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Debt Restructuring in India Post Covid-19

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simple solutions

"From the ashes, a fire shall be woken, A light from the shadows shall spring…" **— J.R.R. Tolkien**

COVID-19's impact on businesses and economy

The entire world is currently witnessing an unprecedented scenario due to the advent of Covid-19. The global economies have subjected themselves to lockdown and have resorted to social distancing measures with a hope to cut down the chain of infection, at least till we get to see some kind of a vaccine to address this gargantuan pandemic or at least the covid cases show a downward curve. The closing down of activities have certainly crippled economies who are staring down on such magnitude of financial challenges hardly encountered before. Businesses have come to a screeching halt. A once only a health crisis has now additionally metamorphosed into an economic catastrophe. The speed and the grasp of this pandemic has been unfathomable and has caught everyone unawares.

One thing we can say with certainty is that there would be a gradual but sure resurrection of businesses and economies. But by the time, this deluge stops, one could only imagine the annihilation that it would have done. There will be significant change in the manner of economic restructuring after Covid-19 as there would be a need to relook and rethink on the turnaround strategies in the context of this 'new normal'.

This pandemic has undoubtedly elicited in substantial reconsideration on the aspect of drafting commercial contracts. A case in point is the *'Force Majeure'* clause which is likely to be invoked and tested in most contracts and there is a high probability that the courts may witness a deluge of cases as a result of it. All of sudden one of the 'boilerplate' clauses of a contract has become a household name – it has gained a renewed significance and a fresh reminder of its subsistence to the draftsmen.

The International Finance Corporation (IFC), a member of the World Bank Group is helping companies by providing $8 billion in financing and preserving jobs around the globe, as was reported some time back.

The recent regulatory reforms and the refurbished Insolvency law has breathed a new life in the insolvency regime and distressed assets sphere in the country. The NPA mess may lessen and in turn give a new lease of life to the business of distressed assets.

Dealing with debt restructuring post COVID-19

Prior to the outbreak, the financial institutions in India were already reeling under the delinquency of loan defaults. This problem has prevailed despite various schemes and measures introduced by the RBI from time to time. Interestingly, the measures have been for both the financial institutions as well as the defaulting entities. Post covid, the challenges would be multifarious.

Sector specific impact of Covid 19

The pandemic coupled with lock downs, has unarguably affected certain businesses severely, namely travel, hospitality, hotels, food and beverage, airline and related businesses. This is primarily due to a complete embargo on public travel and adoption of social distancing. It would be quite simplistic to gauge the severe impact especially on the tourism sector which was eyeing a windfall at the onset of the peak holiday season in India but for the pandemic to bulldoze its dreams. Many small time players could be staring at the prospect of shutting down and if better, being acquired by the bigger fish, if that be the case.

There has been a complete derailment in manufacturing sector plagued by production shutdowns, labour and supply chain disruptions. The MSMEs and small businesses are the ones who have been hit the hardest.

Will COVID-19 affect acquiring distressed businesses in India?

Due to the pandemic, the financial year 2019-2020 ended terribly providing a body blow to the sale of bad assets as there were hardly any takers. This disturbed the maths of the banks and NBFCs who were expecting to lessen their bad loan burden. Going forward, both the liquidity and the valuation aspects shall become critical as regards the functioning of the distressed assets business in India.

One may not be entirely incorrect in apprehending that the next quarter or so could provide a hint as regards the impact on businesses whose viability and resilience would be tested. The near future could see a surge in the availability of distressed assets in India, especially in the travel and tourism, entertainment and other consumer dependent businesses. This may pose a good investment opportunity for private equity investors, ARCs and alike. This is in fact a 'good time' for these 'pack of hunters' to acquire distressed assets at 'drool worthy' valuations. This looks apt time to grab a strategic/controlling interest in businesses with fair fundamentals if one thinks from the perspective of private equity players.

Many cash rich entities, venture capitalists, private equity investors and fund managers may be willing to jump and grab the opportunity which will arise due to a drop in valuation of otherwise well to do businesses and assets in India – albeit this time probably their efforts may be reduced since their task would be akin to picking up the pearls when the sea dries up. The challenge would be to pick up the 'real pearls'.

