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Bankruptcy code: Baby-steps towards recovery of bad loans

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THE HINDU BusinessLine

Challenges ahead: All eyes are on banks to see if they will take the plunge and accept the haircuts

Bargain-hunters on the prowl for big assets, but huge haircuts hang over banks

NEW DELHI, DECEMBER 26

A lot of hope is pinned on the Insolvency and Bankruptcy Code (IBC) to provide the much-needed cure to all the ills in the banking system.

Year 2017 was eventful when it came to taking the initial steps in loan recovery. The Reserve Bank of India's first list of 12 large defaulters — who in aggregate owed Rs.2.6 lakh crore to the banking system — has been able to draw the attention of buyers, including global investment funds. These 12 accounts constituted 25 per cent of the gross non-performing assets (NPAs) in the banking system.

The reason for excitement among buyers for the assets referred to the National Company Law Tribunal (NCLT) is not far to see. They hope to bag great bargains, as India goes about setting its stressed assets house in order. The idea is to get hold of good assets at a fraction of the costs of building new ones. Aiding the buyers in this quest has been a controversial government decision to keep out existing promoters from bidding for the stressed assets. The silver lining is that the existing promoters could bid if they repay the dues to the banking system, which is a tough ask.

According to a recent Motilal Oswal Securities report, tightening the eligibility norms in bidding for stressed assets might lead to higher haircuts for banks in the short run. However, in the long run, it would prevent the re-entry of wilful defaulters in the system and promote transparency, it added.

Interested buyers

From London-based Arcelor Mittal, Korea's POSCO, Blackstone, TPG Capital to domestic biggies like the Tata Group, Mumbai-based Shapoorji Pallonji Group, Ajay Piramal-controlled Piramal Enterprises and Sajjan Jindal's JSW Steel, there is now a good line-up of interested buyers for the stressed assets/companies referred to the NCLT under the insolvency process.

In India, the total outstanding amount for top 50 stressed borrowers, funded by scheduled commercial banks, stood at Rs.3,72,379 crore as on September 30, 2017, according to the RBI.

Banks' haircuts

The main issue is how are banks going to play the insolvency game. Rather than holding on to stressed assets in their balance sheets, will they be ready to take big haircuts? The grapevine in the market is that many prospective buyers are looking for an average 50 per cent haircut in large cases. All eyes are on banks to see if they would take the plunge and accept the haircuts.

Of course, the buyers' response has been good only for large corporates. There are few takers for small and medium companies.

Going by the recent case of resolution at Murli Industries, banks had to settle for as high as 75 per cent haircut, which is not a happy situation for the lenders.

However, Pawan Agrawal, Chief Analytical Officer, Crisil, felt that the quantum of haircuts were more a function of specific cases. High haircuts may be reflective of lower economic value and viability of the businesses being referred, rather than it being a reflection of the IBC process, Agrawal said. "In future, once the resolution process is initiated early, the haircuts are expected to be lower," he said. Tarun Bhatia, Managing Director, Kroll, a global risk consulting firm, said that ultimately recovery for the banks will be market determined and "we anticipate meaningful write-offs".

He said these are early days for the IBC and one needs to see how many accounts achieve meaningful resolution or successful liquidation.

Meanwhile, the Motilal report highlights that haircut at 70 per cent of net stressed loans can impact net worth of lenders by 37-100 per cent. Private banks are better placed than PSU banks in terms of capital availability to absorb such potential losses. However, the government's recapitalisation plan will enable the PSU banks to make necessary provisions towards such assets, according to the report.

Some visibility

By April 2018, there should be some visibility on how the entire IBC process is moving, said an economy watcher. Metal (mainly steel) and power assets form bulk of the cases referred to the NCLT (45 per cent in the RBI's two lists taken together). Healthy recovery in these sectors are critical to assess the success of the NCLT route.

One of the many challenges faced in resolution of accounts under IBC is the RBI's norm of classifying interim debt as standard, which will encourage bankers to go for interim lending in case of operating companies witnessing cash crunch, and thus, help them make a turnaround. Crisil's Agrawal said that 2018 will be a critical year where one would get to know the effectiveness of the IBC, especially about the key expectation of a time-bound resolution. In particular, progress in resolution of large NPAs referred by banks can materially change the asset quality picture of banking system, according to Agrawal.

