

OPPORTUNITIES IN STRESSED ASSETS & FUNDING OF STRESSED ASSETS + RESOLUTION PLAN

Organised by: Committee on Insolvency & Bankruptcy Code of ICAI

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TOPIC 1 - OPPORTUNITIES IN STRESSED ASSETS

Brief Background:

India's regulatory framework to deal with Stressed Assets has started with the following broad developments: -

- Sick Industrial Companies (Special Provisions) Act, 1985 – Gave birth to - BIFR – having a very wide powers as conferred in the SICA. BIFR dealt with issues like revival and rehabilitation on sick companies, winding up of sick companies, institutional finance to sick companies, amalgamation of companies etc. Basically BIFR was a quasi judicial body. SICA failed due to its applicability industrial undertaking and the moratorium as contained therein was often misused.
- The Recovery of Debt Due to Bank and Financial Institutions Act, 1993
- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFSI)
- Insolvency & Bankruptcy Code, 2016

What is Stressed Assets?



- Stressed assets = NPA + written off assets + restructured loans
- Even SMA before a period of 90 Days can be termed as stressed Assets

What has Changed?

- IBC is the Game changer
- IBC has given stressed assets resolution a legal structure, definite procedures, and has provided a level playing field for domestic as well as foreign investors.
- It has established well-defined timelines for the resolution of distressed companies. It denotes a paradigm shift in which creditors take control of assets of the defaulting debtors.

Issues with earlier regulatory framework

- Huge piling up of NPA's
- Creditors were required to wait for years to recover their dues
- Debtors were in control of the entire process
- Was never a timebound process and promoters had a scope to delay the process and frustrate the creditor

New Regulatory framework- The Insolvency and Bankruptcy Code 2016

- Time Bound process
- Creditors in Control of the entire process
- Fragmentation in the Corporate Insolvency framework stands removed
- Credit will flow more freely and will increase the faith and confidence of the creditor.

As per the Economic Survey 2020-21

- almost 1500 companies have either been liquidated or taken over under the IBC
- another almost 1800 companies undergoing the process
- average time taken for resolution of companies is 441 days as opposed to 328 days for liquidation (Statutory upper time limit is 330 days)
- Thus, value of the asset is protected. In addition, lack of consensus amongst lenders, delay in court processes and fear of commercial decision making in the largely Government owned bank system have been a nuisance.

Gross NPA Scenario

- as financial creditors start recognising more non-performing loans, it leads to more distressed debt opportunities for investors including buying these NPAs
- The gross non-performing assets (GNPA) ratio, according to RBI Financial Stability Report 2021, is likely to increase from 7.48 per cent in March 2021 to 9.80 per cent by March 2022 under the baseline scenario; and to 11.22 per cent under a severe stress scenario.

Government Measures:

- Government's frontloading of investment and spending, will likely encourage the turnaround in the economy
- recent formation of the National Asset Reconstruction Company eliminates one of the major headaches of aggregating loans from multiple lenders
- RBI has effectively opened up the trading of stressed loans to other regulated players in the market which was earlier in the domain of ARC
- India offers a unique opportunity for yield hungry investors at one end of the spectrum and the high growth capital risk investors at the end of the spectrum.

Global Players / Domestic Investor:

- global players who are willing are peeping from outside the fence, waiting to see how the new frameworks play out, domestic players have already started working actively in the space to acquire assets at discounted prices.
- Certain reforms, like growth of specialized financial intermediaries like ARCs and AIFs, have made it increasingly feasible for sophisticated investors to bring in resources for reconstruction,
- Stressed Assets as an investment class are set to take off and are a rich source of 'value buy' investment opportunities for foreign FIs looking to invest in India.

Why to invest in Stressed Assets?

Returns:

Given the risk involved in investing distressed companies, the IRR is high and there is a potential to earn very high returns.

Liquidity:

With a better reporting of NPAs, the liquidity in the NPA market is flush.

Cost-Effective Expansion:

Distressed companies allow for a strategic way for vertical or horizontal integration.

Six points to consider while investing in distressed assets

1. Risk & Reward:
2. Low correlation with traditional asset classes:
3. Legal challenges:
4. Partnering with experts:
5. Promoter Friendliness:
6. Robust incentive framework:

Conclusion:

Winds of change are blowing across the Indian investment management sector. Buoyed by easier regulations and tax clarity for Alternative Investment Funds (AIFs), investment advisory and Portfolio Management Services (PMS), and greater availability of domestic capital, star fund managers are turning entrepreneurs. The phenomenon of the owner-fund manager is gathering momentum, and I think this could change the face of the Indian fund management industry.

