAESI Act. Carrying out any other business would require RBI approval. Companies carrying out any other business are to cease to undertake such activities by June 20, 2003.

Methods Available to ARCs for Asset Reconstruction and Recoveries

- Restructuring
- Settlement
- Sale of assets through enforcement of security rights under SARFAESI Act.
- Sale/lease of management and business of the borrower.

- SCs/RCs should not accept deposits (as defined under Section 58 A of the Companies Act, 1956). It can issue bonds and debentures for meeting its funding needs.
- While change or take-over of management/sale or lease of business of the borrower is provided for in the SARFAESI Act, SCs/RCs cannot exercise these powers until the RBI issues necessary guidelines in this regard.
- Every SC/RC shall frame an asset acquisition policy with the approval of their board within 90 days of grant of certificate of registration (CoR) by the RBI. This should, inter alia, provide norms and procedure for acquisition of financial assets, types and desirable profile of the assets, valuation of assets and delegation of powers.
- SCs/RCs may reschedule and settle the debts payable by the borrower in terms of a policy framed by their boards in regard thereto.
- SCs/RCs should formulate a plan for realization of assets, which clearly spell out the steps proposed to reconstruct the assets and realise the same within a specified time frame, which shall not in any case exceed five years from the date of acquisition.
- SCs/RCs may raise funds from qualified institutional buyers (QIBs) by way of issue of security receipts, as per policy framed in this regard, through one or more trusts set up for this purpose. The security receipts, to be issued on private placement basis, can be transferred only amongst QIBs.
- SC/RCs, may, as a sponsor or for the purpose of establishing a joint venture, invest in the equity share capital of another SC/RC for the purpose of asset reconstruction. Surplus funds available may be deployed in government securities and deposits with scheduled commercial banks in terms of a policy framed in this regard by their board. Investments in land and buildings can be made only out of funds borrowed and/or owned funds in excess of the minimum prescribed owned fund of ₹two crore.
- Prudential norms covering capital adequacy, income recognition, asset classification, valuation of investments and provisioning, shall be applicable to the assets borne on the balance sheet of such companies.
- Every SC/RC should classify the assets on its balance sheet into standard and non-performing assets, and the non-performing assets further into sub-standard assets, doubtful assets and loss assets. Provisioning is to be made at the rate of 10 per cent and 50 per cent (100 per cent to the extent the asset is not covered by the estimated value of the security) in respect of substandard assets and doubtful assets, respectively. Loss assets are to be written off. If loss assets are retained in the books for any reason, provisions are to be made to the full extent.
- All investments made by the SCs/RCs are to be valued at the lower of cost or realisable value.
- SCs/RCs should maintain, on an ongoing basis, a capital adequacy ratio, which shall not be less than 15 per cent of its total risk-weighted assets.
- SCs/RCs are, inter alia to make disclosures in the balance sheet and offer document in the form of financial details, interest rate/probable yield, redemption details including servicing arrangements, credit rating, if any, description of assets backing the security receipts.

- Security Receipts are pass through certificates. They represents undivided rights, title and interest of the investors in the financial assets held by the trust.

Asset reconstruction companies should have owned funds of not less than 15 per cent of the assets acquired or ₹100 crore, whichever is less. This requirement has been stipulated to enable ARCs to have a sound capital base and a stake in the management of the NPAs acquired. Further, the ARCs should maintain on an ongoing basis, a minimum capital adequacy of 15 per cent of its risk-weighted assets. They have been granted a maximum realization time frame of five years from the date of the acquisition of the assets. The minimum owned fund has to be maintained irrespective of whether the assets are transferred to a trust set up for the purpose of securitization or not, and until realization of assets and redemption of SRs issued against such assets.

Operating Structure of an ARC

An asset/reconstruction company acquires assets from banks/FIs and transfers these assets to one or more trusts set up U/s. 7 (1) and 7 (2) of the SARFAESI Act, 2002. The trusteeship of such trusts shall vest with the ARC. The trusts shall then issue security receipts to QIBs as defined u/s. 2 (u) of the SARFAESI Act, 2002. Security receipts are in the nature of pass through certificates, evidencing an undivided right title or interest in the underlying assets. The proceeds of the issue are utilized for payment of purchase consideration to sellers. An ARC will get only management fee from the trusts. Any gain arising from the difference between acquired price and realized price, will be shared between the ARC and the beneficiary of the trusts while loss will be borne by beneficiary of the trusts only.

As shown in Figure 14.1, an ARC buys loans of bank at a discount and issues it Security Receipts (SRs) instead of paying cash. The ARC services the loan out of the recovery it makes on them. It charges a 2 per cent management fee which is built into the final redemption of SRs. Banks receive cash only after SRs are redeemed. If ARC's recovery is more than the value of SRs, it keeps back the extra recovery. ARCs can even undertake a secondary sale of loans. The bad loans can be sold to another bank say, a foreign bank. Moreover, if an ARC controls 75 per cent of the bad-debts of the defaulting firm, it can use the security enforcement law to take management control of the company which banks cannot do.

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An increasing trend is witnessed in the security receipts subscribed to by the SCs/RCs since June 2007.

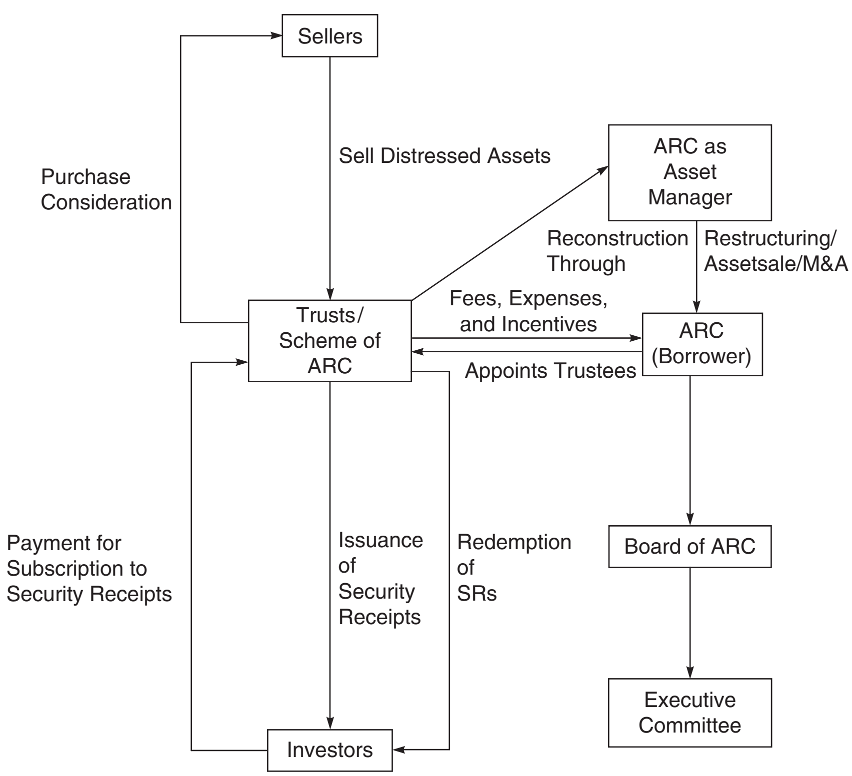

Figure 14.1 Operating Structure of an ARC

Activities of an ARC

An ARC cannot undertake any other activities other than the following without prior permission of the RBI:

- It can act as an agent for any bank or financial institution for the purpose of recovering their dues from the borrower on payment of such fees or charges as may be mutually agreed upon between the parties.
- It can act as a manager referred to in Clause (c) of Sub-section (4) of Section 13 on such fee as may be mutually agreed upon between the parties. However, it cannot act as a manager if acting as such gives rise to any pecuniary liability.
- It can act as receiver if appointed by any court or tribunal.

ARCs can acquire financial assets by way of simple agreement from the banks/FIs subject to some terms and conditions or by an issuance of bonds and debentures to the originating banks/FIs. All the rights of the lender vest in the ARC after acquiring the assets and become party to all the contracts/deeds/agreement. ARCs are also allowed to function as a manager of collateral assets taken over by the lenders under security enforcement rights available to them as a recovery agent for any bank/institution. Since the date of acquisitions of assets, ARCs are given a resolution time frame of maximum five years. As per the act, to discharge its function of asset reconstruction, an ARC can undertake (i) enforcement of security interest; (ii) takeover or change the management of the borrower; (iii) undertake sale or lease of the borrowers' business; and (iv) enter into settlements and reschedule the debt. However, as per the SARFAESI act, for enforcement of security interest, at least 75 per cent of the secured creditors need to agree to exercise this right.

For speedier resolution of NPAs, financial assets due from a single debtor to various banks/FIs may be considered for acquisition. Similarly, financial assets having linkages to the same collateral may be considered for acquisition to ensure relatively faster and easy realization. As per the guidelines, the valuation process should be uniform for assets of same profile and a standard valuation method should be adopted to ensure that the valuation of the financial assets is done in a scientific and objective manner. Valuation may be done internally and or by engaging an independent agency, depending upon the value of the assets involved. The acquired assets may be sold by inviting quotations from persons dealing in such assets, by inviting tenders from the public, by holding public auctions or by private treaty. While there is no restriction on ARCs to acquire assets which are considered to be unrealisable, as per the guidelines to banks, ARCs will normally not takeover such assets and will act as an agent for recovery on a fee basis for these assets.

The Government has allowed 100 per cent foreign direct investment (FDI) in asset reconstruction companies (ARCs) under the automatic route. However, some conditions have been set, including the stipulation that the total shareholding of individual foreign institutional investors/foreign portfolio investors must be below 10 per cent of the total paid-up capital.

Also, FII/FPIs have been permitted to invest up to 100 per cent of each tranche in security receipts issued by ARCs, subject to RBI directions/guidelines.

The investment limit of a sponsor in the shareholding of an ARC will be governed by the provision of the Sarfaesi law, as amended from time to time.

This is expected to boost companies which are struggling for funds, as banks refuse to give steep discounts on stressed assets and the ARCs have to make upfront payment of 15 per cent of the cost of the asset. This will increase the participation of ARCs in revival of stressed assets.

Asset Reconstruction Company of India Limited (ARCIL)

ARCIL is the first asset reconstruction company of India. It is sponsored by the State Bank of India, ICICI Bank Ltd, Industrial Development Bank of India, Housing Development Finance Corporation Limited, and HDFC Bank Ltd. ARCIL has been set up as a private sector entity with 51 per cent of its equity capital being held by the private sector banks. ARCIL started with a capital base of ₹10 crore. This was expanded to ₹220 crore with a view to broad base the equity structure and to have greater participation of major players in the banking sector by reducing individual sponsors' stake from 24.5 per cent to 19.5 per cent.

Resolution Strategies Deployed by ARCIL

- Debt restructuring
- Mergers and acquisitions
- Settlement with promoters
- Strip sale of assets

ARCIL is registered under the RBI under Section 3 of the SARFAESI Act 2002 as a Securitization Company (SC) and Reconstruction Company (RC) to commence business with effect from August 29, 2003 and is considered as a public financial institution within the meaning of Section 4A of the companies Act,1956. ARCIL is also an associate member of the Indian Banks' Association and a member of the CDR system.

Arcil's Objectives

- Convert NPAs into performing assets.
- Act as a nodal agency for NPA resolution.
- Unlock value by utilizing productive assets.
- Create a vibrant market for NPA/restructured debt paper.
- Re-energise the financial sector.

ARCIL has deployed a comprehensive range of resolution strategies such as debt restructuring, mergers and acquisitions, settlement with promoters and strip sale of assets, based on an in-depth analysis of enterprise characteristics. ARCIL is focused towards resolution rather than the reschedulement of debt. Debt aggregation by ARCIL enables single point responsibility and ensure speedy implementation of resolution strategy based on sustainable level of debt within a reasonable timeframe.

