Edited Transcript of

NSE-NYU Stern Conference on Indian Financial Markets 2017

Mumbai, December 14, 2017

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Exchange Plaza, Bandra Kurla Complex
Bandra (East), Mumbai 400051, India

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Preface

We at NSE recognize the usefulness of ideas and insights generated through research and deliberations on policy making relating to the financial markets. As part of its continued efforts to provide research support to policy makers, NSE had organized in collaboration with NYU Stern School of Business, an international conference 'NSE-NYU Conference on Indian Financial Markets' on December 14-15, 2017. This conference was fifth in the series and comprised inter alia keynote addresses by Mr. Ajay Tyagi (Chairman, SEBI) and Dr. Viral Acharya (Deputy Governor, RBI) , and a panel discussion on the Insolvency and Bankruptcy Code (IBC). Mr. Tyagi's speech as well as Dr. Acharya's presentation are available on the NSE website.

In his keynote address, Mr. Tyagi highlighted some of the issues relating to the development of primary and secondary corporate bond market in India, as well as the steps taken to address them. Breaking away from the past trend, the corporate bond market in India has shown a significant growth in the last few years on the primary issuance side, albeit on a low base. However, the secondary corporate bond market's performance in terms of volumes traded and liquidity is not as impressive; and this market continues to lag behind that for other asset classes, such as government bonds. He suggested some reforms with an aim to nudge the market towards greater transparency and better risk management for issuers and investors and result ultimately in more efficient capital raising. In addition, Mr. Tyagi stressed on the need to develop a liquid interest rate derivatives market, while emphasizing that interest rate derivative is an effective tool to hedge interest rate risk in bond portfolios.

Dr. Viral Acharya was the other keynote speaker. In his presentation, which was based on a paper he co-authored with Dr. Arvind Krishnamurthy, "Global spillovers: Managing capital flows and forex reserves", Dr. Acharya explained how foreign reserves of a country and capital controls are complementary and why forex reserves cannot be an effective measure of external sector resilience, unless accompanied by macro prudential/ capital controls.

The panel discussion was on one of the most topical areas in finance in India today, the Insolvency and Bankruptcy Code (IBC). The discussion was preceded by a presentation on the evolution of IBC by Dr. Renuka Sane. The panelists debated on the role of various stakeholders in IBC: promoters, non-promoter shareholders, creditors, insolvency professionals, investors, ARCs and regulators. The broad view that emerged from the discussion was that in many ways, the formation of the IBC is about preservation, development and growth of national assets, which are impeded for various reasons from performing and producing returns for the country. The panel included Dr. M.S. Sahoo (Chairman, Insolvency and Bankruptcy Board of India), Mr Ajay Piramal (Chairman, Piramal Group), Mr. Siby Antony (CMD, Edelweiss Asset Reconstruction Company Ltd.) and Dr. Renuka Sane (Associate Professor, NIPFP), and was moderated by Mr. Uday Kotak (Executive Vice Chairman & MD, Kotak Mahindra Bank).

I take this opportunity to thank Mr. Ajay Tyagi, Dr. Viral Acharya and all the panelists for their valuable contribution. I am also grateful to Mr. Uday Kotak for playing a wonderful role as a moderator in the panel discussion. The deliberations of the panel discussion has been captured in this edited transcript and we believe that the transcript would be useful for industry participants, academics and policy makers.

Nirmal Mohanty
Chief Economist and Senior Vice President
National Stock Exchange of India Limited
Mumbai

Welcome Remarks

Mr. Vikram Limaye, MD & CEO, NSE and Prof. Raghu Sundaram, NYU Stern

Mr. Vikram Limaye:

Good evening, everyone, Mr. Tyagi, Chairman SEBI; Prof. Sundaram of NYU; distinguished panelists, bankers, eminent members of the academic community, economists and guests. I welcome all of you to the 5thNSE-NYU Conference on Indian Financial Markets. This conference is a result of collaboration between NSE and NYU that goes back five years to 2012. The initiative covers not just financial markets but the banking sector as well and the idea of putting this together is to develop a program with NYU to provide a platform for industry and academia to come together and conduct research on issues of mutual interest in the Indian financial markets.

There is another aspect of the conference that is important. The program this evening is part of the conference. This conference call also involves presentation of various research papers. These papers are selected on a competitive basis from an international call for various papers that are reviewed before and after the conference. Some select policy papers are also presented. This afternoon for example, we had three policy paper presentations and an additional six research papers are scheduled to be presented tomorrow. For these presentations we typically invite academics and researchers because the papers are generally technical in nature. However, the session of the conference this evening is not as technical and I think it is important for us to get a perspective from not only the keynote speakers but also an eminent panel that we have. I think this balance is necessary for success of this initiative with NYU.

I am happy to inform you that the initiative is growing in stature and some papers presented here at the conference are getting international attention. One of the papers, for example, has been published in the Journal of Financial Economics, which is a very prestigious publication. It is a very interesting paper on the conflict of interest that credit rating agencies face while rating bonds issued by companies who hire them for the non-rating services. Recently, another paper studying the role of capital constraint traders in stock price crashes in 2006 when there was no algorithmic trading has been accepted for publication in the prestigious Journal of Finance. We have also demystified the research papers to make them relevant for the market participants and policy makers. We have prepared short policy pieces called' white papers' in easy to understand language based on the findings of the research papers. This constitutes the origin of the 'White Paper series' that we have developed. These are widely circulated amongst regulators, practitioners and academics, and are also available on our website.

We start our program today with the first keynote speech of the evening on "Developing the corporate bond market -An unfinished agenda” by Mr. Ajay Tyagi, Chairman of SEBI. In recent years, corporate bonds have become an important source of debt capital, given the decline in bank credit growth. In fact, over the past five years the corporate bond market has grown from 5% of GDP to about 14% of GDP. Greater financial intermediation through domestic mutual funds and strong foreign flows have contributed to the exceptional growth in the corporate bond market. However, issues such as low liquidity and relatively less issuances by the non-financial real sector companies as compared to the financial sector companies remains a cause for concern. Also, secondary market trading in corporate bonds, particularly on exchanges is another area that needs attention. We look forward to Mr. Tyagi’s views on these matters.

The decline in bank credit growth, as most of you know, is a result of the excessive leverage of certain corporate balance sheets and stressed assets on bank balance sheets. It is one of the most important problems facing the Indian economy and the insolvency and bankruptcy code enacted by the parliament in May 2016 is one of the most important instruments for addressing this problem. The Bankruptcy code has arrived at a very critical time for the Indian economy when the domestic banking industry is struggling to cope with mounting bad loans and looking for an effective resolution framework. I expect the discussion today to assess the experience from a variety of perspective and give some insights way ahead.

The last part of the program will be a second keynote speech by Dr. Viral Acharya, Deputy Governor of the Reserve Bank of India, on the topic “Global spillovers: Managing capital flows and forex reserves.” Over the past few years equity flows in to the emerging markets, including India, have been very strong. An important aspect is whether such capital flows are sustainable and what policy measures are necessary in India to manage capital flows and forex reserves. We look forward to Dr. Acharya’s talk to throw some light on this topic. Let me now invite Prof. Raghu Sundaram to say a few words. Once again, on behalf of NSE, I welcome you all to this conference. And thank you very much for your participation.

Nirmal Mohanty:

Thank you, Vikram. So, before Prof. Raghu Sundaram comes to the stage, let me introduce him to the audience. Prof. Raghu Sundaram is Edward I. Altman Professor of Credit and Debt Markets and Professor of Finance at New York University’s Stern School of Business where he teaches derivatives pricing and risk-management. Prior to NYU, he taught at the University of Rochester from 1988 - 96. His research in Finance covers a range of areas including agency problems, executive compensation, corporate finance, derivative pricing and credit risk. He has also published extensively on mathematical economics, decision theory, and game theory. His research has appeared in leading academic journals. Please join me in welcoming him on stage.

