

Asset Reconstruction Companies in India – A Multidisciplinary Approach

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Abstract: Money or Assets provided by banks to companies as loans, when unpaid by borrowers is termed as Non-Performing Assets They are termed as bad assets. In India, as per the norms of the Reserve Bank of India, if for a period of more than 90 days, the interest or installment amount is overdue then that loan account can be termed as a Non-Performing Asset. In this respect, the role of Asset Reconstruction Companies is fundamental in the re-organization of the bank debts. The operations of ARC is distinct that other Non-Banking Finance Companies.

However, in the case of loans, banks do not give much importance to recover the amount. This is on account of many reasons; inability to recover the loans on account of poor workforce; over work on account of entering into un related business namely; insurance, mutual fund, selling gold coins, trading in securities; etc., Asset Reconstruction Companies are instrumental in reducing the NPA and hence play a pivotal role in improving the Financial Statements.

Keywords : Asset Reconstruction Company, RBI, Non- Performing Assets

I. Introduction

The financial sector has been one of the important elements in India's rapidly developing economy. As the financial service sector adds depth, the number of financial intermediaries increase in the developing economies like India. While the banking industry in India is progressively complying with the international prudential norms and accounting practices, there are certain areas in which the banking and financial sector do not have a level playing field as compared to other participants in the financial markets in the world. Further slow pace of recovery of defaulting loans and mounting levels of non-performing assets of banks and financial institutions, requires the need for securitisation and Asset Reconstruction Company.

The Asset Reconstruction Company, acquires, right or interest of any bank or financial institution in loans, advances granted, debentures, bonds, guarantees or any other credit facility extended by banks for the purpose of its realisation. Such loans, advances, bonds, guarantees and other credit facilities. This is facilitated through securitisation. Securitisation, is the purchase of financial assets either by way of issuing security receipts to Qualified Buyers or any other means. Such security receipts would represent an undivided interest in the financial assets.

Since ARC Industry is in its nascent stage, it is essential to deepen the market for security receipts, which are issued by ARCs by developing a secondary market and also allowing more players. On peer-to-peer (P2P) lending, RBI has got several applications and is in the process of giving licences to those who qualify.

Reserve Bank of India, has a reference document to be followed by account aggregator platforms, as there are some concerns around protection of customers and their data. Account aggregators, to be authorised by RBI, can pull out information on financial assets of customers, on request, consolidate them and give them back to customers or users who want the information.

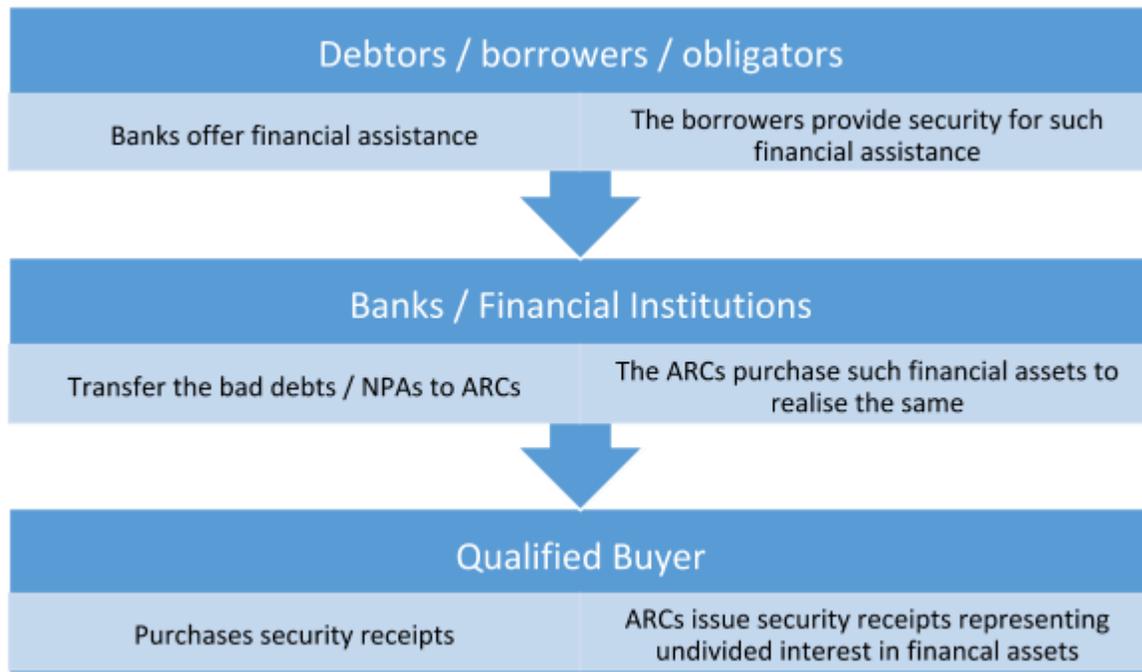


Figure 1 : Working of ARC Source : <https://cleartax.in/s/asset-reconstruction-companies-arcs>