"2017 can be considered as an initial phase of implementation of an effective IBC in India. Even as the rules, infrastructure, and skills of Insolvency Resolution Professionals are falling in place, the number of cases initiated under the code have gathered pace. Even in this initial phase, the IBC has restored the much-needed balance between lenders and borrowers," Agrawal added.

Litmus tests

According to Kroll's Bhatia, 2018 will be a critical year as IBC will be tested for: i) Can promoters really be kept out despite the recent ordinance disallowing them from participating? ii) Will IBC be as relevant for mid and small accounts? iii) Who will be held accountable for the write-offs. Will the borrower/defaulter be tried for fraud?

"With promoters being kept out, as of now we see only the top 25-50 accounts having meaningful outside interest," Bhatia said. Pankaj Dutt, Managing Partner, Alexander Hughes, a global executive search firm, said the Indian banking system could have avoided the current NPA mess had public sector banks given enough attention to the 'risk management' function and focused on having a chief risk officer at a level next to the board.

Bar on wilful defaulters not a moral issue: IBBI chief

PRESS TRUST OF INDIA NEW DELHI, DECEMBER 26:

MS Sahoo, Chairman, IBBI

Keeping out wilful defaulters from bidding for stressed assets is not a “moral issue”, but a choice between certainty and uncertainty, IBBI Chairman MS Sahoo has said.

His comments come against the backdrop of the government, through an Ordinance last month, barring wilful defaulters from bidding for stressed assets under the Insolvency and Bankruptcy Code (IBC).

To introduce Bill

The government will be introducing a Bill this week in Parliament to replace the Ordinance.

Asked whether barring wilful defaulters would narrow the universe of bidders for stressed assets, the IBBI chief replied in the negative. “If we keep undeserving people out of the system, it is not a moral issue,” Sahoo told PTI in an interview. The Insolvency and Bankruptcy Board of India (IBBI) is implementing the Code, which came into force late last year.

Noting that such a move does not narrow the universe of bidders, Sahoo said the issue of wilful defaulters is an economic issue, “which we call moral hazard”.

“The choice is between certainty and uncertainty. Do we go with a person who has a credible record and is likely to deliver or go with a person who does not have a credible record and is unlikely to deliver?” he said.

Act a safeguard

The Ordinance aims at putting in place safeguards to prevent unscrupulous people from misusing or vitiating the provisions of the IBC, the government had said in a statement last month.

“The amendments aim to keep out such persons who have wilfully defaulted, are associated with non-performing assets, or are habitually non-compliant and, therefore, are likely to be a risk to successful resolution of insolvency of a company,” it had said.

The Ordinance to amend the Code was issued amid concerns that a defaulting promoter could wrest back control of the company that is under insolvency even as banks take a hit on the loans.

Bad loans take centre stage in banking industry

K RAM KUMAR MUMBAI, DECEMBER 25: BUSINESSLINE

Less risky option: As large and mid corporate loans continued to turn sour, risk-averse banks pushed less risky retail loans, such as home and auto loans

Policy to deal with NPAs, and the passage of FRDI Bill, will shape sector in 2018

Banks had to go through the mill in 2017. Bad loans, and provisions towards them, dented the balance sheets of most public sector banks (PSBs) and a few large private sector banks. Also, the RBI imposed regulatory sanctions under the prompt corrective action (PCA) framework on a host of stressed PSBs, with restrictions being placed on their management and activities, to ensure that they are nursed back to health.

All this happened amidst credit growth hitting multi-year lows. This in turn magnified the bad loans problem.

Surplus liquidity due to huge deposit accumulation during the demonetisation period, coupled with a lack of credit appetite for most part of the year, triggered deposit and lending rate cuts without the central bank having to do much by way of rate cuts. Retail term deposits of over one year duration declined by about 50 basis points.

Fall in lending rates

The fall in lending rates (which declined almost 100 basis points), however, held no lure for corporates as they were still grappling with excess capacities. Those in a position to borrow, especially in the blue chip category, resorted to the bond markets.