Prof. Raghu Sundaram:

Good evening everybody. On behalf of NYU, it is my pleasure to welcome you all to this 5thAnnual NSE-NYU Conference. The NSE-NYU Conference, as Vikram said, has been a great success from its very inception. NYU has for very many years has been one of the global power houses in academic finance and probably the single most important institution in terms of feeding the firms of Wall Street and global finance. NSE of course has been a power house in terms of developing capital markets here, so the alliance in many ways was a natural one in terms of further study on India. Let us look into why this collaboration has been so successful? To just give you an idea, the first year we started the program, we announced that we would be supporting between five and six research papers and we got 48 applications from people who wanted to study India, most of them from non-Indians. Now when you look at what has been happening in terms of research in Finance, there have been certain very clear discernible trends. For anybody who grew up studying Finance in 1960s, 70s, 80s, even into the 90s, almost all finance theories had been developed in the context of just one single country of America, the United States; its institutions, its capital markets formed the backdrop against which everybody studied finance and all theories were developed. So for example, corporate finance was entirely developed around widely held corporations, very little around family held corporations or other institutional structures.

For example at Stern we are the largest Finance department in the world with people coming from about 25 countries, but research is concentrated in just one country for one simple reason, data. To study anything you need data to formulate ideas, theories, principles, policies and data, which was plentifully available for a long time only in the US markets. Over the last couple of decades, data is something that has become more available around the world and India in particular has attracted lot of attention for this reason. Our partnership with NSE has made it possible for researchers to access data through institutionalized context and that is one reason why research is now flourishing. Research cannot flourish without data and the availability of data has been a big thing.

But that is only part of the story. The other important part is that India has become one of the most exciting countries to study. It has been very exciting for the last 25 years since reforms began 26 years back, but it has become particularly exciting for the last few years as regulations have started changing very rapidly and one is able to assess the impact of these changes almost first hand, what economists love calling natural experiments, experiments that you can look at what happened before and after. So, in the afternoon session we had today for example, the policy papers looked at some aspects of this. Today’s panel discussion, the bankruptcy code is another natural experiment we are going to look at. The opening of 300 million bank accounts, I mean which other country in the world could even dream of something like this happening? 300 million bank accounts, what has the impact of that been? So there was a conference we held at Stern two weeks ago where that was the focus of discussion. There were two separate papers on the impact of opening 300 million bank accounts on various aspects.

So, what has been happening in India, not only due to demonetization but also from the bank recapitalization, and changes in the bankruptcy code: these are very important interesting issues that are happening for international researchers, not just people in India but people who are interested in financial policies worldwide which has been a major reason this conference has attracted so much attention from the academic community. It is our hope that as this conference continues to grow, it will become one of the premier research conferences of the winter season for academics.

So, thank you very much. A special thanks to NSE for this continuing partnership. Thanks to all the researchers who are going to come to this conference and today's participants. So, with that, let me turn the floor back to Nirmal.

Nirmal Mohanty:

Thank you, Raghu. Before I invite Chairman of SEBI, Mr. Ajay Tyagi, on to the stage, let me introduce him. This is the key part of the program. Mr. Ajay Tyagi took charge as Chairman, Securities and Exchange Board of India on 1st March, 2017. Prior to this he was Additional Secretary, in the Department of Economic Affairs, Ministry of Finance, Government of India; handling the portfolios of capital market division, investment division, infrastructure division and currency and coinage division. He is an Indian Administrative Officer of Himachal Pradesh cadre and has held several responsible positions with distinction in the state and central government. Mr. Tyagi?

The Indian Bankruptcy Code

Dr. Renuka Sane, Associate Professor, National Institute of Public Finance and Policy

Good evening, everyone. Thank you all for being here and Nirmal, thank you for inviting me to give this talk. So, in this particular talk I am going to speak just a bit about the history of the bankruptcy code and give a flavor of what the code is. Following my presentation, we will move on to the panel discussion where we can talk about the nuances of the code, what the challenges are going forward and how we expect the system to evolve, because it is such an important system for development of our credit market and our financial system.

So, let me just begin by telling you a bit of the story. May be most of you are familiar with this, of what the system was previously before we got the IBC. So, essentially, when it came to credit markets and when it came to recoveries of dues, you had three main processes: The Companies Act which essentially talked about voluntary restructuring or liquidation, the BIFR (Board for Industrial and Financial Reconstruction), which recommended liquidation or restructuring and SARFAESI (Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest) which was mostly restricted to banks and financial institutions, and as a result other creditors did not really have any remedies. One could of course go to civil courts but not many people chose that option. Despite these mechanisms there were many, many problems with implementation; there was long and slow resolution and there was litigation all around. In fact, there have been research studies that show that because of this entire forum there was a lot of forum shopping where creditors and debtors went to different courts to delay proceedings, and a lot of delay and things just did not get resolved. We were very excited about SARFAESI when it came along, but if you saw the experience of SARFAESI over the last ten years, pendency has been on the rise and again there have been many, many problems.

So, against this background of not having a good exit framework for firms, came the Financial Sector Legislative Reforms Commission (FSLRC). This was a Committee chaired by Justice Shrikrishna which submitted its report in 2013 and gave us the draft of the Indian Financial Code. What the FSLRC did was that it separated the exit of the financial firms or SIFIs (Systemically Important Financial Institutions) from the others, and it said that it would set up a resolution corporation for those firms. The new Financial Resolution and Deposit Insurance (FRDI) Bill which came from the FSLRC report is now currently in the JPC (Joint Parliamentary Committee) and is being discussed. If you are reading the newspapers, you will know it is being discussed quite vibrantly.

After that came the Bankruptcy and Legislative Reforms Commission (BLRC) which submitted its report in 2015. This dealt with the insolvency of the non-financial firms and it got enacted in 2016. So, while FSLRC came first with the LRC, we have the IBC that got enacted before.

So, what is the IBC? There are two main parts to the IBC, one is the part that talks about corporate insolvency and the other part talks about personal insolvency. So, there are two essential processes in corporate insolvency, one is the insolvency resolution process (IRP) and the other is the liquidation process. Similarly, in individual insolvency there are three processes, one is the insolvency resolution process, one is the bankruptcy process and there is a third process for individual insolvency wherein people who are too poor to afford or who have debts below a particular threshold get what is called a fresh start which is essentially like a debt waiver. So far only the corporate insolvency provisions have been notified and we are still waiting to see what happens to the individual insolvency provisions.

To just give you a brief overview of the CIRP, which is the Corporate Insolvency Resolution Process, basically anyone with an undisputed credit claim can trigger the process. Then there is an automatic monitoring moratorium which is a calm period whereby the firm is kept as a going concern to assess solvency. A resolution professional (RP) is appointed and a committee of creditors is formed, so that they decide what to do and what kinds of plans to accept. Anyone can bid for the company. Of course, now there have been some changes whereby there are some restrictions on who can bid. But it is the creditors committee that has the responsibility for all the decisions that will have a material effect on the firm. If no plan is found, it automatically goes into liquidation.

So, if I were to emphasize on some of the design issues of the IBC, what are the key design issues? The first problem was that banking regulation had issues and we were in this era where we took a long time to recognize bad loans. The worry was that banks would have wrong incentives to accept or reject certain resolution plans. The solution was that a winning bid must have 75% of the votes, so that allows other financial creditors to also participate.

The second problem could have been that banks or other creditors just want to delay. The solution that was proposed by the BLRC was that if in 180 days there is no winning bid, the firm goes into liquidation. So, that puts the pressure on accepting a plan and moving fast with the process.

The third problem that we have seen in the country is that the regulation of intermediaries such as CAs, is problematic and SRO's are known to not perform very well. The solution that the BLRC proposed was that you would have an exchange metaphor where the insolvency professional agency IPA would regulate its members.

