

Dispute Resolution Hotline

February 19, 2009

SUPREME COURT STAYS BAN ON DEBT-TRADING BY BANKS

The Hon'ble Supreme Court of India ("Court") vide its order in *ICICI Bank Limited v. Official Liquidators of Ms. APS Star Industries Limited & Others*, S.L.P. (Civil) No(s). 2240/2009 dated February 16, 2009 ("SLP") has temporarily allowed banks to trade in debt, pending final hearing of the SLP on April 14, 2009. The SLP is filed against the judgment of the Gujarat High Court ("Impugned Judgment") dated January 12, 2009 which had disallowed trading in debt by banks. In the instant case, ICICI Bank Limited ("Assignor Bank") executed a deed of assignment in favour of the Kotak Mahindra Bank Limited ("Assignee Bank") by which a basket of NPAs of the Assignor Bank along with underlying security interest, if any, were assigned/transferred on "as is where is" basis to the Assignee Bank at a defined purchase price ("Transaction"). Please refer to our Hotline dated January 28, 2009 ([Court disallows trading in NPAs by Banks](#)) for more information on the Impugned Judgment.

Standard Chartered Bank has also preferred a special leave petition before the Court against the Impugned Judgment since the eventual outcome of this SLP would be a *judgement in rem* and to that extent would severally affect such Transactions in general and not merely the Assignee Bank and the Assignor Bank. The Court has clubbed the hearing of all the three appealing banks viz: ICICI Bank, Kotak Mahindra Bank and Standard Chartered Bank ("Banks"). The Court allowed intervention of the Indian Banks' Association and the Reserve Bank of India ("RBI") as additional parties to the appeal moved by the Banks.

At an earlier hearing of the SLP on February 9, 2009, the Court had directed that no steps should be taken by the banks to implement the Impugned Judgment.

INTERIM ORDER:

The division bench of the Court headed by Justice S. H. Kapadia allowed the Assignee Bank, on furnishing of an undertaking, to participate in proceedings held by the Asset Sales Committee as also in proceedings before the Company Court. The Court directed that pending the final disposal of the SLP, repayments under the secured loans be made to the assignee of such loans (in the instant case, Assignee Bank). The Court has further directed the Assignor Bank and the Assignee Bank to furnish an undertaking that the debt-trading transactions, which they enter into during the pendency of the SLP, will be reversed if this SLP is finally dismissed. The Court noted that this order dated February 16, 2009 is required to ensure that the secured debtors of the assigned loans are not unrepresented. The Court made it amply clear that Court's interim order to allow banks to temporarily conduct business as usual should not be construed as an acceptance of the Transaction pending the present SLP.

ANALYSIS:

Though this order has proved to be a temporary relief for the Banks, the final judgment of the Court would certainly have extensive ramifications for the Asset Backed Securitization ("ABS") market in India, which is at a nascent stage. ABS market in India would take a huge impact, including risk of completely fizzling out, if this SLP is dismissed. ABS business is a global market practice and the judgment would reflect the way Indian banks can compete or do business on globally accepted norms. BASEL II (The international financial industry standard which requires financial institutions to maintain sufficient cash reserves to cover risk associated with financial operations) comprehensively lays down banking norms for securitization and the banks' requirement to maintain capital adequacy ratios.

It would also be interesting to see the submissions of RBI in this matter, since through its guidelines dated July 13, 2005 the RBI has laid guidelines for banks, FIs and NBFCs purchasing/ selling non-performing financial assets, from/ to other banks/FIs/NBFCs (excluding securitization companies/ reconstruction companies).

We will continue to keep you updated on the progress of this SLP.

- **Litigation & Dispute Resolution Team**

Source: <http://courtnic.nic.in/supremecourt/temp/dc%20224009p.txt>

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