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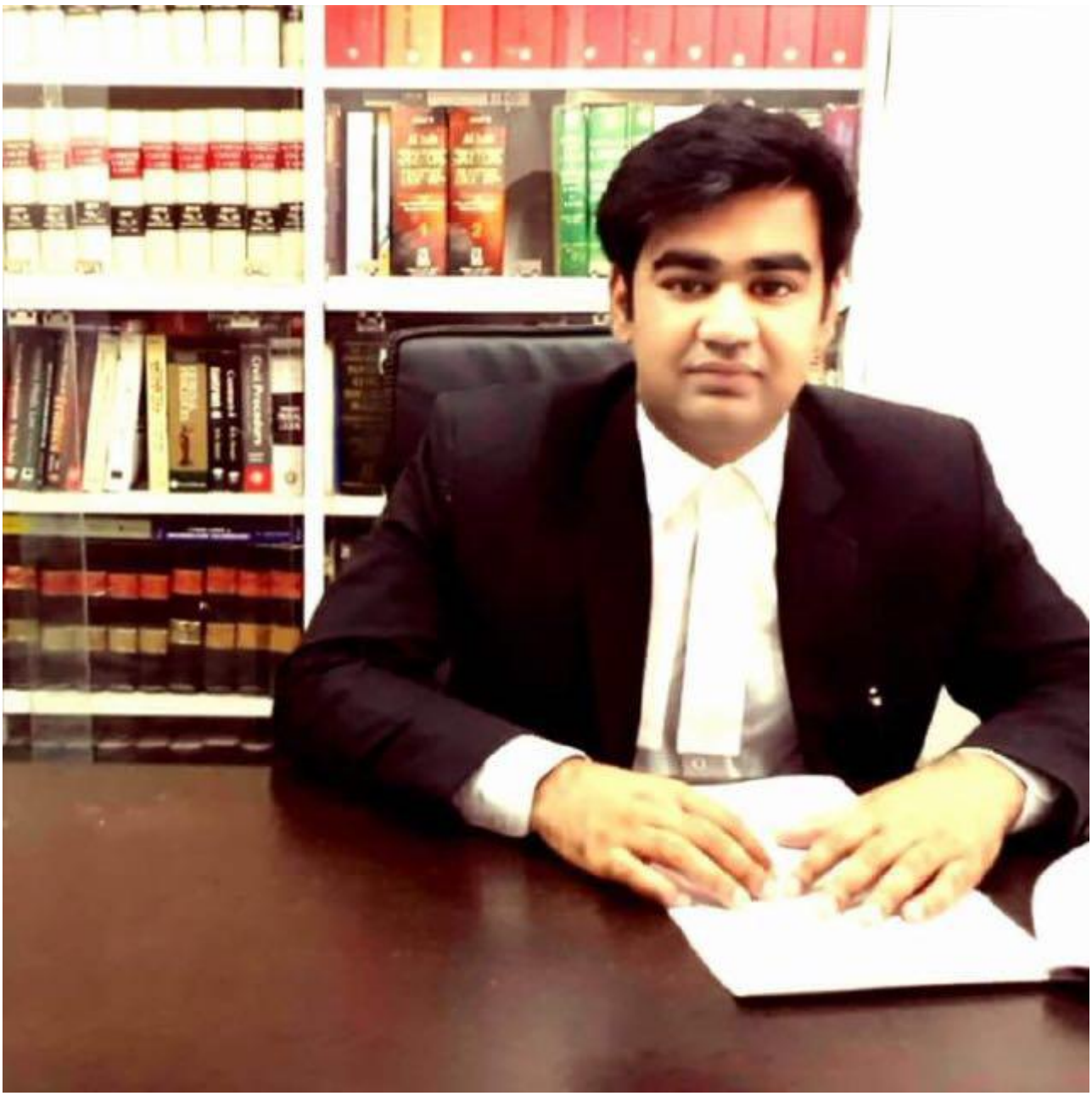

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Stressed Assets Resolution in India: Present and Future

Prelude

Stressed asset market in India of more than USD 150 Billion presents an enormous open door for financial specialists with various courses to take an interest either through the Indian Insolvency and Bankruptcy Code (“Code”) or through out-of-court modes. With Indian moneylenders confronting capital imperatives and expanded investigation by the Reserve Bank of India (“RBI”) on resource and asset quality, there is a solid requirement for capital inflows from outside India. The

stressed assets market in India offers large opportunities in the wake of a liquidity crunch and defaults by Indian corporates, however investors are still finding it difficult to explore the ecosystem as several issues are yet to be settled. The passage of worldwide capital in this space can fortify the procedure dependent on best practices in progressively creating focused resource markets. Many distressed asset and special situation funds are gradually been setting up activities in India either through tie-ups with nearby accomplices or on an independent premise.