As large and mid corporate loans continued to turn sour, risk-averse banks went all out and pushed less risky retail loans — home and auto loans — and were successful in this endeavour.

Farm loan waivers announced by States such as Uttar Pradesh, Punjab, Maharashtra and Karnataka became a cause for concern both for banks and the RBI, as it could undermine credit discipline, increasing the possibility of reduced credit flows to this crucial sector.

Stress likely to reduce

The RBI, in its financial stability report (FSR), cautioned that as per its stress tests, the gross non-performing assets (NPAs) of the banking sector may go up to 10.8 per cent by March 2018 (from 9.6 per cent in March 2017 and 10.2 per cent in September 2017) and further to 11.1 per cent by September 2018. RBI Deputy Governor NS Vishwanathan observed that the overall risks to the banking sector arising from asset quality concerns continue to persist.

Bankers, however, are hopeful that once the 40 large bad loans with exposure aggregating about ₹3.50 lakh crore are tackled under the Insolvency and Bankruptcy Code (IBC) process, and the economy picks up, they could get on with their core business of lending with more vigour in 2018.

They see either resolution or liquidation coming through by April 2018 in the case of the first set of 13 RBI-identified large corporate accounts, which have been proceeded against under IBC. By September 2018, the same would have been happened in the case of the second set of 28 large corporates.

Capital injection and PCA

Moreover, the proposed ₹2.11-lakh crore capital infusion (recapitalisation) into PSBs is expected to galvanise them into action — lend and closely monitor loans for signs of incipient stress.

RBI Governor Urjit Patel has observed that recapitalisation will set up a calibrated approach whereby banks that have addressed their balancesheet issues, and are in a position to use fresh capital injection for immediate credit creation, can be given priority while others shape up to be in a similar position. This is expected to bring market discipline into a public recapitalisation programme.

With almost 10 PSBs being put under the PCA framework, there was intense speculation that many of them would be merged with stronger banks.

The RBI promptly scotched reports of closure of these banks.

Referring to the performance of banks in FY17, the FSR said operating expenses slowed down on account of rationalisation of branches and manpower. The RBI also observed that increasing focus on the business correspondent model has resulted in a steady decline in new brick-and-mortar branches. In FY17, newly opened branches declined by more than 30 per cent. A disconcerting feature, according to the banking regulator, is that 45 per cent of the new branches were opened in tier I centres. A declining proportion of the branches were opened in tier VI centres (population less than 5,000) in recent years.

The Financial Resolution and Deposit Insurance (FRDI) Bill, 2017, became a hot button issue due to concerns that depositors' money may be on the line if a bank goes belly up in the future. In the wake of these concerns, this Bill, which was approved by the Union Cabinet in June 2017 for introduction in Parliament, was referred to a Joint Parliamentary Committee.

While the RBI and the Centre have rescued (bailed out) distressed commercial banks from collapsing by merging them with other banks in the past, the bail-in clause in the FRDI Bill has stoked fears that depositors will lose their money should their bank go down the chute in the future. The last commercial bank to go into liquidation was Kerala-based Palai Central Bank in the early 1960s. Finance Minister Arun Jaitley has sought to allay such fears.

The year ahead

Bankers hope that once recapitalisation (in the case of PSBs) comes through over the next few months, the aforementioned 40 large bad loans are out of the way, and the economy gathers strength, banks will shrug off risk aversion and proceed full steam ahead on the lending front.

They see credit demand coming in, among others, from the retail and infrastructure segments. On the deposits side, the declining trend in deposit rates could reverse after a couple of quarters as banks may need to mobilise deposits to meet credit demand.

Changes, challenges ahead for Insolvency and Bankruptcy Code

MONISH PANDA
AMIT BHATTACHARYA
December 26, 2017

THE HINDU BusinessLine

The year 2017 was a watershed year for the Insolvency and Bankruptcy Code (IBC) which was notified in late 2016. The first insolvency petition was filed by ICICI Bank in December 2016. It was foreseeable that this laudable and long-overdue legislation, would undergo its share of trial by fire throughout 2017.