The essential objective of both the corporate debt restructuring (CDR) and ARCIL is the same-unlocking value from non-performing/distress assets. Hence, they can be seen as complementary resolution efforts in addressing the distressed asset problem.

The ARCIL route has the advantage of taking the asset off the banks' books and creating a secondary market for it, thereby enhancing the value potential.

The SARFAESI Act, 2002 stipulates that once the assets are acquired by any securitization/ARC no further reference can be made by the borrower company to the BIFR. Pending reference before the BIFR shall be made only when any measure is taken by ARCIL under Section 13 (4) of the SARFAESI Act, 2002.

ASREC (India) Limited

Second ARC to operate after ARCIL and UTI is the key promoter in ASREC with an equity of 30 per cent, followed by the Bank of India at 13.64 per cent and LIC, Allahabad Bank, Indian Bank and Standard Chartered Investment and Loans with holdings of 10 per cent each. Other shareholders include Andhra Bank (4.09 per cent), IL & FS (1.82 per cent), and Dena Bank (0.45 per cent).

The second asset reconstruction company (ARC)—ASREC (India) Limited has commenced its operations. This ARC is sponsored by the Specified Undertaking of Unit Trust of India (UTI-I) which is vested with all the assured return schemes of the erstwhile UTI. Three public sector banks—Bank of India, Allahabad Bank and Indian Bank and the public sector life insurance giant—Life Insurance Corporation of India, Infrastructure Leasing and Financial Services Limited (IL&FS) and Deutsche Bank are its shareholders. UTI-I has the largest stake—39 per cent in this company. The size of the ASREC is about ₹7000 crore-the NPAs of UTI-I.

The RBI has issued certificate of registration to eleven securitization companies (SCs/RCs), of which six have commenced their operations.

Trading of NPAs

India's first ARC, ARCIL, invited bids for its acquired loans in July 2005 and received a good response from both foreign and private banks.

An attempt to create a secondary market for bad loans was made in 2004 by some banks such as Kotak Mahindra and Standard Chartered Bank when they bought bad loans from the Japanese bank Sumitomo Mitsui Banking Corporation and ICICI Bank.

The RBI has set the ground rules for buying and selling distressed assets by issuing prudential norms. A bank can sell a bad loan to another bank only after it remains an NPA in its books for two years, while it can sell the same loan to an ARC the day it is classified as an NPA. The norms on trading of bad loans stipulate that the loan should be sold without recourse.

A bank selling its loans to another bank receives hard cash and the loan moves out completely from the seller's book. Acquirers of bad loans are those banks who have low NPAs and are confident of turning around such assets on the strengths of their own resolution skills and also finding a scope for capital appreciation and higher returns. While acquiring such stressed assets, the acquirer takes into account the underlying value of the assets pledged as security, the potential time period for recovery, the amount which can be realized from that account and exclusive rights, if any, over the pledged security. The seller takes into consideration factors such as impact of such a loan sell-off on the balance sheet vis-à-vis the realisable value of the account, opportunity cost and the prospects of whether it would be in a better position to resolve the loan.

Factors inhibiting the growth of the market for bad loans:

1. Security Receipts in India are not listed and traded
2. There is a limit on the holding of a Security Receipt (SR) of a particular asset by an FII. At present, an FII cannot hold more than 10 per cent in the SRs of a particular asset.
3. There is an absence in the pooling of SRs and their securitization. The securitized paper issued out of that pool would be in the form of junk bonds that carry lesser risk than SRs of a specific loan.

ARCs are a mechanism which can help cleanup the balancesheets of banks and financial institutions by cutting short the time to resolution as well as maximizing the recoveries.

CIBIL

Banks and financial institutions have a lot of opportunity to expand their loan business looking to the higher industrial growth expansion plans of the corporate sector and relative importance of infrastructure development. Moreover, increased competition has driven these institutions to focus more on credit growth. Credit growth is associated with credit risk. These institutions have to take due diligence when granting credit so that there is no credit default which results in funds being locked-up in non-performing assets. Good credit decisions depend upon the availability of comprehensive credit information regarding borrowers. Hence, a need was felt for an institution which would provide credit-related information to lending institutions by maintaining a data base of all borrowers.

- Credit Bureaus are specialized financial institutions that maintain records of credit histories of individuals and business entities.

In developed financial markets there are specialized financial institutions, known as credit-bureaus, that maintain records of credit histories of individuals and business entities. They are usually set up by lenders—mostly banks and credit card companies. Whenever an individual seeks a loan from a bank or finance company the lender before extending the loan checks his credit profile with the bureau to find out whether the borrower has defaulted with any other lender and whether he is capable of settling the loan. This credit bureau also enables lenders to take quick decisions and charge a differential price based on the credit profile of the borrower. If the lenders, perceived that the risk of repayment of a borrower is low, he will charge a lower interest rate, otherwise, a higher one. The lender has not merely to judge the creditworthiness of the borrower, but he also has to monitor the borrower's behaviour during the term of the loan to assess whether there is a risk of default. This depends on the lender's ability to gather accurate and timely information about the borrower. There always exists some degree of information asymmetry between borrowers and lenders. It is the credit bureau which provides the formal mechanism by which lenders can pool and share information about the characteristics of potential borrowers. Also, it discourages borrowers from becoming over-debted by obtaining credit from multiple lenders.

Functions of Credit Bureau

- Maintain records and credit histories of borrowers.
- Provide information of borrowers to lenders.
- Help mitigate adverse selection and moral hazard problems in the market for credit.

Credit Bureau helps mitigate certain problems which arise on account of insufficient or limited credit information. There exist 'adverse selection' and 'moral hazard' problems in the market for credit. Adverse selection refers to a situation where bad borrowers take higher amount and number of loans from various lenders even at higher interest rates. Moral hazard is a phenomenon whereby a borrower having taken a loan, makes a material change in income or spending that affects his ability to repay the loan. This phenomenon occurs when the borrowers knows that the lender cannot monitor borrowers' behaviour during the tenure of the loan.

The State Bank of India (SBI), Housing Development Finance Corporation Limited (HDFC), Dun and Bradstreet Information Services India Private Limited (D&B), and TransUnion International Inc (TransUnion) signed the Shareholders' Agreement on January 30, 2001 to establish the Credit Information Bureau (India) Limited (CIBIL). They initially held the share capital of CIBIL in the proportion of 40 : 40 : 10 : 10 respectively. The shareholding pattern has been diversified to include:

State Bank of India (10 per cent), Bank of Baroda (5 per cent), TransUnion International Inc (10 per cent), Dun & Bradstreet Information Services India Pvt Ltd (10 per cent), Bank of India (5 per cent), The Hongkong and Shanghai Banking Corporation Ltd (5 per cent), Indian Overseas Bank (5 per cent), Sundaram Finance Ltd (2.5 per cent), Housing Development Finance Corporation Ltd (10 per cent), Punjab National Bank (5 per cent), Union Bank of India (5 per cent), Citicorp Finance (India) Ltd (5 per cent), ICICI Bank Ltd (10 per cent), Central Bank of India (5 per cent), Standard Chartered Bank (5 per cent), and GE Strategic Investments India (2.5 per cent). CIBIL provides credit information of borrowers to banks, financial institutions, non-banking financial companies, housing finance companies and credit card companies. The data is shared on the principle of reciprocity—data can be obtained from CIBIL only by members who contribute all data on all borrowers.

CIBIL is India's first credit information bureau to help the financial institutions make informed, objective and speeder credit decisions and thereby curb the growth of NPAs and improve the functioning of the financial system.

The CIBIL maintains the database of suit-filed accounts of ₹ one crore and above and suit-filed accounts (willful defaulters) of ₹25 lakhs and above.

Various Measures initiated by RBI to revitalise the stressed assets

The Reserve Bank of India has taken various measures that aimed at revitalizing the stressed assets in the economy. The measures taken by the Reserve Bank include CDR mechanism introduced in 2001, Joint Lending Forum (JLF) and Corrective Action Plan (CAP) mechanism introduced in January 2014, the Flexible Structuring of Long Term Project Loans to Infrastructure and Core Industries (5: 25 Scheme) in July 2014, Strategic Debt Restructuring Scheme (SDR)in June 2015 and the scheme for Sustainable Structuring of Stressed Assets (S4A) in June 2016. The CDR mechanism has already been discussed and the other initiatives by RBI are as below:

Part A – Strategic Debt Restructuring (SDR) Scheme: It is an improved version of Corporate Debt Restructuring (CDR) mechanism which has empowered banks to initiate change of ownership and management and convert debt into equity of the defaulting borrowers whose assets have turned bad, if necessary.

1. The Strategic Debt Restructuring (SDR) has been introduced with a view to ensuremore stake of promoters in reviving the stressed accounts and providing banks with enhanced capabilities to initiate change of ownership, wherevernecessary, in accounts which fail to achieve the agreed critical conditions and viability milestones. Therefore, banks should consider using SDR only in cases where change in ownership is likely to improve the economic value of the loan asset and the prospects of recovery of their dues. The trigger for SDR must be non-achievement of viability milestones and/or non-adherence to 'critical conditions' linked to the option of invoking SDR, as stipulated in restructuring agreement, and SDR cannot be triggered for any other reason.
2. Henceforth, banks should include necessary covenants in all loan agreements, including restructuring, supported by necessary approvals/authorizations (including special resolution by the shareholders) from the borrower company, as required under extant laws/regulations, to enable invocation of SDR in applicable cases. Further, the Joint Lenders Forum (JLF) will have the option to initiate SDR to effect change of management of the borrower company in cases of failure of rectification or restructuring as a CAP as decided by JLF, subject to compliance with the stipulated conditions..
3. The 'new promoter' (to whom the lenders divest their equity) should not be a person/entity/subsidiary/associate, etc., (domestic as well as overseas), from the existing promoter/promoter group and banks should exercise the necessary due diligence in this regard.
4. Banks should explore the possibility of preparing a panel of management firms/individuals having expertise in running firms/companies who could be considered for managing the companies till ownership is transferred to the new promoters. Banks may consult IBA and other industry bodies in this regard.
5. In no case the current management should be allowed to continue without the representatives of banks on the board of the company and without supervision by an entity/person appointed by the banks.
6. The general principle of restructuring should be that the shareholders bear the first loss rather than the lenders. Accordingly, personal guarantees/commitments obtained from existing promoters should also cover losses incurred by the lenders. Therefore, banks should devise an appropriate mechanism as per the bank's board approved policy towards invocation/release of personal guarantees and this should be based on the principle of reasonable satisfaction of lenders' claims. This could include pledge of the existing promoters' share in favour of the lenders if not already done. In any case, personal guarantees should be released only after transfer of ownership and/or management control to the new promoters.
7. On the issue of divestment of banks' holding in favour of a 'new promoter', the asset classification benefit will be available to the lenders provided they divest a minimum of 26 per centof the shares of the company (and not necessarily 51 per centabinitio as required hitherto) to the new promoters within the stipulated time line of 18 months and the new promoters take over management control of the company. Lenders would thus have the option to exit their

SDR Eligibility

i. Conversion of outstanding debts can be done by a consortium of lending institutions. Such a consortium is known as the Joint Lenders Forum ("JLF").
ii. The JLF may include banks and other financial institutions such as NBFCs.
iii. The Scheme will not be applicable to a single lender.