The fourth problem that we have seen consistently in our bankruptcy processes before was that there would be disputes about facts and there would be continuous litigation around these facts and the solution proposed by the BLRC was that you would have regulated information utilities and they would record evidence which would then expedite the process at the courts.

Fifth problem was that you cannot really anticipate the full process prematurely, because you really do not know what to expect. The solution to that was to set up a regulatory body, the Insolvency and Bankruptcy Board that we see now which would have quasi-legislative powers and therefore it would also write regulations and put more detail into the process of insolvency. So the law would be about high principles and the regulator would then write regulations.

Finally, the sixth problem that we have been continuously facing is judicial intervention, and judicial intervention especially on commercial decision s – such as the one where the NCLT allowed the government to appoint directors in a company. So we know that this is a problem in the Indian set up. And so the proposal or the solution proposed by BLRC was that courts would only be involved in procedural correctness and they would not participate on commercial decisions.

Chart I: IBC design issues

1. Problem: Banks have the wrong incentives
    - Solution: A winning bid must have 75% of the votes.
2. Problem: Creditors (banks) want to delay
    - Solution: If in 180 days, there is no winning bid, go to liquidation.
3. Problem: IP regulation; SROs don’t work
    - Solution: Exchange metaphor
4. Problem: Disputes about facts
    - Solution: Regulated information utilities to record indisputable evidence.
5. Problem: Can’t code the full process prematurely
    - Solution: A regulator, Insolvency and Bankruptcy Board, with quasi-legislative powers.
6. Problem: Judicial intervention on commercial decisions
    - Solution: Courts which are involved only in ensuring procedural correctness.

Now, let me discuss where we stand on this project at present. On some issues we have stuck to what the BLRC principles were, on other issues we have deviated and perhaps that is something that we will discuss in more detail going forward on the panel. But just to reflect on what has happened through the past one to one and half years, the IBC was passed as law on May 13, 2016; the IBBI has been setup and I think it has issued about 14 pieces of subordinate legislation so far; the IP industry is built up. Unfortunately so far, no IU has come into operation, though we are told that there is one IU in the making. Every time there is a new law there have always been challenges to the constitutionality of the law, and that has happened with IBC as well, but the Bombay High Court has dismissed an early challenge to the constitutionality of the IBC.

The first case Innoventive Industries started on 17th January, 2017, and if I am not wrong, it has gone into liquidation very, very recently. The first resolution plan for Synergies-Dooray Automotive Limited was also approved in August 2017. The RBI has taken 12 big defaults into IBC and we are told that more are in the offering, and all of these are ongoing cases.

I saw the September 2017 Newsletter on the IBBI website and it said that 353 firms were undergoing resolutions, I think the number is almost 400 today, or perhaps a bit more. Interestingly, most of these cases have been initiated by what is called the operational creditor and not the financial creditor. So, this is a very interesting piece of development in the IBC and in fact there have been some filings by the debtor itself, so that is also an interesting way to see that the IBC is moving forward.

We had a very interesting few months with the home buyers case, the JP case for example, on how to treat these home buyers who had moved the Supreme Court against the JP bankruptcy proceedings for fear of losing their deposits towards their homes. And for some time, the IBBI decided to have a third category of creditors but, I think that has moved along. Most recently, what has generated a lot of interest and debate is the IBC Ordinance, which has effectively banned about eight categories of people bidding in the IRP including the promoter, and has caused quite a stir with some cases in court. So, we will see what happens to that ordinance.

Finally, we have some hope that a personal insolvency regulation for guarantors in small businesses is likely to be released soon. So, while personal insolvency will not be applicable to all individuals, at least this is a start and the debt recovery tribunals are supposed to be the adjudicating authority for personal insolvency. So that is also an interesting development and we will see how that evolves over time.

I would like to end this presentation with some questions on what next for the IBC. I will reserve some of my remarks perhaps for the panel, but where are we going from here and how are these things likely to evolve? I think that all of these questions will have a bearing on how the IBC evolves. For example, how will the institutional infrastructure evolve; what will happen to the IUs and IPs and how are we going to regulate them; how vulnerable will this process be to litigation; how will judicial decisions shape outcomes. I think that this is an extremely important feature of the Indian system in general because very often you have courts intervening on various issues and they will have a bearing on the IBC. Recently we have seen some decisions that have bearing on commercial matters such as the NCLT allowing the government to name directors in a private company and this is going to shape IBC and it remains to be seen how that happens.

How will policy evolve? For example, the Promoters Ordinance is an example of a policy decision that has a huge bearing on the process of IBC and what we see going forward on the policy issues. How is all of this going to impact credit markets, both on the debtor side as well as on the creditor side? How are other creditors going to think about credit markets? Are we going to see a different class of creditors? Are we going to see corporate bond markets take off, because finally now banks are not the only ones who have some power of recovery mechanism, and I think that this will have a very important bearing on how we move forward and how the financial system in the country moves forward. So here are a few references and collection of resources that a lot of us had worked and put together for the BLRC and commentary going forward, so we welcome you to see some of these resources and comments on this will be most welcome.[1] Thank you.

1 Ajay Shah and Susan Thomas, "The Indian bankruptcy reform: The state of the art, 2017", Ajay Shah's blog, 13 July 2017. Collection of resources: http://ifrogs.org/POLICY/blrc.html

Panel discussion: *Implications of the 'Insolvency and Bankruptcy Code' for Creditors and Corporates*

Panelists: **Dr. M.S. Sahoo**, Chairman, Insolvency and Bankruptcy Board of India

Mr. Ajay Piramal, Chairman, Piramal Group

Mr. Siby Antony, CMD, Edelweiss Asset Reconstruction Company Ltd.

Dr. Renuka Sane, Associate Professor, NIPFP

Moderator: **Mr. Uday Kotak,** Exec. Vice Chairman & MD, Kotak Mahindra Bank

Uday Kotak: Good evening. As you know, we have gathered here to discuss one of the most topical areas in finance in India today, the Insolvency and Bankruptcy Code (IBC) and the crucial part of this process. I compare this to almost like a Bollywood movie which got started about a year ago where we have probably now seen in the last few weeks and months some very interesting scenes and maybe now is the intermission time. I think we are in a very crucial phase where a lot of critical aspects, and I think Renuka rightly pointed out many of them, will get cleared over the next six months. Therefore, I think the time to watch how this whole thing shapes up is between now and June 2018, and in many cases you are going to see where the resolution period is coming to an end, there will be some extensions and a lot new filings happening. Like everything else in India, things evolve, meander and finally we find the right landing, I hope, in this whole area. Today, we have got a very eminent set of people here in this group, including the regulator himself, potential solvers and potential buyers. In terms of setting the tone, I would like to invite each of my colleagues here on this dais to speak for about five to seven minutes, give their initial points of view, then we will have a discussion on the various points before we throw it open for Q & A.

I will follow the simple sequence and continue immediately on my left. So Ajay, maybe you want to get off the mark first, because finally we want to see resolution more than anything else.

Ajay Piramal: Thanks. On me being first off the mark, it reminds me of my school days and I was always lucky that my second name did not begin with 'A', otherwise you are always called first. I used to always be in the end but you have got me on the wrong side.

Before we go to resolution of non-performing loans, let us first understand where the environment is. I think today, as far as India is concerned, we can see that there is a good economic growth. I do not think there is any other country which can have real GDP growth of 7% - 8%, and therefore in nominal terms 12% - 13%. If I remove agriculture, because we are not talking agriculture here in terms of stress, about industry or manufacturing or services, have witnessed an average growth of 15%; A growth seen in very few economies in the world. And even if you see the energy and enthusiasm of people here, I think I do not see that anywhere else in the world. So it is an environment which is a good environment to be in but perhaps the biggest constraint to this growth would be the availability of finance.

