Scanning through The Indian BFSI Sagas

The Indian Banking & Finance sector has seen a wide range of highs and lows in the past decade. While there has been a lot all over the news and other knowledge domains, Lex Witness takes an extra mile and speaks to one of the maestros of the Indian Legal Fraternity – Mr. Alok Dhir, Founding & Managing Partner, Dhir & Dhir Associates. A lot of unanswered and unsolved riddles got answered during the conversation. Read On.

Alok Dhir
Founding & Managing Partner,
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What are your views on the current scenario of NPAs in the Indian Economy?

In one word `alarming'. The continuing impact of the global meltdown of 2008-09 has adversely impacted the Indian Businesses leading to a speedy deterioration of financial health of companies resulting in failures in meeting their debt obligations to the Banks/FIs culminating into NPAs.

Around 11.3% of the total advances of the banking sector are under stress, which include 5.1% as declared NPAs and 6.2% as restructured advances.[1] The scenario is likely to become graver as large number of the `ever greened accounts', mainly in the Infra & Steel space are likely to slip into the NPA net in the wake of continuing slow pace of the economy and Asset Quality Review being taken by the RBI.

The menacing increase in the NPA portfolio of the banks has drastically widened the ambit of legal services that may be required from the legal professionals by the various stakeholders. The various innovative financing and restructuring mechanisms introduced by the RBI viz. Flexi Restructuring (5:25) to address the issues of delinquency arising in infra lending, the conventional CDR mechanism and the recently introduced Strategic Debt Restructuring (SDR) which enables the lenders to Change the Management of defaulting borrower companies by permitting conversion of debt into equity and/or by pledge invocation, would entail substantial challenges.

In addition to the above non statutory mechanism, the Govt. has promulgated the Insolvency & Bankruptcy Act (IBA). IBA is intended to achieve a time bound insolvency resolution in order to arrest any depletion in the underlying assets and minimize loss to the stakeholders. IBC is a novel legislation and would require services from specialized professionals experienced in Restructuring, Resolution &

The new law is a welcome move as it would end the complexities and delays that have arisen due to existence of multiple laws in India, operating under multiple judicial forums, to address loan defaults, Insolvency and Resolution, Bankruptcy & Recovery. The Bankruptcy code provides a 'single window' to provide Insolvency resolution in a speedier and time bound manner with an overall objective of balancing the interest of stakeholders, preserving economic value, faster turnaround of viable businesses, promoting investment, ensuring early release of locked up banks' funds, arrest flow of bad money behind good money, development of a robust corporate debt market in India with wider and cheaper availability of credit and improve the 'ease of doing business' ranking of India.

[1] RBIs Financial stability report for December 15 quarter

Insolvency to achieve the desired objectives.

As such the growing stress in the lending portfolios of the Banks/FIs has evolved a wide array of services for the legal profession and at the same time has saddled the professionals with greater degree of responsibility both towards the society and the economy at large.

Do you think it is time to correct lending mechanisms as far as the Indian banking system is concerned?

The increase in NPAs is also attributable to reckless lending by some banks in the past, improper monitoring of borrowers' accounts, higher interest rates etc. The appraisal mechanism has seriously lacked in developing expertise to establish the techno economic viability of the project and the majority lending has been hovering around the conventional 'Asset backed approach'. However, with the changing economic scenario, increased fund requirement for development of infrastructural facilities, growth of the Information Technology sector and the meteoric rise in the service sector etc. it has become imperative for the Indian lending institutions to see beyond their 'one size fits all' model of lending. The lending mechanisms have to be innovated after factoring the peculiarities and constraints of each sector. It has to rapidly shift to 'cash generating capacity' method of lending and all the repayment obligations should be fixed on that basis only. For instance the Infra projects are characterized by high capital investments, long gestation period and annuity based returns therefore the lending mechanism has to be customized to suit the above business model. The lending mechanisms for service providers, technology developers and aggregators should be based on an assessment of their 'revenue generating ability' as these businesses are not `asset heavy'. Lending to any of such sectors relying on the conventional method is sure to be doomed.

Apart from the appraisal an effective lending mechanism should also comprise an equally efficient monitoring system to enable early detection of instances of delinquency before they assume monstrous proportions, and if the same is beyond control, the system should have an easy 'exit route' policy be it through an effective dispute resolution process/assignment/ acquisition through an Asset Reconstruction Company or monetization under SARFAESI, CIRP through IBA or liquidation as the last resort.

Is it favourable time for ARCs to look at India as a prospective market?