TOPIC 2 - FUNDING OF STRESSED ASSETS

Top factors driving fund managers to start their own outfits

Evolving AIF Regulations and tax clarity:

Setting up an onshore fund in India became a lot easier after SEBI introduced the AIF regulations. Launching onshore hedge funds became possible for the first time. The figure of Registered ATFs has gone up from 235 in 2016 to about 946 as of now.

Rise of The Domestic Limited Partner:

There are larger pools of domestic capital available in India today and investors are looking for differentiated strategies that can help them maximize their returns. Alternative investments are becoming popular among this set.

Increasing momentum of alternatives as an asset class:

Investments made by AIFs surpassed INR 24,800 crore at the end of the second quarter of 2016-17, as against INR 11,255 crore at the end of September 2015. As at March 2022 this investment has reached to the level of Rs. 2,84,058 Crores

A new breed of fund managers eager to plug the gaps:

India has a wider pool of experienced fund managers, across asset classes today. These fund managers have the confidence, expertise, as well as a strong network of relationships to fly solo.

The rise of owner-fund managers will have significant implications for wealthy Indian investors. These include:

- Availability of differentiated and tailored investment strategies:
- Greater choice, for both investors and fund managers:

- Alignment of interests:
- Negotiated fees:
- Greater stability:
- Lock-ins with star managers:

In conclusion

The changing regulatory and taxation climate in India is finally beginning to foster a nurturing environment for newbie investment funds. Investment professionals with 10-12 years' experience of delivering great returns are taking advantage of these developments to launch focused investment vehicles.

While a few hiccups related to support infrastructure, taxation and fund raising remain, the stage has been set for deeper activity in the sector, including in the alternatives space. This will enable investors to further diversify their portfolios, choose from a larger range of investment opportunities, as well as demand more personalized services. I think this is sufficient reason for both investors and fund managers to be excited!

TOPIC 3 – RESOLUTION PLAN

What is a Resolution Plan?

- a plan proposed by Resolution Applicant for Insolvency Resolution of the Corporate Debtor which may include provisions for the restructuring of the corporate debtor, including by way of merger, amalgamation and demerger.

Who is a Resolution Applicant?

A resolution applicant is a person who submits the resolution plan to a resolution professional and is not disqualified u/s. 29A of the Code. Even the creditors or the promoters of the Corporate Debtor can become resolution applicants and submit a resolution plan.

Who is not or cannot be a Resolution Applicant?

The section defines that a person will not be able to submit a resolution plan if that person or any other persons acting jointly with that person is:

- an undischarged insolvent;
- a wilful defaulter;

➤ **Who is not or cannot be a Resolution Applicant?.....Continued**

- Having an account of a corporate debtor, at the time of submitting the insolvency resolution plan, under the management of such person or of whom such person is a promoter, categorized as a non-performing asset under the guidelines of the RBI and that one year has elapsed since such classification until the date of initiation of CIRP of the corporate debtor;
- has been convicted for any offence punishable with imprisonment;
- is disqualified to act as a director under the Companies Act, 2013;
- is prohibited by the Securities and Exchange Board of India from trading in securities or accessing the securities markets;
- has been a promoter or in the management or control of a corporate debtor for which an order for PUFET transactions has been passed by the AA or
- has any other disability defined in the code.

What are the main ingredients of a resolution plan?

Section 30 of IBC spells out the necessary ingredients for a Resolution Plan.

- should not be in contravention to any of the provisions of the law for the time being in force
- In case the Resolution Applicant envisages any relief or concessions from any State/Central Authority, it should be ensured that such reliefs or concessions are permissible under the provisions of law in force.
- Regulation 37 of the CIRP Regulations, lays down various measures (like obtaining clearances or permissions etc from forest or environment dept) that should be addressed in the Resolution Plan.
- If a resolution plan envisages significant acquisition of shares, then the necessary compliances with the regulator (The above is in contrast with the provisions as contained under SICA which permitted the BIFR to grant exemption from complying with the SEBI Takeover norms)
- If the proposal requires merger or amalgamation, it has to be ensured that such merger does not contravene the provisions of the Competition Act. Thus at times permission may be required to be obtained from Competition Commission of India (CCI).

- Regulation 38, covers the mandatory condition of the resolution plan.
- plan shall identify the source of funds
- plan should provide for insolvency resolution process cost and should ensure that it should be paid in priority over other creditors.
- operational creditor, it should be ensured that liquidation value in priority to any financial creditor
- payment made to the dissenting financial creditors – Ensure liquidation value

Whom to Submit Resolution Plan?