The problem that we had before the movie being started or being shot or being released was the twin balance sheet problem. One is that you had banks which had capital stuck in assets which would have never yielded any results and also companies themselves were so highly leveraged that you could not see any new investment taking place. So I think the IBC and all that has been done in the last 1.5 - 2 years has been a tremendous move. If you talk about reform, I think this is really a big bang reform which people do not call it, but it is a huge one. What I understand is that, in such a short period this has been done, there are no other countries which have had an experience that within eight to nine months, the IBC has actually been put into place. So, I think we should congratulate you all here on my left for having done this.

What has been done? The fact is today, the 12 assets which have been recognized by RBI constitute about 25% of the total NPA of the banks. Just think about the whole magnitude! Also, before these assets were recognized as NPAs, the banks used to provide 2% and now suddenly it became 10% overnight. It could not have gone up five times unless and until something was being hidden which had to come out. Therefore, I think this has been a tremendous move. The fact that we have $32.5 billion in recapitalization has also been a big move. Again, I have some doubts about whether public sector banks will use this money well, because one is to provide the capital but I think it is as important to see that you have the management that will take adequate risk and which will do the lending, because I do not know what will happen otherwise to the capital that has been given.

The ordinance we talked about for promoters and errant promoters has been a topic of great discussion I think. But one thing it has brought and I read that today in the newspaper, I think some are saying that balance of power has shifted today from the promoter to the creditor. My opinion is that to some extent this was required, because otherwise you had a situation that the banks kept lending money and it was not a loan, it was more like equity. So banks continued to lend more, talked about it as equity, never got a return and there was no action being taken. There are issues on identifying promoters, but on the whole I would support that such an ordinance has been brought. Obviously, it has been too broad and it includes just about everybody, so we need to look at what changes are needed. I know that Dr. Sahoo and his team are looking at it. It is obvious that the small and medium-scale industries have to be left out and we will have to find some resolution on that.

What will this do to a creditor? If you look at it, till now actually the financial creditors were also taking advantage. We have had so many instances in the past whether it is the SARFAESI or the CDR, the banks were just ever-greening their balance sheets and bloating up the assets, if I may say so. The fact that RBI came down heavily and said that 50% of you have to provide for the day, you recognize and you put it into NCLT and so on has been a very positive thing I think.

One of the important consequences of the IBC is that more sensible lending will take place as there will be better and thorough evaluation of projects. Also sometimes I find that in business if you have a sick/weak project, then it is not run on economic terms. In other words you can just sell the output at any price you want because you do not care, you do not care for profitability anymore, you just want to keep it running for the banks to keep funding you. I have seen this in the textile industry for a long time. Sick mills continued for years and that had impact on even smaller companies, because after all it is a competitive situation, you have to sell in the market. So, I think this will make it clearer that weaker businesses cannot survive or they need a resolution to be done and an early resolution because we all know that usually when creditors would really kick the can for the next person to handle or after three, four, five or ten years, businesses which were sick would still continue to remain so. I think overall this will be good for the economy, we will see that there will be better project evaluation, there will be better projects being run.

For the corporates also, I think it is the first time for corporates to experience that the balance of power is shifting in the hands of the creditors. In some ways it is a once in a lifetime opportunity for many companies to consolidate, make better businesses and to see that businesses can compete in a global environment. This is an opportunity for companies to accumulate assets and become bigger. It is also really a stern message for all of us in corporate India, you cannot take banks for granted anymore which we used to do earlier and that people have to bring in some equity in the long-term if there is stress, the promoters need to bring in equity along with the banks. Otherwise what was happening till now, it was only the bank which was providing equity during stress or a loan which was called equity. So I think IBC is a good thing.

I have a few worries too. The size of the problem is large, may be $200 billion and there is not enough money for this. There is only about $5 billion or $10 billion funds available, how will we get the balance? That is where we need the corporate bond market, that is where we need early and quick resolution, we need predictability. Renuka has raised the point that we need to get quicker resolution. For instance, we do not want the courts to come in and say that "Okay! Now home owners have higher stance over creditors." What has been stated let us implement that. I also hear that there is a talk that you may replace the liquidation value with enterprise value. I mean if we start doing these things, it will become very difficult to resolve issues. I take the case of the Kingfisher Villa. Originally the value of the Kingfisher Villa was put at I think Rs. 170 crores or something like Rs. 150 crores. Two or three bids failed, finally it was sold for Rs. 70 crores.

So, I think we do not want to go through this process again and again. As I said before the ordinance, let us look at genuine promoters. If you have a promoter who is backed by let us say a large private equity firm, they would have done the diligence, they will not have a fraud promoter to back. I think such cases where there are small promoters or small scale industries we will have to make some provisions so that it can go ahead.

I think I have exhausted my time.

Uday Kotak: Thank you Ajay and I think what you said is absolutely true. Shift of balance of power which is very defining and in-effect a lot of Indian companies believed that banks were the ultimate private equity providers with all the upside to the promoters and the downside to the bankers; and that is how the system worked for a long time. You rightly raised another important point that we have to be careful about not changing the goalpost too much and too often as we go down this path, and much more sort of learn as we move ahead before making frequent changes. There will be changes, of course, because of the nature of the newness of the whole IBC process.

And before I go to Dr. Sahoo and Renuka you have presented, I would go to Siby to get the Asset Reconstruction Company's (ARC) perspective. Siby has been in the resolution process for the last few years, facing challenges with the process, including one of the most important issues which I think ARCs and banks both grappled with:"How do you get a fair clearing price for the assets?" Ajay rightly pointed out that some of the valuations at which the system worked was completely artificial, valuations given by so called empanelled valuers were normally inflated so that more money could be given in terms of lending and there was some fundamental issue, including the valuations of the Security Receipts (SRs) which are sitting on the balance sheets of many ARCs. So, how do you go from the world of last two years to this new world and what will change and how do you implement this in real life as you see it. And as we know, you are amongst the largest holders of SRs in the Indian market place.

Siby Antony: Thanks, Uday. I mean, it is a great piece of legislation as far as an ARC is concerned. In fact, I have been a banker for nearly four decades now, so I have seen three cycles perhaps before this. In 1980s, in fact Renuka actually touched upon that, in 1980s we had BFR; legislation came with great hope with a lot of good intentions. Then in the 1990s we had DRT, in 2000 we had SARFAESI and now we are in the early days of IBC. All legislations came with very good intentions and purposes, somehow as stakeholders we failed to protect them. I think we as stakeholders should take blame for not protecting these legislations.

I remember when BFR was set up in IDBI, we had a separate cell to manage BFR. But finally, I think it was hijacked by somebody, it became almost an asylum for unscrupulous promoters. DRTs could not be developed into an institution, even today DRTs take five to seven years for a resolution. SARFAESI, we thought it would bring great opportunity for the lenders. SARFAESI is still a good legislation but for small loans, may be for a housing loan or other mortgage loans. But when you look at large assets, large factories, it is just ineffective. Why it is ineffective? Because even today promoters can make it a law and order situation and police will not interfere, police will not help you to take over the asset when it comes to larger assets. So it is getting confined to smaller assets, housing loans and things like that. IBC is a great piece of legislation, we all have great hopes. As stakeholders, we need to protect it,that is our objective, our intention. As an ARC, I am a great stakeholder in this because we look towards this legislation as a panacea for all our problems now and it started off very well and we are fortunate to have a regulator who is very receptive and responsive. Problems are quickly attended to by a Government, who is very keen that this legislation should pick up and get perfected as early as possible. Another good thing the RBI did is to refer these 12 cases to IBC and these 12 cases are the most complex cases. So almost all issues, we believe, all issues of the lenders will be resolved in one way or other and the judicial decisions will come, and it will get perfected very fast because thanks to Dr. Sahoo and the Government of India, they are very keen about this legislation.

