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Indian Banks - Growth Dilemma

Practical Global Business Resolution needed

- Credit growth -
  2015-16 - 10.9%
  2016-17 - 8.3%

Stressed Assets and the Insolvency and Bankruptcy Code 2016

India has a history of financial transactions since the Vedic age.

English banking law lent a lot to Indian banking law. Banking law has within it the elements of Contract Act, and other commercial and civil laws. The amendment to Reserve Bank of India Act in 2006 brought in the cash reserve ratio principle and vested unto it specific powers to issue guidelines and circulars binding on all banks.

The economic reforms that began in 1991 changed India's business and commercial roadmap and resulted in free entry and exit of enterprises, inflow and outflow of resources and productive use of investments. Here, the banks became the growth drivers. The banks were exposed to many a risk involving credit, liquidity, interest, operational and market. The predominant among these was debt recovery.

Though the banks strengthened their position through better appraisal process, yet the incidence of Non Performing Assets (NPAs) increased. This certainly affected profitability of banks adversely. Slowly, it became a serious problem, hitting worst the public sector banks. To this there is a linkage – corporate India started falling sick as its ability to pay interest on its debts weakened (Credit Suisse Report). This resulted in accumulation of Non Performing Assets. During the past three years, there has been a steady increase in NPAs (Credit Suisse Report). The companies whose interest coverage was less than one per cent for four or more of the past eight quarters, was at thirty three percent, up from twenty nine per cent from the previous quarter. Needless to say, interest coverage denotes a company's ability to pay interest on its loans, the failure whereof turns the loan into a Non Performing Asset.

As of June 2016, the total amount of Gross Non-Performing Assets for public and private sector banks was around Rs.6 lakh crore, the recent report being 6.14 lakh crore (The Economic Times, June 28, 2017). Top twenty NPA accounts of public sector banks then stood at Rs.1.54 lakh crore (The Hindu, November 21, 2016). If we look back, it can be seen that the deterioration started seriously since 2009. By March 2016, the situation was worse. The lowest level of NPAs was in 2007-08 and 2008-09 (Handbook of Statistics on Economy, RBI). Asset quality of scheduled commercial banks by March 2016 showed that it is beyond the financial

sector in India and it is effectively a fiscal risk, imposing a burden on the already stressed State Exchequer.

The recovery actions by creditors especially the Public Sector Banks despite enactment of special laws such as the Recovery of Debts Due to Banks and Financial Institution Act, 1993, Securitization and Reconstruction of Financial Assets & Enforcement of Security Interest Act, 2002, of the Sick Industrial Companies (Special Provisions) Act, 1985 and the winding up provisions under the Companies Act, 1956 did not yield desired results. The Presidential Towns Insolvency Act, 1909 and the Prevention Insolvency Act, 1920 were of the pre-independence era.

The Insolvency and Bankruptcy Code 2016, which received the Presidential assent on May 28, 2016, is an enactment "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 maximizing of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of the Government dues..."

Considering the need and timeliness of the Code, Dr. M.S. Sahoo, Chairperson of Insolvency and Bankruptcy Board of India says in the first issue of Insolvency and Bankruptcy News (Vol.1, October-December 2016) that:

> " It has been a paradox that an economy, which allowed free entry and free competition, did not permit free exit and in the process suffered the inefficiencies of several zombie entities in the system for so long. The third pillar has now been erected in the form of Insolvency and Bankruptcy Code, 2016. This code offers a market directed, time bound mechanism for resolution of insolvency, wherever possible, or exit, wherever required, and thereby ensures freedom to exit."

The new Code's objective is to promote entrepreneurship, availability of credit and to look after the interests of all stakeholders and amend the laws relating to insolvency resolutions not confined to corporate functions but also partnerships and individuals in a time bound manner, and to maximize value of assets of such entities. Thus, a single legislation earlier contained in different Acts has been brought in to bring greater clarity in law and facilitate application of consistent and coherent provisions to all stakeholders whether affected by failure of business or inability to pay debts.

Last month the Government proclaimed an ordinance giving wide ranging powers to the Reserve Bank to issue directions especially to public sector banks to resort to the Code under guidance of RBI's Internal Advisory Committee, on specific account(s) which need to go before the Adjudicating Authority under the Code. The RBI has made its diktat clear now that banks have to make 50% provision on loan of the company before it is referred to NCLT; 100% provision if the court orders liquidation of the assets.

The strong steps taken by Reserve Bank to resolve NPAs are likely to raise provisioning by a whopping 25 per cent this year as lenders will take up to 60 percent hair cut while resolving these accounts. This also sends a message to borrowers to adhere to credit discipline and to banks to adhere to definite timelines. Obviously, the choice left will be to resort to insolvency.

Under the Code even the Corporate Debtors have an option to move the Adjudicating Authority under the Code. Under the Code default is a state of insolvency. The failure and consequent insolvency can be prevented and can be resolved either as a going concern and if it has already reached the unresolvable proportions, the answer is liquidation. The Code addresses all these aspects, namely, preventing insolvency, providing a market determined and time bound mechanism for reconstruction and resolving insolvency wherever it is possible. It promotes ease to exit. The Committee of Creditors along with Insolvency Professionals play a predominant role. The time limit provided under the Code gives it a clear distinction from all earlier legislations. The Code permits 180 days for resolution of insolvency process with only one time extension up to ninety days in exceptional circumstances or deserving cases. The Code also provides a fast track process for certain categories of corporate persons with resolution process to be completed within ninety days with one time extension of 45 days.

The Corporate Debtors will be well motivated to use the provisions of the Insolvency and Bankruptcy Code, 2016, and their failure will not come in their way to participate in the new restructured scheme, provided their creditors still have faith in them. This will bring about resolution and restructure their finances, thereby putting their Non-Performing Assets into use which ultimately will help them to re-build their economy. There will be high order of discipline and amiable decisions without fear of any investigation.

The Code can certainly bring about two definite changes. Public Sector Banks and financial lenders would be eager to take decisions under the Code for a resolution mechanism. Some apprehensions can be there. For

example, there may be no buyers to take the assets in a particular sector, and future cash flows. All these would be within the domain of the Committee of Creditors themselves and can be solved with the help of the insolvency professionals. The time period of six months would be available to them to resolve the issues and get back to the main stream with the resolution in place, failing which liquidation would be the consequence.

The changes around cannot be ignored. In 2012, the interest rate was 12.8%. As per the Code, it is now 6.25%.

There can be teething troubles considering the tasks underlying the Code. As time rolls, the rules and regulations will undergo constant evaluation and necessary updation, with willingness to adopt changes. This would help encourage stressed companies to see reason and seek resolution.

A.S. Chandhiok
New Delhi, June 28, 2017.

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