

# INDIA

Stressed assets in India – the future SIP

# P W C



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Dinesh has 25+ years of experience in corporate finance and investment banking, specialising in M&A transactions and fund raising. He has helped companies across sectors in the areas of business planning, market assessment, financial modelling, JV partner search, acquisitions and asset sales. He has also worked with several banks and financial institutions for the resolution of stressed assets.

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## BIO

Rohit is a Partner in the Corporate Finance and Investment Banking and Business Recovery Services practice at PwC India. He has more than 17 years of experience in financial advisory services. He has helped companies in the areas of business planning, valuations, financial modelling, fund raising and M&A transactions.

Rohit has extensive experience in advising clients on the resolution of stressed assets under the IBC, 2016. He has undertaken multiple resolution plan advisory mandates and advised resolution professionals and lenders in the CRIP.

Rohit completed his Bachelor of Technology in Mechanical Engineering from the Indian Institute of Technology, Delhi, and PGDM from the Indian Institute of Management, Indore.

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Shivam is the Associate Director in the BRS practice at PwC India. He has more than ten years of experience in the field of M&A and stressed asset solutions. He also looks after the BRS practice in PwC Bangladesh.

Shivam has led more than eight corporate insolvency resolution mandates under the IBC framework and is leading various debt restructuring and debt funding mandates in Bangladesh. During his stint with PwC, he has worked with the World Bank to assess the NPL situation for a South Asian country and to compare the best practices for insolvency and bad bank followed across various jurisdictions.

Shivam is a Chartered Accountant and has completed his Bachelor of Commerce from Delhi University.

# STRESSED ASSETS IN INDIA – THE FUTURE SIP

## A long road to resolving non-performing assets (NPAs)

Timely and successful resolution of NPAs<sup>1</sup> has been a priority for every economy. The Sick Industrial Companies Act (SICA) was introduced in India in 1985 for the revival and rehabilitation of sick assets which were identified based on their net worth erosion. The primary body governing the act was the Board for Industrial and Financial Reconstruction (BIFR), which was established to revive companies which had the potential to sustain themselves

and liquidate those that did not. Though creditors under the SICA had the right to approve the scheme, the onus of decision-making and managing the operations of a company remained in the hands of the management. Despite the SICA being in place, by 2016, India's stock of NPAs had risen

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In 2016, legislators orchestrated a paradigm shift from a 'debtor-in-possession' model to a 'creditor in control' model.

to USD 3,498 billion. The alarming fact was that the gross NPAs (as a percentage of total debt) reached 9.6 %<sup>2</sup>. This was a result of multiple factors such as multiple laws/regulations that governed insolvency resolution, a debtor-in-possession model which further delayed decision-making due to lack of borrower intent to resolve insolvency and poor lending practices. This led to the establishment of a new insolvency resolution regime, which would not only be more effective and efficient but also serve as a deterrent to the creation of new NPAs.



## The Insolvency and Bankruptcy Code (IBC) – a new dawn

In 2016, legislators orchestrated a paradigm shift from a 'debtor-in-possession' model to a 'creditor in control' model. The IBC was published in the official gazette on 28 May 2016. Thereafter, SICA was fully repealed in December 2016, making the IBC the one law which would govern insolvency resolution. The IBC lays down the insolvency resolution process for corporate persons, partnership firms and individuals in a time-bound manner with the goal of maximising the value and promoting entrepreneurship. With the objective of proceeding incrementally and building capacity, the Corporate Insolvency Resolution Process (CIRP) for companies and limited liability partnerships was introduced. In due course, provisions related to pre-packs with directions to resolve the asset faster for micro, medium and small enterprises and individual insolvency for personal guarantors to corporate debtors were also introduced. The IBC also includes clauses for Liquidation in case CIRP fails or clauses on Voluntary Liquidation. This article focuses on the CIRP and its progress so far.

### Salient features of the IBC

Since 2016, the act has undergone various amendments and with every amendment, lawmakers have tried to make it more practical and accessible for all stakeholders, including investors both domestic and global (high net worth individuals, private equity funds, hedge funds, asset reconstruction companies, financial institutions, alternative investment funds, interim fund providers, etc.) to promote value maximisation and entrepreneurship.