Coming to ARC's role in the financial system: Just to give a brief introduction, ARCs came as an agent of the bank. So till 2014 perhaps they worked as an agent of the bank and the bank decided the price and terms of sale. So it was only an agent as you had a very nominal skin in the game with 5% and 95% of beneficial interest retained with the banks in the form of security receipts. Security receipt was, in a sense, a hope note meaning if you recover, you pay that. So it was an agency business till 2014. Dr. Raghuram Rajan brought that great concept of a higher skin in the game for ARCs and right pricing by the bank. He wanted the banks to price the asset rightly and sell it to ARC. I think that was a great move. So the success of an ARC should be seen in the context of this system of 15:85. Under 15:85, ARC is not an agent of a bank because the management fee doesn't give you the protection of your capital. In a 5:95 scenario, being an agent, it was a management fee driven business. It is a great thing that it has changed into more cash and Reserve Bank's intention is to move towards full cash as is prevalent in all developed countries. Actually in all developed countries if you look at, bad assets are bought and sold at 15/20/30 Cents per Dollar, not more than 30 cents per dollar, whereas in India, that could not have happened because the banking system does not have capital to absorb the losses. They can't take the haircuts. So security receipts came as a via media for that. And if an asset which can be sold outright, an ARC can absorb it around 35-40 or 45 cents per dollar depending on business value and recover may be 75 cents per dollar out of that. I just want to clarify to all of you, in a 15:85 structure unless you recover 160% of your acquisition value you don't make your 18% to 20% IRR. And ARC system works in 18% to 20% IRR. You may ask why foreign funds are not coming into India, that is a different discussion altogether. Broadly, they are yet to get comfortable with the Indian legal system and their expected IRR of maybe 25%-30% for which the pricing may not be right. But for an ARC to get 18% to 20% IRR, I think what you need to recover is around 1.5 to 1.6 times of your acquisition price. So valuation of an asset is a function of the quality of assets and business robustness. We have even acquired assets at 100%. It all depends on the quality of the assets. If I acquire an asset at 100%, there will not be any haircut to the bank whatsoever. Then also we make our IRR--is it a good business to be in? Just to give you an example of a port in south, we acquired almost 100% of the debt at 100% cost. No haircut to the banks. We have restructured that with interest rate of 10%. The management fees which you earned, say at 2% p.a. gives you around 10% to 12% IRR and the debt is restructured. When the debt is restructured at 10% or 11%, contribution of ARC of up front cash of 15% also earns that interest. So you are home with 20% IRR. There are optionalities of equity upside, etc, if the economy picks up, in which case ARC can earn much better returns on its investment. The good thing about security receipt structure is, the bank continues to keep the option of upside in case the economy picks up.

Uday Kotak: Great. With that I will request Dr. Sahoo to tell us maybe a little bit of the journey so far which is pre-intermission movie, but also tell us, what is the story ahead?

Dr. M. S. Sahoo: On a lighter note, most of us sitting on this side are partners in the same crime, particularly Mr. Kotak and Mr. Piramal who sit on the Advisory Committee on Corporate Insolvency of the IBBI and many of its regulations have their stamp of approval. So if things are not fine, you know who to blame.

Let me turn to the subject. Sitting in the NSE premises, it is significant to note that the Stock Exchanges have found a use of the Code. Bombay Stock Exchange (BSE) has reportedly triggered insolvency resolution of seven companies for non-payment of listing fees.

Mr. Antony mentioned about decennial milestones. I find that reforms have three major decennial phases in the past three decades. In the 1990s, we focused on freedom to enter into business, primarily led by reforms in securities laws. In the decade beginning 2000, we focused predominantly on freedom at market place, primarily led by reforms in competition laws. This decade has focus on freedom to exit, the ultimate freedom, primarily led by reforms in insolvency law.

When work commenced on the first two phases, we had enough experience. We had a century old securities market, and we had centuries old competitive markets and there were enough professionals and institutions to support these reforms. But in case of the third phase, we started on a clean slate. The IBBI, Insolvency Professionals (IPs), IPAs, Adjudicating Authority, and Information Utility, being creations of the IBC, are absolutely brand new. There isno background knowledge and everybody is on a steep learning curve, everybody is learning by doing.

Consider securities reforms. SEBI was set up in 1988; the SEBI Ordinance was promulgated in 1992. The real reforms and the modern regulatory architecture that we see today came with another Ordinance in 1995. In the intervening period, we experienced fly-by-night operators, vanishing companies and so on, that still haunt us. It took 3-4 years to create institutions to sustain securities reform. Similarly, competition law was enacted in 2001. The actual implementation happened only in 2009. Thus, usually a major reform takes 3-4 years to mature and deliver. During this period, we often meander here and there a little bit, but do not lose the direction. As regards the third phase, we seem to be moving in the right direction. The challenge is to not lose direction.

The challenge is to revisit the rules and regulations now and then to address emerging challenges. In less than a year, the IBC has witnessed an Ordinance. The Corporate Insolvency Resolution Process regulation, which is at the heart of everything that is going on now, is getting amended at quarterly intervals to meet the demand of the stakeholder. Whenever there is a demand for some regulatory change, we do respond and we do so in a very consultative and transparent manner.

A point was made about the core objectives. The only objective of the code is resolution in case of financial distress. The resolution in turn has many objectives. The very first objective, as written in the long title of the Code, is the maximization of the value of assets of the corporate debtor. The changes in law made in the recent past, including the Ordinance, aim at maximization of the value of assets of the corporate debtor. If the enterprise value exceeds the liquidation value, that is, the company has some organizational value, it is a failing but viable business; then let us not kill the organization, let us preserve the organizational capital, let us make all possible efforts expeditiously to resurrect it. This can happen only if we have credible and competent people who can be entrusted with the distressed corporate entity for revival. Let us have a resolution plan, which is grounded on the actual market circumstances, is feasible and viable, submitted by a person who we can trust, who has the capability and a clean track record. The Ordinance debars certain people from submitting resolution plans who are unlikely to deliver. It does not talk at all about promoter versus non-promoter. It simply says that if a person has been debarred from either accessing or trading in the securities market, whether he is a promoter or not, he must not run a distressed company. How does such a person raise resources to run the business, if he can't access the securities market?

I do not agree with the view that this debarment will depress the valuation. Assuming that it would depress valuation, let me emphasize that the Code is focused on the maximization of the value of the assets of the corporate debtor, not valuation from the perspective of one set of stakeholders. Further, the possibility that value would be depressed does not mean that we would allow every market manipulator to trade in the stock market. In any case, what has been done is that only a small set of undeserving people have been kept out, while the entire world is the market. While supply comes from only one source, the demand comes from the entire world. The focus rather should be: How do we create a market environment where one can raise interim finance to prevent diminution in the value of the corporate debtor as a going concern, where we generate many competitive resolution plans, where we get best value by selling liquidation assets. These require a conducive market microstructure, and certainties of processes and outcomes. We need to facilitate development of market; a lot of facilitation has already been done by various authorities, we need to do more. So the solution lies in enabling and encouraging more people to participate.

Uday Kotak: Great. Thank you Dr. Sahoo, Renuka? You have any comments post your presentation on any of the points which we have discussed.

Renuka Sane: Well, I have a few things to say about what worries me about the process going forward. So in my presentation I have alluded to let us say judicial interventions or how will the infrastructure develop? Also, just a few observations on what is going on that is kind of worrisome. So let me come to the question of judicial decisions. There are 3 recent decisions that stand out which perhaps we should discuss. One is the NCLT declaring that the 14-day time limit for admission of petitions is now not mandatory, other one is the Supreme Court (SC) allowing for settlement between two parties once they have entered IBC to now allow for settlement outside and finally, for the recent case where 75% vote is sort of lowered to 60% vote of the committee of creditors by the NCLT again.

Uday Kotak: Is there a judgment to that?

Renuka Sane: Yes, very recent. So now NCLT has said that…..

Uday Kotak: But that is against the law, isn't it?