One of the biggest Indian conglomerates is witnessing series of private equity investments in its new age businesses as the conglomerate had publicly declared about its target to cut down on its huge debt pile. It's a rarity to witness such back to back deal making especially in these extremely torrid times. One may see this as early signs of economic recovery and may imagine that all is not lost at the end and the resilience of the country can stand the test of the time. One may even reckon this as a mere aberration.

Relaxations in IBC to help ease debt restructuring and distressed businesses

Apart from the various reforms enacted by the current regime in India, the insolvency law too has seen some reforms, as a result of the pandemic. The government is in the process to provide a formal suspension on commencement of new insolvency proceedings – for a period of at least 6 months to 12 months. The intent propagated is to shield the MSMEs and small businesses amongst other objectives. The requisite notification is yet to be made public and thus the details of such further IBC amendments cannot be analysed at this juncture. The moot question is whether the suspension will be applicable to the defaults occurred during the lockdown period or whether to the defaults that have occurred prior to the lockdown period i.e. existing (pre-covid) defaults. Also, whether the suspension will apply to applications already filed with the NCLT but where such application is yet to be admitted. Moreover, whether there would be any additional time for matters where resolution plans have already been filed with the NCLT and the NCLT is yet to decide on the same. Such additional time period may be felt necessary by the Resolution Applicants – essentially to reanalyse their resolution plans in the aftermath of the pandemic situation.

In light of the RBI Circular of February 12, 2018, dealing with the restructuring of stressed assets, being struck down by the Supreme Court, RBI came out with the new regime on June 07, 2019. Under such new regime, many creditors and the borrowers would have entered into Inter Creditors Agreements and a time period of 180 days was provided. The moot question is *what would be the fate of the cases where the restructuring has already been agreed upon by the parties but were yet to be enforced*? Whether the ratings of these businesses would suffer as a result of this pandemic needs to be seen or whether their pre-COVID situation would be considered considering they were in a position to restructure their loans only to become one of the fatalities of this pandemic.

RBI's Prompt Corrective Action (PCA)

In India, financial institutions from both the private and public sector have been victims of poor corporate governance. Most public sector banks are under various stages of PCA and which seem to be saved due to the consolidation.

Therefore, it can be said that the current scenario of the financial institutions in the country is quite a distance from being ascertained as any way near being reckoned as strong and we are constrained to tackle the pandemic with hardships and limited resources.

Dealing with debt restructuring post COVID-19

The government of India has been coming out with various measures including certain temporary regulatory relaxations such as loan moratoriums, liquidity support which will definitely act as a catalyst for the economy to gather some strength and aim to stand back on its feet, both during and post the COVID-19 era. At this moment, this appears to be a work in progress, to say the least.

The central government has also launched certain relaxations for the states by increasing the limit of short-term credit where the governments can borrow from the central bank. The limits have been increased as much as 30% which will be effective till September 30, 2020. The RBI has also activated (*for one year*) the counter-cyclical capital buffer, which banks have to maintain in their accounts for mitigating their losses in a particular business cycle. On April 17, 2020, the RBI, as part of its set of relief measures, has also announced another tranche of LTRO to ensure adequate liquidity.

Reassessment of current business plans, understanding and evaluating the potential of the available resources and prioritising the implementation will be crucial steps for tackling future business opportunities for enterprises in India. The viability of various businesses will be tested in the coming times. Businesses which are more resilient to such force majeure events and are able to deliver productive results even in such scenarios might see a boost in investments in the post COVID-19 era.

Debt Schemes of Mutual Funds in the news

It may not be a coincidence that post the close down of certain debt schemes by a mutual fund house, the RBI opened up the liquidity window even for mutual funds. It’s another matter altogether that SEBI has recently advised the concerned mutual fund house to focus on returning money to its investors in the context of such fund house winding up its certain debt schemes. The SEBI press release states that certain sections of media reported that tightening of norms for investment in unlisted debt by SEBI was one of the factors that added to pressure on their debt schemes which resulted in winding up of their schemes. The press release further states that in light of credit events since September 2018, which led to challenges in the corporate bond market, a need was felt to review the regulatory framework for Mutual Funds and take necessary steps to safeguard the interest of investors and maintain the orderliness and robustness of their investments. It was observed that unlisted debt securities, particularly bespoke securities in which only a single investor invested, suffered from both forms of opaqueness: opaqueness of structure and true nature of risk on the one hand and lack of ongoing disclosure in respect of financials of the issuer on the other. SEBI also noted that despite the regulations being clear, some mutual fund schemes seem to have chosen to have high concentrations of high risk, unlisted, opaque, be spoke, structured debt securities with low credit ratings and seem to have chosen not to rebalance their portfolios even during the almost 12 months available to them so far.