SDR Process:

- Joint lender's forum meets to discuss recovery plans.
- Banks decide whether the entire loan or a part of it can be converted into equity
- All lenders under the JLP must collectively hold 51% or more of the equity shares issued by the company
- Consent of at least 75% of creditors by value and 60% of creditors by number.
- A decision has to be taken by the lenders within 30 days of the review of the account.

remaining holdings gradually, with upside as the company turns around. Lenders should, however, grant the new promoters the 'Right of First Refusal' for the subsequent divestment of their remaining stake .In other words, the new promoter should have acquired at least 26 per cent of the paid-up equity capital of the borrower company and the new promoter of the company will also be in 'control' of the borrower company, according to the definition of 'control' provided in the Companies Act, 2013. The new promoter should be the single-largest shareholder of the borrower company, which will allow the promoter to make sweeping changes with regard to the board and operations.

8. JLFs are required to adhere to certain prescribed timelines during SDR process. In partial modification of the extant instructions, the JLF can have flexibility in the time taken for completion of individual activities up to conversion of debt into equity in favour of lenders (i.e., up to 210 days from the review of achievement of milestones/critical conditions) as per the SDR package approved by JLF. The benefit of 'stand-still' in asset classification will apply from the reference date itself. However, if the targeted conversion of debt into equity shares does not take place within 210 days from the review of achievement of milestones/critical conditions, the benefit will cease to exist. Thereafter, the loans will be classified as per the conduct of the account as per the extant income recognition, asset classification and provisioning norms.
9. Equity shares acquired and held by banks under the scheme shall be exempt from the requirement of periodic mark-to-market (stipulated vide prudential norms for classification, valuation and operation of investment portfolio by banks) for an18 month period.

   However, there is a possibility of banks facing a cliff-effect of provisioning at the end of the 18 month period on account of mark-to-market requirement (if a part of the equity shares are retained) and/or on account of recognizing loss on sale of equity shares to the new promoters. In view of this, it has been decided that banks should periodically value and provide for depreciation of these equity shares as per IRAC norms for investment portfolio. Banks will, however, have the option of distributing the depreciation on equity shares acquired under SDR, over a maximum of four calendar quarters from the date of conversion of debt into equity, i.e., the provisioning held for such depreciation should not be less than 25 per centof the depreciation during the first quarter, 50 per centof the depreciation as per the current valuation during the second quarter and so on. Furthermore, the banks desiring to have a longer period for making provisions, say 6 quarters, can start making extant provisions in anticipation of MTM requirement, from the reference date itself.
10. JLF should divest their holdings in the equity of the company as soon as possible. On divestment of banks' holding in favour of a 'new promoter', the asset classification of the account may be upgraded to 'standard'. However, the quantum of provision held by the bank against the said account as on the date of divestment, which shall not be less than what was held as at the 'reference date', shall not be reversed.

    It is possible that the lenders may not be able to sell their stake to new promoters within the 18 month period, thus revoking the 'stand-still' benefit, which may result in sharp deterioration in the classification of their remaining loan exposures from what prevailed on the 'reference date'. In order to avoid the cliff effect of resultant provisioning, the banks should build provisions such that, by the end of the 18 month period from the reference date, they hold provision of at least 15 per cent of the residual loan. The required provision should be made in equal instalments over the four quarters. This provision shall be reversed only when all the outstanding loans/facilities in the account perform satisfactorily during the 'specified period' (as defined in the extant norms on restructuring of advances) after the transfer of ownership/management control to new promoters.
11. The guidelines contained in points 3 and 6 will also be applicable to cases where change in ownership has been carried out Outside Strategic Debt Restructuring Scheme. In addition, point 7 will also be applicable to such cases subject to the condition that lenders along with the new promoters should hold at least 51 per cent of the paid up equity capital of the borrower company.
12. The pricing formula under strategic debt restructuring scheme has been exempted from the Securities and Exchange Board of India (SEBI) (Issue of Capital and Disclosure Requirements) Regulations, 2009 subject to certain conditions. Further, in the case of listed companies, the acquiring lender on account of conversion of debt into equity under SDR hasalso been exempted from the obligation to make an open offer under regulation 3 and regulation 4 of the provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

    Accordingly, the SDR framework will also be available to an ARC, which is a member of the JLF undertaking SDR of a borrower company.

13. At the time of divestment of their holdings to a 'new promoter', banks may refinance the existing debt of the company considering the changed risk profile of the company without treating the exercise as 'restructuring' subject to banks making provision for any diminution in fair value of the existing debt on account of the refinance. In this regard, banks should strictly adhere to the provisioning as prescribed under SDR framework while refinancing the existing debt of the company under the 'new promoter'. If banks partially write off the existing loan which is being refinanced, the abovementioned provision for diminution in fair value will be net of the amount written off.
14. These revised guidelines will be applicable prospectively. However, it would be prudent if banks follow these guidelines even in cases where JLF has already decided to undertake SDR.

Part B – Framework to Revitalize the Distressed Assets in the Economy of Joint Lenders' Forum Empowered Group (JLF – EG) Under this framework, banks are required to identify the stress in the account and implement a revival plan before the account turns into NPA. To facilitate early warning signs, RBI created a platform called the Central Repository of Information on Large Credits (CRILC) in 2014 where all lenders are mandated to provide status of all such accounts where Aggregate Exposure (AE) is more than ₹50 Million. The banks are required to furnish credit information to CRILC on all their borrowers having aggregate fund and non-fund based exposure of ₹50 million and above with unique identification through Permanent Account Number (PAN).

Banks are required to identify initial stress in the account, before it turns into NPA, by creating three sub categories under Special Mention Account (SMA) category as mentioned below:

SMA – 0: Principal or interest payment not overdue for more than 30 days but account shows signs of initial stress.

SMA – 1: Principal or interest payment overdue between 31-60 days.

SMA – 2: Principal or interest payment overdue between 61-90 days.

Bankers are mandated to form a consortium of lending institutions known as Join Lending Forum (JLF) as soon as any of the lenders has classified the account as SMA – 2 and AE is more than ₹1000 Million. But, they can also form JLF even if the above two conditions are not met.

Collective Action Plan (CAP) is formulated by JLF to arrive at an early and feasible solution to preserve the economic value of the underlying assets as well as the lender's loans. There are three options available under CAPas follows**:**

Rectification: Commitment from the borrower to regularize the accounts without any change in terms and conditions of the loans. Also, the possibility of getting some other equity/strategic investors may be explored.

Restructuring: Will be undertaken only if it is prima facie viable. JLF can undertake restructuring without referring it to the CDR cell; however, it is required to carry out detailed Techno Economic Viability (TEV) study to conform the viability of the restructuring package.

Recovery: If the above two options cannot be worked out, then the process of recovery may be resorted.

15. In terms of the extant guidelines, the decisions on the Corrective Action Plan (CAP) must be approved by a minimum of 75 per centof creditors by value and 60 per centof creditors by number in the JLF. On a review, the proportion of lenders, by number, required for approving the CAP has been reduced to 50 per cent.
16. In case of revitalizing distressed assets, JLF will finalize the Corrective Action Plan (CAP) and the same will be placed before an Empowered Group (EG) of lenders, which will be tasked to approve the rectification/restructuring packages under CAPs. In partial modification to this,the approval of JLF-EG is mandatory only in cases of rectification with additional finance and cases of restructuring under a CAP.
17. The composition of JLF-EG is as follows:
    a. The top two banks in the system, in terms of advances, namely SBI and ICICI Bank, will continue to be permanent members of JLF EG, irrespective of whether or not they are lenders in the particular JLF.
    b. If SBI and ICICI Bank are the lenders in a JLF, the JLF-EG would consist of these two banks, the three lenders (other than ICICI Bank and SBI) having largest exposures to the borrower and the two largest banks in terms of advances[1] which do not have any exposure to the borrower.

c. If either of SBI or ICICI bank is a lender, the JLF-EG would consist of these two banks, the four lenders (other than ICICI Bank and SBI) having largest exposures to the borrower and the next largest bank in terms of advances[2] which does not have any exposure to the borrower.

d. If neither SBI nor ICICI Bank are the lenders in a JLF, then the JLF-EG would consist of these two banks and the five lenders having largest exposures to the borrower.

e. All the JLF-EG members would have equal voting rights irrespective of the size of exposure to the borrower.

18. In terms of the extant guidelines, the JLF is required to arrive at an agreement on the option to be adopted for Corrective Action Plan (CAP), i.e., either rectification, or restructuring or recovery, within 45 days from (i) the date of an account being reported as Special Mention Account-2(shortly written as SMA-2) wherein the principal or interest payment is overdue between 61-90 days by one or more lenders, or (ii) receipt of request from the borrower to form a JLF, with substantiated grounds, if it senses imminent stress. The JLF should sign off the detailed final CAP within the next 30 days from the date of arriving at such an agreement. Further, the banks were advised that dissenting lenders who do not want to participate in the rectification or restructuring of the account as CAP, which may or may not involve additional financing, will have an option to exit their exposure completely by selling their exposure to a new or existing lender(s) within the prescribed timeline for implementation of the agreed CAP. The **exiting lender will not have the option to continue with their existing exposure and simultaneously not agreeing for rectification or restructuring as CAP**. The new lender to whom the exiting lender sells its stake may not be required to commit any additional finance, if the agreed CAP involves additional finance. In such cases, if the new lender chooses to not to participate in additional finance, the share of additional finance pertaining to the exiting lender will be met by the existing lenders on a pro-rata basis.

    If the dissenting lender is not able to exit by arranging a buyer within the above prescribed time, it has to necessarily adhere to the agreed CAP and provide additional finance, if the CAP so envisages.

    Further, in some cases, there are undue delays by banks in communicating their decision on CAP, which defeats the very purpose of this framework for initiating prompt corrective measures in cases of stressed accounts. Therefore, an incentive structure for banks to communicate their decision on the agreed CAP in a time bound manner has been designed. Accordingly, the asset classification and provisioning norms prescribed shall apply to different categories of lenders where the CAP has been agreed by majority of the members of JLF (i.e., lenders with 75 per cent by value of debt and 50 per cent by number).

19. Furthermore, additional funding provided under restructuring/rectification as part of the CAP will have priority in repayment over repayment of existing debts. Therefore, instalments of the additional funding which fall due for repayment will have priority over the repayment obligations of the existing debt. Necessary conditions shall accordingly be incorporated in the JLF agreement.

Part C – Prudential Guidelines on Restructuring of Advances

20. The accounts classified as 'standard assets' should be immediately re-classified as 'sub-standard assets' upon restructuring as per the extant guidelines. Further, as per extant norms, any additional finance may be treated as 'standard asset' during the specified period under the approved restructuring package.

21. While the borrowers indulging in frauds and malfeasance will continue to remain ineligible for restructuring, banks may review the reasons for classification of the borrowers as wilful defaulters, especially in old cases where the manner of classification of a borrower as a wilful defaulter was not transparent and satisfy itself that the borrower is in a position to rectify the wilful default. The restructuring of such cases may be done with the board's approval, while for such accounts the restructuring under the CDR Mechanism may be carried out with the approval of the Core Group only.

22. With a view to preserving the economic value of viable accounts, in cases of fraud/malfeasance where the existing promoters are replaced by new promoters and the borrower company is totally delinked from such erstwhile promoters/management, banks and JLF may take a view on restructuring such accounts based on their viability, without prejudice to the continuance of criminal action against the erstwhile promoters/management. Further, such accounts may also be eligible for asset classification benefits that are available on refinancing after change in ownership, if such change in ownership is carried out under guidelines on 'prudential norms on change in ownership of borrowing entities (outside strategic debt restructuring scheme)'. Each bank may formulate its policy and requirements as approved by the board, on restructuring of such assets.

23. Restructured accounts classified as non-performing assets, when upgraded to standard category will attract a provision of 5 per cent in the first year from the date of upgradation.

