Bolstering ARCs

Focus on quicker resolutions and co-investor model among imperatives

August 2019
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Message from CRISIL

All eyes are on resolution of stressed assets as India sets sights on becoming a $5 trillion economy. Achieving the vaunted goal would be difficult unless the huge investment locked up in these assets is released.

In the context, the importance of asset reconstruction companies (ARCs) cannot be reiterated enough.

In recent years, an enabling regulatory framework – including the Reserve Bank of India's (RBI's) resolution framework and the Insolvency and Bankruptcy Code (IBC) – has paved the way for attracting investors into the stressed-assets space and helped speed up resolution.

To be sure, up till 2013, the stressed assets space only had the ARCs, though it wasn't until the second half of fiscal 2014, when banks got a regulatory nudge to clean up their balance sheets, that ARCs really took off.

Today, this space has evolved into an entire ecosystem, with a diverse set of investors, and improved recovery rates & resolution timelines. Our estimates indicate the Indian banking system’s gross non-performing assets (NPAs) will come down a notch to Rs 9.1 lakh crore by the end of this fiscal, from Rs 9.4 lakh crore a year ago.

All this spells a huge opportunity for the asset reconstruction space.

If anything, some of the expectations set when the IBC was first introduced still need to be met.

Recent revision to the RBI guidelines and amendments to the IBC will, hopefully, be a shot in the arm for the industry. In the revised regulatory regime, and given the trend of higher cash deals, access to a multi-platform ecosystem will be critical for growth of ARCs. Also, while there is a lot of investor interest, ironing out issues regarding legal aspects and resolution timelines will be critical to boost investor confidence.

Gurpreet Chhatwal
President, CRISIL Ratings
Message from ASSOCHAM

Asset reconstruction companies (ARCs) were created under a central legislation, namely the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI Act), to resolve non-performing assets (NPAs) of the financial sector and play a significant role in creating an ecosystem to develop a vibrant debt market. While the SARFAESI Act empowered banks/FIs to repossess and liquidate assets of defaulting companies, ARCs were envisaged as an infrastructure to resolve and recover from NPAs either through asset reconstruction/revival or through asset liquidation. Despite the limitations, ARCs have addressed NPAs worth over Rs 2 trillion and have turned around several small and large cases back to health and added value to the economy.

During the last 2-3 years, several steps have been taken by the government and RBI to resolve growing stress in the financial system, such as IBC, revised stressed asset resolution framework by RBI, etc. Despite these measures, barring a few large assets, most stressed assets have either no strategic buyers, or buyers want to acquire the asset for throw-away prices. Many of these assets are moving towards liquidation. ARCs can play a significant role in ensuring that these assets become operational and are sold at a better value at an opportune time for the benefit of lenders and other stakeholders.

Given the Hon'ble Prime Minister’s target for making India a $5 trillion economy, the role of ARCs becomes significant in providing the necessary impetus to core sectors such as engineering, infrastructure and utilities which can contribute to overall economic growth.

To address the key issues, opportunities and challenges in India’s stressed asset segment, the ASSOCHAM with the support of industry leaders has organised the National Summit on Asset Reconstruction with the theme, ‘ARCs –Shifting Gears to Stay Relevant in the Post-IBC Era.’

ASSOCHAM has prepared a study on the subject with the objective of capturing the status of ARCs in India and chart the way forward. We hope this paper would be useful to policy makers, people engaged in businesses and help in fostering informed debate.

Balkrishan Goenka
President, ASSOCHAM
Message from ASSOCHAM

This fourth edition of National Summit on ARCs 2019 is taking place at a very appropriate time, with the financial markets and governmental and regulatory bodies being acutely concerned about the increasing volume of stressed assets in the banking sector. Serious debate has been taking place on this subject at the highest level to evolve lasting solutions to this issue.

The government has already introduced the IBC which is three years old now, has gained traction with every passing year and helped contain both existing NPAs and fresh slippages in the banking system.

ARCs have played a predominant role in the Indian stressed-assets space. If we look into the past, prior to year 2013, the stressed-assets space in India comprised of only ARCs. However, with the change in regulations and slew of measures taken by the government, entire ecosystem was opened up to increase the investor base. In the meantime, with the change in regulations, ARCs also have tried to shift their gears and adapted to the evolving regime.

ARC will be ideal for many sectors like power, engineering, and those sectors or units where investor interest is likely to be low. Hon’ble Prime Minister, Shri Narendra Modi has given an inspirational call for achieving $5 trillion economy by fiscal 2025. It is definitely IBC and ARCs which will play a big role to achieve this.

Our Knowledge Partner CRISIL has prepared very comprehensive report. This report, along with the discussions during the Summit, should help evolve objective strategies for the further evolution of the ARCs sector.

I thank the Knowledge Partner for their valuable contribution and convey my best wishes for the success of the Summit.

Saurabh Sanyal
Deputy Secretary General, ASSOCHAM
Message from Association of ARCs in India

Asset reconstruction companies (ARCs), as an institutional framework for NPA management, have been in existence for about 17 years. With the amendment of the SARFAESI Act in September 2016 and subsequent regulatory modifications, together with transformational reforms such as the Insolvency and Bankruptcy Code 2016, introduced by the government, the functioning of ARCs underwent a structural shift towards real asset reconstruction as against focused recovery earlier.

The asset reconstruction phase is thus 3 years old and this period has witnessed successful reconstruction and turnarounds. NPAs of Rs. 9.6 lakh crore and another Rs. 3-4 lakh crore of stressed assets offer huge opportunity to ARCs and distressed asset Funds. Additionally, new opportunities are emerging from non-banking entities like NBFCs and HFCs.

Looking at the opportunity, several ARCs have tied up funds with international sovereign, pension and other funds. Edelweiss, Kotak, SSG, are a few of those which have made such arrangements. Many large funds like Blackstone, SSG, Bain Capital, Lone Star, Apollo, etc., have set up ARCs to take advantage of the investment opportunities. It is estimated that about $5 billion is available for investment in Indian distressed assets by/through ARCs and funds. However, pricing of assets continue to be a major hurdle in development of the distressed asset market. A few large resolutions under the IBC process has shown recovery in the range of 15% and 45%, with a couple of exceptions. Several companies are staring at liquidation in the absence of investor interest under IBC.

It is time the banks take a considered view of appropriate resolution tool for maximising value. ARCs will be ideal for many sectors like power, engineering, and those sectors or units where investor interest is likely to be low. The RBI, on its part, should revisit its regulation regarding sale of NPAs to ARCs, for ARCs to play a bigger role in resolution and maximisation of value for banks.