- IBC Sec. 30 (1) states that, a resolution applicant may submit a resolution plan to the resolution professional prepared on the basis of the information memorandum.
- (2) The resolution professional shall examine each resolution plan received by him to confirm that each resolution plan— (a) provides for the payment of [insolvency resolution process](#) costs in priority to the repayment of other debts of the corporate debtor; (b) provides for the repayment of the debts of operational creditors; (c) provides for the management of the affairs of the CD after approval of the resolution plan; (d) the implementation and supervision of the resolution plan; (e) does not contravene any of the provisions of the law for the time being in force; (f) conforms to such other requirements as may be specified by the Board.

- RP has to ensure that the Resolution Plan is accompanied with affidavit that the Resolution Applicant is eligible under section 29A of Code
- If the resolution plan does not comply with the regulations, it will be rejected – Regulation 39(1A) of CIRP Regulations, 2016.
- The resolution professional shall present to the Committee of Creditors (CoC) for its approval such resolution plans which confirm the conditions in section 30(2) of IBC as well as relevant CIRP regulations.
- Once the resolution plan is submitted, the CoC shall evaluate the resolution plans received as per evaluation matrix to identify the best resolution plan and approve it with modifications as it deems fit – Regulation 39(3) of CIRP Regulations, 2016.

Whether a Resolution applicant or his representative can attend the COC meeting?

- the resolution applicant or his representative may attend the meeting of the committee of creditors in which the resolution plan of the applicant is considered:
- Provided that the resolution applicant shall not have a right to vote at the meeting of the committee of creditors unless such resolution applicant is also a financial creditor.

Whether negotiation can take place between CoC and RA?

- Maximization of stakeholder's value being the basic objective of the code, nothing stops CoC and RA to negotiate and renegotiate the value and other terms and conditions of the plan before the plan is accepted or rejected by the CoC.

Who Grants Approval to Resolution Plan?

- The CoC may approve a resolution plan by a vote of not less than 66%, of voting share of the FC,
- Approval or rejection of plan is at the discretion of CoC – RP or AA cannot interfere in this decision taken by CoC, If rejected, AA is left with no other option other than passing a liquidation order.

Who will submit the plan to Adjudicating Authority?

- After approval of Committee of Creditors (CoC), the RP shall submit the resolution plan to the AA – section 30(6) of Insolvency Code, 2016.
- The resolution plan so approved shall be binding on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan – section 31(1) of Insolvency Code, 2016.

Can a Resolution Plan approved by the CoC be withdrawn?

- There is no explicit provision in the code, for allowing withdrawal of the Resolution Plan. The provisions relating to withdrawal are only for the applications filed u/s 7, 9 and 10 for initiation of CIRP – no provisions have been expressly made for withdrawal of Resolution Plans.

What should be the Table of Contents of a typical Resolution Plan?

Details which should normally be the contents of the resolution plan are elucidated below. These are illustrative in nature and not exhaustive.

1. Definitions and interpretations of the terms that are used in your resolution plan.
2. Executive Summary
3. Brief about Corporate Debtor - from Information Memorandum or from the website of CD or the information available in public domain
4. Overview of Resolution Applicant. - since when established, the sector or area of operation, all the statutory registration details, volume of activity, organisational structure etc
5. Creditworthiness or Financial Ability of the Resolution Applicant This will help to gain confidence of COC and Bench

6. Prior experience of managing / turnaround of the Companies if any
7. Key Challenges and Trends in Industry
8. Note on Turn around –
9. Financial Plan –
10. Important terms for implementation of plan (Here it should be remembered that there cannot be conditions as a conditional plan is void ab initio and is not acceptable.
11. Business Plan
12. Implementation Schedule – Should give a detailed plan of how the plan is going to be implemented
13. Mechanism regarding the management and control of the affairs of the Company
14. Manner of Supervision and implementation of plan. (This requires that a monitoring committee be set up who will do this job.)
15. Declaration that the plan is not in contravention of provisions of any applicable law for the time being in force.
16. Statement on how the interest of all the stakeholders has been taken care of.

17. Sources of funds from which the proposed payments shall be made.

18. Reliefs and concessions sought for

19. Financial projections & assumptions

20. Schedules (as may be required as per RFRP document)

Conclusion:

To sum up, once the Resolution Plan is approved by the committee of creditors under section 30 (4) and subsequently by the AA by its order under section 31(2), the **Resolution Plan becomes binding on the CD and its employees, members, creditors, guarantors and other stake holders including the Central Government, any State Government, or any other local authority to whom statutory dues are owed.** Section 238 of the Code having the overriding effect stipulates that in the case of any inconsistency between the provision of the Code and other laws the former shall prevail which is augmented by the Apex Court in its various judgments, as and when the priority of Code was challenged. Lastly, Section 32 A of the Code which came into effect on 28th December 2019, gives immunity to the resolution applicant relating to the liability of a CD for an **offence** (civil or/and criminal) committed prior to the commencement of the corporate insolvency resolution process.



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