1. <https://thelawdictionary.org/non-performing-asset>

2. <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/0F5R2316BB76DB39BF964542B9D1EBE2CBC273E7.PDF>



CIRP is a time-bound, well-drafted process which needs to be concluded by either approving a resolution plan for continuing the asset as a going concern or initiating the liquidation of the CD. The initial time period for conclusion of CIRP is 180 days, which can be further extended by 90 days, subject to the approval of the Adjudicating Authority (AA).

CIRP can be initiated upon establishment of default<sup>3</sup> for an amount exceeding or equal to \*USD 0.12 million by the CD. The creditor (either operational or financial) files an application against the CD to the AA requesting the AA to initiate CIRP against the CD. Upon admission of the application, a moratorium<sup>4</sup> is imposed to prevent any coercive action against the CD while the powers of management is suspended. A qualified insolvency professional is appointed as the interim resolution professional or the resolution professional (IRP or RP) to run the process and manage the affairs of the CD. The RP works along with the Committee of Creditors (CoC) which is formed within 30 days from the date of initiation of CIRP comprising financial creditors who are not a related party of the CD. Such financial creditors, forming the part of CoC, have voting rights that are directly proportional to the amount of their admitted claim as on the date of initiation of CIRP.

The RP is entrusted with two key tasks:

1. preserving the value of the CD and
2. finding the right investor (resolution applicant or RA) who is able to offer a comprehensive resolution plan maximising the value for each stakeholder of the CD.

The RP has independent powers under the IBC and works under the supervision of the CoC for certain critical matters which require their consent such as the approval of the resolution plan.

On receipt of the resolution plans, all the legally compliant resolution plans are put to vote and the one that attains maximum votes by the CoC (not less than 66%) is filed with the AA for its final approval. Upon obtaining such approval, the resolution plan is to be implemented by the RA in a timebound manner.

3. Section 3 (12) of The Insolvency and Bankruptcy Code, 2016

4. Section 14 of The Insolvency and Bankruptcy Code, 2016

5. <https://tradingeconomics.com/india/ease-of-doing-business>;

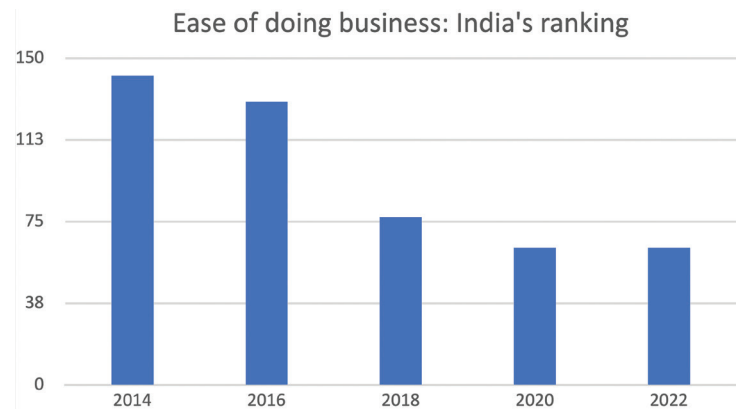
<https://inc42.com/buzz/economic-survey-2022-23-india-reduced-39000-compliances-ease-of-doing-business/#:~:text=According%20to%20the%20World%20Bank,rank%20from%20142%20in%202014.>

6. [https://rbidocs.rbi.org.in/rdocs/AnnualReport/PDFs/RBIAR201617\\_FE1DA2F97D61249B1B21C4EA66250841F.PDF](https://rbidocs.rbi.org.in/rdocs/AnnualReport/PDFs/RBIAR201617_FE1DA2F97D61249B1B21C4EA66250841F.PDF)

7. Status Note on CIRP – IBBI website.

## IBC report card

The shift from debtor-in-possession model to creditor-in-control has given a lot of power and autonomy to the creditors and resulted in speedier resolution of NPAs. The implementation of the IBC has raised India's rank of 'Ease of doing business' from 130th in 2016 to 63rd in 2022.<sup>5</sup>