Honorable Prime Minister has given an aspirational call for achieving $5 trillion economy by fiscal 2025. It is definitely a motivational phrase and the entire nation will be striving to achieve this. The government, on its part, has undertaken path-breaking initiatives, including increased infrastructure funding and transformational reforms such as the Goods and Services Tax (GST), the Real Estate (Regulation and Development) Act, 2016 (RERA), IBC and bank recapitalisation.

There are, of course, several challenges that we may encounter on the way. The main challenge is the NPA in the financial system and revival of stressed assets. In an environment where new capital formation is nominal, asset reconstruction will be crucial. Significant investment has already been made in the power generation sector, steel, mining, etc., which are underperforming or idle. Revival of these assets will be the key to achieve our aspiration of $5 trillion economy. And the role of ARCs and funds will be critical.

Against this background, we are holding ARCON 2019, with the theme ‘Towards a $5 trillion economy – Asset Reconstruction is the Key’. I am sure all the ARCs, banks/NBFCs and funds operating in India will have to play a critical role in this journey towards achieving this aspiration.

Siby Antony
Chairman, Association of ARCs
Executive summary

After tripling between fiscals 2015 and 2018, the Indian banking system’s gross NPAs are showing signs of easing. Bank NPAs are expected to shrink 350 basis points (bps) to ~8% by March 2020, compared with the peak of 11.5% in March 2018 and 9.3% in March 2019.

The decline will be driven by a slowdown in NPA accretion and stepped-up recoveries from existing NPA accounts. Resolution of large NPA accounts, especially under the IBC, will help, assuming the bulk of the cases pending with the National Company Law Tribunal (NCLT) will be resolved. A pick-up in credit growth will be a booster, too.

That said, there is significant potential opportunity for stressed-assets investors, given around Rs 9.4 lakh crore NPAs in the banking system as on March 31, 2019. Of this, the corporate segment, which has seen active interest from most investors, is estimated to account for ~70%. Large stressed borrowers have debt aggregating to Rs 5.4 lakh crore, which is a huge playing field in itself for investors.

Additionally, an enabling regulatory framework has paved the way for attracting investors in the stressed-assets space. Indeed, regulations introduced in recent years – including RBI’s revised resolution framework (issued in June 2019), and the IBC, with its recent amendments (passed in Lok Sabha in August 2019) – augur well for resolution of stressed assets.

The recovery rates and resolution timelines have improved. However, some of the expectations set during the IBC’s introduction still need to be met.

Notably, regulatory changes in recent years have been aimed at putting ARCs’ skin in the game and diversifying the potential investor base for stressed assets. In August 2014, the minimum investment requirement by ARCs for the acquired assets was increased to 15% from 5%. The norms for investments in ARCs and security receipts (SRs) – including for foreign investors – were eased subsequently.

But the real push came when the provisioning norms for the selling banks were changed, wherein their investments in SRs over 50% (effective April 1, 2017) led to higher provisioning requirement by banks. This limit is now at 10%, effective April 1, 2018.

Given this, the business model of ARCs has become more capital-intensive, with a need to either put in their own funds or bring in other investors.

Fiscal 2019 saw a structural shift, with a substantial jump in the cash share of the acquisition cost, resulting in sizeable investments by investor groups, apart from the selling institutions and ARCs.

That said, ARCs have been able to rope in external investors to subscribe to the SRs. In fact, in fiscal 2019, foreign banks, stressed-assets funds and global pension funds subscribed to ~60% of total SRs issued by CRISIL-rated ARCs.

Given the higher capital requirement, the partnership model will be the way forward for ARCs. It could be via various routes, ranging from investment in ARCs, investments in SRs to direct investments in stressed assets.

To summarise, there is a sizable opportunity in the stressed-assets space for investors, with IBC being a game changer. The IBC ecosystem is developing at a fast pace, but adherence to the timelines remains a challenge. According to a poll conducted by CRISIL, 89% of the respondents believe ARCs will remain relevant in the post-IBC era. With a higher cash share becoming a norm, ARCs will need to focus more on resolutions and attracting co-investors.
A sizeable opportunity in India’s stressed-assets market

With gross NPAs of the banking sector at Rs. 9.4 lakh crore as on March 31, 2019 and estimated to decline to Rs 9.1 lakh crore as on March 31, 2020, there remains a large opportunity in the stressed-assets market for players. Interestingly, the bulk of these NPAs lie in the corporate segment, a sector that has seen most of the activity.

Gross NPAs of Indian banks

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross NPAs (Rs lakh crore)</th>
<th>Gross NPAs (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>6.0</td>
<td>7.5%</td>
</tr>
<tr>
<td>2017</td>
<td>8.0</td>
<td>9.5%</td>
</tr>
<tr>
<td>2018</td>
<td>10.5</td>
<td>11.5%</td>
</tr>
<tr>
<td>2019</td>
<td>9.4</td>
<td>9.3%</td>
</tr>
<tr>
<td>2020</td>
<td>9.1</td>
<td>8.0%</td>
</tr>
</tbody>
</table>

Source: RBI, CRISIL estimates

Segment-wise breakup, gross NPAs (March 2019)

Stressed assets in the large-corporates segment

As on March 31, 2019, large stressed assets in the corporate sector, estimated to be around Rs 5.4 lakh crore, create a huge playing field for investors. Of the total, the NCLT’s list-1 and list-2 comprised around Rs 2.1 lakh crore, while the existing stock of NPAs comprised another Rs 2 lakh crore. Over and above this, assets of around Rs 1.3 lakh crore are estimated to be under stress but have not been recognised as NPAs. These assets could potentially slip into NPAs over the near-to-medium term.

Composition of large stressed accounts (March 2019)

<table>
<thead>
<tr>
<th>Account Type</th>
<th>Rs. lakh crore</th>
</tr>
</thead>
<tbody>
<tr>
<td>NCLT 1</td>
<td>0.9</td>
</tr>
<tr>
<td>NCLT 2</td>
<td>1.2</td>
</tr>
<tr>
<td>Other accounts in top 100 gross NPAs</td>
<td>2.0</td>
</tr>
<tr>
<td>Total stress</td>
<td>1.3</td>
</tr>
<tr>
<td></td>
<td>4.1</td>
</tr>
</tbody>
</table>

Source: RBI, CRISIL estimates
Industry-wise break-up of large stressed assets

Of the Rs. 4.1 lakh crore of large NPA accounts, power, infra, and steel constitute about 50%. Power-sector accounts constitute the largest proportion, and resolution in this sector has not been significant. The revised stressed-assets framework is expected to benefit the stressed power sector assets that were operational and on the verge of being referred to the insolvency proceedings under the IBC (estimated at Rs 1 lakh crore as on March 31, 2019).