Narasimham Committee I and II and Andhyarujina Committee constituted by the Central Government for the purpose of examining banking sector reforms that necessitates for changes in the legal system. These Committees, inter alia, have suggested enactment of a new legislation for securitisation and empowering banks and financial institutions to take possession of the securities and to sell them without the intervention of the court. Acting on these suggestions, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 was enacted to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto. The provisions of the SARFAESI Act enabled banks and financial institutions to realise long-term assets, It allows banks and other financial institution to auction residential or commercial properties(of Defaulter) to recover loans. manage problem of liquidity, asset liability mismatches and improve recovery by exercising powers to take possession of securities, sell them and reduce non-performing assets by adopting measures for recovery or reconstruction. According to RBI guidelines (2018), Restructuring is an act in which a lender, for economic or legal reasons relating to the borrower's financial difficulty, grants concessions to the borrower. Restructuring would normally involve modification of terms of the advances / securities, which would generally include, among others, alteration of repayment period / repayable amount / the amount of instalments / rate of interest / roll over of credit facilities / sanction of additional credit facility / enhancement of existing credit limits / compromise settlements where time for payment of settlement amount exceeds three months.

In case a loan account becomes a non-performing asset one of the following two things can be done:

- 1) Write-off the loan: In this case the bank assumes the loan given as a loss.
- 2) Sell it to Asset reconstruction companies: ARC's buy the loan at a lesser value than what they think can be recovered from the borrower. They then take it upon themselves to recover part of the loan from the borrower. The advantage to the Bank is that they get back a portion of the loan instead of losing the entire amount.

II Discussion

RBI has issued guidelines on February, 12, 2018 which gives a framework for resolution of stressed assets. The Reserve Bank of India has issued various instructions aimed at resolution of stressed assets in the economy, including introduction of certain specific schemes at different points of time. In view of the enactment of the Insolvency and Bankruptcy Code, 2016 (IBC), it has been decided to substitute the existing guidelines with a harmonised and simplified generic framework for resolution of stressed assets.

According to these guidelines, RBI has directed the Banks to identify initial stress in loan accounts, immediately on default, by classifying stressed assets as special mention accounts (SMA) as per the following categories SMA Sub-categories Basis for classification –

Principal or interest payment or any other amount wholly or partly overdue between

SMA-0 1-30 days

SMA-1 31-60 days

SMA-2 61-90 days

As provided in terms of the circular DBS.OSMOS.No.14703/33.01.001/2013- 14 dated May 22, 2014 and subsequent amendments thereto, lenders shall report credit information, including classification of an account as SMA to Central Repository of Information on Large Credits (CRILC) on all borrower entities having aggregate exposure of ` 50 million and above with them. The CRILC-Main Report will now be required to be submitted on a monthly basis effective April 1, 2018. In addition, the lenders shall report to CRILC, all borrower entities in default (with aggregate exposure of ` 50 million and above), on a weekly basis, at the close of business on every Friday, or the preceding working day if Friday happens to be a holiday. The first such weekly report shall be submitted for the week ending February 23, 2018.

B. Implementation of Resolution Plan

4. All lenders must put in place Board-approved policies for resolution of stressed assets under this framework, including the timelines for resolution. As soon as there is a default in the borrower entity's account with any lender, all lenders – singly or jointly – shall initiate steps to cure the default. The resolution plan (RP) may involve any actions / plans / reorganization including, but not limited to, regularisation of the account by payment of all over dues by the borrower entity, sale of the exposures to other entities / investors, change in ownership, or restructuring⁴

. The RP shall be clearly Aggregate exposure under the guidelines would include all fund based and non-fund based exposure with the lenders. Restructuring is an act in which a lender, for economic or legal reasons relating to the borrower's financial difficulty. Restructuring would normally involve modification of terms of the advances / securities, which may include, among others, alteration of repayment period / repayable amount / the amount of instalments / rate of interest; roll over of credit facilities; sanction of additional credit facility; enhancement of existing credit limits; and, compromise settlements where time for payment of settlement amount exceeds three months.

