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The rupee today opened at 69.63 a dollar

Insolvency suspension to bite banks as stressed asset resolution seems distant

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- While the effect of the lockdown is expected to lead to a pile-up of bad assets, the lack of effective recovery mechanisms outside the IBC is worrisome for lenders already reeling from bad assets
- Analysts say the IBC freeze for 12 months could be a setback for banks looking for resolution or liquidation under the legal umbrella

MUMBAI : Concerned over deteriorating asset quality post covid-19, banks are now hamstrung with regard to resolution and recovery as the government has suspended fresh insolvency cases for 12 months.

While the effect of the lockdown is expected to lead to a pile-up of bad assets, the lack of effective recovery mechanisms outside the Insolvency and Bankruptcy Code (IBC) is worrisome for lenders already reeling from bad assets.

A banker at a Mumbai-based public sector bank said this effectively closes an important avenue of debt resolution being used by lenders. He added that there are also a few clarifications required pertaining to the IBC announcement. “For instance, while the finance ministry presentation talks about suspension of fresh IBC cases for a year, it is unclear if the Reserve Bank of India (RBI) will be able to refer companies to the bankruptcy tribunal. The central bank is the only authority allowed to do so in the case of non-bank financiers, a sector where there is tremendous stress," said the banker quoted above, on condition of anonymity.

Dewan Housing Finance Corp Ltd (DHFL) was the first non-bank lender to be referred to the NCLT under new rules notified by the government on 15 November. The NBFC sector has been facing a liquidity crunch for quite some time now beginning with the default of Infrastructure Leasing & Financial Services (IL&FS) in 2018. However, the better rated ones among these financiers have been able to borrow despite sectoral challenges.

According to analysts at Emkay Research, the IBC freeze for 12 months could be a setback for Indian banks looking for resolution or liquidation under the legal umbrella and would ease credit discipline with corporate borrowers. “The overall package is a disappointment for expectations of a revival of demand in the economy, and for sectors that are stressed due to the lockdown," the Emkay report said on 17 May.

This comes at a time when bankers expect asset quality to deteriorate and rating agency Crisil estimates that bad loans will rise to 11-11.5% by March 2021 from the 9.6% expected for FY20. Moreover, the closure of the IBC window will also affect the provisioning of banks. For instance, the 7 June RBI circular on stressed assets requires banks to set aside 20% of the exposure in additional provisions if they fail to resolve an asset within 210 days. While this money can be reversed only when a resolution plan has been implemented, for cases referred to IBC, half the provisions can be reversed as soon as the case is referred to the tribunal and the rest on its admission.

Bankers have also preferred IBC to other mechanisms because it has legal backing and is sanctioned by a tribunal. Of the total 3,312 corporate insolvency cases as on 31 December, 2019, financial creditors have initiated 1,439 cases and operational creditors have initiated 1,630 cases. Data from the Insolvency and Bankruptcy Board of India (IBBI) showed that financial creditors or lenders have been able to realise 43.15% of their admitted claims as on 31 December, 2019.

However, not everyone believes that the IBC is the only option for lenders to recover their dues. Nirmal Gangwal, founder and chairman of Brescon & Allied Partners LLP, a debt restructuring advisory firm, said that in the absence of the IBC, a one-time debt recast window by the RBI will be very useful.

“A one-time debt restructuring will be much faster than the IBC and companies that are genuinely stressed will get a new lease of life. They can be turned around without going through the long-winding process of bankruptcy tribunals," said Gangwal.

Meanwhile, some experts are awaiting the notification for the proposed amendment for more clarity. “I am hoping that there will be clarity on whether the amendment will cover cases that have been filed but pending admission, or cases that relates to past debts and arose prior to the present pandemic," said Alipak Banerjee, leader (International Dispute Resolution), Nishith Desai Associates. According to Banerjee, the enhancement of the default threshold from ₹1 lakh to ₹1 crore will not have any practical implications if the entire process is put to a standstill for one year.