

Our viewpoint: India

Overview

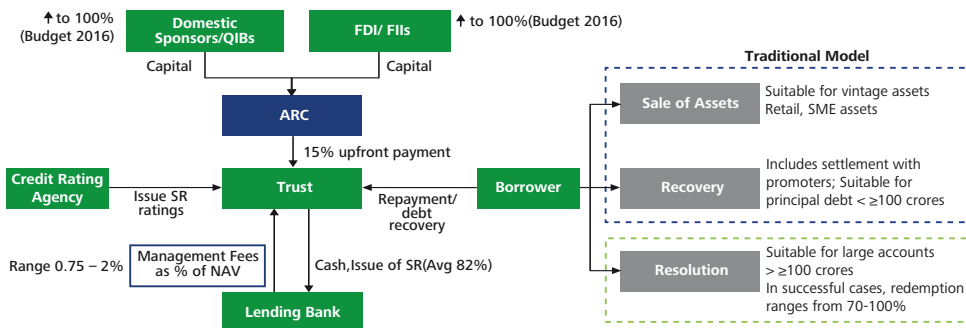
The Indian banking sector has traditionally not been aggressive in recognising and impairing stressed assets. This resulted in a ballooning problem in recent years on account of the global slowdown and deteriorating asset quality in sectors like steel, infrastructure and textiles. The Reserve Bank of India (RBI) is seeking to remedy the situation after finding major instances of under-recognition of provisions in Indian banks. Recent measures by the RBI to get banks to correctly classify and provide for loans has resulted in the Indian banking sector seeing a significant increase in stressed assets by c100% from 2013 levels to an estimated \$150bn in 2016.

In recent years the RBI has introduced a number of reforms to manage stressed assets, in an effort to counter the impact on bank profitability and, in turn, the real economy. Over the past year, the RBI has stepped up pressure on the banks to take action against delinquent debtors. The RBI also demanded the banks make adequate provisions for their troubled loans, whether or not they are formally classified as non-performing, by the end of March 2017.

Asset Reconstruction Companies (ARC): not adequately geared to deal with the issue

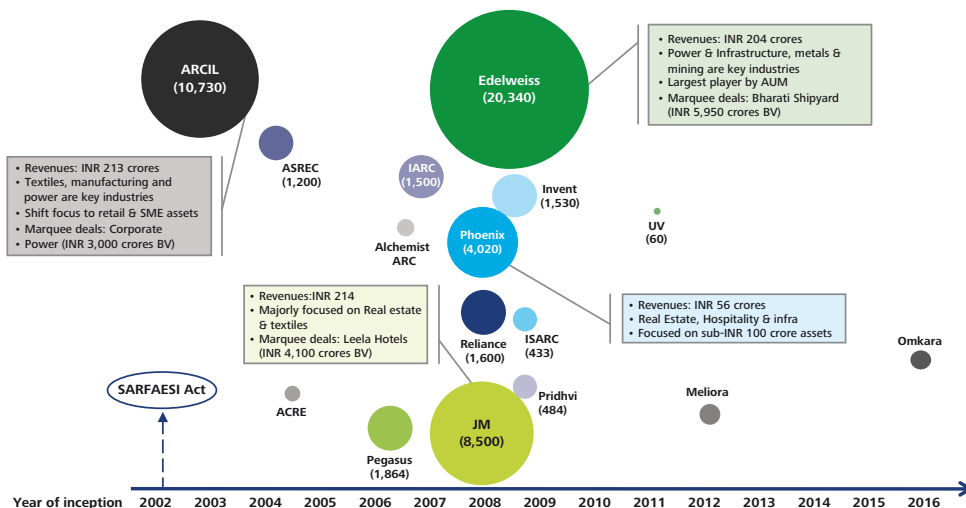
ARCs were created as a result of the passage of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, (SARFAESI Act) to maximise recovery from the NPL assets through dedicated and experienced work-out skills. Unlike in international markets where arms-length loan portfolio sales are common, the Indian market has seen a significant transfer of asset to the ARCs as the statute allows for de-recognition on transfer and predominantly transacts through the issue of security receipts (SRs).