When the law was introduced in 2016, India's federal bank, the Reserve Bank of India (RBI), directed banks to initiate insolvency proceedings against the twelve largest NPA accounts, referred to as the 'dirty dozen'. This was done with the objective of resolving the biggest NPA accounts to ease the balance sheet pressure on banks and to test the IBC at its seams. The dirty dozen accounted for 25%<sup>6</sup> of the total gross NPA at that time. Since the IBC began with 12 of the largest NPA accounts, it caught the attention of investors and regulators and ensured a fast-learning curve with a series of swift amendments to mend the loopholes in the IBC. Out of these twelve, as on today, eight have been resolved successfully (two are still under CIRP and two are under liquidation).

To understand the progress, as on 30 April 2022, 5349 applications have been admitted under CIRP, out of which 500 have been resolved successfully, resulting in a realisation which is almost double the amount in comparison to the liquidation value of the corporate debtor.<sup>7</sup>

## Acquisitions under the IBC – the clean slate principle

Acquisitions under IBC provides an asset on a 'clean slate principle' that provides the new buyer protection from all past civil and criminal liabilities. Various case laws can be accounted as judicial precedents which bring clarity to the stated 'clean slate' doctrine.

Once the plan is approved by the AA, it becomes binding to all the stakeholders including and not limited to the

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While IBC has largely been a success story, the participation of foreign investors as RAs has been limited.

central government, state government or any local authority to whom the debt is owed, guarantors and any other stakeholders. Additionally, a few other benefits are available under IBC such as the carrying forward of accumulated tax losses which offers a healthy tax shield to the new owner

post the turnaround of the CD. In a normal mergers and acquisition (M&A) scenario, such accumulated losses and unabsorbed depreciation are allowed subject to certain conditions. The IBC (enabled by amendments in other acts/regulations) also envisages a single-window clearance from the AA through the resolution plan to give effect to all kinds of restructuring (carve-out, merger, demerger, delisting) and ensures speedy implementation of the resolution plan.

## Strengthening the ecosystem

While IBC has largely been a success story, the participation of foreign investors as RAs has been limited. The biggest deterrent for RAs to participate is the inordinate delay in the admission of CD and approval of the resolution plan by the AA<sup>8</sup>. A number of amendments have been proposed to the Insolvency and Bankruptcy Board of India (Regulator or IBBI), which shall hasten both the admission process as well as the approval of the resolution plan by AA. The amendments proposed in this regard have been produced for the ease of reference below:

- AA to mandatorily consider the application for the initiation of CIRP filed by the financial creditor on the occurrence of default and upon fulfilment of necessary requirements.
- AA to rely on information utility (IU is the platform where the occurrence of default by the CD is to be filed by financial creditors, operational creditors or CD) for applications filed by the financial or operational creditor to initiate the insolvency rather than the AA assessing the claim by itself.

In addition to the amendments brought under the IBC framework, the following amendments have been introduced in other RBI frameworks as well, with the endeavour to put the stressed asset sector at a platform that shall enable wider reach and participation from both financial and strategic investors. Given below is a brief overview of the amendments:

- Under the existing Alternative Investment Fund (AIF), regulations Special Situations Funds (SSF) has been introduced as a special category to invest in stressed assets in India in which a pool of investors (be it foreign or domestic) collaborate and create a special fund. SSF should be with a corpus of at least \*USD 12 million. These SSFs can either act as a RA or may acquire the loan from an existing financial creditor.