In the case of Innoventive Industries, the Supreme Court held that once an interim resolution professional (IRP) takes charge of the insolvent company, the directors lose any right to prefer an appeal on its behalf.

The judgment in Mobilox Innovations removed all ambiguities regarding the extent to which the Adjudicating Authority can investigate the veracity of a "dispute" for the purposes of a notice under Section 8. In Macquarie Bank,the Supreme Court made a purposive interpretation while empowering an advocate to send a demand notice on behalf of an Operational Creditor.

In Lokhandwala Kataria Construction, NCLAT held that, under IBC, financial creditors cannot withdraw insolvency application by mutual settlement after admission, to the detriment of the interests of other creditors.

However, the Supreme Court, exercising its inherent powers under Article 142, allowed such withdrawal pursuant to mutual settlement between the parties.

In June, the RBI issued a press release asking banks to initiate insolvency proceedings against 12 large corporate debtors who cumulatively owed a debt of 1.9 lakh crore.

Essar Steel challenged the circular before the Gujarat High Court which was ultimately dismissed. But the RBI, in the meanwhile, amended the press release where it had asked the NCLT to accord priority to the12 firms.

While the matter is pending resolution, one interesting twist was the challenge by home buyers to the insolvency proceedings against Jaypee, before the Supreme Court. The Supreme Court has now undertaken the exercise to restore equity in favour of the home buyers by ensuring them refund of money or delivery of homes.

August witnessed the approval of the first insolvency resolution scheme by the NCLT in the Synergies-Dooray Automotive case.

Ordinance passed

In November, the Insolvency and Bankruptcy (Amendment) Ordinance was passed which prevented promoters of an insolvent company from bidding for the assets of the same. This was challenged before the Punjab and Haryana High Court by RMS Pvt Ltd and other debtors before various high courts. In December, in Unigreen Global and Leo Duct Engineers case, the National Company Law Appellate Tribunal (NCLAT) held that the Adjudicating Authority, while admitting a Section 10 Application for voluntary insolvency resolution, cannot go beyond the records which had to be submitted in Form 6 (Rules).

RCom now faces an insolvency petition filed by China Development Bank. Also, according to the RBI mandate, banks will refer 24 more stressed accounts for insolvency resolution.

Year 2018 promises to be full of interesting developments vis-à-vis the IBC, particularly on the fate of the Insolvency Ordinance, fruition of the insolvency proceedings of the 12 large debtors, further developments in the Jaypee and RCom cases and what would be the fate of the 24 accounts identified by the RBI.

According to news reports, the government plans to make further amendments to the IBC. This development will also be interesting.

Countering growing inequality

Pulapre Balakrishnan

DECEMBER 27, 2017

THE HINDU

Indian social policy must raise health and education levels all around, as China has done

The release recently of the ***World Inequality Report*** 2018 has brought into focus an aspect of economic progress in India. This is the continuous growth in inequality here since the mid-1980s. To grasp this, consider the reported finding that the top 1% of income earners received 6% of the total income in the early 1980s, close to 15% of it in 2000, and receives 22% today. As this is a report on a global scale, we can see the trend in inequality across the world, providing a comparative perspective across countries.

In particular, it enables a comparison of economic progress made in India and China. This is not flattering of India. Since 1980, while the Chinese economy has grown 800% and India's a far lower 200%, inequality in China today is considerably lower than in India. The share of the top 1% of the Chinese population is 14% as opposed to the 22% reported for India. The authors go on to emphasise that growing inequality need not necessarily accompany faster growth, observing that inequality actually declined in China from the early 21st century. By then China had grown faster for longer than most countries of the world ever did.

Basket of indicators

The findings in the ***World Inequality Report*** serve as grist to the mill that is the study of the progress of nations. But before we proceed to reflect on them we may pause to consider their underlying methodology. First, the results are based on the share of top incomes. This is not invalid but some of the findings may alter if we adopt measures of inequality that characterise the entire distribution. To be precise, the inequality ranking of China and India may now reverse. But this need not hold us back as it is evident that China's performance is far superior all round to that of India.

