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Tackling NPAs & Bad Loans through Change of Management - Not So Tactical

Sandeep Kumar Gupta & Sunny Thakral

The banking sector has been facing the brunt of Non-Performing Assets and the situation has worsened to an extent that the total stressed assets portfolio of the commercial banks has reached an alarming level of approximately 11% of the total advances, as on 31st March, 2016. Tackling the NPAs and recovery therefrom, has been the key agenda of the Regulator Reserve Bank of India (RBI) and the legislature alike.

The RBI, in its effort to address the menace of growing NPAs of the bank, has promulgated several schemes/mechanisms/guidelines/circulars to enable the banks to restructure their dues. Some of the popular norms are as follows:

- Income Recognition and Asset Classification Guidelines (IRAC Norms)
- Corporate Debt Restructuring
- Flexi Restructuring Scheme for core sector industries & infrastructure sector Long Term Infrastructure Bonds
- Corrective Action Plan and Joint Lenders Forum Guidelines
- Provisions with respect to Wilful and Non Co-operative borrowers
- Strategic Debt Restructuring Scheme (SDR)
- Change of Management of defaulting entities outside SDR
- Scheme for Sustainable Structuring of Stressed Advances (S4A Scheme), etc.

Despite the proactive measures being promulgated by the regulator, the results are not as expected.

CHANGE OF MANAGEMENT (WITHIN & OUTSIDE SDR)

In order to effect a change of management in the defaulting borrower entities within the framework of SDR and outside of the SDR, the lenders may, in terms of the already existing restructuring agreement (within SDR) or already existing loan agreement (outside SDR) collectively trigger a Change of Management upon the occurrence of a default, through conversion of loans into shares (within SDR), pledge invocation and/or through issuance of fresh equity shares (outside SDR) in a manner, that, subject to the provisions of Banking Regulation Act 1949, the lenders collectively acquire at least 51% stake in the borrowing company with an intent to off load the same (at least 26%) in favour of a `new

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promoter' within the stipulated time frame of 18 months to avail the benefits of asset classification.

The full enabling guidelines issued by RBI still met with some challenges, as listed below:

1. The shareholders' resolution (Section 62(3) of Companies Act, 2013) or for issuance (under Section 62(1)(c) of Companies Act, 2013) is required to issue shares to lenders towards the debt equity swap initiated under SDR.

2. Banks have to scout for a professional management to be able to manage the affairs of such a company and in the Indian context, where most of the business houses are `family driven' there would be substantial key information which would only be with the erstwhile promoters

3. In the event of failure of the scheme the account will again slip into NPA and adequate provisioning will have to be made as per the extant IRAC norms as if the said 'stand-still' clause for asset classification was never in force.

4. One of the critical problems of the Scheme is that the minimum conversion price is that of the face value. If market value is less, then loss needs to be booked by banks.

5. The `New promoter' is not exempt from complying with the SEBI norms of minimum public shareholding.

6. RBI has, in its circular, clearly mentioned that Banks should be mindful of not resorting to violation of Sec. 19(2) of the Banking Regulation Act, 1949.

The success of the SDR mechanism is clouded with uncertainty as during the last 15 months, especially ever since the SDR guidelines were introduced, hardly 22 accounts approximately have seen Change of Management coming into effect by lenders.

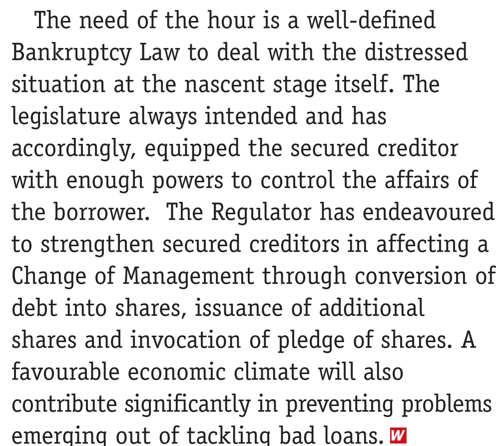
THE LEGISLATIVE STORY

The legislature has also enacted several legislations which contain numerous provisions to ensure a speedy recovery of the public money locked in NPAs and also to empower the lenders to enforce their security interest in the underlying assets without the intervention of the court or carry out a change in management with an intent to speedily recover their dues from the defaulting borrowers.

While the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) offered protection to the industrial companies from institution or continuation of any legal proceedings/action, the SARFAESI empowered the lenders to enforce their security interest without any court intervention.

Section 18 under SICA provided enabling provisions for effecting Change of Management, if required, for revival/rehabilitation of sick industrial company. Section 9 of SARFAESI empowers an Asset Reconstruction Company to inter-alia take over or change the management of business of the borrower company and Section 13(4)(b) of SARFAESI provides for takeover of management of the business of defaulting borrowers for the purposes of recovery of secured debt. However, one must note that creation of security interest does not mean transfer of ownership rights to the lenders. Any property over which security interest is created, belongs to the borrower and the rights of secured creditors over such property are limited to the extent of recovery of outstanding loan.

SUMMING IT UP



The need of the hour is a well-defined Bankruptcy Law to deal with the distressed situation at the nascent stage itself. The legislature always intended and has accordingly, equipped the secured creditor with enough powers to control the affairs of the borrower. The Regulator has endeavoured to strengthen secured creditors in affecting a Change of Management through conversion of debt into shares, issuance of additional shares and invocation of pledge of shares. A favourable economic climate will also contribute significantly in preventing problems emerging out of tackling bad loans.

Sandeep Kumar Gupta is a Partner at Dhir & Dhir Associates, Advocates & Solicitors. He is a qualified chartered accountant with an extensive experience of more than two decades in banking, project finance and debt restructuring of entities in distress, both through the CDR mechanism and on bilateral basis. He is a part of the corporate consultancy team of the firm, advising client on matters related to settlements/restructuring with lenders, business and corporate restructuring, including the Strategic Debt Restructuring and S4A mechanisms and other insolvency-related issues.

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