24. General Conditions

24.1 Instructions on 'special regulatory treatment for asset classification' on 'prudential norms on income recognition, asset classification and provisioning pertaining to advances' stand withdrawn.

24.2 Henceforth, the following general conditions would be applicable in all cases of restructuring in addition to general conditions:

i. All restructuring packages will be required to be implemented in a time bound manner. **All restructuring packages under CDR/JLF/Consortium/MBA arrangement should be implemented within 90 days from the date of approval. Other restructuring packages should be implemented within 120 days from the date of receipt of application by the bank.**

ii. Promoters must bring additional funds in all cases of restructuring. Additional funds brought by the promoters should be a minimum of 20 per cent of banks' sacrifice or 2 per cent of the restructured debt, whichever is higher. The promoters' contribution should invariably be brought upfront while extending the restructuring benefits to the borrowers. Promoter's contribution need not necessarily be brought in cash and can be brought in the form of conversion of unsecured loan from the promoters into equity.

iii. Banks should determine a reasonable time period during which the account is likely to become viable, based on the cash flow and the Techno Economic Viability (TEV) study.

iv. Banks should be satisfied that the post restructuring repayment period is reasonable and commensurate with the estimated cash flows and required DSCR in the account as per their own board approved policy.

v. Each bank should clearly document its own due diligence done in assessing the TEV and the viability of the assumptions underlying the restructured repayment terms.

24.3. All other instructions under 'prudential norms on income recognition, asset classification and provisioning pertaining to advances' shall remain unchanged.

Part D – Flexible Structuring of Project Loans

25. Guidelines contained on 'flexible structuring of long term project loans to infrastructure and core industries' are also applicable to External Commercial Borrowings (ECBs) availed for funding projects in infrastructure and core industries sectors, subject to regulations issued under the Foreign Exchange Management Act, 1999.

Part E – Sale of financial assets to securitisation company (RC)/ reconstruction company (RC)

26. Reserve Price: The banks were advised that the auction process for sale of NPAs to SCs/RCs should be more transparent, including disclosure of the reserve price, specifying clauses for non-acceptance of bids, etc. In this connection, it is clarified that banks shall disclose the reserve price at the time of inviting bids/expression of interest from the SCs/RCs.
27. Due Diligence: Thebanks shall provide adequate time and due facilitation to SCs/RCs to conduct due diligence on financial assets offered for sale. The banks shall provide not less than 2 weeks for submission of bids from the time of inviting bids/expression of interest from SCs/RCs.
28. Treatment of security receipts/pass through certificates post realization period:In terms of extant instructions, if redemption of any of the instruments issued by SC/RC (and invested by banks) is limited to the actual realization of the financial assets assigned to the instruments in the concerned scheme, the bank/financial institutionshall reckon the Net Asset Value (NAV), obtained from SC/RC from time to time, for valuation of such investments. In this connection, it has been decided that security receipts/pass through certificates which are not redeemed as at the end of the resolution period (i.e., five years or eight years as the case may be) will be treated as loss asset in the books of the banks.

Scheme for Sustainable Structuring of Stressed Assets (S4A)

In order to ensure that adequate deep financial restructuring is done to give projects a chance of sustained revival, the Reserve Bank, after due consultation with banks, has decided to facilitate the resolution of large accounts, which satisfy the conditions set out in the following paragraphs.

Eligible Accounts

For being eligible under the scheme, the account should meet all the following conditions:

i. The project has commenced commercial operations.
ii. The aggregate exposure (including accrued interest) of all institutional lenders in the account is more than ₹500 crore (including rupee loans, foreign currency loans/external commercial borrowings,);
iii. The debt meets the test of sustainability as outlined below.

Debt Sustainability

A debt level will be deemed sustainable if the Joint Lenders Forum (JLF)/Consortium of lenders/bank conclude through independent techno-economic viability (TEV) that debt of that principal value amongst the current funded/non-funded liabilities owed to institutional lenders can be serviced over the same tenor as that of the existing facilities even if the future cash flows remain at their current level. For this scheme to apply, sustainable debt should not be less than 50 per cent of the current funded liabilities.

Sustainable Debt

The resolution plan may involve one of the following options with regard to the post-resolution ownership of the borrowing entity:

a. The current promoter continues to hold majority of the shares or shares required to have control.
b. The current promoter has been replaced with a new promoter, in one of the following ways:
   i. Through conversion of a part of the debt into equity under SDR mechanism which is thereafter sold to a new promoter.
   ii. In the manner contemplated as per prudential norms on change in ownership of borrowing entities (Outside SDR Scheme).
c. The lenders have acquired majority of shareholding in the entity through conversion of debt into equity either under SDR or otherwise and
   i. allow the current management to continue or
   ii. hand over management to another agency/professionals under an operate and manage contract.

Note: Where malfeasance on the part of the promoter has been established, through a forensic audit or otherwise, this scheme shall not be applicable if there is no change in promoter or the management is vested in the delinquent promoter.

In any of the circumstances mentioned above, the JLF/consortium/bank shall, after an independent TEV, bifurcate the current dues of the borrower into Part A and Part B as described below:

a. Determine the level of debt (including new funding required to be sanctioned within the next six months and non-funded credit facilities crystallizing within the next 6 months) that can be serviced (both interest and principal) within the respective residual maturities of existing debt, from all sources, based on the cash flows available from the current as well as immediately prospective (not more than six months) level of operations. For this purpose, free cash flows (i.e., cash flow from operations minus committed capital expenditure) available for servicing debt as per latest audited/reviewed financial statement will be considered. Where there is more than one debt facility, the maturity profile of each facility shall be that which exists on the date of finalizing this resolution plan. For the purpose of determining the level of debt that can be serviced, the assessed free cash flow shall be allocated to serviceeach existing debt facility in the order in which its servicing falls due. The level of debt so determined will be referred to as **Part A** in these guidelines.
b. The difference between the aggregate current outstanding debt, from all sources and Part A will be referred to as **Part B** in these guidelines.
c. The security position of lenders will, however, not be diluted and Part A portion of loan will continue to have at least the same amount of security cover as was available prior to this resolution.

The Resolution Plan

The Resolution Plan shall have the following features:

a. There shall be no fresh moratorium granted on interest or principal repayment for servicing of Part A.

b. There shall not be any extension of the repayment schedule or reduction in the interest rate for servicing of Part A, as compared to repayment schedule and interest rate prior to this resolution.
c. Part B shall be converted into equity/redeemable cumulative optionally convertible preference shares. However, in cases where the resolution plan does not involve change in promoter, banks may, at their discretion, also convert a portion of Part B into optionally convertible debentures. All such instruments will continue to be referred to as Part B instruments in this circular for ease of reference.

Valuation and Marking to Market

For the purpose of this scheme, the fair value for Part B instruments will be arrived at as per the following methodologies:

- Equity: The equity shares in the bank's portfolio should be marked to market preferably on a daily basis, but at least on a weekly basis. Equity shares for which current quotations are not available or where the shares are not listed on the stock exchanges, should be valued at the lowest value arrived using the following valuation methodologies:
- Break-up value (without considering 'revaluation reserves', if any) which is to be ascertained from the company's latest audited balance sheet (which should not be more than one year prior to the date of valuation). In case when the latest audited balance sheet is not available, the shares are to be valued at ₹1 per company. The independent TEV will assist in ascertaining the break-up value.
- Discounted cash flow method where the discount factor is the actual interest rate charged to the borrower plus 3 per cent, subject to the floor of 14 per cent. Further, cash flows such ascash flow available from the current as well as immediately prospective (not more than six months) level of operations occurring within 85 per cent of the useful economic life of the project only shall be reckoned.
- Redeemable cumulative optionally convertible preference shares/optionally convertible debentures: The valuation should be on discounted cash flow (DCF) basis. These will be valued with a discount rate of a minimum mark up of 1.5 per cent over the weighted average actual interest rate charged to the borrower for the various facilities. Where preference dividends are in arrears, no credit should be taken for accrued dividends and the value determined as above on DCF basis should be discounted further by at least 15 per cent if arrears are for one year, 25 per cent if arrears are for two years, so on and so forth (i.e., with 10 per cent increments).

Where the resolution plan does not involve a change in promoter or where existing promoter is allowed to operate and manage the company as minority owner by lenders, the principle of proportionate loss sharing by the promoters should be met. In such cases, the lenders shall, therefore, require the existing promoters to dilute their shareholdings, by way of conversion of debt into equity/sale of some portion of promoter's equity to lenders, at least in the same proportion as that of part B to total dues to lenders. JLF/Consortium/bank should also obtain the promoters' personal guarantee in all such cases, for at least the amount of Part A.

The upside for the lenders will be primarily through equity/quasi-equity, if the borrowing entity turns around. The terms for exercise of option for the conversion of preference shares/debentures to equity shall be clearly spelt out. The existing promoter or the new promoter, as the case may be, may have the right of first refusal in case the lenders decide to sell the share, at a price beyond some predetermined price. The lenders may also include appropriate covenants to cover the use of cash flows arising beyond the projected levels having regard to quasi-equity instruments held in Part B.

Other important principles for this scheme are the following:

a. The JLF/Consortium/bank shall engage the services of credible professional agencies to conduct the TEV and prepare the resolution plan. While engaging professional agencies, the JLF/Consortium/bank shall ensure that the agency is reputed, truly independent/free from any conflict of interest, has proven expertise and will be in a position to safeguard the interest of lenders while preserving the economic value of the assets. Further, from a risk management perspective, the lenders should avoid concentration of such assignments in any one particular professional agency.
b. The resolution plan shall be agreed upon by a minimum of 75 per cent of lenders by value and 50 per cent of lenders by number in the JLF/consortium/bank.
c. At individual bank level, the bifurcation into Part A and Part B shall be in the proportion of Part A to Part B at the aggregate level.

Overseeing Committee

a. An Overseeing Committee (OC), comprising of eminent persons, will be constituted by IBA in consultation with RBI. The members of OC cannot be changed without the prior approval of RBI. The resolution plan shall be submitted by the JLF/consortium/bank to the OC.
b. The OC will review the processes involved in preparation of resolution plan, etc., for reasonableness and adherence to the provisions of these guidelines, and opine on it.The OC will be an advisory body.

Asset Classification and Provisioning

(A) Where there is a change of promoter:

In case a change of promoter takes place, i.e., a new promoter comes in, the asset classification and provisioning requirement will be as per the 'SDR' scheme or 'outside SDR' scheme as applicable.