C. Implementation Conditions for Resolution Plan

A RP in respect of borrower entities to whom the lenders continue to have credit exposure, shall be deemed to be 'implemented' only if the following conditions are met:

- a. the borrower entity is no longer in default with any of the lenders;
 - b. if the resolution involves restructuring; then
 - c. all related documentation, including execution of necessary agreements between lenders and borrower / creation of security charge / perfection of securities are completed by all lenders;
 - ii. the new capital structure and/or changes in the terms of conditions of the existing loans get duly reflected in the books of all the lenders and the borrower.
6. Additionally, RPs involving restructuring / change in ownership in respect of 'large' accounts (i.e., accounts where the aggregate exposure of lenders is ` 1 billion and above), shall require independent credit evaluation (ICE) of the residual debt⁵ by credit rating agencies (CRAs) specifically authorised by the Reserve Bank for this purpose. While accounts with aggregate exposure of 5 billion and above shall require two such ICEs, others shall require one ICE.

III. Functions of ARC

As per RBI Notification No. DNBS.2/CGM(CSM)-2003, dated April 23, 2003, ARC performs the following functions :-

- (i) Acquisition of financial assets (as defined u/s 2(L) of SRFAESI Act, 2002)
- (ii) Change or takeover of Management / Sale or Lease of Business of the Borrower
- (iii) Rescheduling of Debts
- (iv) Enforcement of Security Interest (as per section 13(4) of SRFAESI Act, 2002)
- (v) Settlement of dues payable by the borrower

IV. How Does an ARC Works

ARC functions more or less like a Mutual Fund. It transfers the acquired assets to one or more trusts (set up u/s 7(1) and 7(2) of SRFAESI Act, 2002) at the price at which the financial assets were acquired from the originator (Banks/FIs).

- 1) ARC will take over the NPA's from banks for fixed cost which is less than the NPA amount.
- 2) NPA is transferred to ARC along with any security which is pledged while taking loan.

- 3) Now ARC will issue security receipts for fixed interest rate and will raise money.(These raised money can be invested in financial institutions)
- 4) Now ARC will start legal procedure to sell the pledged security in the market which will take many years depending on the complications involved. Meanwhile Money raised by issuing security receipts are used for meeting expenses of the company, ARC has to pay timely interest on security receipts to the buyers (qualified institutional buyers).
- 5) After selling the asset by clearing all litigations, ARC will redeem (take back) the security receipts which are issued earlier for agreed price.

Profit of ARC = Sale Price of security + Interest on investment - Purchase cost of NPA - Interest on Security Receipts - Expenses.

Security Receipts under the Securitised Debts

"security receipt" means a receipt or other security, issued by a securitisation company or reconstruction company to any qualified institutional buyer pursuant to a scheme, evidencing the purchase or acquisition by the holder thereof, of an undivided right, title or interest in the financial asset involved in securitisation. The trusts issues Security Receipts to Qualified Institutional Buyers. The trusteeship of such trusts shall vest with the ARC. ARC will get only management fee from the trusts. Any upside in between acquired price and realized price will be shared with the beneficiary of the trusts (Banks/FIs) and ARC. Any downside in between acquired price and realized price will be borne by the beneficiary of the trusts (Banks/FIs).

Asset Reconstruction Company (India) Ltd. (ARCIL)

ARCIL is the first asset reconstruction company (ARC) in the country to commence the business of resolution of non-performing loans (NPLs) acquired from Indian banks and financial institutions. ARCIL is sponsored by prominent banks and financial institutions such as State Bank of India (SBI), IDBI Bank Limited (IDBI), ICICI Bank Limited (ICICI) and Punjab National Bank (PNB). It commenced business consequent to the enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (Securitisation Act, 2002). ARCIL played a pioneering role in setting standards for the industry in India. It has been spearheading the drive to recreate value out of NPLs and in doing so, it continues to play a proactive role in reenergizing the Indian industry through critical times. Since its inception, ARCIL has resolved over Rs.780 billion worth of Non-Performing Assets (NPAs) acquired from Indian banks and Financial Institutions. There are other private asset reconstruction companies too.

V. Conclusion

Banking is acceptance of deposits from the public for the purpose of lending loans to the public and investment in securities. The provisions of the SARFAESI Act enabled banks and financial institutions to realise long-term assets, manage problem of liquidity, asset liability mismatches and improve recovery by exercising powers to take possession of securities, sell them and reduce non-performing assets by adopting measures for recovery or reconstruction.

Thus, ARC may issue Mortgage backed securities to the public by pooling the loan amount and the interest paid by the loaners will be paid to the investors who invest in these securities. After they realise the money from the public, thus loan amount will be given to the company and the profit may be shared in accordance with the agreement.

They also have the right to step into the shoes of the management of the defaulter entity and take certain measures to ensure that the debt of the bank is recoverable, in simple words the management of the defaulter entity will be replaced by the management of the ARC and after ensuring the recovery of the debt taken by that entity, they will restore the old management.

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