China has grown faster, has far lower poverty and far higher average income, and its income distribution is less unequal at the very top. The World Development Indicators data released by the World Bank show that per capita income in China was five times that of India in 2016 while the percentage of the population living on less than $1.90 a day was about 10 times less at the beginning of this decade. India has a forbidding gap to traverse in all directions, but for now let us focus on inequality.

It is the comparative perspective contained in the Report that makes it useful. India-based researchers have for some time now pointed out that the country is becoming less equal since 1991. Also, we need not turn to the experience of China to recognise that growth need not be unequalising. We know independently that inequality in India declined for three and a half decades since 1950 even as the economy grew steadily, though maybe not spectacularly. It is important to comprehend this outcome if we are to understand the source of inequality in India, not to mention why India lags China.

Now, is a comparison of the progress made in China and India meaningful at all? Yes it is, for though representing different political systems, they had both been large agrarian economies at similar levels of per capita income when they had started out in the early 1950s. Moreover, the absence of democracy in a society does not by itself guarantee faster economic growth and greater income equality. For a populous poor country to lift itself to a higher growth path and stay there requires imaginative public policy and a steady governance. We can see this in the divergent economic histories of North and South Korea. So what is it that China did better than India?

The Chinese clue

If there is to be a meta narrative for China's economic development, it is that its leadership combined the drive for growth with the spreading of human capital. Human capital may be understood as a person's endowment derived from education and robust health. When a population is more or less equally endowed, as it was in China when it began to draw ahead, the human capital profile of a country may be represented by a rectangle. Now the returns to labour would be relatively equal compared to the country in which the distribution of human capital is pyramidical, which is the case for India. To see the latter better, note that the share of the Indian population with secondary schooling is less than 15%. China had by the early 1970s achieved the level of schooling India did only by the early 21st century. The spread of health and education in that country enabled the Chinese economy to grow faster than India by exporting manufactures to the rest of the world. These goods may not have been the byword for quality but they were globally competitive, which made their domestic production viable. The resulting growth lifted vast multitudes out of poverty. As the human capital endowment was relatively equal, most people could share in this growth, which accounts for the relative equality of outcomes in China when compared to India. An ingredient of this is also the greater participation of women in the workforce of China, an outcome that eludes India.

While concluding this brief account of China's progress, two points may be made. China is no exception to the general history of progress made in East Asia, right down to the authoritarianism, only that China has remained even more authoritarian. This makes it appropriate to term progress in the country as growth through human capital-accumulation for there can be no human development without democracy, whatever may be the health and educational attainments of a population. Recent revelations suggest that the massacre of pro-democracy protesters at Tiananmen Square in 1989 was far greater than believed to be.

This brings us back to India. India has lower per capita income, persistent poverty and by all accounts rising inequality. It may be said in the context that economic progress here has been neither efficient nor equitable. Democracy per se cannot be held responsible for this. There are States in India with superior social indicators than China. This shows that not only is democracy not a barrier to development but also that similar political institutions across India have not resulted in same development outcomes across its regions. Nor can we remain complacent that democracy is combined with superior social indicators in some parts of India when income levels are lower here than what China has demonstrated is achievable.

Deepening democracy

Given the growing inequality in India, the direction that public policy should now take is evident. There is need to spread health and education far more widely amidst the population. India's full panoply of interventions, invariably justified as being pro-poor, have not only not spread human capital, but they have also not been able to prevent a growing income inequality.

A ritualistic focus on the trappings of democracy, from frenetic election campaigns to stylised skirmishes in the legislatures, has not worked to deliver its promise. We now need to reorient public policy so that the government is more enabling of private entrepreneurship while being directly engaged in the equalisation of opportunity through a social policy that raises health and education levels at the bottom of the pyramid.

Public Sector Banking and the Unmet Expectations of Rural India : Article written by Com C H Venkatachalam, General Secretary, All India Bank Employees Association and published by **The Hindu Centre for Politics and Public Policy.** Full article can be accessed with the following link:

http://thehinducentre.com/the-arena/current-issues/article9998934.ece

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AIBEA THIS DAY – 28 DECEMBER	
1977	Four hours strike: 3rd Bipartite Agitation.
1978	Strike Action: 3rd Bipartite Agitation.
2009	9th B P Talks with IBA

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