(B) Where there is no change of promoters:

i. Asset classification as on the date of lenders' decision to resolve the account under these guidelines (reference date) will continue for a period of 90 days from this date. This standstill clause is permitted to enable **JLF/consortium/bank to formulate the resolution plan and implement the same within the said 90 day period**. If the resolution is not implemented within this period, the asset classification will be as per the extant asset classification norms, assuming there was no such 'stand-still'
ii. **In respect of an account that is 'Standard' as on the reference date, the entire outstanding (both Part A and Part B) will remain standard subject to provisions made upfront by the lenders being at least the higher of 40 per cent of the amount held in part B or 20 per cent of the aggregate outstanding (sum of Part A and Part B).** For this purpose, the provisions already held in the account can be reckoned. Since the standard assets require lower provisions, this would require banks to set a smaller amount aside.
iii. In respect of an account that is classified as a non-performing asset as on the reference date, the Part B instruments shall continue to be classified as non-performing investment and provided for as a non-performing asset as per extant prudential norms, as long as such instruments remain in Part B. The sustainable portion (Part A) may optionally be treated as 'Standard' upon implementation of the resolution plan by all banks, subject to provisions made upfront by the lenders being at least the higher of 50 per cent of the amount held in part B or 25 per cent of the aggregate outstanding (sum of Part A and part B). For this purpose, the provisions already held in the account can be reckoned. In other words, the sustainable part of the debt can be classified as standard if banks set aside provisions equal to at least 50 per centof the debt classified as unsustainable or 20 per centof aggregate debt, whichever is higher.
iv. In all cases, lenders may upgrade Part B to standard category and reverse the associated enhanced provisions after one year of satisfactory performance of Part A loans. In case of any pre-existing moratorium in the account, this upgrade will be permitted one year after the completion of the longest such moratorium, subject to satisfactory performance of Part A debt during this period. However, in all cases, the required MTM provisions on Part B instruments must be maintained at all times. The transition benefit available can however be availed. In other words, the unsustainable part of debt, whether the account was NPA or standard at the time of restructuringcould be upgraded to standard, if the sustainable half of the debt was performed satisfactorily for one year. Banks would also be allowed to reverse all provisions made when the unsustainable half of the debt is upgraded. However, in all cases, the required mark-to-market provisions on instruments after conversion of unsustainable debt must be maintained at all times.
v. Any provisioning requirement on account of difference between the book value of Part B instruments and their fair value, in excess of the minimum requirements prescribed as per the above para (ii) and (iii), shall be made within four quarters commencing with the quarter in which the resolution plan is actually implemented in the lender's books, such that the MTM provision held is not less than 25 per cent of the required provision in the first quarter, not less than 50 per cent in the second quarter and so on. For this purpose, the provision already held in the account can be reckoned.
vi. If the provisions held by the bank in respect of an account prior to this resolution are more than the cumulative provisioning requirement prescribed in the applicable sub-paragraphs above, the

excess can be reversed only after one year from the date of implementation of resolution plan (i.e., when it is reflected in the books of the lender, hereinafter referred to as 'date of restructuring'), which is subject to satisfactory performance during this period.

vii. The resolution plan and control rights should be structured in such a way so that the promoters are not in a position to sell the company/firm without the prior approval of lenders and without sharing the upside, if any, with the lenders towards loss in Part B.

viii. If Part A subsequently slips into NPA category, the account will be classified with slippage in category with reference to the classification obtaining on the reference date and necessary provisions should be made immediately.

ix. Where a bank/NBFC/AIFI chooses to make the prescribed provisions/write downs over more than one quarter and this results in the full provisioning/write down remaining to be made as on the close of a financial year, banks/NBFCs/AIFIs should debit 'other reserves' [i.e., reserves other than the one created in terms of Section 17(2) of the Banking Regulation Act, 1949] by the amount remaining not provided/not written down at the end of the financial year, by credit to specific provisions. However, a bank/NBFC/AIFI should proportionately reverse the debits to 'other reserves' and complete the provisioning/write down by debiting profit and loss account, in the subsequent quarters of the next financial year. The banks shall make suitable disclosures in notes to accounts with regard to the quantum of provision made during the year under this scheme and the quantum of unamortized provisions debited to 'other reserves' as at the end of the year.

Once the resolution plan prepared/presented by the lenders is ratified by the OC, it will be binding on all lenders. They will, however, have the option to exit as per the extant guidelines on Joint Lenders' Forum (JLF) and Corrective Action Plan (CAP).

Flexible Structuring of Long Term Project Loans toInfrastructure and Core Industries

This scheme is generally referred to as the **5:25 flexible structuring scheme**.

During the last decade, commercial banks have become the primary source of long term debt financing to projects in infrastructure and core industries. Infrastructure and core industries projects are characterized by long gestation periods and large capital investments. The long maturities of such project loans consist of the initial construction period and the economic life of the asset/underlying concession period (usually 25 to 30 years). In order to ensure stress free repayment of such long gestation loans, their repayment tenureshould bear some correspondence to the period when cash flows are generated by the asset.

Banks are unable to provide such long tenor financing owing to asset-liability mismatch issues. To overcome the asset liability mismatch, they invariably restrict their finance to a maximum period of 12-15 years. After factoring in the initial construction period and repayment moratorium, the repayment of the bank loan is compressed to a shorter period of 10-12 years (with a resultant of higher loan instalments), which not only strains the viability of the project, but also constrains the ability of promoters to generate fresh equity out of internal generation for further investments. It might also lead to levying higher user charges in the case of infrastructure projects in order to ensure that greater cash flows are generated to service the loans. As a result of these factors, some of the long term projects have been experiencing stress in servicing the project loan.

With a view to overcomethese problems, banks have requested the RBI that they may be allowed to fix longer amortization period for loans to projects in infrastructure and core industries sectors, say 25 years, based on the economic life or concession period of the project, with periodic refinancing, say every 5 years. The banks have indicated that the following:

i. This would ensure long term viability of infrastructure/core industries sector projects by smoothening the cash flow stress in initial years.

ii. They would be able to extend finance to such projects without getting adversely impacted by asset-liability management (ALM) issues.

iii. The need for restructuring (owing to initial stressed cash flows due to 10-12 year loan tenors normally fixed) would be minimized, allowing banks to once again take up financing/refinancing of these project loans.

iv. They could shed or take up exposures at different stages of the life cycle of such projects depending on bank's single/group borrower or sectoral exposure limits.

v. With reduction of project risk and option of refinancing, ratings of such projects would undergo upward revision allowing lower capital requirement for banks andalso access to corporate bond markets to project promoters at any stage based on such refinancing, etc.

The long tenor loans to infrastructure/core industries projects, say 25 years, could be structured as follows:

i. The fundamental viability of the project would be established on the basis of all requisite financial and non-financial parameters, especially the acceptable level of interest coverage ratio (EBIDTA/ Interest pay-out), indicating the capacity to service the loan and the ability to repay over the tenor of the loan.
ii. Allowing longer tenor amortization of the loan (Amortization Schedule), say 25 years (within the useful life/concession period of the project) with periodic refinancing (refinancing debt facility) of balance debt, the tenor of which could be fixed at the time of each refinancing, within the overall amortization period.
iii. This would mean that the bank, while assessing the viability of the project, would be allowed to accept the project as a viable project where the average Debt Service Coverage Ratio (DSCR) and other financial and non-financial parameters are acceptable over a longer amortization period of say 25 years (amortization schedule), but provide funding (initial debt facility) for only, say 5 years with refinancing of balance debt being allowed by existing or new banks (refinancing debt facility) or even through bonds.
iv. The refinancing (refinancing debt facility) after each of these 5 years would be of the reduced amounts determined as per the original amortization schedule.
v. The repayment at the end of each refinancing period would be structured as a bullet repayment, with the intent specified upfront that it will be refinanced and such bullet repayment shall be allowed to be considered in Asset Liability Management (ALM) of banks. The repayment may be taken up by the same lender/a set of new lenders/a combination of both/by issue of corporate bonds as a refinancing debt facility and such refinancing may repeat till the end of the amortization schedule.

Thus, the lenders are allowed to fix longer amortization period for loans to projects in the infrastructure and core industries sector, for say 25 years, based on the economic life or concession period of the project, with periodic refinancing, say every 5 years.

Conditions for 5:25 Flexible Structuring Scheme

Term loans to projects, in which the aggregate exposure of all institutional lenders exceeds ₹500 crore, in the infrastructure and the core industries sector will qualify.

Banks may fix a fresh amortization schedule for the existing projects loans, once during the life time of the project, after the Commercial Operations Date (COD) without it being treated as restructuring subject to:

i. The loan is standard as on date of change of loan amortization schedule.
ii. The net present value of the loan remains same before and after the change in the amortization schedule.
iii. The fresh loan amortization schedule should be within 85 per centof the initial concession period/ life of the project. In case of accounts which are already classified as NPA, the banks are allowed to extend the flexiblestructuring scheme. However, it shall be considered as 'restructuring' and such accounts would continue to remain classified as NPAs.

If banks refinance any existing infrastructure and other project loans by way of take-out financing, even without a pre-determined agreement with other banks/FIs and fix a longer repayment period, the same would not be considered as restructuring if the following conditions are satisfied:

i. Such loans should be 'standard' in the books of the existing banks and should have not been restructured in the past.
ii. Such loans should be substantially taken over (more than 50 per centof the outstanding loan by value) from the existing financing banks/financial institutions.
iii. The repayment period should be fixed by taking into account the life cycle of the project and cash flows from the project.

The RBI has allowed lenders to extend the 5 : 25 scheme to new project loans. The scheme can also be extended to existing project loans with an aggregate exposure of ₹250 crore to banks, compared to the earlier mandate of ₹500 crore. The RBI has increased the scheme's coverage to all sectors. It has also allowed small and mid-sized projectswhere banks have at least ₹250 croreexposureto qualify for this scheme.

In a bold move, the RBI empowered banks to take control of a company if it fails to meet specific milestones under the corporate debt restructuring (CDR) plan. To achieve the change in ownership, the lenders under the Joint Lender's Forum (JLF) should collectively become the majority shareholder by conversion of their dues from the borrower into equity.

Issues relating to revitalizing the stressed assets: Despite so many initiatives taken up by the government and the RBI to revitalize the stressed assets, the non-performing assets have been increasing at a rate of 34 per cent per annum and it is estimated by the RBI that the stock of non-performing assets is around ₹8,00,000crore and for which no efficacious remedy is available for its proper use by defaulter debtor or recovery by creditors.

1. In India, the laws dealing with individual insolvency, the Presidential Towns insolvency Act, 1909 and the Provincial Insolvency Act,1920 are almost a century old.

   Thereafter, many laws and acts such as Contract Act, the Sick Industrial Companies (Special Provisions) Act, 1985 and the winding up provisions of the Companies Act, 1956 or special laws such as the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, have neither been able to aid recovery for lenders nor aid revival or restructuring of firms. As both the legal and institutional machinery for dealing with debt default has failed, it has led to the creation of idle stock of assets and under-utilization of productive capacity of both human and physical capital and thereby, destroying the value of the firm andalso national resources. Neither the lenders are willing to lend further which has created a credit crunch nor are the promoters willing to adopt new measures for the revival and repayment which has impeded for the growth of new projects inhibiting the growth of GDP.
2. According to a report of investment banking firm RBSA Advisors, only 15 per cent cases, i.e., 94 Cases of ₹68,894 crores have successfully exited from CDR since its inception. The corporate debt restructuring of 44 firms with a debt of ₹27,015 crore failed in 2014/15. Only five firms with a total debt of ₹1,399 crore managed to exit the CDR successfully. It lost charm after the withdrawal of forbearance benefit by RBI from 1 April 2015.
3. The success of CDR and SDR depends on successful turnaround of the company, which requires a disciplined approach and broad oversight function. The existing management may continue in disguise and finding new promoter/partner is always a challenge.

   Moreover, the lenders have faced difficulties in its successful implementation due to lack of adequate expertise, time and resources to run the distressed company. Also, the lenders find it difficult to find new promoters/partners as the potential buyers expect a significant discounted price on account of unsustainable levels of debt and lack of reliable information of the distressed company to make a value assessment.
4. It needs due and proper appreciation as that the change of management is not very easy in the Indian context.
5. The promoters' resistance in taking new investors/partners on board is also a hurdle. To bring equity and balance amongst all stake holders in such a unit is also a herculean task for the existing management as well lenders including unsecured creditors.
6. Bankers/Lenders of money, goods and service either do not have the expertise to manage diverse companies or do not have time and experience to turn around a stressed company or apprehend to bring success.
7 The substantial cause of vested interest resulting into valuation mismatch between banks and Asset Reconstruction Companies (ARCs) has resulted in subdued growth in distressed asset sales.
8. Another issue is confusion due to the lack of a unified law/framework to deal with the problem. India currently has multiple laws to deal with insolvency as also bankruptcy, which leads the entire resolution process fragmented, expensive and time-consuming with very low recovery rate. Resultantly, the winding up of a business and recovery of debt is a cumbersome process and therefore attempts are being made to thwart the process.
9. There is lack of adequate and credible real time data regarding assets and indebtedness of a company which further stresses the problem.
10. Creditors, employees and other stakeholders have different and competing claims for which no efficacious remedy to deal with or specification in any regulatory law regarding how to determine priority of claims.
11. Till date the promoters are not willing to part with the possession of the assets and creditors are not willing to put the assets in its proper use for the benefit of all and courts are not able to deal with confronting claims.