Sector-wise break-up of large stressed accounts

Source: CRISIL estimates
Implementation of key regulations is a long-term positive for the resolution of stressed assets. The government has been proactively dealing with stressed assets and bringing in changes through reforms and regulations.

The RBI’s revised framework for resolution of stressed assets (issued in June 2019) and IBC are the two key developments amid the continuously evolving regulatory space over the past five years.

**Revised framework for resolution of stressed assets**

The RBI’s revised framework for resolution of stressed assets strikes a fine balance between the tight regulatory timelines mandated previously and the inordinate delays in resolving and provisioning for such assets.

With no mandatory referral to the IBC, the framework provides an option for resolution outside of IBC and puts more onus on banks to formulate a plan. It also provides a statutory review period after default, so that banks can decide on the resolution strategy, including its implementation.

To discourage banks from delaying the resolution process and referral to the IBC, the revised framework stipulates additional provisioning of 20-35% when the delay is beyond 210 days from default. The framework provides a breather for stressed accounts that had resolution plans under implementation, but had to be referred to the IBC because of a delay of 180 days. As highlighted above, one of the key beneficiaries will be the stressed power sector assets that were operational and were on the verge of being referred to insolvency proceedings under the IBC.

Source: CRISIL analysis
## Key changes in the revised prudential framework and their impact

<table>
<thead>
<tr>
<th>The revisions</th>
<th>Potential impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in timelines for the implementation of resolution plan</td>
<td>The additional 30-day review period provides lenders time to formulate their strategy for, and approach to, resolution</td>
</tr>
<tr>
<td>No mandatory referral of stressed assets for resolution under IBC</td>
<td>It will provide an option to resolve the stressed assets outside the ambit of IBC, which, in some cases, can lead to improved realisation due to better preservation of intrinsic value of the assets</td>
</tr>
<tr>
<td>Inter-creditor agreement (ICA) between lenders</td>
<td>Will lead to faster decisions with approval of only 75% of lenders (by value) and 60% (by number of lenders) needed instead of 100% previously</td>
</tr>
<tr>
<td>Accelerated provisioning on delay in the implementation of the RP.</td>
<td>Will disincentivise lenders from avoiding referring cases to IBC wherever required</td>
</tr>
<tr>
<td>Inclusion of non-banking financial companies (NBFCs) and small-finance banks (SFBs) under the framework</td>
<td>A step in the right direction considering that they form around 20% of overall credit in the Indian financial landscape</td>
</tr>
</tbody>
</table>
Insolvency and Bankruptcy Code

The IBC is aimed at protecting the interests of all stakeholders, including banks and financial institutions, secured and unsecured creditors, and employees. Even the ARCs stand to benefit from speedy recovery. Besides, if implemented well, it can also aid the development of the corporate bond market, especially for lower-rated issuances. For the government, India’s ‘ease of doing business’ ranking can further improve, and, for stakeholders, there can be greater clarity on getting their share of dues.

IBC’s impact on its stakeholders

- Quicker resolution and hence, release of capital in the banking system
- Instills better credit discipline among borrowers
- Fosters innovation and entrepreneurship
- Improves ‘ease of doing business’ and ‘global competitiveness’ rankings
- India’s ease of doing business rank improved from 130 in 2017 to 77 in 2019
- Predictable recovery process enhances investor confidence
- Deepens Indian bond markets beyond the AA and AAA rating categories
- Enhances creditor rights
- ARCs can churn capital faster and enhance returns

Source: CRISIL analysis
Strengthening the Code

The IBC, which is three years old now, has gained traction with every passing year and has helped contain both the existing NPAs and fresh slippage in the banking system.

The number of cases under IBC has increased to 2,162 over years. Of these, 120 cases have already been resolved; 174 cases are under review/appeal or settled; 101 cases are withdrawn and balance 475 cases have been liquidated.

Rise in number of cases admitted under IBC

Source: Insolvency & Bankruptcy Board of India (IBBI) quarterly newsletter – January-March 2019 publication

Improved recovery rates

The average recovery rate (ARR) under IBC is better than the other resolution mechanism. ARR for the 120 cases resolved under IBC was 43% until June 2019, which is better than that under earlier mechanisms. The ARR as of March 2019 was also 43%. In fiscal 2019 alone, around Rs 70,000 crore was recovered through IBC, against Rs 35,000 crore through other resolution mechanisms in the previous fiscal. In its analysis till March 2019, CRISIL has not included the 378 liquidated cases, as 75% of these were with the Board for Industrial and Financial Reconstruction (BIFR) and/or defunct. Including these cases along with the 94 resolved cases throws up an ARR of 23%.

Further, according to the Union Budget 2019-20, the IBC, promulgated in December 2016, has helped recover a significant ~Rs 4 lakh crore\(^1\) from gross NPAs.

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\(^1\) As quoted by the finance minister during the budget speech on July 4, 2019
Average recovery rate (%) under resolution regimes

The time taken for resolution of cases under the IBC remains a major issue. The resolution timelines of 180 days (extendable up to 270 days), as prescribed in the IBC, did not include the time taken for judicial and legal processes. Also, there were infrastructure bottlenecks, resulting in significant delays even in the admission of Corporate Insolvency Resolution Process (CIRP) applications. As a result, there were considerable delays in resolving cases. For instance, 34% of the 1,291 cases (outstanding as on June 30, 2019) are pending beyond 270 days.

Timeframe for outstanding cases as of June 2019

Source: IBBI data
Amendment seeks to address issues

The IBC amendments recently passed in Lok Sabha should be an enabler for resolution of stressed assets in the country. IBC was promulgated to create a creditor-friendly and structurally strong ecosystem that facilitates the initiation of the insolvency process, and enables easier and faster resolutions. More importantly, it has instilled better credit discipline. However, there have been challenges in terms of adherence to resolution timelines, clarity on priority of cash flow distribution among creditors etc.

The amendments address these issues in three ways:

One, it aims to complete the corporate insolvency resolution process (CIRP), including litigation and other judicial processes, within 330 days.

The resolution timelines of 180 days (extendable up to 270 days) as prescribed in IBC didn’t include the time taken for judicial and legal processes. Also, there were infrastructure bottlenecks resulting in significant delays even in admission of CIRP application. As a result, there were considerable delays in resolving cases.

Two, the amendments reiterate the primacy of financial creditors (FCs). This is in the backdrop of a recent judgement passed by the National Company Law Appellate Tribunal which treated FCs and operational creditors (OCs) at par. These amendments prescribe distribution of cash-flows as per Section 53 of IBC that provides for seniority of FCs over OCs.

