

Insolvency and Bankruptcy Hotline

June 02, 2017

STRESSED ASSETS - RBI GRANTED SWEEPING POWERS

- Ordinance amends the Banking Regulation Act, 1949 empowers RBI to direct banks to resolve specific stressed assets and initiate Insolvency Resolution Process, as per the Insolvency and Bankruptcy Code, 2016.
- RBI amends Joint Lender Forum (*as defined below*) norms to accelerate the Corrective Action Plan for stressed loans.

As of December 2016, gross Non-Performing Assets (“NPA”) for public and private sector banks stood at a staggering figure of USD 10 billion (approximately). India has had a long-suffering history with bad loans which have handicapped the lending power banks and financial institutions and has adversely affected Ease of Doing Business in India.¹

In keeping with its aim to streamline the process of resolving stressed assets and with a larger endeavour to ensure ease of doing business in India, legislators and regulators have introduced changes to the Joint Lender Forum (“JLF”) norms and the Banking Regulation Act, 1949 (“Banking Regulation Act”). Nishith Desai Associates, continuing with its practice of highlighting important regulatory changes, is bringing you this alert which provides a brief overview of certain key regulatory announcements with our comments.

CHANGES INTRODUCED

(A) RBI can direct banks to initiate insolvency resolution process against specific stressed assets

The Banking Regulation (Amendment) Ordinance, 2017 (“Ordinance”) has been promulgated by the President of India with a view to give extensive powers to Reserve Bank of India (“RBI”) to issue directions to banks for resolution of stressed assets. The Ordinance introduced two new sections to the Banking Regulation Act, Section 35AA and Section 35AB which enable RBI to direct banks to commence the Insolvency Resolution Process against the defaulting company under the Insolvency and Bankruptcy Code, 2016 (“Bankruptcy Code”). The RBI has also been granted the discretion to set up one or more advisory/supervisory committees to advise banks on resolution of stressed assets.

(B) Thresholds for creditors’ consent needed for deciding the Corrective Action Plan (“CAP”) reduced

The “Framework for Revitalising Distressed Assets in the Economy – Guidelines on Joint Lenders’ Forum and Corrective Action Plan” (“JLF Framework”) was introduced in April, 2014 to revitalize distressed assets by focusing on early recognition of distress, introducing prompt steps for resolution and facilitating fair recovery for lenders.

Under the JLF Framework, before a borrower account is declared as an NPA, a JLF is formed to explore options under a CAP for the borrower to regularize the account to bring it out of its stressed state, or restructure the bad loan by seeking personal guarantees from promoters or in the event that neither of these options are viable, initiate recovery process. The objective of the JLF Framework is to revive stressed assets *before* they are classified as NPAs. The JLF could explore the following options for implementing CAP:

- Rectification:** this includes bringing in additional funding by promoters or existing lenders or any third party for regularizing the account;
- Restructuring:** this includes obtaining commitment from promoters by obtaining their personal guarantee. The lenders may also sign inter creditor agreement and require the borrower to sign a ‘debtor creditor agreement’ for effecting restructuring process;
- Recovery:** If (a) and (b) are not viable, the lenders may decide to proceed with the most suitable recovery process.

Following the Ordinance, the RBI introduced changes² to JLF Framework in an attempt to remove the practical challenges faced by lenders while forming a JLF and adopting the CAP by lowering the percentage of affirmative votes needed to finalize and implement the CAP. Under the previous JLF Framework, for implementing CAP, 75% of the creditors in value and 60% of creditors by number had to agree to the decision proposed by the JLF. As per RBI’s amendment, CAP can now be decided by an affirmative vote of a minimum of 60 % of creditors by value and 50 % of creditors by number, in the JLF.³

Additionally, in the same vein of facilitating speedier resolution of stressed financial assets, RBI has reiterated that dissenting lenders shall be allowed to leave the JLF. It has also stipulated that lenders must implement the decision of the JLF without any additional conditions. Banks have further been directed to empower their executives to implement the JLF decision without requiring any further approval from their respective board to ensure speedy implementation. Any non-adherence to timelines or instructions under the JLF Framework will attract monetary

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penalties on the concerned banks.

ANALYSIS

These recent developments are a welcome part of a larger exercise to carry out a comprehensive reform of the fragmented regime of insolvency and stressed financial assets framework. Prior to these developments and the enactment of the Bankruptcy Code, there were several laws and different forums for litigation which resulted in conflicts of jurisdiction, clogged forums and beleaguered debtors and creditors

Considering that RBI already has extensive powers granted to it under the Banking Regulation Act, the impact of the Ordinance will have to be tested in light of subsequent amendments which are expected to be brought by the Government in its attempt to curb rising number of NPAs. The Ordinance, as it is currently worded, seems to suggest that the applicability of Section 35AA and 35AB is limited to 'banking companies' as defined under the Banking Regulation Act and would thus not extend to non-banking financial companies. Further, the new amendments have not put to rest the issue of parallel claims in different forums. For example, a dissenting creditor to the JLF may exit the JLF or an operational creditor⁴ (who may not, in all cases be governed by the JLF Framework) may in parallel approach the NCLT to initiate an Insolvency Resolution Process upon occurrence of a single instance of default.

Such parallel attempts at resolution of distressed assets may only decelerate the resolution process. In such a scenario, a company may not be able harmonize divergent plans on resolution adopted by different creditors under separate regulatory frameworks.

Additionally, the conditions on which RBI may direct banks to commence insolvency proceedings have not been envisaged under the Ordinance. It is also unclear whether RBI would only approve the roadmap or plan of action presented by the bank before it or will actively participate in formulating such roadmap. Following the amendment, RBI has also made changes in the constitution of the Oversight Committee (constituted under the Scheme for Sustainable Structuring of Stressed Assets) to include more members to deal with the volume of cases referred to the Oversight Committee.

With a vastly new insolvency and NPA resolution landscape in place, it remains to be seen whether these measures would help unclog the system.

– Swati Sharma, Atikant Kaur & M.S. Ananth
You can direct your queries or comments to the authors

¹ *Global Financial Stability Report*, World Economic Forum, October 2016 – Ch. 1, Page 31 – “However, banking systems are vulnerable to further declines in growth or profits, particularly in countries at later stages of the credit cycle (such as India), where slowing credit growth and risks from elevated levels of nonperforming loans are most acute (see the October 2015 GFSR).”
² RBI Circular DBR.BP.BC.No.67/21.04.048/2016-17, dated May 5, 2017
³ However, under the IBC, financial creditors constituting 75% of the voting share of the Committee of Creditors have to approve the Insolvency Resolution Plan
⁴ Operational creditor as defined under Section 5(20) read with Section 5(21) of IBC

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