12. As a result, India currently ranks 136 out of 189 countries in the World Bank's index on the ease of resolving insolvencies/bankruptcy. The average time taken to resolve insolvency in India is 4.3 years compared to 0.6 years for Japan, 1 year for UK and1.5 years for USA.

For resolving all these issues, the government has framed and implemented the Insolvency and Bankruptcy Code, 2016.

The Insolvency and Bankruptcy Code, 2016

The Insolvency and Bankruptcy Code, 2016 (IBC) was passed by the Parliament on 11 May 2016 and received Presidential assent on 28 May 2016. It was notified in the official gazette on the same day, but the implementation was kept in abeyance till the next notification which implemented it from 1 December 2016. The provisions of the code are being implemented in a phased manner from time to time.

Objectives of IBC

An act to consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for the maximization of value of assets of such persons, to promote entrepreneurship, the availability of credit and balance the interests and inviting participation in the process of revival of all the stakeholders including alteration in the order of priority of payment of government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto. Thus, the IBC provides for a comprehensive eco system regulator, the provision of insolvency professionals and industry of information utilities under judicial monitoring and supervision.

The vision of the IBC is to encourage entrepreneurship and innovation through the use of stressed assets for its better utilization and contribution to the growth of GDP by striking balance and equity amongst interested parties and participation of all stakeholders under the guidance of experts of the field. The government envisages that the debtor-creditor relationship is bound to change.

The Scheme and Framework of the Code:

The Code is divided in 5 Parts with chapters therein. Part I deals with preliminary and definitions (Section 1 to 3). Part II deals with corporate persons. (Section 4 to 77, chapter I to VII). Part III deals with individual and partnership firm. (Section 78 to 187, chapter I to VII). Part IV deals with Registration of IPA, IU, etc., and Inspection and Investigation, Finance and Accounts. (Section 188to 223, chapter I to VII) and Part V deals with miscellaneous. (Section 224 to 255)

The provisions of this code shall apply to the following:

a. Any company incorporated under the Companies Act, 2013 (18 of 2013) or under any previous company law.
b. Any other company governed by any special act for the time being in force, except in so far as the said provisions are inconsistent with the provisions of such special act.
c. Anylimited liability partnership incorporated under the Limited Liability Partnership Act, 2008 (6 of 2009).
d. Such other body incorporated under any law for the time being in force, as the central government may, by notification, specify in this behalf.
e. Partnership firms and individuals, in relation to their insolvency, liquidation, voluntary liquidation or bankruptcy, as the case may be.

Salient Features of the IBC

1. IBC has brought about a paradigm shift from the existing 'Debtor in possession' to a 'Creditor in control' regime under the guidance of an expert in the field. Under laws previous to IBC, the debtors were in possession of the assets whereas the new code presupposes the control of the creditors instead of debtors and management rights are vested with the able expert like resolution professional on commencement of the process. It allows creditors to assess the viability of a debtor as a business decision and agree upon a plan for its revival or a speedy liquidation. The paradigm shift of obligation is cast on creditors to come to decision to revive or liquidate a defaulting company rests on creditors rather than promoters/courts.

   Further, the IBC has classified creditors in two parts namely as financial creditors and operational creditors and recently incorporated under other categories on account of recent development who can apply for insolvency on default of debt or interest payment or repayment of advance made towards purchase. Default has been defined as non-payment of debt carrying time value for money when whole or any part or instalment of the amount of debt has become due and payable and is not repaid by the debtor or the corporate debtor, as the case may be. At present, the default should be at least ₹100,000 (USD $1495) which may be increased up to ₹10,000,000 (USD $149,500) by the Government.

2. The aim of IBC is to consolidate all erstwhile insolvency laws and amend multiple legislations including the companies act. The code would have an overriding effect on all other laws relating to insolvency and bankruptcy. Such consolidation will bring about a greater clarity of law and facilitate the application of its provisions to different stakeholders affected by business failure or inability to pay debt.
3. In this creditor-driven insolvency resolution under the able guidance of expert resolution professional, the code proposes two independent stages: **Insolvency Resolution Process**, during which the financial creditors assess whether the debtor's business is viable to continue and the options for its rescue and revival and **Liquidation**, if the insolvency resolution process fails or financial creditors decide to wind up and distribute the assets of the defaulting debtor.
4. The code has created a new institutional framework, consisting of a regulator, insolvency professionals, information utilities and adjudicatory mechanisms, that will facilitate a formal and time bound insolvency resolution process and liquidation. It has introduced qualified Insolvency Professionals (IPs) as intermediaries to oversee the process. IBC has paved the way for setting up of Insolvency and Bankruptcy Board (IBB) as an independent body for the administration and governance of insolvency and bankruptcy law and information utilities (IU) as a depository of financial information which will reduce the information asymmetry between the stakeholders of the insolvency process.
5. It has introduced a 'moratorium period' which provides time to stakeholders to conduct discussions and arrive at a resolution plan.
6. The code aims to resolve insolvencies in a strict timeline, i.e., ascertain the default so as to the admission of the application within 14 days, appointment of RP within 7 days, immediate vesting of powers of management rests within RP as a going concern, the commencement of moratorium period, the evaluation and viability determination must be completed within 180 days. After a moratorium period of 180 days (which is extendable up to 270 days), IPs to take over the assets of the company. Specification of timeline and its corresponding adherence makes IBC distinct from earlier laws and also enables the protection of the value of the firm as a going concern. It provides for compulsory liquidation of corporate debtors if the resolution plan has not been agreed upon within 180 days of the resolution process.
7. Moreover, IBC has also clearly defined the 'order of priority' or the waterfall mechanism for distribution of assets in case of liquidation. The most important change made by the IBC is to render government dues secondarily to most other dues. Thus, all the unsecured creditors have a priority over the government dues which were not the case in the earlier laws including the provisions of the Companies Act, 1956. IBC can be considered as a bold step worth appreciating being taken by the government and the law makers which considers claims of government being subordinate to the claims of the unsecured creditors.
8. Investigation powers have been given for the first time by the code. Antecedent transactions may be investigated and in case of illegal diversion of assets, personal contribution can be ordered by the court.

Institutional Framework

The law has created five pillars of institutional infrastructure: i) The Insolvency and Bankruptcy Board of India ii) Insolvency Professional Agency iii) Information Utility iv) Insolvency Professional and v) Adjudicating Authority.

The Insolvency and Bankruptcy Board of India(IBB) is the apex body for promoting transparency and governance in the administration of the IBC and will be involved in setting up the infrastructure as an Insolvency Professional Agency(IPA) and Accrediting Insolvency Professionals(IPs) and Information Utilities(IUs).IBB will play the role of regulator under the code by prescribing the regulations.

Insolvency Professional Agency(IPA) is a registered body with the Board(IBB) and enrols IPs and empowered to prescribe bye-laws. At present, the Institute of Chartered Accountants of India and Institute of Company Secretaries of India have formed a separate company u/s 8 of the Companies Act, 2013 to function as an IPA.

Information Utility(IU) is a centralized repository of financial and credit information of borrowers, which would accept, store, authenticate and provide access to financial information provided by listed companies and creditors. 'Financial information', in relation to a person, means one or more of the following categories of information, namely: (a) records of the debt of the person; (b) records of liabilities when the person is solvent; (c) records of assets of person over which security interest has been created; (d) records, if any, of instances of default by the person against any debt; (e) records of the balance sheet and cash-flow statements of the person; and (f) such other information as may be specified. Such information would be available to all stakeholders including creditors, resolution professionals, liquidators and other stakeholders in insolvency and bankruptcy proceedings. The purpose of instituting such information repository is to remove information asymmetry and dependency on the debtor's management for critical information that is needed to swiftly resolve insolvency and eliminate the delays and disputes about facts when default does take place.

Insolvency Professional (IPs) also known as resolution professionals are persons enrolled with IPA and regulated by the board and IPA. IPs are appointed by applicant and conduct resolution process by verifying the claims of the creditors ,managing the debtor's business during the moratorium period and helping the creditors in reaching a consensus for a revival plan. If the revival plan is not approved by consensus, the business goes into liquidation. In liquidation, the insolvency professional acts as a liquidator and bankruptcy trustee. The government has decided to appoint limited period IPs who are professionals like Chartered Accountants, Cost Accountants, Company Secretaries, and Lawyers and are in practice for more than 15 years in order to have adequate number of IPs and thereafter, to qualify as an IP, they will have to clear an examination in a stipulated time period.

Adjudicating authority in the case of IBB would be National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT)for corporate persons and LLP constituted under section 408 of the Companies Act,2013. NCLT will be responsible for corporate insolvency, entertain or dispose any insolvency application, approve/reject resolution plans, decide in respect of claims or matters of law or fact thereof. Appeal against the order of the NCLT can be made to the National Company Law Appellate Tribunal (NCLAT) and thereafter to the Supreme Court. For individuals and other persons, the adjudicating authority is the Debt Recovery Tribunal (DRT) and appeal against its order lies with the Debt Recovery Appellate Tribunal and thereafter to the Supreme Court.

CORPORATE INSOLVENCY RESOLUTION PROCESS

To initiate an insolvency process for corporate debtors, the default should be for at least ₹100,000 (USD 1495) (which limit may be increased up to ₹10,000,000 (USD 149,500) by the government). The code proposes two independent stages:

Insolvency Resolution Process, during which financial creditors assess whether the debtor's business is viable to continue and the options for its rescue and revival.

Liquidation, if the insolvency resolution process fails or financial creditors decide to wind down and distribute the assets of the debtor.

Persons who may Initiate Corporate Insolvency Resolution Process

Where any corporate debtor commits a default, a financial creditor, an operational creditor or the corporate debtor itself may initiate corporate insolvency resolution process. The significant feature of the act is an opportunity/obligation to the defaulting debtor to opt for the resolution process under the provision of the Act.

Financial creditormeans any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to. Essentially, there must be a financial debt. Financial debt means a debt along with interest, if any, which is disbursed against the consideration for the time value of money and it includes following:

a. Money borrowed against the payment of interest.
b. Any amount raised by acceptance under any acceptance credit facility or its dematerialized equivalent.
c. Any amount 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 non-recourse 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.

A committee of creditorswill be constituted under section 21 of this code which will consist of all financial creditors of the corporate debtor. Voting right of a financial creditor is based on the proportion of the financial debt owed to such financial creditor. The approval of the committee of creditors shall be obtained by a vote of not less than 75 per cent of the voting shares.Secured creditors and financial debts owed to unsecured creditors have been accorded priority over government dues.

Operational creditor means a person to whom an operational debt is owed on account of dispute in goods or service and for which no payment is received and includes any person to whom such debt has been legally assigned or transferred. 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.

Operational creditors are not eligible to be a part of the committee of creditors. Operational creditors or their representatives (provided their aggregate dues are not less than 10 per cent of the debt) are allowed to attend the meetings of the committee of creditors but are not allowed to vote. Operational debts are to be paid at last, before making any surplus payments to preference and equity holders.