8. <https://www.mca.gov.in/content/dam/mca/pdf/IBC-2016-20230118.pdf>

- Loans raised from foreign lenders by an Indian entity, known as External Commercial Borrowings (ECB), can now be availed for restructuring/refinancing of stressed assets. Successful resolution applicant, who are also eligible borrowers, can raise ECB from foreign lenders and such an ECB shall be considered under the automatic route and can be processed without the prior approval of the RBI.
- In the year 2002, Asset Reconstruction Companies (ARCs) were introduced under The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) with the objective of transferring the NPAs from the banks. ARCs, having a certain net worth, have now been allowed to come forward as Resolution Applicants and submit a resolution plan under the CIRP, subject to the fulfilment of conditions as specified.
- Apart from private ARCs, a bad bank has been established in India, known as National Asset Reconstruction Company Limited (NARCL) along with an Asset Management Company (AMC) called India Debt Resolution Company Limited (IRDCL) for the aggregation and resolution of NPAs. A majority of the stake in NARCL is held by public sector banks and the remaining is held by private sector banks. Recently, it has been observed that the NARCL has started submitting Resolution Plans for CDs under IBC.<sup>9</sup>
- IBC regulations were amended to formulate the strategy of marketing the assets of the CD in consultation with the CoC for a wider reach and potential RAs as the targeted audience. As per the law, the RP should mandatorily publish the Expression of Interest (EOI) in the newspaper (both English and regional language) in the state of registered office. With this amendment, RPs shall now work on the strategy to market the asset as much as possible, be it via publication, or running road shows.

## Enhancing the role of the IBC

The Insolvency and Bankruptcy Board of India (IBBI), the esteemed regulatory body responsible to monitor the principles laws and regulations as laid down under the IBC, disseminates discussion paper from time to time, to solicit comments from public and stakeholders in the insolvency ecosystem. One such recent recommendation is 'reimagining the consideration of the resolution plan' which suggests the examination of multiple plans for the same CD during the CIRP. Within this proposed framework, it is suggested to call for multiple resolution plans for one CD to achieve value maximisation by attaining an optimal resolution plan that would feature the provisions necessary to acquire the CD as a going concern and manage its affairs post approval by the AA. As proposed in this amendment, the RP can call upon multiple resolution applicants to bid for whole or part of the CD leading to a better value and increased participation (and sum of parts approach). Certain other measures have been proposed, which are aimed at enhancing the efficacy of IBC:<sup>10</sup>

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IBC regulations were amended to formulate the strategy of marketing the assets of the CD in consultation with the CoC for a wider reach and potential RAs as the targeted audience.

- Expanding the applicability and bringing the amendments to pre-packaged insolvency resolution framework and fast-track CIRP to the prescribed categories of CDs as notified by the central government. This is expected to result in a speedy resolution for wider category of CDs and gain more traction with the RAs.

9. <https://timesofindia.indiatimes.com/city/kolkata/bad-bank-narcl-is-highest-bidder-for-2-troubled-srei-cos/articleshow/96751590.cms>  
 10. <https://www.mca.gov.in/content/dam/mca/pdf/IBC-2016-20230118.pdf>

- Disclosure of valuation estimates of the CD in the IM shall serve as a guidance on expected value to the RAs, thereby, avoiding protracted negotiations to maximise the value of the CD.
- Protection of a RA after the implementation of the resolution plan with respect to various past liabilities – either by any government or statutory authority regarding the claims arising before the commencement of the CIRP.

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Until now, ARCs (be it public like NARCL or private) would acquire the NPAs from the bank and work towards their resolution.

- Incentivising interim finance providers by allowing them to be a part of the CoC meeting, therefore, making it more attractive (in addition to getting paid in priority under waterfall mechanism) for financial institutions to lend to the CD during CIRP and help preserve value.

Another discussion paper issued by the RBI on securitisation of stressed assets framework<sup>11</sup> acts as an instrumental amendment which would bring about a paradigm shift for the stressed assets in India. Currently, securitisation is allowed only through ARCs wherein stressed loans are acquired from the lenders (or by CD as per the new amendment). With this framework, there would be more private players (as per the eligible norms) who would come forward to acquire these NPAs, manage and engage with a new pool of investors who would be ready to subscribe to the security receipts of the stressed sector. To sum up, until now, ARCs (be it public like NARCL or private) would acquire the NPAs from the bank and work towards their resolution. At present, there are 28 ARCs in India sharing the burden of NPAs from banks. With this amendment, there would be a new category of special purpose vehicle (SPE) apart from SSF, who would be competing with these ARCs to attain a better price discovery.