Three, committee of creditors (CoC) is empowered to factor in commercial consideration for cash flow distribution, and decide on liquidation even before preparation of information memorandum. These changes reiterate the importance of CoC in the overall resolution process.

These changes in IBC will facilitate more time-bound resolution, bring clarity over distribution of cash-flows amongst creditors and reiterate the importance of CoC. Unambiguous regulations and timely resolutions are crucial to restore the investor confidence. Strengthening judicial and other infrastructure is critical at this juncture.

The other changes include enabling faster decision making in cases where financial creditors covered under Section 21 (6A), such as homebuyers, are involved. Decision approved by a majority of such FCs will be considered for the resolution plan. In many cases, decisions couldn’t be reached among large number of FCs because of a lack of consensus or shortage of attendance.

Additionally, providing flexibility to arrive at a comprehensive resolution plan and making the resolution plan binding for all stakeholders will enhance confidence in the IBC process.
ARCs: A key component in the stressed-assets space

ARCs have played a predominant role in the Indian stressed-assets space. If we look into the past, prior to year 2013, the stressed-assets sector comprised only ARCs. However, with the change in regulations and a slew of government measures, the entire ecosystem was opened up to increase the investor base. In the meantime, with the change in regulations, ARCs have tried to shift their gears and have adapted to the evolving regime. In this journey, they have travelled a significant distance since inception.

Characteristics of the three phases of the ARC market

<table>
<thead>
<tr>
<th></th>
<th>Phase I FY03-FY14</th>
<th>Phase II FY14-FY17</th>
<th>Phase III FY18 onwards</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of ARCs</td>
<td>1→14</td>
<td>14→24</td>
<td>29 ARCs Consolidation* &amp; new entrants</td>
</tr>
<tr>
<td>Proportion of cash deals versus SR deals</td>
<td>Low</td>
<td>Low</td>
<td>Moderate to high</td>
</tr>
<tr>
<td>Percentage of SRs held by banks</td>
<td>High</td>
<td>High</td>
<td>Moderate to high</td>
</tr>
<tr>
<td>Discount on acquisition</td>
<td>High</td>
<td>Low to moderate</td>
<td>Moderate to high</td>
</tr>
<tr>
<td>Magnitude of regulatory changes</td>
<td>Moderate</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Capital requirement</td>
<td>Low</td>
<td>Moderate</td>
<td>High</td>
</tr>
</tbody>
</table>

* Consolidation is for existing ARCs and new entrants is expected to be foreign players; SR: Security Receipts

Phase I (fiscals 2003 to 2014)

While ARCs came into existence in the early-2000s, they did not really take off in terms of scale until the second half of fiscal 2014, when there was a regulatory push for banks to clean up their balance sheets. In India, the first ARC was seeded in 2003, but there was not much progress in the first decade of the new millennium, as the ecosystem was evolving.

During this phase, the minimum capital investment by ARCs for the acquisition of stressed assets was only up to 5% of the acquisition value, while the balance 95% could be invested by banks in the form of SRs. This was known as the 5:95 model. Therefore, the initial capital investment requirement by an ARC was low. Further, with large acquisitions taking place under the 5:95 model, the AUM of ARCs increased by over 4x between June 2013 and June 2014. This was all towards the end of Phase I.

Notably, during the phase, there were less valuation mismatches between ARCs and banks for asset acquisition, as banks were selling old assets and discounts were higher. Banks were holding a large proportion of SRs and, hence, the risk did not get fully transferred from the banks’ books. Cash deals were very minimal in this phase.

The challenge for the ARCs in this phase was to increase the value they were supposed to bring to the resolution process. Though ARCs successfully reconstructed a few large accounts and demonstrated the ability to recover through asset sales, the recovery rate was not up to the potential due to pendency in legal issues, delay in debt aggregation and acquisition of high vintage assets.
Phase II (fiscals 2014 to 2017)

The beginning of Phase II, in CRISIL's view, is where amendments to regulations were expected to increase the stake of ARC and improve the recovery prospects for ARCs. With the minimum requirement for ARC investments in SRs increased to 15% in August 2014, the 5:95 model shifted to a 15:85 model. As a result, the capital requirement for ARCs increased significantly, as the regulator wanted ARCs to have more 'skin in the game'.

The reset initially led to a decline in the pace of asset acquisition by ARCs, as they became very choosy in terms of acquiring assets. AUM growth fell sharply during the beginning of the phase; however, it picked up as new ARCs were set up. ARCs raised capital for asset acquisitions and bank NPAs mounted.

In this phase, cash deals remained low, as ARCs only invested 15% of the acquisition value and banks continued to hold a large proportion of SRs in assets sold by them.

The discounts on acquisition were lower than those seen in Phase I, given the issue of valuation mismatch, especially for larger assets.

Recovery improved during this phase, compared with Phase I, due to a few critical factors such as acquisition of lower vintage assets, quicker debt aggregation, and lower threshold for consent to enforce the SARFAESI Act in case of an asset sale.

The phase saw a number of regulatory changes

<table>
<thead>
<tr>
<th>Key regulations</th>
<th>Impact</th>
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<tbody>
<tr>
<td>Management fees to be calculated on NAV rather than the acquisition value</td>
<td>• Leads to decline in earnings of ARCs</td>
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<tr>
<td></td>
<td>• Incentivises ARCs to recover more</td>
</tr>
<tr>
<td>ARCs to be the members of joint lenders forum</td>
<td>• Helps ARCs gain access to NPA sales, thus quickening the recovery process</td>
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<td></td>
<td>• Quicker debt aggregation</td>
</tr>
<tr>
<td>Requirement of rating in six months (versus twelve months earlier)</td>
<td>• Quicker fair-value assessment for banks</td>
</tr>
<tr>
<td>Insolvency and Bankruptcy Code</td>
<td>• Shifts from ‘debtor in possession’ to ‘creditor in possession’</td>
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<td></td>
<td>• Instils credit discipline and attracts investors</td>
</tr>
<tr>
<td>Changes in regulatory norms for foreign direct investment (FDI) and foreign institutional investment (FII) in SRs and sponsor holdings in ARCs</td>
<td>• Boost capital flows</td>
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<tr>
<td></td>
<td>• Addresses low capital issues of ARCs</td>
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<td></td>
<td>• Attracts foreign distress-asset funds</td>
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<tr>
<td></td>
<td>• Leads to price discovery</td>
</tr>
<tr>
<td>RBI guidelines for banks for the sale of stressed assets (stricter provisioning norms and valuation norms)</td>
<td>• Helps banks diversify investment risk in SRs</td>
</tr>
<tr>
<td></td>
<td>• Brings more transparency in valuation and better price discovery</td>
</tr>
<tr>
<td>Increase in the net-owned funds requirement for ARCs to Rs 100 crore from Rs 2 crore</td>
<td>• Will lead to consolidation</td>
</tr>
<tr>
<td>Listing of SRs in the secondary market</td>
<td>• Helps improve liquidity, subject to active trading</td>
</tr>
</tbody>
</table>
Phase III (fiscal 2018 and beyond)

Structural changes on the back of the regulatory push have marked the beginning of the third phase. The major push will set the course of the ARCs' business and reset their business model. The key regulatory change was a higher provisioning requirement for banks. First, with effect from April 1, 2017, the RBI has increased the provisioning requirement for banks investing more than 50% of the value of stressed assets sold by them in SRs issued in lieu. Subsequently, the limit has been reduced to 10% from April 1, 2018. Finally, the implementation of the IBC was a game-changer in the resolution landscape.