Initiation of Corporate Insolvency Resolution Process by Financial Creditor

1. A financial creditor either by itself or jointly with other financial creditors may file an application for initiating corporate insolvency resolution process against a corporate debtor before the adjudicating authority when a default has occurred.

   Explanation: For the purposes of this sub-section, a default includes a default in respect of a financial debt owed not only to the applicant financial creditor but to any other financial creditor of the corporate debtor.
2. The financial creditor shall make an application under sub-section (1) in such form and manner and accompanied with such fee as may be prescribed.
3. The financial creditor shall, along with the application furnish the below:
   a. Record of the default recorded with the information utility or such other record or evidence of default as may be specified.
   b. The name of the resolution professional proposed to act as an interim resolution professional.
   c. Any other information as may be specified by the board.
4. The adjudicating authority shall, within fourteen days of the receipt of the application under sub-section (2), ascertain the existence of a default from the records of an information utility or on the basis of other evidence furnished by the financial creditor under sub-section (3).
5. Where the adjudicating authority is satisfied that:
   a. A default has occurred and the application under sub-section (2) is complete, and there is no disciplinary proceedings pending against the proposed resolution professional, it may, by order, admit such application.
   b. Default has not occurred or the application under sub-section (2) is incomplete or any disciplinary proceeding is pending against the proposed resolution professional, it may, by order, reject such application.

   Provided that the adjudicating authority shall, before rejecting the application under clause (b) of sub-section (5), give a notice to the applicant to rectify the defect in his application within seven days of receipt of such notice from the adjudicating authority.
6. The corporate insolvency resolution process shall commence from the date of admission of the application under sub-section (5).

7. The adjudicating authority shall communicate–
   a. The order under clause (a) of sub-section (5) to the financial creditor and the corporate debtor.
   b. The order under clause (b) of sub-section (5) to the financial creditor, within seven days of admission or rejection of such application, as the case may be.

Insolvency Resolution by Operational Creditor

1. An operational creditor may, on the occurrence of adelivering a demand notice of default, of unpaid operational debtor copy of an invoice demanding payment of the amount involved in the default to the corporate debtor in such form and manner as may be prescribed.
2. The corporate debtor shall, within a period of ten days of the receipt of the demand notice or copy of the invoice mentioned in sub-section (1) bring to the notice of the operational creditor.
   a. Existence of a dispute, if any and record of the pendency of the suit or arbitration proceedings filed before the receipt of such notice or invoice in relation to such dispute.
   b. The repayment of unpaid operational debt shall be considered.
      i. By sending an attested copy of the record of electronic transfer of the unpaid amount from the bank account of the corporate debtor.

      Or

      ii. By sending an attested copy of record that the operational creditor has encashed a cheque issued by the corporate debtor.

   Explanation: For the purpose of this section, a 'demand notice'which means a notice served by an operational creditor to the corporate debtor demanding repayment of the operational debt in respect of which the default has occurred.

Application for initiation of corporate insolvency resolution process by operational creditor

1. After the expiry of the period of ten days from the date of delivery of the notice or invoice demanding payment, if the operational creditor does not receive payment from the corporate debtor or notice of the dispute, the operational creditor may file an application before the adjudicating authority for initiating a corporate insolvency resolution process.
2. The application under sub-section (1) shall be filed in such form and manner and accompanied with such fee as may be prescribed.
3. The operational creditor shall, along with the application furnish the below:
   a. A copy of the invoice demanding payment or demand notice delivered by the operational creditor to the corporate debtor.
   b. An affidavit to the effect that there is no notice given by the corporate debtor relating to a dispute of the unpaid operational debt.
   c. Acopy of the certificate from the financial institutions maintaining accounts of the operational creditor conforming that there is no payment of an unpaid operational debt by the corporate debtor.
   d. Such other information as may be specified.
4. An operational creditor initiating a corporate insolvency resolution process under this section may propose a resolution professional to act as an interim resolution professional.
5. The adjudicating authority shall, within fourteen days of the receipt of the application under sub-section (2), by an order institute the following:
   i. Admit the application and communicate such decision to the operational creditor and the corporate debtor if—
      a. The application made under sub-section (2) is complete.
      b. There is no repayment of the unpaid operational debt.
      c. The invoice or notice for payment to the corporate debtor has been delivered by the operational creditor.
      d. No notice of dispute has been received by the operational creditor or there is no record of dispute in the information utility.
      e. There is no disciplinary proceeding pending against any resolution professional proposed under sub-section (4), if any.
   ii. Reject the application and communicate such decision to the operational creditor and the corporate debtor, if—
      a. The application made under sub-section (2) is incomplete.
      b. There has been repayment of the unpaid operational debt.

c. The creditor has not delivered the invoice or notice for payment to the corporate debtor.
d. Notice of dispute has been received by the operational creditor or there is a record of dispute in the information utility.
e. Any disciplinary proceeding is pending against any proposed resolution professional.

Provided that the adjudicating authority, shall before rejecting an application under sub clause (a) of clause (ii) give a notice to the applicant to rectify the defect in his application within seven days of the date of receipt of such notice from the adjudicating authority.

6. The corporate insolvency resolution process shall commence from the date of admission of the application under sub-section (5) of this section.

Initiation of Corporate Insolvency Resolution Process by Corporate Applicant

The term 'corporate applicant' means (a) corporate debtor; or (b) a member or partner of the corporate debtor who is authorized to make an application for the corporate insolvency resolution process under the constitutional document of the corporate debtor or (c) an individual who is in charge of managing the operations and resources of the corporate debtor or (d) a person who has the control and supervision over the financial affairs of the corporate debtor.

1. Where a corporate debtor has committed a default, a corporate applicant thereof may file an application for initiating corporate insolvency resolution process with the adjudicating authority.
2. The application under sub-section (1) shall be filed in such form, containing such particulars and in such manner and accompanied with such fee as may be prescribed.
3. The corporate applicant shall, along with the application furnish the information relating to—
   a. Its books of account and such other documents relating to such period as may be specified.
   b. The resolution professional proposed to be appointed as an interim resolution professional.
4. The adjudicating authority shall, within a period of fourteen days of the receipt of the application, by an order—
   a. Admit the application, if it is complete; or
   b. Reject the application, if it is incomplete.

   Provided that the adjudicating authority shall, before rejecting an application, give a notice to the applicant to rectify the defects in his application within seven days from the date of receipt of such notice from the adjudicating authority.
5. The corporate insolvency resolution process shall commence from the date of admission of the application under sub-section (4) of this section.

Persons not Entitled to Make Application

The following persons shall not be entitled to make an application to initiate corporate insolvency resolution process under this Chapter, namely:

a. A corporate debtor undergoing a corporate insolvency resolution process.
b. Acorporate debtor having completed corporate insolvency resolution process twelve months preceding the date of making of the application.
c. Acorporate debtor or a financial creditor who has violated any of the terms of resolution plan which was approved twelve months before the date of making of an application under this chapter.
d. A corporate debtor in respect of whom a liquidation order has been made.

Explanation: For the purposes of this section, a corporate debtor includes a corporate applicant in respect of such corporate debtor.

Appointment and Tenure of Interim Resolution Professional

1. The adjudicating authority shall appoint an interim resolution professional within fourteen days from the insolvency commencement date.
2. Where the application for corporate insolvency resolution process is made by a financial creditor or the corporate debtor, as the case may be, the resolution professional, as proposed respectively in the application under section 7 or section 10, shall be appointed as the interim resolution professional, subject to the approval of IBB, if no disciplinary proceedings are pending against him.

3. Where the application for corporate insolvency resolution process is made by an operational creditor and
   a. No proposal for an interim resolution professional is made, the adjudicating authority shall make a reference to the board for the recommendation of an insolvency professional who may act as an interim resolution professional.
   b. Aproposal for an interim resolution professional is made under sub-section (4) of section 9, the resolution professional is as proposed, shall be appointed as the interim resolution professional, if no disciplinary proceedings are pending against him.
4. The board shall, within ten days of the receipt of a reference from the adjudicating authority under sub-section (3), recommend the name of an insolvency professional to the adjudicating authority against whom no disciplinary proceedings are pending.
5. The term of the interim resolution professional shall not exceed thirty days from date of his appointment.

Appointment of Resolution Professional (IP)

1. The first meeting of the committee of creditors shall be held within seven days of the constitution of the committee of creditors.
2. The committee of creditors, may, in the first meeting, by a majority vote of not less than 75 per cent of the voting share of the financial creditors, either resolve to appoint the interim resolution professional as a resolution professional or to replace the interim resolution professional by another resolution professional.
3. Where the committee of creditors resolves under sub-section (2):
   a. To continue the interim resolution professional as resolution professional, it shall communicate its decision to the interim resolution professional, the corporate debtor and the adjudicating authority.
   b. To replace the interim resolution professional, it shall file an application before the adjudicating authority for the appointment of the proposed resolution professional.
4. The adjudicating authority shall forward the name of the resolution professional proposed under clause (b) of sub-section (3) to the board for its confirmation and shall make such appointment after confirmation by the board.
5. Where the board does not confirm the name of the proposed resolution professional within ten days of the receipt of the name of the proposed resolution professional, the adjudicating authority shall, by order, direct the interim resolution professional to continue to function as the resolution professional until such time as the board confirms the appointment of the proposed resolution professional.

   Immediately upon receipt of the approval by the regulator and the committee of creditors, IP will take over the running business of the defaulting company. Thus, from the date of appointment of IP, all powers of the board of directors shall be suspended and vested in the hands of IP. He shall propose a 'resolution plan' which means a plan proposed for insolvency resolution of the corporate debtor as a going concern. He shall have the immunity from criminal prosecution or any other liability done in good faith. IP may also act as liquidator and form an estate of assets and consolidate, verify and determine the value of creditors' claims.

Time-limit for Completion of Insolvency Resolution Process

1. Subject to sub-section (2), the corporate insolvency resolution process shall be completed within a period of 180 days from the date of admission of the application to initiate such process.
2. The resolution professional shall file an application to the adjudicating authority to extend the period of the corporate insolvency resolution process beyond 180 days, if instructed to do so by a resolution passed at a meeting of the committee of creditors by a vote of 75 per cent of the voting shares.
3. On receipt of an application under sub-section (2), if the adjudicating authority is satisfied that the subject matter of the case is such that corporate insolvency resolution process cannot be completed within 180 days, it may by order extend the duration of such process beyond 180 days by such further period as it thinks fit, but not exceeding 90days:

   Provided that any extension of the period of corporate insolvency resolution process under this section shall not be granted more than once.

Declaration of Moratorium and Public Announcement

1. The adjudicating authority, after admission of the application under section 7 or section 9 or section 10, shall, by an order—
   a. Declare a moratorium for the purposes referred to in section 14.
   b. Cause a public announcement of the initiation of corporate insolvency resolution process and call for the submission of claims under section 15.
   c. Appoint an interim resolution professional in the manner as laid down in section 16.
2. The public announcement referred to in clause (b) of sub-section (1) shall be made immediately after the appointment of the interim resolution professional.

Moratorium

1. Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the adjudicating authority shall by order declare moratorium for prohibiting all of the following, namely:
   a. The institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority.
   b. Transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein.
   c. Any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
   d. The recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.
2. The supply of essential goods or services to the corporate debtor as may be specified shall not be terminated or suspended or interrupted during moratorium period.
3 The provisions of sub-section (1) shall not apply to such transactions as may be notified by the Central government in consultation with any financial sector regulator.
4 The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process.

   Provided that where at any time during the corporate insolvency resolution process period, if the adjudicating authority approves the resolution plan under sub-section (1) of section 31 or passes an order for liquidation of corporate debtor under section 33, the moratorium shall cease to have effect from the date of such approval or liquidation order, as the case may be.