Renuka Sane: Well, they are inferring it to say that, as I think the judgment read that, because the RBI allows the JLF to go with less than 75 % of the creditors, this must be okay. But these kinds of decisions make me worried about where this process is going forward and it is not aligned with the policy and legislative intent of the BLRC. Similarly on the policy evolution, for example the recent SC case of the public interest takeover of the company. The NCLT had allowed the government to name new directors on the board of the debt-ridden firm, to protect the interest of home buyers--the SC stayed the decision. That also is worrisome.

Uday Kotak: Are you worried about the takeover under public interest or the SC judgment?

Renuka Sane: The SC judgment. So I mean in the name of public interest, the takeover of Unitech, the case that we have recently seen. That also worries me.

Uday Kotak: The SC judgment stopped it.

Renuka Sane: No, NCLT has taken over the directors of…

Uday Kotak: That is correct. But it was Supreme Court's decision?

Renuka Sane: Yes, that is right. So I am talking about the NCLT part of it. And on the institutional infrastructure also, I think that there are concerns about the IU regulations or how the IP profession is shaping up. For example, we have barred foreigners from becoming IPs. We have in parallel the RBI setting up a public credit registry that sort of is at odds with anIU industry in the IBC set up. So I think these are all concerns that we have to address going forward and if we don't address them we might have a problem on our hands.

Uday Kotak: Any comments on Renuka's observations on change of the rules, particularly this latest Unitech situation? Ajay?

Ajay Piramal: I think what Renuka is saying is right. We need clarity but I guess it is evolving and soon there should be clarity on it. That is the point. If we don't have clarity and every time it is going to be a subjective review by somebody else then I don't think people will get the confidence and you won't encourage investors coming in, right?

Uday Kotak: Yes.

Ajay Piramal: And we do need capital.

Uday Kotak: I will put up some questions here and try to initiate a debate on this. The first question is that the ordinance will again come to the parliament to be formally enacted as a law. Do we want any change in the ordinance? Any feedback from the group?

Renuka Sane: I think that the ordinance has a very wide scope. Even if I were to agree with barring certain kinds of people and that itself is a question mark, but suppose I agree with Dr. Sahoo that we don't want specific kind of people to participate. I think the ordinance as it is today, seems to disbar pretty much everybody, many in India for certain. The definition of related party is very vague. It seems that almost everyone is related to everyone and that is going to be a problem. For example, we have debarred willful defaulters, but how the RBI calls somebody a willful defaulter, that process has not been reviewed. So it is a little difficult to just call someone a willful defaulter and disbar them from the process. I think that a rethink on what those 8 categories are and how do we define them more narrowly is important and define them to bid for what? I mean, one promoter or one person just bidding for his or her own firm, or every other firm. I think that also requires a rethink.

Raghu Sundaram: I think I fully agree with her on one point. I would have allowed if the decision of any type of resolution applicant to the COC, because COC knows everything. A wilful defaulter or people who have siphoned off funds are a no-no, they should never be allowed to come in. But one-year NPA, people associated with that being debarred is questionable because NPA happens for factors beyond their control sometimes. Perhaps that should have been left to the COC. Maybe even in the COC, some evaluation criteria is getting evolved. I mean, just give it a chance. Why I am saying this is because we are thinking of only these 12 large cases or maybe another 25 cases after that. Where some quality assets are there, there could be good strategic attractions, strategic interest in those cases. But there are hundreds of cases, particularly the medium and small ones, with the banking system where there is no strategic interest. What happens to them?

Uday Kotak: Ajay, what are your thoughts? What are the changes you would like to see in the ordinance or you are happy?

Ajay Piramal: No. I think I actually agree with this and this is what I said earlier also that there is a moral hazard. In the large cases, there is clear diversion of funds, should you allow the same promoter to come? Frankly, in large number of assets you are not going to get 100% of the value. In the books of the bank, a lot of the assets are inflated because you keep adding interest on interest on interest. Who is going to pay for that? Then if you see that I am going to give an asset at 50% which maybe the real value, I think that will never sell and we are seeing large loans. So to say, therefore we will have to segregate. But on the other hand, what Mr. Antony said is also true. Small and medium industries may not get anybody else to come and some promoters may genuinely have had issues in the business, maybe the environment was bad or whatever be the reason. So should they be banned? No. It is actually a very difficult and delicate thing and definitely needs some change because today I am told that even if a private equity person has invested in a firm which has become an NPA, that person cannot invest in another resolution. I guess it still needs more thought but that you should bar some kind of promoters has to be. Otherwise it will not go through, I don't see any government, any parliament passing it. So we need to recognize it and there is a moral hazard.

Dr. M. S. Sahoo: Yes. I agree that there is a big moral hazard here. Do we want to repeat a cycle that someone defaults, undergoes this process only to give a haircut for bankers, and retains the company, as if nothing has happened? Do we want hair cut for creditors to be the only outcome of the process? Would you ever have a credit market? When you know, this is the rule of the game, you will repeat the game every three years, you will default, go to NCLT, and again 50% hair cut for bankers. If you continue giving a haircut of 50% a few times, eventually nothing would be left. So is that the message we want to give? I do not think, the suggestion to consider an ineligible promoter if he offers 25% more than the best offer is workable? The guy who is mischievous will always offer a hyped value. And you can't say no to him on the ground that his hyped offer is not reliable. The guy who is genuine and wants to really run the company will offer a realistic value. Then the process will end up accepting the hyped offer and rejecting realistic offer.

Uday Kotak: You know one of the things which I understand is, why this rule came in is because within the policy framework there is a perception that it has been a fixed match between promoters, ARCs and banks so far and a lot of this was actually going around. This is why I think something like the promoters ordinance came, where effectively the system is saying that this needs to be changed. When it comes to willful defaulters, there are many companies where the promoters have not been formally declared willful defaulters in-spite of misuse of funds in those companies. So I think it is a very difficult balance between the two. My personal view is, and maybe we can comment on this, assuming in the first round you get only one bidder or zero bidders, should there be a way in such a situation that if there is a second round, we could allow promoters?

Ajay Piramal: So one of the concerns I also have is that if an existing promoter wants to bid, will you really get…

Uday Kotak: First round, no bidding. But assuming in the first round of bidding such a scenario arises.

Ajay Piramal: But even the person knowing that, okay, let us make the first round unsuccessful, can they do something? Sometimes they may have links within. I don't know, I am just speculating. I am really not sure of this.

Uday Kotak: So friends and others will be told that don't bid for this?

Ajay Piramal: No, it is not friends and others. I think the full information. I am not sure whether it will be available to all the bidders and some incorrect, I don't know.

Uday Kotak: Let me ask the reverse. I mean from the point of propriety, assuming say a committee of creditors has to decide and where there is only one bidder, what happens? Should that bill be accepted, not accepted? How do you ensure transparency? Actually in many assets you could see one bidder.

Siby Antony: Absolutely, there is an issue if there is only bid.

Ajay Piramal: I don't have a solution yet. I think we have to address a lot of these issues. It is a sensitive issue, it is an important issue, but I don't have an answer yet to all that.

Siby Antony: What I meant was minus mark for the promoters bid. Why I said this is because the evaluation criteria is being evolved like this. Upfront cash, NPV, before that (-25) marks because upfront cash has 30 marks, maybe NPV has 30 marks.

Uday Kotak: But how do you enact it as a law? That is the problem.

Siby Antony: No, it is an evaluation criteria, I leave it to the COC.

Uday Kotak: Renuka, your thoughts on this, assuming that you get only one bidder, how do you handle this?

Renuka Sane: I think it should be left to the committee of creditors and…

Uday Kotak: And to give it to that one bidder.

Renuka Sane: Yeah, or they will go into liquidation and see what, if that one bidder is better than liquidation then you go for that one bidder. I feel that it is not for us to be making that decision.

Uday Kotak: No, what happens when the promoters are not being allowed and you get only one bidder?

Renuka Sane: Yes, even so. I think it is a commercial decision that the committee of creditors make. So I would stick with the IBC intent and say it is what it is and make a choice.