In CRISIL-Assocham’s January 2018 report on ARCs, titled ‘Arc of Change’, we expected a structural shift in the industry as mentioned in Phase III of the table above:

- Large players with deep pockets will dominate the market and smaller players will consolidate with larger ones, given the capital constraints
- However, discounts will increase because valuation becomes critical with more cash deals; this further increases the capital requirement for acquisition
- The percentage of SRs with banks for new assets will decline, while the number of cash deals will rise

We have seen many of the above-mentioned shifts actually pan out in fiscal 2019, which will be discussed in the next section of the report.
ARCs touch a new milestone with AUM crossing Rs 1 lakh crore

Assets under management (AUM) of ARCs, as measured by SRs outstanding, crossed the Rs 1 lakh crore-mark as on March 31, 2019, up 7% from the previous year.

While the value of debt (~Rs 40,000 crore) acquired in fiscal 2019 was largely stable compared with the past couple of years, AUM growth slowed owing to a higher discount rate and increase in SR redemptions.

For CRISIL-rated ARCs (accounting for ~75% of overall industry AUM), the cumulative SR redemption ratio increased to ~15% as on March 31, 2019, from ~8% a year before. While this increase has been driven primarily by resolution of a few large stressed accounts, write-offs have also contributed.

Trend in AUM of ARCs

With an increase in the proportion of cash deals, we expect discounts to remain on the higher side. To make way for newer acquisitions and also attract new and repeat investors, it is imperative ARCs quickly resolve the assets and redeem the SRs. Therefore, AUM growth for ARCs would likely be range-bound at 8-10% over the medium term.

Source: RBI, CRISIL estimates; AUM for ARCs is SRs outstanding
Structural shift to higher cash share with regulatory changes

Business dynamics and, hence, the business model for ARCs has changed in tandem with the regulatory changes. In fiscal 2015, the proportion of cash share increased slightly as the RBI mandated ARCs move towards the 15:85 model from 05:95. Effective April 2017, regulatory changes mandated higher provisioning for selling banks if their investments in SRs exceeded 50%. The limit was reduced to 10% effective April 2018, which increased the cash proportion to over 90% for acquisitions done in fiscal 2019, from less than 20% two years ago.

Cash as a portion of total acquisition cost

Given the ARCs’ capital constraint on how much they can invest on their own, the higher cash proportion necessitated participation of co-investors.

Till fiscal 2017, SRs were subscribed to by either the selling institution or the ARCs. However, in the past two fiscals, particularly 2019, a lot of institutional investors, including global pension funds, domestic funds, foreign banks, private equity players, and hedge funds, have invested in SRs.

The share of institutional investors increased to almost 60% in fiscal 2019 from a minuscule 1% in fiscal 2017. This trend should continue and the growth of ARCs will be determined by their ability to attract investors, which will depend on their ability to recover.

Trend of SR subscribers’ break-up – Diversification in SR subscribers increased over last two years

Source: CRISIL estimates
ARCs’ recovery rates

Realistically, ARCs have a long way to go in terms of recovery.

In the first phase, though ARCs successfully reconstructed a few large accounts and demonstrated the ability to recover through asset sales, the recovery rate was not up to the potential due to pendency in legal issues, delay in debt aggregation and acquisition of high vintage assets.

But ARCs have learnt from past experience and are implementing successful strategies to improve recovery rates. Over the past few years, recoveries have improved for the following reasons:

1. **Quicker debt aggregation:** In case of large accounts with multiple lenders, inter-creditor issues arise, thus delaying the aggregation process. However, with the amendments in regulations, ARCs have been able to participate in joint lenders’ forums, thus quickening the NPA sales process and reducing the debt aggregation period. This has also been facilitated by a change in the SARFAESI Act, which now requires the consent of 60% of lenders for enforcement, compared with 75% earlier.

2. **Acquisition of lower vintage of assets:** Further, ARCs are acquiring stressed assets which are recent NPAs and, in some instances, not yet classified as NPAs. This increases the chances of a revival, subject to other conditions being met in a timely manner, such as arrangement of working capital funds, capital infusion by promoters, and re-scheduling of debt. The average age of NPAs being sold has fallen below two years – compared with around five years in the past – and is expected to decline further.

3. **Positive changes in regulatory framework and improved credit discipline:** Over the past three years, there have been slew of measures in the regulatory space taken by the government to improve stressed asset issue; amongst the key beneficiaries are ARCs. These have also instilled credit discipline among borrowers and provides the ARCs more bargaining power to negotiate with the borrowers.

4. **Support from the promoters of a company under resolution:** Support from the promoters of a company, in the form of equity infusion or running the business, has also helped the ARCs.

The regulatory changes such as increase in minimum threshold of ARCs' investment in SRs to 15% from 5%, higher provisioning norms for selling banks, and IBC have increased the focus on timely resolutions and recovery. ARCs, too, are shifting gears and implementing strategies for a quicker resolution to stay relevant.
Recoveries are expected to improve going forward

Gross recovery* as a percentage of principal debt acquired

<table>
<thead>
<tr>
<th></th>
<th>Recovery Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto 2008-A</td>
<td>36%</td>
</tr>
<tr>
<td>Upto 2012-A</td>
<td>38%</td>
</tr>
<tr>
<td>Upto Jun. 2017-A+P^</td>
<td>40-44%</td>
</tr>
<tr>
<td>Upto Dec. 2018-A+P</td>
<td>44-48%</td>
</tr>
</tbody>
</table>

A: Actuals, P: Projections, CRISIL estimates;

*Recovery rate: Gross recovery/principal debt acquired, For June 2017 and December 2018, the recovery rate also includes future expected recovery;

^Data realigned from earlier estimates

CRISIL has covered recovery for five years; hence, for the last two periods, that is June 2017 and December 2018, the recoveries expected in future have been included. CRISIL expects the recovery rate to improve to 44-48%, driven by lower vintage and better quality of assets acquired in recent years, positive changes in the regulatory framework, and improved credit discipline among borrowers.