The adjudication authority will declare moratorium period during which no action can be taken against the company or the assets of the company. The main motto of IBC is to focus on running of a company on a going concern basis. Thus, the threat from secured creditors under the SARFAESI Act shall also be mitigated during the moratorium period. Resolution plan has to be prepared by the IP and approved by the committee of creditors.

A committee of creditors will be constituted wherein party to be excluded from the committee related as defined in Section 24. Each creditor shall vote in accordance with the voting share assigned to it and if 75 per cent of the creditors approve the resolution plan, the said resolution plan shall be implemented.

If the resolution plan is not approved by the committee of creditors, then within a specific time period it would cause initiation of liquidation. Similarly, debtors have also a right to opt for voluntary liquidation by passing a special resolution in general meeting. IP may act as liquidator and exercise all powers of the board of directors. The liquidator shall form an estate of assets and consolidate, verify and determine the value of creditors' claims.

Public Announcement of Corporate Insolvency Resolution Process

1. The public announcement of the corporate insolvency resolution process under the order referred to in section above shall contain the following information, namely:
   a. Name and address of the corporate debtor under the corporate insolvency resolution process.
   b. Name of the authority with which the corporate debtor is incorporated or registered.
   c. The last date for submission of claims.
   d. Details of the interim resolution professional who shall be vested with the management of the corporate debtor and be responsible for receiving claims.
   e. Penalties for false or misleading claims.
   f. The date on which the corporate insolvency resolution process shall close.

Distribution of assets (Priority Waterfall)

1. Notwithstanding anything to the contrary contained in any law enacted by the Parliament or any State Legislature for the time being in force, the proceeds from the sale of the liquidation assets shall be distributed in the following order of priority and within such period and in such manner as may be specified, namely:
   a. The insolvency resolution process costs and the liquidation costs paid in full.
   b. The following debts which shall rank equally between and among the following:
      i. Workmen's dues for the period of 24 months preceding the liquidation commencement date; and
      ii. Debts owed to a secured creditor in the event such secured creditor has relinquished security in the manner set out in section 52.
   c. Wages and any unpaid dues owed to employees other than workmen for the period of twelve months preceding the liquidation commencement date.
   d. Financial debts owed to unsecured creditors.
   e. The following dues shall rank equally between and among the following:
      i. Any amount due to the Central government and the State government 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.
      ii. Debts owed to a secured creditor for any amount unpaid following the enforcement of security interest.
   f. Any remaining debts and dues.
   g. Preference shareholders, if any and
   h. Equity shareholders or partners, as the case may be.
2. Any contractual arrangements between recipients under sub-section (1) with equal ranking, if disrupting the order of priority under that sub-section shall be disregarded by the liquidator.
3. The fees payable to the liquidator shall be deducted proportionately from the proceeds payable to each class of recipients under sub-section (1) and the proceeds to the relevant recipient shall be distributed after such deduction.

   Explanation: For the purpose of this section—
   i. It is hereby clarified that at each stage of the distribution of proceeds in respect of a class of recipients that rank equally, each of the debts will either be paid in full, or will be paid in equal proportion within the same class of recipients, if the proceeds are insufficient to meet the debts in full.
   ii. The term "workmen's dues" shall have the same meaning as assigned to it in section 326 of the Companies Act, 2013(18 of 2013).

Fast Track Corporate Insolvency Resolution Process

It aims to expedite the insolvency resolution process of certain categories of corporate debtors with lesser complexities. The fast track process cuts down the time taken to complete an insolvency resolution to almost half as compared to the regular process under the code.

1. An application for fast track corporate insolvency resolution process may be made in respect of the following corporate debtors, namely:
   a. A corporate debtor with assets and income below a level as may be notified by the Central government.
   b. A corporate debtor with such class of creditors or such amount of debt as may be notified by the Central government.
   c. Such other category of corporate persons as may be notified by the Central government.

Time period for completion of fast track corporate insolvency resolution process:

1. Subject to the provisions of sub-section (5), the fast track corporate insolvency resolution process shall be completed within a period of 90days from the insolvency commencement date.
2. The resolution professional shall file an application to the adjudicating authority to extend the period of the fast track corporate insolvency resolution process beyond ninety days if instructed to do so by a resolution passed at a meeting of the committee of creditors and supported by a vote of seventy five per cent of the voting share.

3. On receipt of an application under sub-section (2), if the adjudicating authority is satisfied that the subject matter of the case is such that fast track corporate insolvency resolution process cannot be completed within a period of 90days, it may, by order, extend the duration of such process beyond the said period of 90days by such further period, as it thinks fit, but not exceeding 45 days:

   Provided that any extension of the fast track corporate insolvency resolution process under this section shall not be granted more than once.

Manner of initiating fast track corporate insolvency resolution process

An application for fast track corporate insolvency resolution process may be filed by a creditor or corporate debtor as the case may be, along with the following:

a. The proof of the existence of default as evidenced by records available with an information utility or such other means as may be specified by the board.
b. Such other information as may be specified by the board to establish that the corporate debtor is eligible for fast track corporate insolvency resolution process.

The process for conducting a corporate insolvency resolution process and the provisions relating to offences and penalties shall apply to this fast track process as the context may require.

Liquidation

Under the code, a corporate debtor may be put into liquidation in the following scenarios:

i. 75 per cent majority of the creditor's committee resolves to liquidate the corporate debtor at any time during the insolvency resolution process.
ii. The creditor's committee does not approve a resolution plan within 180 days (or within the extended 90 days).
iii. The NCLT rejects the resolution plan submitted to it on technical grounds.
iv. The debtor contravenes the agreed resolution plan and an affected person makes an application to the NCLT to liquidate the corporate debtor.

Once the NCLT passes an order of liquidation, a moratorium is imposed on the pending legal proceedings against the corporate debtor and the assets of the debtor (including the proceeds of liquidation) vest in the liquidation estate.

Insolvency Resolution Process for Individuals/Unlimited Partnerships

For individuals and unlimited partnerships, the code applies in all cases where the minimum default amount is ₹1000 (USD 15) and above (the government may later revise the minimum amount of default to a higher threshold). The code envisages two distinct processes in case of insolvencies such asautomatic fresh start and insolvency resolution.

Under the automatic fresh start process, eligible debtors (basis gross income) can apply to the Debt Recovery Tribunal **(DRT)** for discharge from certain debts not exceeding a specified threshold, allowing them to start afresh.

The insolvency resolution process consists of preparation of a repayment plan by the debtor, for approval of creditors. If approved, the DRT passes an order binding the debtor and creditors to the repayment plan. If the repayment plan is rejected or fails, the debtor or creditors may apply for a bankruptcy order.

CONCLUSION

The government has made an attempt to provide a skeletal through framework of code and expects the judiciary to infuse flesh and blood in the skeleton to energize the code. IBC aims at early identification of financial failure and maximizing the asset value of insolvent firms. The code also has provisions to address cross border insolvency through bilateral agreements and reciprocal arrangements with other countries. For the first time a structured and time-bound process for insolvency resolution and liquidation has been initiated, which should significantly improve debt recovery rates and help in the revival of Indian corporate bond market which will thereby help India improve its World Bank insolvency ranking. However, the implementation of IBC 2016 is itself a great challenge and not only the government or judicial authority but the professionals and corporates shall also have to align themselves and cooperate for its successful implementation .The government is proposing a separate framework for bankruptcy resolution in failing banks and financial sector entities. The government is open and ready to amend the code on its judicial review.

KEY TERMS

Asset Reconstruction Company   Non-performing Assets   Securitization

SUMMARY

1. Non-performing assets (NPAs) are loans given by a bank or a financial institution wherein the borrower defaults or delays interest or principal payments. According to the RBI norms, any interest or loan repayment delayed beyond 90 days has to be identified as a non-performing asset.
2. Now banks and financial institutions saddled with bad loans have multiple options like direct settlement across the table, legal recourse in the form of approaching the high court or debt recovery tribunals, enforcement of the new securitization law (where securities pledged with them could be attached and subsequently sold), and lastly selling it to asset reconstruction companies (ARCs).
3. Banks have been advised to devise one-time compromise settlement scheme for resolution of NPAs. As per this scheme, for NPAs upto ₹10 crore, the minimum amount that should be recovered should be 100 per cent of the outstanding balance in the account.
4. Lok Adalats have been setup to help banks to settle disputes involving accounts in ‘doubtful’ and ‘loss’ category with outstanding balance of ₹5 lakh to ₹20 lakh.
5. Debt recovery tribunals were setup under the Recovery of Debts due to Banks and Financial Institutions Act, 1993. This act provides for the establishment of tribunals for expeditious adjudication and recovery of debts due to banks and FIs and for matters connected therewith and incidental thereto. DRTs have been empowered to decide on cases of advances of ₹10 lakh and above.
6. The scheme of CDR was institutionalized in 2001–02 to provide a timely and transparent system for restructuring of corporate debts of ₹20 crore and above with the banks and financial institutions.
7. The Reserve Bank has advised the public sector banks to examine all cases of willful default of ₹ one crore and above and file criminal suits in such cases. A willful defaulter does not get any new loans from FIs nor can he raise funds from the capital market.
8. The Government enacted the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 for enforcement of security interest for realization of dues without the intervention of courts or tribunals. This act is a step towards bringing down the level of risk in the system and encouraging banks to lend.
9. An Asset Reconstruction Company (ARC) is setup to help the banks and financial institutions to clean up their balance sheets. The functions of an ARC are acquisition of financial assets, change or take over of management/sale or lease of business of the borrower, rescheduling of debts, enforcement of security interest, and settlement of dues payable by the borrower.
10. The Asset Reconstruction Company of India Limited (ARCIL) is the first asset reconstruction company of India. It is sponsored by the State Bank of India, ICICI Bank Ltd, Industrial Development Bank of India, Housing Development Finance Corporation Limited, and HDFC Bank Ltd.
11. The Credit Information Bureau of India Limited provides credit information of borrowers to banks, financial institutions, non-banking financial companies, housing finance companies, and credit card companies.

REVIEW QUESTIONS

1. What is a non-performing asset? What are the prudential norms relating to non-performing assets?
2. Which are the tools available to banks to manage their NPAs?
3. What is corporate debt restructuring? What is the eligibility criteria for cases to be referred under this mechanism? How does this mechanism operate?
4. Write notes on
   a. Lok Adalats
   b. Debt reovery tribunals
5. What is SARFAESI Act? What are its objectives? How can a secured creditor enforce his right under this act?
6. Why is an ARC important constituent of the financial system? What are its functions? State the methods available to ARCs for asset reconstruction and recoveries?
7. What is a credit bureau? What are the functions of a credit bureau?

CASE STUDY

Brief History

ABC Limited is engaged in manufacturing Stainless Steel and Mild Steel products comprising of Ingots, Rolled Products, Plates, Billets, Hot Rolled Coils, Cold Rolled Coils, and also having captive power plant (CPP) and other products. The company is profit making since last 15 years, *i.e.*, since inception. The company has achieved the turnover of ₹2,000 crores during the financial year 2007–08 which includes export turnover of ₹780 crores. The company has earned net profit of ₹82.30 crores for the financial year 2007–08 after providing for depreciation of ₹34 crores. The company has employed about 1,300 employees including Workers, Supervisors, Managers and Administrative Staff. The company is listed with Mumbai Stock Exchange and National Stock Exchange and the price of the share quoted between ₹150 and ₹200 per share before stock market melt down.

The balance sheet of the company as of 31.3.2008 & 30.11.2008 is as under:

The company was profit making company since inception and up to 31.03.2008. It had paid dividend up to the financial year 2007–08. However, due to world wide recession and sudden drop