The recent Ease of Doing Business initiatives taken by the Finance Ministry of India as a piece of improvement bundle in the wake of flare-up of pandemic has put an embargo on the fresh proceedings under the Code for next one year coupled with an increase in the threshold of default from previous limit of One Lakh Rupee to One Crore Rupees with an intention to prevent cash-strapped companies from being forced into insolvency in light of instigated economic crisis.

Code which breezed through numerous litmus assessment defending its goal, inside a period length of three years turned into a viable yardstick for banks and financial institutions to resolve their long time pending bad loans and Non- Performing Assets ("NPA") and for corporates to resolve, reconstruct and revive after successfully dealing with their stressed assets. However, the pause introduced for temporary period on initiation of fresh proceeding will slow down this process of restructuring of stressed assets in India from domestic as well as global point of view. To ensure that the legal rest didn't further lead to the mounting level of bad debts and stressed assets in India, it is need of an hour to decently and decisively investigate each aspect of the restructuring options available on the table to distress the stressed assets that could be practiced in the interim.

Upfront Challenges on Board

Considering the solace that the banks and financial institutions felt while taking the doorway paved by the Code and the transitory suspension of their right to file for insolvency against the defaulting corporate debtor will further add a bottleneck to the process of distressing the bad assets in India meanwhile. As edgy time calls for frantic measures and sensible steps taken on restructuring front in this challenging environment will go a long way in overcoming the following stumbling blocks that exist today in the stressed asset market in India thereby making resolution a little cumbersome and time consuming process.

a. Dependency of investment prospects in stressed assets market on certainty of the law and process deployed.
b. Establishment of a sound market for ensuring free trade of stressed assets at an alternative price.
c. Existing bandwidth of judicial infrastructure.
d. Absenteeism of pre insolvency framework to counter the risks at rudimentary phase.
e. More call for improved corporate governance and disclosure requirement on corporates for timely disclosure of distress.
f. Degree of risk to the minority stakeholders having disproportionate power.
g. Lack of a credible information database on stressed assets.

Present Perspective on Restructuring

Taking into account the current vulnerability by the virtue of COVID-19 upheaval in each business perspective and to prevent bad loans from further piling up in this time of angst and season of

apprehension, banks and corporates need to come forward wilfully to work more co-operatively and to look for the choices still accessible to them to restructure their NPAs in light of the fleeting suspension to file for bankruptcy so as to ensure that restructuring and rebuilding in the present situation procures organic products in future also. The existing restructuring options available under different laws and framework are enumerated underneath.

a. **Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 ("SARFAESI") :** Though the right of filing insolvency petition against the defaulting corporates has been temporarily taken away from the secured creditors, yet secured creditors do have an option to exercise reconstruction of the stressed asset through the SARFESI route. By invoking these provisions, secured creditors have many right for enforcement of security interest under Section 13 of SARFAESI and are also entitled to take over the management of the stressed asset to realise the defaulted amount including interest.
b. **Inter Creditor Agreement ("ICA") :** In line with RBI Circular dated 7th June 2019 on "Prudential Framework for Resolution of Stressed Assets", Indian Banks Association came out with the concept of ICA which provides that in the situation where a resolution plan is to be implemented, all lenders have to enter into an ICA during the 30-day review period (given to lenders after the first default to decide on the resolution strategy and implementation) to provide for ground rules for finalisation and implementation of the resolution plan with respect to borrowers with credit facilities from more than one lender. ICA entered between lead lender and other lenders also covers provisions pertaining to the meetings of lenders, voting matters, payment to dissenting lenders and additional funding. Under ICA, lead lender put on table the proposed valuation methodology to compute the resolution value and the proposed resolution plan for voting before other lenders.
c. **Companies Act, 2013 ("Act") :** This Act provides for organic as well as non-organic modes of restructuring of a corporate entity. Organic modes provide for the restructuring wherein the company undergoes internal changes by way of capital restructuring/business restructuring via issuance of share capital, change in debt equity structure, right issue, issue of sweat equity shares, buy back of shares, employee stock purchase scheme etc. On other hand non organic mode provides for amalgamation or merger provided under Chapter XV of the Act (Section 230 to 240). The amalgamation includes reconstruction of company, transfer of whole or any part of undertaking, property or liabilities of any company to another company or companies, demerger of a company into two or more companies, amalgamation of small companies or of a 100 % subsidiary into its holding company and also the amalgamation of companies with foreign company. The sole objective of amalgamations is the combination of two or more companies and their resources, productions, supplied, skill and most importantly liquidity. In the era of fast changing world of globalisation, with the market demand and requirement of large size and capital, amalgamation also acts as tool to not only overcome losses but to also become global market players.
d. **Insolvency and Bankruptcy Code, 2016 ("Code") :** With Section 7,9 and 10 on standstill for a while, restructuring of an unhealthy company can still be carried out by way of Voluntary Liquidation as specified under Section 59 of the Code read with Insolvency and Bankruptcy Board of India (Voluntary Liquidation Process) Regulations, 2017. The formal process of converting all the assets into cash and paying off creditors and other stakeholders though brings the life of the company to an end but also prevent further deterioration in the value of its assets.
e. **SEBI Provisions –** As a prelude to non-organic restructuring, corporates often embark of acquisition of companies and then take steps to amalgamate or merge the acquired company or vice versa. Such acquisition could be friendly or agrees acquisition or compulsory

acquisition pursuance to law or a combination of hostile takeover and law both. The law relating to takeovers is provided under Companies Act, 2013 and SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. Under the Companies Act, 2013, the power of a company to acquire shares of another company is provided under Section 186. Apart from this Section 235 of the Act also provides for similar provisions in relation to transferee company acquiring shares from persons who did not sell or have not agreed to sell shares held by them, notwithstanding approval of the scheme.