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2 RBI, in its financial stability report June 2019, has published the recovery rate for ARCs based on SR origination dates. The two recovery rates are not comparable. RBI’s analysis is based on actual recovery. The recovery rate for debt acquired prior to 2014 has seen a recovery track record of atleast 5 years and hence, higher recovery. Whereas the debt acquired during 2014-2018 has lower recovery rate as the recovery for future years is not factored in. CRISIL’s recovery rate factors in actual plus recovery expected in the future years. RBI’s recovery is calculated in present value terms wherein CRISIL’s analysis is based on nominal value terms i.e. recovery not adjusted for time value. Further, CRISIL has calculated the recovery on principal dues whereas the RBI study is based on total bank claims.
Multi-platform investment strategy the way forward

While ARCs were the only dominant player till some time back, the present space has a wide range of investors. With regulations becoming more supportive of investment in the stressed assets space, it has become more of a multi-platform play in the past two years. The changes have created better opportunities for players to invest in Indian stressed assets. Today, there are multiple co-investment avenues for potential investors: one through direct investment in a specific asset and three through ARCs.

Investment options in stressed-assets space

<table>
<thead>
<tr>
<th>Investment options</th>
<th>March 2017</th>
<th>March 2019 [E]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct investment in company</td>
<td>Limited interest</td>
<td>Increased interest by both funds and business houses</td>
</tr>
<tr>
<td>Invest in existing ARC (net worth)</td>
<td>Rs 4,000-4,500 crore</td>
<td>Rs 7,500-8,000 crore</td>
</tr>
<tr>
<td>Set up a new ARC (number of ARCs)</td>
<td>23</td>
<td>29</td>
</tr>
<tr>
<td>Direct investment in security receipts (SRs)</td>
<td>Rs 123 crore</td>
<td>Rs 7,117 crore*</td>
</tr>
</tbody>
</table>

Source: CRISIL estimates; Media reports

*All industry numbers are based on CRISIL’s representative set, which forms ~75% of industry AUM

1. **Direct investment in companies** – The increased interest for direct investment can be seen in some recent transactions in the sector, particularly in the steel space. Direct investment is likely to gain traction even for financial investors once sector-specific teams are developed and more expertise is gained.

2. **Investment in an existing ARC** – In the Budget for fiscal 2016, the SARFAESI Act, 2002, was amended to enable a sponsor to hold a 100% stake in the ARC, compared with 50% earlier. This led to an increase in capital invested in ARCs, which is also reflected in doubling of their networth.

3. **Setting up a new ARC** – Rules pertaining to FDI were changed, wherein 100% FDI was permitted in ARCs through the automatic route, compared with 49% earlier. Now, foreign investors with deep pockets can set up their own ARCs without an Indian partner. The number of ARCs has also risen (29 as of now in India).

4. **Directly investing in SRs** – The government also allowed 100% FII/FPI investments in SRs. Earlier, they were allowed to invest up to 74% of each tranche of the schemes of the ARC. Direct investment in SRs by third-party investors has also increased significantly.

~ US$7 billion investments planned in the space
Challenges and the outlook

Outlook

Sizeable opportunity for investors in stressed assets and across various sectors

Cash share: With the proportion of cash share increasing significantly in recent years and becoming the industry norm, ARCs need to focus on resolutions to stay relevant

IBC: A game-changer, with its ecosystem developing at a fast pace with the increase in the number of benches/judges, information utility and more resolution professionals

Pace of referrals to the IBC could moderate under the revised stressed asset resolution framework

Challenges

Adherence to IBC timelines still remain a challenge

Demand for SRs in the secondary market needs to be created

Partnership model: Ability to attract co-investors under multi-platform ecosystem will be critical for future growth of ARCs
CRISIL has conducted a survey across 66 participants across capital market institutions, banks and non-banking finance companies to obtain the view of market participants on stressed assets. Here are the results.

1. Is RBI’s new framework for stressed assets more effective than the February 12th circular?

- Yes: 89%
- No: 11%

2. What is the likely investment in stressed assets by investors in next two years?

- < $5 billion: 40%
- $5 - $10 billion: 49%
- > $10 billion: 11%

3. What do you think will be the preferred mode of investment in stressed assets?

- Direct investment in a company: 42%
- Invest in ARCs: 23%
- Invest in Security Receipts issued by ARCs: 35%

4. Would ARCs stay relevant in resolving stressed assets in the post IBC era?

- Yes: 89%
- No: 11%
5. What is your expectation of the annual growth rate of the ARCs' AUM for the next two years?

- Option A: < 5% (10%)
- Option B: 5-10% (51%)
- Option C: < 10% (39%)

6. Have ARCs played the designated role of resolving stressed assets effectively till date?

- Yes (45%)
- No (55%)

7. Do you expect timelines under the IBC to improve and lead to quicker recovery?

- Yes (77%)
- No (23%)
Annexures

CRISIL’s past opinion pieces on ARCs/NPAs

Ratings

Press Release
August 21, 2019

ARC AUM tops Rs 1 lakh crore, but growth slows
Regulatory changes increase capital intensity of ARC business model

Assets under management (AUM) of asset reconstruction companies (ARCs), as measured by security receipts (SRs) outstanding, crossed the Rs 1 lakh crore mark as on March 31, 2019, up 7% from the previous year, a CRISIL estimate shows (Annexure 1).

While the volume of debt acquired remained range-bound at around Rs 40,000 crore, AUM growth, which was 25% in fiscal 2018, slowed on higher discount rates and increase in SR redemption costs.

For CRISIL-rated ARCs (accounting for ~75% of overall industry AUM), the cumulative SR redemption ratio increased to ~15% as on March 31, 2019, from ~10% a year before (refer Annexure 2). While this increase has been driven primarily by resolution of a few large stressed accounts, write-offs have also partly contributed.

Notably, regulatory changes in recent years have been aimed at increasing ARCs’ risk in the game and diversifying the potential investor base for stressed assets. In August 2014, the minimum investment requirement by ARCs for assets acquired was increased from 5% to 10%. Norms for investment in ARCs as well as SRs, including for foreign investors, were eased subsequently.

But the real push came when the provisioning norms for the selling banks were changed, wherein their investment in SRs over 50% (effective April 1, 2017) led to higher provisioning requirements by banks. This limit is now at 10%, effective April 1, 2019.