It is also proposed that the originator would sell their identified NPAs to these SPEs who would further appoint the servicing entity to manage the stressed funds and maximise recoveries. While it might take some time to finalise this, the objective is certainly inclined towards finding a better resolution and a more focused team. Participating in the Indian stressed asset landscape The insolvency law is meant to work in conjunction with amendments to various regulations, such as those governing banking, the Securities Exchange Board of India (SEBI), the Income-tax Act, 1961, and the Companies Act. The goal is to achieve a comprehensive solution to resolve NPAs and make the process easier and accessible to a wider range of investors. These efforts are aimed at creating synergies that can help tackle the various problems related to NPAs.

To summarise, while the investor can surely participate directly as a RA, there are multiple indirect ways for investors (foreign or domestic) through which they can participate in the Indian stressed asset landscape:

- A pool of investors getting registered under AIF, known as SSF, with a minimum corpus of \*USD 12 million can either choose to put a resolution plan or acquire a loan from the existing lender.
- Alternatively, eligible foreign players might extend lending in the form of ECB at the time of submission of resolution plan.
- Incorporate private ARCs with minimum net owned fund of \*USD 122 million along with fulfilling other requirements as mentioned under the regulatory framework of ARCs issued by the RBI and can undertake activities as RA apart from acquiring the loan.
- Incorporating the SPE (proposed) once the securitisation of stressed asset framework comes into the picture.

11. <https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=21728>





These amendments, and the ones that may come in the future, shall accelerate the flow of funds into the Indian economy to resolve stressed assets which have potential. The formation of the bad bank (NARCL) in the resolution process, registration of a number of SSFs and the introduction of many amendments in the applicable legal framework are all aimed at resolving India's NPA problem in the most effective manner. These measures offer investors an opportunity to participate in India's stressed assets landscape, just like they would invest in a systematic investment plan (SIP).

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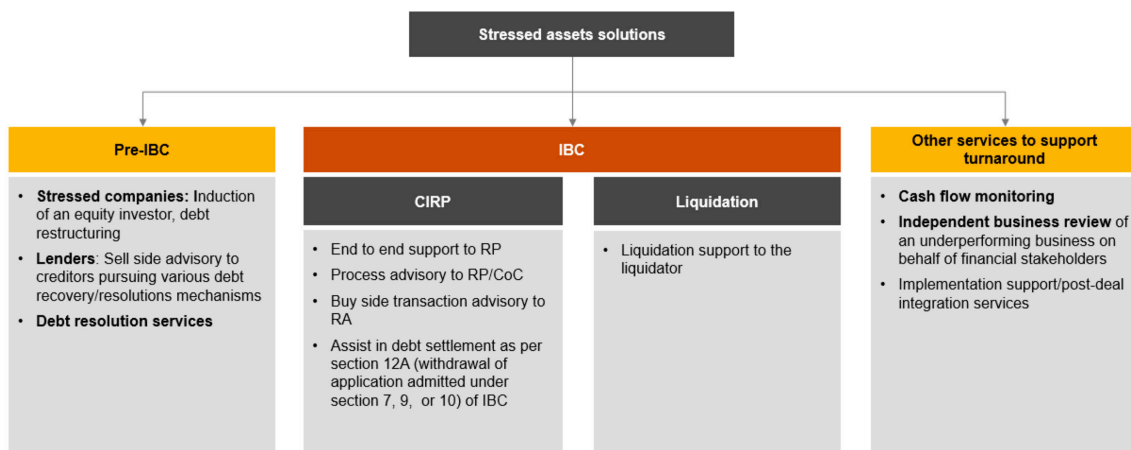
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PwC's Business Recovery Services in India and Bangladesh works with organisations to negotiate great outcomes at speed.





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- M&A advisory
- fund raising
- initial public offerings (preparation)

We are a community of solvers combining human ingenuity, experience and technology innovation to deliver sustained outcomes and build trust.

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\*USD 0.12 Mn shall be construed as equivalent to INR 1 Cr



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