Dr. M. S. Sahoo: The solution is not allowing a tainted person to come in; the solution is to create a market which obviously is an important challenge. So let's focus on creating a vibrant market for resolution plans.

Renuka Sane: Sir, the only thing that I worry about here is classifying someone as tainted is a little difficult, even though we have some 8 criteria. As you said, this was problematic. But it is hard to know before hand from these criteria whether this was intentionally done so or not, and my sense would be to not be moralistic about where the promoter comes from.

Dr. M. S. Sahoo: It is not moralistic at all.

Uday Kotak: Okay. I will move to another subject in this context. As Dr. Sahoo said, we are trying to get maximization of value. I shall ask the view around this panel and obviously will subsequently open up to the audience here. Now we are talking about very illiquid assets. In the next 6 months, value will be much more about perception rather than reality. If we did a review say 3 years later on two time frames; 6 months and 3 years, do you think fair value will be achieved or the buyer will do better or the creditors will do better through this process?

Dr. M. S. Sahoo: I think that this law will bring huge behavioral changes. As a debtor, I know that if I default, the process will take me on a clear, defined path. Not just that, I may not be eligible; even if I am eligible, I may not offer the most competitive resolution plan. Therefore, I will do my best to avoid this path.

So also the behavior of the creditor, while sanctioning the loan or filing an application to initiate resolution process.

Uday Kotak: I agree that this would lead to good behavior, Dr. Sahoo. But for these assets which come under the IBC process, finally the objective is achieving fair value where the creditors maximize their price and the buyer doesn't lose.

Dr. M. S. Sahoo: I do not agree with maximization of value for creditors. A corporate debtor in distress has many stakeholders. Creditors are of course the most important stakeholders in this situation. The first order objective of the Code is resolution, that is, the corporate debtor should survive, then only all stakeholders would benefit. The second order objective is maximization of value, not of a set of stakeholders, but of the assets of the corporate debtor.

Uday Kotak: Resolution?

Dr. M. S. Sahoo: We want resolution where every stakeholder swims with the company. If a creditor wants recovery, it has many options for recovery. IBC is not one of them. IBC is not for recovery: Recovery is an individual effort by a creditor to recover its dues through a process that has debtor and creditor on opposite sides. When creditors recover their dues - one after another or simultaneously from the available assets of the firm, nothing may be left in due course. Thus, while recovery bleeds the firm to death, resolution endeavours to keep the firm alive. In fact, the IBC prohibits and discourages recovery in several ways.

Uday Kotak: Therefore, if I hear what you are saying is, not only should creditors get a good deal but the buyers should be able to resolve and transform these to create value. That is it.

Dr. M. S. Sahoo: We are dealing with a corporate, which is an amalgam of interest of various stakeholders. Just because creditors are in-charge of the corporate today, it does not mean that the corporate has lost its character and it would serve the interests of creditors only. Being a legal person,the corporate should continue to exist in perpetuity and must therefore take care of interest of all stakeholders.

Uday Kotak: Ajay, keeping in mind your view that capital is scarce and the supply is a lot more, logically scarce capital should make good returns.

Ajay Piramal: It has to make a decent return, otherwise nobody is going to come as much as we want, and I think Dr. Sahoo is right. The enterprise actually has to give return and to your point whether the creditor will get more, will the buyer get more, I think it depends on the assets. So we have seen a few assets. Some of them are definitely good and probably the creditors will get what they want. Talking of behavior, I think big change will be that creditors will push the debtors to actually settle quickly or get a resolution with the threat of going to IBC which is a good thing. So very often there is decay in the value of the asset over time. So it is better to solve the issue upfront. If you have a problem, it is like cancer at the first stage you tackle it, it can get cured in most cases. But if you wait till terminal stage, then there is no cure. So I think all creditors till now were actually pushing the can. Forget it; somebody else will do it, now they have to settle. So that is one thing and there they will get higher value. But ultimately will the creditor get more or the debtor or the buyer? It really depends on the assets. I have seen some assets where you know the working capital is so inflated. The company don't have either the receivables, they don't have the inventory and banks have valued it. You think they will get value? No chance.

Uday Kotak: Let me shift to another subject. Now with the ordinance as it stands, the promoters cannot bid. So let us see, we are talking about somewhere around Rs. 12-14 lakh crore of assets and most of them will go down the IBC route. So, in most of these cases, the promoters would lose the companies. How do we see the process of replacing the operating management by the potential bidders? Looks like many of the bidders are going to be institutions, partnering with some of the players. How do we see operating management being put in place in these situations? And given the size of the problem, this is a question that will need deeper thinking.

Siby Antony: Actually this is one area which needs to be developed in this country. Unfortunately, in our situations, promoter and management is the same. So if you want to change the management, you need to disregard the promoter. For the first time, fortunately IBC has brought that capability. We can do that. But what we need to develop is a professional operating company, operating partners along with it might be private equity (PE) or asset reconstruction companies (ARCs); they should be able to operate it. But challenges will be there because it is a different cup of tea, running a company is a different cup of tea.

Uday Kotak: No. Some of the bankers present here have tried to in many cases implement S4A (Scheme for Sustainable Structuring of Stressed Assets) and other such measures which have required a change in operating management. However, I don't think it has been easy to get operating management for running these companies. So if you have such a large number of companies coming in; where bids have been submitted primarily by financial biddersalong with some strategic partners, isn't there a risk? I think that this is something which needs to be focused on. There is a need for a whole new cadre of professional entrepreneurial managers coming in.

Ajay Piramal: Sir, my view in this is, first of all there will be consolidation. I think the successful bigger players will get larger. In the world this is what has happened. Anyway, it is going to happen here and it is good. If the company has gone sick and has gone to such a bad state, I think the promoters or managers should not be there. Anybody should be better than that, so that is one. Second, I think that there are good professionals available in the country, it is not that. You can get professionals from abroad. I have seen people doing that. If you have a good compensation package in India today, it is as good as anywhere else. So you can get professionals. Therefore the way we are approaching this is not only financial. I don't think financial solution is enough. You have to have operational solution. So either you partner with somebody who has deep knowledge of that industry and has a successful track record, or you yourself may have done it or you can hire management. What else do private equity funds do to get good returns? So I think we should not worry unnecessarily about that; if somebody is going to put so much money, they will find a solution.

Dr. M. S. Sahoo: No. Who is asking you to throw out the existing management? All key managerial people who are there start reporting to the IRP and subsequently, to RP. Under a resolution plan, there may be change in shareholding or board composition, but resolution is as a going concern. Post resolution, the resolution applicant has the choice of continuing with the existing managerial personnel or take a different set of people. So I don't see any crisis in this regard, as the managerial personnel are not compulsorily thrown out.

Uday Kotak: Okay. With that I think we have had a fair discussion around this panel. I would like to now open it up for participation by the audience here. So as we look at this, I will request questions, maybe we will start with Krishnamurthy Subramanian first.

K. Subramanian: I am actually going to build on the very good point that Mr. Antony made about how SARFAESI has actually been very effective for small borrowers but not for the larger ones. I think this is a part that creates a significant worry. If you dig a little deeper, why is it that SARFAESI actually has been good for the smaller and not for the larger ones is because people with deeper pockets and networks tend to “work the system” and the same aspect will continue. Why would it not continue? Worldwide, we have seen instances where strategic default is used as a tool, bankruptcy is used as a tool and particularly by people who have right connections. So what basically have afflicted SARFAESI, might continue to afflict the IBC as well. So what is the way of resolving this particular problem, which relates to the ability for the people with deep pockets to work the system?

Siby Antony: I would like to mention one point. Though I mentioned that SARFAESI is good for smaller loans, why it doesn’t work for larger assets is because you need external support to complete your transaction there. You need a CM’s support, a Collector or Superintendent of Police to take physical possession of the asset. You need police protection there. But these are avoided in the Insolvency and Bankruptcy Code. Once it comes under the insolvency and bankruptcy code, the RP takes over and takes full control and by law, the Board gets suspended and the company is in the control of the RP. For the RP system to be developed, will of course take time. But as of now if you look at the 12 cases,the majority of them is in the control of the RP. You don’t need the support of an external agency, such as the police or the CM. That requires deep pockets and all that, but this doesn’t happen here.