Says Krishnan Bittramer, Senior Director, CRISIL Ratings: “With selling banks unwilling to invest more than 10% in most cases, the business model for ARCs has become more capital-intensive, with a need to either put in their own funds, or bring in other investors. In such a scenario, quicker recoveries by ARCs becomes even more critical as it helps free the capital deployed by them to make way for newer acquisitions and also attract new and repeat investors.”

More importantly, the year saw a structural shift, with a substantial jump in the share of the acquisition cost, resulting in slower investment by investor groups, apart from the selling institutions and ARCs. Cash as a portion of total acquisition cost for the fiscal 2019 was ~46%, which is a substantial pick up from 26% last fiscal.

Says Subba Sri Narayanan, Director, CRISIL Ratings: “ARCs have been able to rope in external investors to subscribe to the SRs. In fact, in fiscal 2019, for CRISIL-rated ARCs, foreign banks, stressed assets funds and global pension funds, subscribed to ~65% of total SRs issued. Two years ago, this was negligible (refer Annexure 3).”

Going ahead, given the increased requirement of capital, CRISIL believes the partnership model will be the way forward for ARCs. It could be via partner routes — ranging from investment in ARCs themselves to investment in SRs to direct investments in stressed assets.

Also, the stressed assets opportunity remains sizable, with gross non-performing assets of Indian banking industry at a whopping Rs 9.6 lakh crore as on March 31, 2019. However, ARCs’ ability to tap this opportunity and grow sustainably will hinge on their ability to collaborate with other investors and accelerate their pace of recoveries.

1 Capitalized as cumulative SRs redeemed as at a particular quarter/cumulative SRs issued as at the same date.

Annexures

Annexure 1: Trend of AUM growth of ARCs

Annexure 2: Trend of cumulative SR redemption ratio

Annexure 3: Trend of investment proportion by different subscriber types in SRs
Press Release

Bank NPAs to shrink 360 bps to ~8% by March 2020

Driven by resolution of large ticket stressed assets and slowing pace of fresh accretion to NPAs

Asset quality of banks should witness a decisive turnaround this fiscal with gross non-performing assets (NPAs) reducing by 350 basis points (bps) over two years to ~8% by March 2020 compared with a peak of ~11.5% in March 2018 and 9.3% in March 2019. This will be driven by a combination of resolution in fresh accretions to NPA as well as stepped up recoveries from existing NPA accounts.

Significantly, public sector banks (PSBs), which account for over 80% of the NPAs in the system, should see their gross NPAs climb down over 400 bps to ~10.5% by March 2020 from a peak of 14.0% in March 2018.

To be sure, slippages have been on the wane since last fiscal. The rate of accretion of fresh NPAs halved in fiscal 2019 to 3.7% compared with 7.4% the previous fiscal and is expected to drop to ~3.2% in fiscal 2020 (refer Chart 1). This is mainly because banks have already recognised ~Rs 17 lakh crore of stressed loans as NPAs since fiscal 2016, led by accelerated NPA recognition following the Reserve Bank of India’s (RBI’s) stringent norms and asset quality reviews. CRISIL estimates for fiscal 2020 also factor in slippages from the stress being witnessed in a few large corporate and financial sector entities.

What, however, will help reduce the stockpile significantly this fiscal is a pickup in recoveries and resolutions from large NPA accounts, especially under the Insolvency and Bankruptcy Code (IBC) and pick up in credit growth. This is assuming bulk of the pending cases in the National Company Law Tribunal (NCLT) would be resolved with higher recovery rates and faster resolution times than that hitherto seen in the country.

According to Krishnan Sitraraman, Senior Director, CRISIL Ratings, “In fiscal 2019, write-offs, coupled with recoveries under IBC in key large stressed assets, played a critical role in resolution of NPAs. Further, after a gap of six years, the pace of NPA resolution is estimated to have overtaken that of fresh slippages for the banking system in fiscal 2019. Private banks, which have had fewer asset quality issues, should also witness an improvement in portfolio performance.”

The improvement would be driven by two major factors which should result in corporate loans exhibiting a substantial reduction in NPA levels:

First, the resolution of some large NPA accounts under NCLT-1 and NCLT-2 is expected to fructify by the end of this fiscal. This could account for almost half of the total reductions in gross NPAs of the banking system by March 2020. Recapitalisation has ensured that a number of PSBs have the balance sheet strength to provide for reasonable haircuts on resolution of stressed assets.

Second, trends in corporate credit quality are supportive at an aggregate level. CRISIL’s credit ratio – number of upgrades to downgrades – increased to 1.61% in H2 of FY2019 compared with 1.67% in fiscal 2018. Though the credit ratio could moderate going forward, steady domestic growth and benign interest rates should continue to support credit profiles in the corporate sector.

Although delinquencies have inched up marginally in the retail segment and portfolios are yet to fully season given strong growth in the past few years, the granular nature of these loans should ensure diversification and support against material deterioration going forward. Also, given the RBI’s stance on restructuring of loans to small and medium enterprises (SME) till the end of fiscal 2020, the overall NPA position of banks should continue to witness an improving trend.

According to Vidyasanthan Ramanwamy, Associate Director, CRISIL Ratings, “We believe the seasonality of retail loans and performance of SME loans post the restructuring period will shape the asset quality trends for the banking sector, especially PSBs, over the medium-to-long-term. Nevertheless, with the improvement in the corporate stressed assets situation, overall NPAs in the banking system should continue their downward trend over the medium term.”

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1 NCLT-1 and NCLT-2 refer to the two tranches of 12 and 28 large NPA accounts respectively referred for resolution to the NCLT under the IBC.

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Chart 1: Trend in gross NPAs ratio and slippages ratio for banking sector

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<tbody>
<tr>
<td>Gross NPAs ratio</td>
<td>7.5%</td>
<td>6.0%</td>
<td>5.3%</td>
<td>7.4%</td>
</tr>
<tr>
<td>Slippages ratio</td>
<td>6.0%</td>
<td>3.7%</td>
<td>3.2%</td>
<td>3.7%</td>
</tr>
</tbody>
</table>

Source: CRISIL, Estimate
In three years of IBC, more hits than misses
Implementation largely on track, though resolution timeline remains a challenge

Exactly three years since it was legislated, the Insolvency and Bankruptcy Code, 2016 (IBC) has made material progress in addressing the logjams it was supposed to – which is faster recovery of stressed assets and quicker resolution timelines.

Recovery through the IBC was –Rs 70,000 crore in fiscal 2019 – or twice the Rs 35,500 crore1 recovered through other resolution mechanisms such as the Debt Recovery Tribunal, Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, and Lok Adalat – in fiscal 2016.

Says Gurpreet Chhatwal, President, CRISIL Ratings. “The recovery rate for the 94 cases resolved through IBC by fiscal 2019 is 43%, compared with 26.5%2 through earlier mechanisms. What’s more, the recovery rate is also twice the liquidation value for these 94 cases, which underscores the value maximisation possible through the IBC process.”