Typical ARC transaction structure



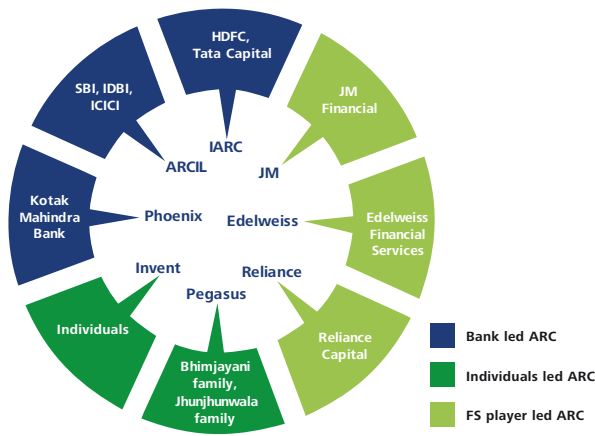
Last 14 years have seen 16 entities being licensed by the RBI. The Asset Reconstruction Company (India) Limited (ARCIL) was the first one to be set up and Edelweiss currently has the largest assets under management. Despite the number of entities the current capacity of the balance sheets of the ARCs is insufficient to absorb material levels of distressed assets from the banking the system.

There have been a number of changes proposed by the RBI to increase the transparency in acquisition and management of the stressed assets by the ARCs. These include an increase in cash component required for acquisition from 5% to 15%, reduction in stipulated time to formulate a restructuring plan from 12 months to 6 months and stricter basis for calculating the management fee. All of these changes are aimed to incentivise the ARCs to improve recoveries from the troubled assets.



Note:

- The size of the coloured bubbles and number in the brackets in INR crores corresponds to the AUM (at acquisition price) of the ARC.
- The ARCs indicated by grey coloured bubble have inadequate market data, Deloitte analysis.



The Department of Industrial Policy & Promotions has recently issued notification increasing foreign direct investment in ARC to 100%. The recent shift in the regulatory environment has led to a number of domestic and international investors applying to the RBI for licenses to start ARCs. Prominent amongst these are JC Flowers & Co in partnership with Ambit, Eight Capital and a large real estate developer. These and other investors with specialist restructuring/turn around capabilities will look to aggregate debt and implement turn around strategies (including under the Strategic Debt Restructure route) to enhance recoveries.

Regulatory shift

The Government of India and the RBI have enacted several reforms and new regulations in a bid to create a structure to deal with the increasing problem of NPAs. These include:

- RBI has taken steps to make transaction between Banks and ARCs more transparent to ensure value to Banks can be maximised.
- An increase in Foreign Direct Investment in ARC from 49% to 100% under automatic route – increased capital base for ARC to buy more assets.
- Proposals to allow domestic non institutional investors to invest in SRs issued by ARCs and allowing FII and FPI to invest upto 100% in the SRs.
- ARCs can now buy and sell loans with other ARCs which is expected to facilitate debt consolidation.
- Consent threshold for enforcement has been reduced from 75% to 60%.
- Management fee is now based on NAV of SR as opposed to the gross outstanding value of SR.
- RBI has allowed sale of sub-standard accounts to ARCs, against an earlier ruling not allowing a sale before two years of ageing of NPA.
- Reforming Bankruptcy procedures

The Insolvency and Bankruptcy Bill: Bringing Indian Insolvency practices in line with global practices

India has one of the lowest recovery rate for creditors in cases of default (20% of value of debt on NPV basis as per the Bankruptcy Law Reform Committee).

Currently, for instances of default, there are multiple mechanisms that exist for the recovery of dues for creditors, including SARFAESI, Debt Recovery Tribunal (DRT), Board for Industrial and Financial Reconstruction, filing of a civil suit, liquidation under the Companies Act and non-judicial forum of Corporate Debt Restructuring (CDR) / Joint Lender Forum (JLF) / Strategic Debt Restructuring (SDR). The various mechanisms are governed by different regulations and regularly come for review to the judicial system due to ambiguity on jurisdiction, compounding the delays.

To address the situation insolvency procedures have been proposed by the Bankruptcy Law Reform Committee formed by the Finance Ministry. The Insolvency and Bankruptcy Bill (Bill), 2016 seeks to become an overarching legislation that provides creditors with the means to enhance recoveries from debtors not least by reducing time to resolution. The Bill was passed by the Lok Sabha (lower house of the Indian parliament) on 5 May 2016 and by Rajya Sabha on 11 May 2016.