Some options for debt restructuring and the importance of legal guidance

To reiterate, some sectors would be more affected than the others due to the pandemic. The removal of impact of legacy of non-compliances by the promoters on the potential buyers, under the insolvency regime, should prove to be a morale booster for the acquirers as they are insulated from the erstwhile violations. Though, the bidders who had already submitted their resolution plans would need to relook into the same as a matter of its feasibility post covid 19 as many bidders may cite force majeure/ frustration for fulfilling their commitments. Further, the possible suspension of new insolvency filings coupled with the enhancement of threshold for initiating insolvency proceedings may be viewed as another opportunity by the defaulting companies/ promoters to restructure their debts, preferably by out of court means, by entering into fresh arrangements with their bankers/creditors backed by recently announced RBI measures. By such restructuring/ cleaning of the house, the borrower companies can also make themselves attractive targets for investors.

Schemes of Arrangements under Companies Act

In the event of suspension of new IBC filings, the lenders and/ or the borrower companies may even consider approaching the NCLT with Schemes of Arrangement under Section 230 of the Companies Act to restructure the debts. This way creditors can also pray for safe custody of assets of the borrower company till such scheme of arrangement is made effective. Basically, arrangement similar to a moratorium under IBC can be envisaged.

RBI Circular of June 07, 2019

The debt restructuring can also happen under the RBI Circular of June 07, 2019 (Prudential Framework for Resolution of Stressed Assets) which applies to Scheduled Commercial Banks, All India Term Financial Institutions, Small Finance Banks and others. However, the said RBI Circular does not apply to Mutual Funds, AIF, Overseas Lenders/ banks and other sectoral regulated entities. From a regulators perspective, the scope of this Circular could be widened so as to include entities which are governed by other sectoral regulators such as Insurance regulator, SEBI, pension regulator etc. This would pave way for more restructuring of debts thereby clearing bad assets scenario. Needless to state, this would require concerted efforts of various regulators who have already provided certain relaxations under their respective regimes with respect to restructuring of stressed assets/loans – such as relaxations under SEBI Takeover Code, SEBI Delisting Regulations et al.

Measures under SARFAESI Act

Since fresh IBC proceedings may not be permitted, the IBC option would be ruled out for the creditors, at least for the time being. The Operational Creditors, subject to the provisions of their respective contracts, may have to resort to either arbitration or file civil suits. As regards the Financial Creditors (depending whether secured or otherwise), may have to review their collateral, the probable valuation of the same in current times and enforcement of the same under SARFAESI Act.

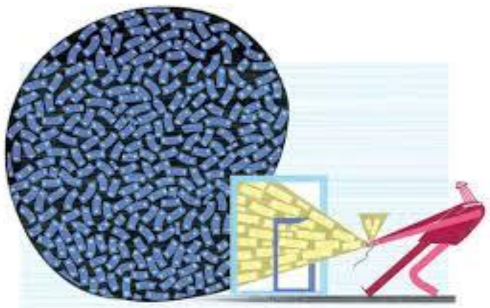
SARFAESI Act provides various measures such as enforcement of security, debt into equity conversion and taking control and charge of management of the borrower etc. SARFAESI Act also permits sale of assets of the borrower company by way of public auction or private treaty. In case the security is shared, then all such security holders would have to assent so as to resort to any of the SARFAESI Act enabled security enforcement tools.

SEBI Consultation Paper on Preferential Issue in companies having stressed assets

The recently announced SEBI Consultation Paper on Preferential Issue in companies having stressed assets looks promising and provides some relief for making acquisitions in companies having stressed assets. On offer are relaxations from making open offer and ease on pricing, however subject to certain conditions. The Lenders and private equity players can consider this option as and when the same is made operational by SEBI.

Options for ECB and FCCB holders

For Financial Creditors such as ECB and FCCB holders, the ECB Guidelines would have to be referred to. Else, these creditors may approach the foreign courts and then seek enforcement in Indian Courts.



