

SUDIPTO DEY

Following the Supreme Court's order striking down the RBI circular on stressed assets, the spotlight expectedly is now on the banking regulator. Both the government and the RBI have said that they are working on a revised version of the February 12, 2018, circular that would lay down resolution framework of stressed assets. Experts, however, point out that the challenge before the regulator is to use its general powers of banking supervision and prudential regulation to ensure that banks take corrective measures against defaulters in a time-bound manner and enable out-of-court resolution of stressed accounts.

The apex court on April 2 had stuck down the circular on the ground that Section 35AA of the Banking Regulation Act did not give the RBI the power to initiate proceedings under the Insolvency and Bankruptcy Code (IBC) on its own. These powers could only be exercised in consultation with the government.

"Primary challenge will be to have a mechanism of obtaining the government's approval for directions on sending specific unresolved accounts to the National Company Law Tribunal (NCLT). Otherwise, powers of the RBI were upheld," says Cyril Shroff, managing partner, Cyril Amarchand Mangaldas.

According to Shreya Prakash, a research fellow at the Vidhi Centre for Legal Policy, it is key from a legal standpoint that the RBI should, going forward, ensure that directions for mandatory initiation of proceedings under the IBC are taken with prior authorisation of the Central government, and with respect to specific defaults.

Legal experts point out that this was earlier done by the RBI when it nudged 12 highly stressed debtors — popularly referred to as the 'dirty dozen' — into corporate insolvency resolution process under the IBC.

Experts say the regulator should consider taking a nuanced approach to enable out-of-court resolution of stressed accounts. First, the framework prescribed in the February 12 circular required the consent of all creditors to the resolution plan in the

How will RBI walk the tightrope

While coming up with a revised framework for resolution of stressed assets, the regulator should be careful of the potential for other legal challenges, say experts

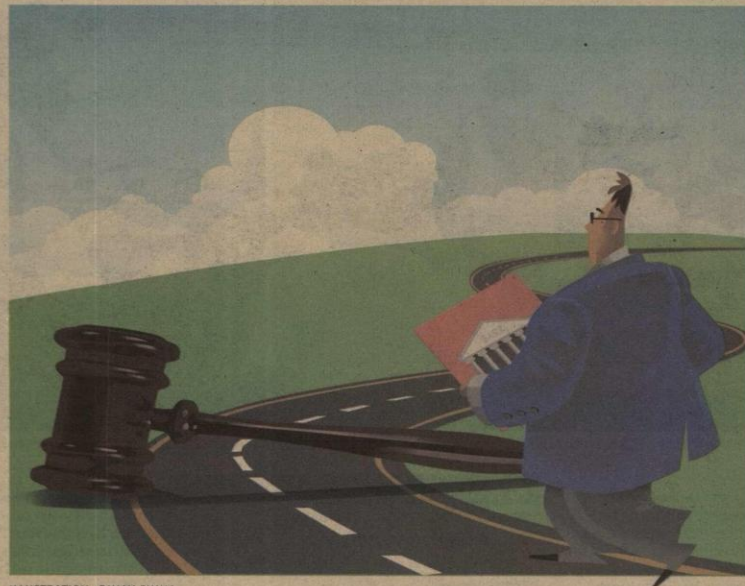


ILLUSTRATION: BINAY SINHA

out-of-court resolution. "This created possibilities of hold-outs," says Prakash. Second, the out-of-court resolution mechanism prescribed in the February 12 circular was common for all sectors. This did not take into account special circumstances of sectors like power and sugar.

The Internal Advisory Committee of the RBI, along with banks and the government, may prepare a list of

prospective cases which may be referred under the Code depending on various factors and also taking into account the observations of the apex court's ruling.

"The only glitch which we foresee for the moment is that what the RBI would be classifying/outlining as specific default?" says Devesh Juvekar, partner, Rajani Associates. The challenge is to maintain in some

form in the new framework the flexibility on the manner of resolution and time pressure that the February 12 circular provided, says Shroff.

Experts warn that in devising a new stressed asset framework, the RBI should be careful of the potential for other legal challenges. Prakash points out that there are several contentious issues under the IBC over which the apex court is yet to give its

TAKEAWAYS FROM SC'S ORDER

THE SUPREME COURT reaffirmed the principle that economic laws should be granted greater latitude

IT HELD THAT FROM the enactment of Section 35AA of the Banking Regulation (Amendment) Act 2017, it is clear that the RBI can issue directions to banks to initiate insolvency proceedings only after directions from the Centre

THE APEX COURT declared the circular 'invalid' as a whole and with no effect in law. This order can incentivise pre-bankruptcy restructurings, with lesser compulsion

ruling. "Challenges could arise in connection with any revised circular that the RBI comes out with," she adds.

Experts say the IBC is a powerful tool in the hands of banks. However, it will be helpful for the RBI and the central government to collectively set out clear, transparent and predictable guidelines for the pathway to the IBC, so that there is no scope for a challenge, says Suharsh Sinha, partner, AZB & Partners

Shroff is quick to note that insolvency tends to be value destructive for businesses. Hence, a focus on consensual restructuring is important. "Any list of cases should be prepared after efforts of consensual restructuring for such accounts have failed," he adds.

Juvekar is of the view that the banking regulator should consider giving a separate treatment for NPAs caused due to wilful defaulters, and those where defaults are because of reasons such as policy changes in various sectors, such as coal, infrastructure and power. That experts say is easier said than done.

While the new circular should retain flexibility of banks on how to re-structure/revive a distressed asset, experts say banks at the same time must be made more accountable and responsible for their decisions.

"Banks may feel the need for a judicial stamp in any decision on re-structure or revival of a stressed asset, especially when haircuts are sizable," says Ashutosh Agarwala, senior advisor, Duff & Phelps, a valuation and corporate finance advisory firm.

Experts say the revised framework for resolution of stressed asset may also expedite the introduction of pre-packaged bankruptcy schemes in India.

The Insolvency and Bankruptcy Board of India has recently initiated measures to come out with pre-packaged bankruptcy schemes. Experts point out that for such schemes to be successful, there would be a need for some amendments in the IBC and the Companies Act, 2013. That would be a long drawn affair involving several rounds of stakeholder discussions. For the time being, all eyes are on the banking regulator to lift the pall of uncertainty around the framework for resolution of stress assets.