Overview of Bankruptcy Bill

Existing Legal System

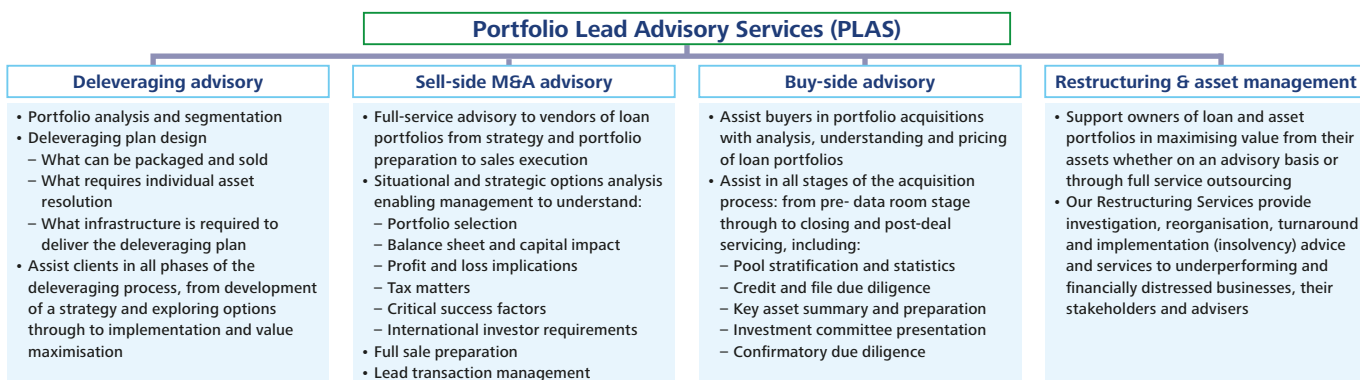
Overlapping jurisdictions	SARFAESI Act, DRT, BIFR, SICA, liquidation under Companies Act and non-judicial forums such as CDR/JLF/SDR	"Time taken to resolve insolvency in India is 4.3 years as opposed to 0.8 in Singapore" World Bank
No single regulator	Cases decided by the above regulations regularly come for review to the High Court due to ambiguity on jurisdiction, creating further delays in the recovery process	
Official Liquidators	Court appointed official liquidators over-burdened with cases, cause delays in distribution of assets of the insolvent debtor	

Proposed Bankruptcy Bill

Unified Code	Single code to address insolvency for companies, limited liability partnerships, partnership firms and individuals	<div style="border: 1px dashed black; padding: 5px; margin-bottom: 5px;">Early identification of distress</div> <div style="border: 1px dashed black; padding: 5px; margin-bottom: 5px;">Time bound resolution and liquidation</div> <div style="border: 1px dashed black; padding: 5px; margin-bottom: 5px;">Clears ambiguity on rights of various stakeholders</div> <div style="border: 1px dashed black; padding: 5px;">Might affect sale to ARCs; internal resolution by banks/sale to AIFs/NBFCs</div>
Adjudicating Authority	National Company Law Tribunal (NCLT) for Corporates and LLPs, and DRT for Individuals and other Partnership firms	
Insolvency Regulator	Insolvency and Bankruptcy Board of India to be setup	
Insolvency Professionals	Registered Insolvency Professionals will can act as Resolution Professional, Bankruptcy Trustee and Liquidator	
Resolution Process	Speedy resolution process prior to liquidation to revive the company with a timeline of 180 days which can be extended by another 90 days	
Information Utilities	Information repositories that collect, collate, authenticate & disseminate financial information from listed companies, financial & operational creditors	

Portfolio Lead Advisory Services



Maximising value in non-core and underperforming assets



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- The core senior team has advised governments, financial institutions, regulatory authorities and global private equity firms on deleveraging and loan portfolio transactions across every major asset class covering over \$300bn of assets, with over \$50bn in Asia.
- All senior team members have more than 20 years of experience as both advisors and principal investors in loan portfolios in both Europe and Asia and hence bring a unique perspective to advising clients on portfolio acquisition and divestment.
- The core PLAS team is supported by a dedicated network of over 140 professionals globally, ensuring the ability to act both domestically and cross-border. A delivery model that leverages extensive international experience combined with deep, local market insight.

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 <p>Project Churchill: Successful sale and completion of a £2.6bn CRE portfolio in the UK.</p>	 <p>Project Horse: Buy side advisory to acquire a €2.5bn loan portfolio in the UK.</p>	 <p>Project Consum.it: Buy side advisory to acquire a €1.3bn unsecured loan portfolio in Italy.</p>	 <p>Project Aran: Buy side advisory to acquire a €5.6bn CRE and residential loan portfolio in Ireland.</p>
 <p>Confidential: Buy side advisory to acquire a €2bn corporate loan portfolio in Italy.</p>	 <p>Project Bisonte: Buy side advisory to acquire a loan servicing platform in Spain.</p>	 <p>Project Adelaide: Successful sale and completion of a €850m CRE loan portfolio in Germany.</p>	 <p>Project Sagres: Successful sale and completion of a €250m SME loan portfolio in Portugal.</p>

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