With such large stock of distressed assets aggregating more than INR 9 Trillion in the Indian Banking system, the Banks are under pressure to clean up their Balance Sheets by March 2017 as directed by RBI Governor Mr. Raghuram Rajan. Perhaps, it is most opportune time for the ARCs to step forward for debt aggregation for efficient resolution and recovery. It makes lot of commercial sense as it gives an opportunity to the investors in distress space to acquire assets at huge discounts compared to the peak valuation. Further, with the prevailing uncertainties in the stock market and money market the distressed asset space provides more promising returns. Apart from the commercial angle the ARCs would also significantly contribute towards an effective resolution of distressed assets. ARCs with focus and domain expertise in resolution and the statutory/ regulatory empowerments for resolution are in a better position to implement timely resolution strategy thereby enhancing the value of stakeholders.

Why do you think that the quantum of bad loans or stressed lending more prominent in case of non-private banks?

The primary reason for this is that Public Sector Banks have a significant exposures to sectors such as steel, aviation, mining, infrastructure, real estate and related sectors, as compared to private sector banks (whose books are more heavily weighted towards retail assets) and incidentally all the above stated sectors are bleeding, not because of any kind of indecisiveness or laxity on part of the PSBs but due to macro-economic issues and other factors beyond the control. Another major reason is that unlike the private banks, the PSBs have huge social lending obligations which cast a further dent on the asset health of the PSBs, as compared to private banks.

Private sector banks have also been ever greening their NPAs and under reporting them by issuing various ingenious methods. However, the game has started getting uncovered which is evident from the fact that in last nine months (April-December 2015), gross NPAs of private banks rose 39% to ₹ 1,16, 334 crore, compared with a 34% growth to ₹ 10,15,219 crore for state-owned banks. *(Source - HT Mumbai - 17.03.2016)*

The above growth rate of NPAs is despite a substantial credit growth for Private Banks at 17% as compared to a drop of 18% for PSBs. If we discount the credit growth rate of Private Banks and factor in the negative growth rate of PSBs, the growth of NPAs for Private Banks would be substantially large. Recently, ICICI Bank has made an exceptional provisioning of ₹ 3600 Crore over and above the provisioning as required under RBI guidelines reflecting that there may be more hidden NPAs in the books of the Private Sector Banks.

What are your thoughts on the Bankruptcy Code? How helpful would it be for the current situation?

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It is a paradigm shift from the prevailing statutory mechanism i.e. the Sick Industrial Companies (Special Provisions) Act 1985 (SICA) and ushers in the `Creditor in Possession' regime against the `Debtor in Possession' era. The law minimizes the judicial intervention in the process as the collective wisdom of the financial creditors will dictate the entire proceedings and to ensure a speedier resolution, strict time lines are stipulated for the completion of entire process (within a maximum of 180 days, extendable by another 90 days) failing which liquidation would be the only fate of the defaulting borrower.

In contrast to the existing legislation, the new law empowers even the unsecured lenders and the operational creditors to initiate Insolvency proceedings. In order to protect any further deterioration/stripping of assets, immediately upon initiation of the process the management would move to an Insolvency Resolution Professional appointed by a Committee of Creditors. During the continuation of the Insolvency Resolution Process there would be a `calm period' and all creditors' claims shall stand frozen (including an action under the SARFAESI Act). The new law ends the discrimination amongst secured/ unsecured/domestic/foreign lenders by doing away with the concept of `class of creditors' instead a resolution plan approved by super majority of voting share of financial creditors' (including foreign financial creditors) shall be considered by the Adjudicating Authority.

The law gives substantial weightage to the operational creditors by according them a defined priority in the distribution waterfall. The law protects the interest of the workmen by according them a priority in payment compared to financial creditors and sovereign debt while at the same time limiting their priority claim to 24 months.

The law envisages setting up of Information Utilities for collection and dissemination of financial information from borrower companies and financial and operation creditors of the Company and make them available to all the stakeholders for a better transparency into the financial status of the debtor company. Further an Insolvency & Bankruptcy Board shall be set up to act as a regulator with powers to make regulations and have an oversight over the functioning of Insolvency Agencies, Professional and Information Utilities.

India is a capital starved country and therefore it is essential that productive resources locked up in unproductive and unviable business are quickly freed to be pumped back into the systems. The new law with its emphasis on easier and time bound resolution can ensure this and allow entrepreneurs to get a fresh start.

However the success of the law is hugely dependent upon the establishment of an eco-system and the enabling infrastructure and appointment of experienced and competent Members to implement the enactment. In the absence of the same, the desired success will never be achieved.