The crucial obligation under the takeover regulations is the requirement to make an 'open offer' to the public shareholders of the target company upon a substantial acquisition of shares or voting rights or acquisition of control of the target company, directly or indirectly. In addition to the acquirer, the target company and the intermediaries are also saddled with obligations during an open offer. For instance the target company is not permitted to carry out certain corporate transactions during this period unless the approval of shareholders of the target company by way of a special resolution by postal ballot is obtained. The whole concept of Takeover resolves around offering an exit option to the public/minority shareholders in the event of change in shareholding or control of the target company.

Future Perspective on Restructuring

In light of past super examples like US Great Depression 1929, UK Financial Crisis 1976, Asian Financial Crisis 1997, Global Financial Crisis etc. restructuring laws and modes have experienced key changes in their individual locales and each time economies have risen out to be increasingly more grounded and productive while managing the difficulties and coming out with an out of box thoughts.

In the event that in the mean time ban on new filings of indebtedness in India can be glanced in a positive way, then this transitory space and time could be used to enhance the legal executive structure with melange of technology in the systems, working out more on qualitative regulations to remove existing glitches in the framework, upgradation of aptitude, skills and practice of the insolvency practitioners to make sure that with two steps backward on restructuring front today, India makes an extraordinary hop in restructuring and turnaround space tomorrow and subsequently rises out as one of the major restructuring hub of Asia. To make Indian insolvency framework robust with passing time and to provide fairly and squarely solution to every issue in distress market, following reforms are quintessential and may land up soon in Indian's distressed asset market.

a. **Pre-Pack Sales :** Considering USA and UK model, Pre-Pack Sale whenever introduced in India will be subset of pre insolvency resolution instrument thereby providing financial creditors and corporate debtor a superior platform to work in advance on the resolution strategy of the corporate debtor with the advise of an Insolvency Professional, before the filing of an insolvency petition under the provisions of the Code. Pre-Pack Sale is a corporate rescue tool that can result in change in the ownership of the business of the company along with continuity in the trade of the company and preservation of the employment of the company without compromising on the value of the business, relationship with stakeholders and goodwill of the company that has been built over the years. To make pre-Pack Sales a big hit, their acknowledgment under the Code with a characterized set of guidelines will be fundamental to insightfully handle the situations such as sale of business of the company to

the connected party or where nepotism towards secured financial creditors is more.

b. **Sectoral Resolution Schemes:** At present, maximum stressed assets lies in power and real estate sector followed by steel, telecom and textile sector. Considering present situation immense potential lies to turnaround aviation, hospitality and manufacturing segment too. Each sector requires explicit parameters to be catered to come out with a meaningful resolution. Such a scenario calls for sector specific relief package with the cooperation of regulators operating in different sectors and financial creditors to quickly work out on resolving the industry specific distress.

c. **Group Insolvency:** With group structures holding prominence in the business horizon of India, there is a need to outline a comprehensive framework on the subject of group insolvency. There are situations where the directors and promoters may boost their inclinations and the chance of restoration of organizations when companies which are part of vast group undergoes restructuring jointly. As of late, the need of such framework was acknowledged in the cases such as Videocon, Amtek, Educomp, Era Infrastructure, Lanco, Jaypee and Aircel, where extraordinary issues emerged from their interconnection with the group companies and when their exist no set of law, rules and regulations under the Code to deal with such situation. Adjudicating Authority and Hon'ble Supreme Court on their wisdom have passed few orders to partially redress the emerging issues; however feasible model on group insolvency need to be worked out at the earliest.

d. **Cross Border Insolvency:** Hailing back from the year 2000 different committees in India have advanced their report before the government accentuating the need to bring in place a robust framework to deal with the issues of cross border insolvencies in line with UNCITRAL Model Law on Cross Border Insolvencies.With globalization, the investment of different countries in India has also multiplied. With increment in global ventures in India, foreign nations should be given a protection, a sense of security and comfort that their investments are safe in India. Formal cross border insolvency laws is quintessential need of an hour to protect the rights of domestic as well as foreign investors. The upcoming model is expected to cover mechanism to ensure judicial cooperation between bankruptcy courts of different jurisdictions, developed theory of Centre of Main Interest, alignment with best international practices and reciprocal arrangements.

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