A key economic reform, the IBC has shifted the balance of power to the creditor from the borrower. It has instilled a significantly better sense of credit discipline. Today, there is a sense of urgency and seriousness among defaulting borrowers because losing their asset is very much a possibility if the resolution process fails.

Indeed, as per a report available on the Insolvency and Bankruptcy Board of India (IBBI)’s website, almost Rs 2.02 lakh1 crore of debt pertaining to 4,452 cases were disposed of even before admission into the IBC process, as the borrowers made good the amounts in default to the creditors.

This gets reflected in slower accretion of new non-performing assets (NPAs) in the Indian banking system. CRISIL estimates the banking sector’s gross NPA (aggregate) has declined to ~10% in end-March 2019 from 11.5% the year before on the same date.

The Supreme Court’s decision to quash the Reserve Bank of India’s February 12, 2018, circular does provide banks greater flexibility in resolving stressed assets. But the fact that the apex court also simultaneously upheld the IBC in its entirety is a huge positive.

That said, resolution timelines are still an issue. Though the resolution timelines for cases resolved through IBC is 524 days, which is much better compared with 4.3 years3 earlier, it is still above the 270 days set out in the code.

As on March 31, 2019, there were 1,143 cases outstanding under the IBC of which resolution of 32% of the cases was pending for more than 270 days. Significant delays also trigger liquidation. Also, there are a few big-ticket accounts for which resolution has not been finalised for over 400 days.

Then there are other challenges such as burden on the National Company Law Tribunal to resolve a large number of cases, clarity on priority of claims, limited number of information utilities, and creation of a secondary asset market, which need to be addressed.

Says Nitesh Jain, Director, CRISIL Ratings, “Looking back, we believe that IBC ecosystem is indeed strengthening at a fast pace. Going ahead, success will hinge on timely resolution of stressed assets and a conducive ecosystem.”

Given all this, the stressed assets resolution framework in the country is a work in progress. However, IBC’s proactive stance in seeking and acting on feedback from other stakeholders augurs well, as testified by the fact that the IBC has undergone two major amendments already.

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1 As per the Reserve Bank of India’s report on Trend and Progress of Banking in India 2017-18
2 As per the World Bank’s Doing Business Report 2019
4 As per the World Bank’s Doing Business Report 2019
Ratings

Press Release
June 10, 2019 | Mumbai

New stressed assets resolution framework is well-balanced now

Provides additional flexibility to lenders while focusing on efficient resolution

The Reserve Bank of India’s (RBI) revised prudential framework for resolution of stressed assets announced on Friday strikes a fine balance between tight regulatory timelines mandated previously for resolving stressed assets, and inordinate delays that occurred in the past when resolving and provisioning for such assets.

By doing away with mandatory referral of stressed accounts under the Insolvency and Bankruptcy Code (IBC), the new framework puts the onus on banks to devise a suitable resolution plan (RP). It also provides a 30-day review period after default for them to decide on the resolution strategy, including nature and implementation approach (see Table 1).

Table 1: Key changes in the revised prudential framework and their impact

| Change in timelines for implementation of RP | The additional 30-day review period provides lenders time to formulate their strategy for, and approach to, resolution |
| No mandatory referral of stressed assets for resolution under IBC | It will provide an option to resolve the stressed assets outside the ambit of IBC, which in some cases can lead to improved realisations due to better preservation of intrinsic value of the assets |
| Inter-creditor agreement (ICA) between lenders | Will lead to faster decisions with approval of only 75% of lenders (by value) and 60% (by number of lenders) needed instead of 100% previously |
| Accelerated provisioning on delay in implementation of RP | Will disincentivise lenders from referring cases to IBC whereby required |
| Inclusion of non-banking financial companies (NBFCs) and small finance banks (SFBs) under the framework | Step in right direction considering they form around 20% of overall credit in the Indian financial landscape |

Said Krishnan Sitaraman, Senior Director, CRISIL Ratings. “The new prudential framework is a breather for stressed accounts where RPs were under implementation but had to be referred to the IBC because of not being completed in 180 days. One of the key beneficiaries will be stressed power sector assets that were operational and on the verge of being referred to insolvency proceedings under the IBC. These are estimated at ~Rs. 1 lakh crore and banks were staring at significant haircut on many of these assets.”

To discourage banks from delaying both, the resolution process and the reference to IBC, the prudential framework stipulates additional provisioning of 20-35% in a phased manner (see Table 2) beyond what has already been made in accounts where resolution has been delayed beyond 210 days from default.

But the additional provisioning can be written back either once the RP is implemented or upon filing and admission of the stressed account under IBC. That is an incentive for lenders to go for quick decisions.

Table 2: Timelines for additional provisioning

| Timeline for implementation of RP | Additional provisions to be made as a percentage of total outstanding if RP is not implemented within timeline |
| 180 days from the end of review period (210 days after default) | 20% |
| 365 days from default | 15% (Total additional provisioning of 35%) |

“The revised framework provides much needed clarity on the way forward in stressed assets resolution after the Supreme Court had annulled the RBI’s previous circular of February 2018. It should help reduce the stockpile of gross non-performing assets (NPAs) further over the medium term,” said Vydia Nathana Ramaswamy, Associate Director, CRISIL Ratings.

NPAs in the banking system have declined in fiscal 2019 to ~9.3% as of March 2019 after tripling to ~11.5% in the four fiscals till March 2018.
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ASSOCHAM initiated its endeavour of value creation for Indian industry in 1920. Having in its fold more than 400 Chambers and Trade Associations, and serving more than 4,50,000 members from all over India. It has witnessed upswings as well as upheavals of Indian Economy, and contributed significantly by playing a catalytic role in shaping up the Trade, Commerce and Industrial environment of the country.

Today, ASSOCHAM has emerged as the fountainhead of Knowledge for Indian industry, which is all set to redefine the dynamics of growth and development in the technology driven cyber age of ‘Knowledge Based Economy’.

ASSOCHAM is seen as a forceful, proactive, forward looking institution equipping itself to meet the aspirations of corporate India in the new world of business. ASSOCHAM is working towards creating a conducive environment of India business to compete globally.

ASSOCHAM derives its strength from its Promoter Chambers and other Industry/Regional Chambers/Associations spread all over the country.

About association of ARCs in India

Association of ARCs in India (Association) is a representative body of all 29 ARCs operating in India. The Association is a platform for exchange of ideas among members and it represents common issues affecting functioning of ARCs in various fora. It organizes various programmes for interaction among all stakeholders pertaining to ARC Sector.

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