Refinancing

The refinancing option could also be opted by the companies. Banks would be also be more than willing for this especially considering more cash left in their kitty thanks to the spate of recent large rate cuts by the RBI owing to the sluggish credit growth.

ARCs and PE investors

The quality of assets and the valuations would be key for the ARCs and PE investors would like to cash on the never before like opportunity. The emphasis would be on the quality of underlying asset/collateral, which the investors would be keen to ascertain before providing debt funding. It would be interesting to see how the rating companies operate in these times.

It would be worthwhile to comprehend the mode of acquisition of distressed financial assets by ARCs i.e. the quantum of Security Receipts vis-à-vis cash component. It can be sensed that the emphasis would be more on cash component owing to the liquidity crunch. The big reason is the provisioning requirements by banks.

Scope for Legal Advice

In these times, the role of lawyers becomes ever more critical – whether the lawyers acting for the promoters/companies or for the investors / ARCs or bankers. As such, the legal documentation post covid 19, would attain heightened significance. The due diligence exercise would be expected to be carried more by virtual means (read data room mode) as compared to the actual site visits earlier for obvious reasons, at least for the near future. The lawyers would have to guide their clients with special emphasis on clauses such as 'Material Adverse Change/Material Adverse Effect', 'Force Majeure', Specific Representations and Warranties, Indemnification, Disclosures by the promoters/ companies, Events of Defaults, Cure Periods, Closing conditions, covenants and undertakings of promoters/ companies, Events requiring prior investor/lender consent – more so integrating a flavour of covid 19 to such provisions. These provisions would be negotiated to the maximum possible extent so as to benefit ones client. There could be also now more emphasis on obtaining Warranties and Indemnity Insurance policies as part of commercial transactions.

Covid 19 have also affected employees and their employability. Thus, the structuring would also need to be done considering the human angle – employees, their retrenchment, appraisals etc. For the transactions which are caught in the midst of this pandemic, may prefer to wait and watch till the storm goes by and then take a decision.

The transactions requiring regulatory permissions would have to be structured with special emphasis on the time element and whether the same could be mitigated.

The importance and the need for electronic contracts/digital signatures, e-stamping and e-registration has been never felt before than in these times of lockdown and social distancing. Stakeholders have already begun with these and going ahead such tools may become a norm, more so due to its utility value.

Finding opportunities and design structures for investing in India

To attract foreign investment, India's response to the pandemic will be that of paramount importance. Several players in the world economic market are waiting with their hawk eyes to see India's position in the post pandemic market.

However, in order to attract investors and for effective debt restructuring in India, the government will have to continue responding to the pandemic with strong shoulders albeit with limited resources. Also, business enterprises need reimagining their business plans in order to be more efficient and restructure their units so as to attract investments – both from within and outside India. Additional measures and regulatory relaxations could prove to be the necessary booster shot to re-position India as a 'go to investment destination' who has already shown direction to the world in the pandemic battle with its exemplary initiatives.

Recently, the exchange control norms in India underwent certain changes more so with respect to foreign investment from countries sharing land borders with India and from people/citizens of such countries sharing land borders. Having said so, the foreign investments from such countries are nevertheless still permitted, albeit under an approval route. These steps are understandable as the same are undertaken to guard against opportunistic takeovers/ acquisitions in such testing times where the valuations are akin to a 'low hanging fruit'. This is more so to have a check on protecting country's sovereignty and security. Eventually, it is cardinal to have a balance between economic reforms as well as economic protection.

Airline, services, hospitality, tourism and such other sectors have been the biggest casualties of this pandemic. As such banks and financial institutions, having exposure to these businesses, would need to do a rethink and restructure such accounts by unprecedented relief measures and blessings of RBI would only complete the circle. New restructuring measures would have to be thought out to revive these businesses to the extent possible.

Conclusion

The pandemic will certainly change the entire business ecosystem in India and the plans would have to be redrawn. The process would have to be started right from scratch to address the new normal. But they say the, change is the only constant and that good times or bad times, nothing is permanent. History has shown that with changing times, people learn to adapt and gradually become adept at dabbling with changes. It is said that 'Extraordinary times calls for extraordinary measures' and what a poignant moment than the present one to redefine this adage. Let us hope that all the efforts and measures results in the economy rising like a Phoenix from the pandemic ashes.

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