Can Asset Reconstruction Companies (ARCs) be Part Solution to the Indian Debt Problem?

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SECTION III

Section III provides the following analysis ;

- It assesses the capital adequacy of Indian ARCs and corresponding regulatory norms
- It examines , If ARCs could play a significant role in price discovery of distressed assets
- It concludes latest economics survey's to fester problem of high proportion NPAs on bank balance sheet
- It focus is to highlight the current limited role of ARCs which can and should be enhanced

International Experience in Addressing Unsustainable Bank Debt

Securum and RTC was set up by Sweden and US in section I&II

In this cases IBRA provided the capital to resolve illiquidity-insolvency to make banks systematic

Where else the Italian banks are in serious trouble in Europe

Central banks are consulting European commission and bank to avert the financial crisis

Post 2008 crisis , US, European and other central banks provided support to financial institutions

Repeated government funded bailouts creates moral hazard of banks enjoying to big to fail status

US Federal reserve bank insisted SIFIs on plans to wind down situation of in solvency without creating a systematic crisis

Changes in law of Sweden and US , Indonesia by government and regulators reduced the future risk by banks

This past experience of foreign RTC and ARCs helps India to resolve the high volume of stressed assets without full funding by government

Size, Nature and Consequences of Indian Debt Overhang

- It shows that loans to industry, adjusted for inflation, have been coming down steadily since 2005-2006.
- The real loan growth rate has decreased from around plus 5 percent in 2012-2013 to about minus 7 percent in 2015-2016.
- One of the principal reasons for the current reduced bank lending is that large debtor corporates which have stressed balance sheets have either defaulted or been tardy in debt service payments
- According to survey 2016-17,The Indian banking sector has dealt with even higher levels of NPLs in 1997 than at the end of 2016

RBI's overview on Indian overhang problem

- Government and RBI look for ways out of the debt overhang problem
- Using morality as a benchmark could be counterproductive or sub-optimal
- Government always bail out private firms at tax-payer cost does not make sound economic sense leading to moral hazard
- Private sector firms have to be held responsible due to their huge corresponding borrowings
- large private firms did not recognize the risks of shortfalls in revenue flows compared to debt obligations
- Corporates were irresponsibly sanguine about their ability to complete high cost projects on time.

Interminable Legal Obstacles And Roadblocks

- SARFAESI Act were meant to reduce delays in disputes of debtors and creditors
- The act represented progress compared to SICA-BIFR
- Setting up of DRTs too was a step forward as cases were processed faster than these tribunals and courts
- The situation has not measurably improved for creditors even after SARFAESI and DRTs
- At the end of 2015, 70000 appeals were pending with DRTs
- RTC was involved in 110000 lawsuit highest by any even compared to India due to faster legal processes.
- In India , IBC 2016, NCLT and the insolvency and board of India have been enacted to recover dues faster
- Court process have been tedious and has been an issue of social justice lead to setting up of NCLT & IBBI TO make courts act more decisively and delay relief
- Amendment to SARFAESI act in 2016 should help ARCs raise funds and restructure defaulting companies
- It empower DRTs in civil courts and facilitates to reduce the time taken for adjudication process.

“Bad” Bank for India

Economic survey 2016-17 suggested setting up of public sector assets rehabilitation agency (PARA) or bad bank

It suggested PARA could be funded by assigning a fraction of equity to government

A bad bank fully owned by government with professional management hand over will lead to principal – agent issue as in the case of Securum bad bank of Sweden

Debt forgiveness for defaulting Indian corporates leads to undesirable future of banks. However , no decision is been taken in setting up of bad bank yet by finance minister or regulatory

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Asset reconstruction companies (ARCs)

Union budget of 2017 referred briefly to support for Indian ARCs

RBI stipulated that 15% of value of the acquisition has to be paid by ARCs , which resulted in sharp drop of acquisition

ARCs being thinly capitalized can still bring arms-length and professional valuation of NPAs in PSB portfolio

The scanning and digitization of legacy data relating to huge stock pending cases need to be expedited

ARCs are not endowed with adequate risk capital to create a great impact on restructuring net NPAs of Indian banks

The stock exchanges would be to list SRs issued by ARCs to provide liquidity through secondary market

In RBI circular , Banks/NBFC/FI were at par with in term of purchase of distressed assets

RBI stipulated that funds can only be raised by ARCs from private capital market sources

DRTs need financial resources to outsourced detail analytical work to private firms creating a support to Indian ARCs

Conclusions

large Indian corporates have free American put options166 on the debt owed to PSBs

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Large corporate borrowers have been able to default/delay debt repayments with little by way of material consequences

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RBI puts out Asset Quality Reviews at periodic intervals

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RBI's bank supervisory warnings need to be sharper and the warning signals need to be more insistent

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ARCs could be qualitative and somewhat quantitative solution without injection of foreign capital

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ARCs can provide market" feedback on valuations of NPAs and provide restructuring solutions for the debt overhang problem

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The importance of accurate valuations, turnaround options plus speedier legal remedies cannot be overstated.

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ARCs can function reasonably and could be a larger part of solution against NPAs in India

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