Uday Kotak: Okay. I will have Subir Gokarn here.

Subir Gokarn: Thank you for an excellent set of thoughts on this issue. I have one question for Ajay Piramal and one question for Madhu. Ajay, you raised the issue of resources and I think we have to move from the sort of ideal state and the strengths of this legislation in an ideal situation to the reality of market situation now. So where are the resources coming from? Where are they going to come from? Are we going to be dependent largely on foreign funds coming in? Or is it going to be a pricing issue? So I was wondering whether there is any kind of problem emerging in this one sided, uneven market situation itself. Lots of assets to be resolved--but not enough buyers. Madhu, on a lighter note, you can take Madhusudan Sahoo out of the Competition Commission, but you can’t take the Competition Commission out of Madhusudan Sahoo. Lot of these assets are in monopolistic sectors. Are competition considerations going to become an issue in resolution because you might expect that when you put your mission of maximization of value into play, sectoral consolidation is going to be a significant issue.

Successful companies are going to want to take over unsuccessful ones in the same sector. So how does one bring competition considerations into this whole equation?

Ajay Piramal: Sir, I think the buyers' market will take a little time to develop. As of now, I think there seems to be enough interest in the assets. As regards funding, I think there will be external funds that we will have to look at. I believe that it is necessary to do some consolidation as well. So existing stronger companies must get access to these resources and that is where I think the banking system in India will come into play. I believe that the equity markets will also open up ultimately, which will allow some more funds to come in. But it is going to be a challenge. If you have Rs 200 billion of bad assets, I still don't know where all the money will come from. So, we will have to start developing an alternative.

Subir Gokarn: If I can follow up Uday. So I am dealing with a bad asset. Somebody comes along and says look, lend me money and I will buy these assets. So essentially this sort of circulates…

Ajay Piramal: No, but the person who will buy it, will obviously be a better operator. He will buy it at the right price and that is the risk that the bank or the lender will take on that. It will be priced correctly, when the person buys it will price it to what he thinks will fetch him a return on. Sometimes consolidation does help. So if I have a distribution set up and I acquire something, I don't need overheads and so on.

Uday Kotak: And in fact, if I take on from Ajay, first of all, there is a $200 billion or Rs. 12-14 lakh crores worth of assets which will be cleared. Let us say that the recovery percentage could be about 40% and we can debate on that. So you are then talking about a recovery amount which is say Rs 5 lakh crores. Assuming the equity value is more or less wiped out, at a debt equity ratio of say 3:1 or 2.5:1, on Rs. 5 lakhs crores, you are talking about equity requirement of about Rs. 1.2 to 1.5 lakhs crores. So that is much more manageable. That is the risk capital. So when you look at the problem as Rs. 12 lakhs crores, that is the gross value, a lot of which is due to ever greening in the previous 5 to 7 years. So it is really not true money. It is money which was created in air so that banks' P&Ls and balance sheets were okay for a while. So if you stripped all that out, you are down to a situation where frankly the need for equity is about Rs 1.5 lakh crore or $20 billion to $25 billion. It is not $200 billion. Therefore at $200 billion it looks like a very large number, but if you sort of cut, slice and dice and then you can have various structures. There could be equity; and there could be pure debt. So you will see different kinds of financial structures play in this market with different kind of risk profiles. However these solutions will need to work for the assets to recover, not only from a financial point of view, but also from an operating performance point of view which will help bring back these stressed assets into an effectively performing economy. Post all this, will arise the question of competition or no competition. Will we see too much power go into few hands?

Dr. M. S. Sahoo: See, this has two dimensions. One is what we call combinations, i.e., mergers and acquisitions resulting in creation of a big entity with huge market power. But here we are talking about stressed companies. There are two options: either company survives or company dies. If the company dies, that is the maximum harm one can do to competition. But if you somehow can help the business of the company to survive, then you are helping competition. Assuming that the merger goes through and the Competition Commission does nothing: Two enterprises merge to form a big enterprise. Even after merger, the Competition Commission has the authority to deal with abuse of dominant position. I don't see much of an issue here.

The second aspect is competition in the market for resolution plans. The solution is making efforts for market creation. There was an editorial today on this. The idea is to create a market. We are looking at present versus future. So possibly, if this kind of people are allowed, there maybe a better price discovery and also, creditors may get a better value;but they are maximizing their short-term gains. However, after two years when the same process is repeated, then they become worse off. So if we want the companies to survive in the long run, we have to maximize the future gains rather than present gains. Stock market has many illiquid companies. That does not mean, we would allow the tainted people, who have been debarred by SEBI from trading, to trade the securities of those companies. So I think the solution is to create a market; that is a long term solution and let us look at long term horizon.

Uday Kotak: I will have Mr. Khan.

H.R. Khan: I have few questions, but I will confine to one or two. One was taken up by Subir. The other question relates to issues that are evolving and are at a very critical and inflection phase. Let us take for example the issue of approvals. Some new promoter comes, who has to get a mining approval.

So, are you putting in place a protocol or is there a dialogue, so that this happens seamlessly? Same is the case in case of approvals in the competition issue. The second issue which is rightly highlighted by Mr. Uday Kotak is that as the ordinance becomes an act, there may be few glitches, which we need to look at with an open mind. Finally, of course, there is a whole issue of taxation that I think also has to be looked at.

Uday Kotak: I think taxation is also a big issue because there are lot of changes which are required. And Dr. Sahoo, just one clarification. Is a bid in the IBC process for restructuring exempt from Competition Commission?

Dr. M. S. Sahoo: No. Approval of the Commission is required, if it attracts provisions of Section 6 of the Competition Act.

Uday Kotak: A resolution plan, if it is approved by Committee of Creditors and blessed by NCLT, is it exempt from Competition Commission?

Dr. M. S. Sahoo: No. Any exemption needs to be explicit. For example, SEBI has exempted takeovers under resolution plans from making a public offer or issue of shares under resolution plans from preferential pricing norms. Ministry of Corporate Affairs has clarified that approval of the shareholders of the corporate debtor for a particular action required in the resolution plan for its implementation, which would have been required under the Companies Act or any other law, is deemed to have given on its approval by the NCLT. Under competition law, certain combinations below a threshold of value are exempted. When somebody is submitting a resolution or plan, he comes with open eyes what approvals are required. He would plan how to get it.

Uday Kotak: And with that, let me ask the largest owner of the $200 billion of assets, State Bank of India. Madam, over to you.

Anshula Kant: You know my question as an interested party comes with vested interest. Mr. Piramal mentioned in the passing: why not liquidation value; why are we talking about enterprise value? My question is just the reverse: why not enterprise value and why liquidation value? Does it not end up, ultimately taking a hit for the exchequer because this is a time bound resolution process. If you don't do it 180 plus 90 days, that is 270 days, anyway you go to the liquidation value. At least you should try and optimize the bids that you get and save tax payer's money.

Ajay Piramal: No. Because there is a bidding process that will be there for the resolution, so you will get whatever is the worth of that asset in the eyes of the bidder.

That is what I am saying. If banks set an artificial enterprise value, what will happen is, everybody will say, this is the value and you are getting much below that. Further, as regards valuation by an expert valuer, there can be a lot of variation. How do you determine enterprise value? Will it be discounted cash flow, or will it be some other method? I mean there are 10 different methods which people can come up with.

Anshula Kant: You know you start with a handicap with IM (Information Memorandum) as you are declaring the liquidation value.

Ajay Piramal: You don't declare it. It will come later. If you ask me for one standard formula for enterprise value, I can give you 5 different. With my discounting rate, I have to just change the terminal rate by half a percent and the value will go up by a huge amount. So it will be just an unnecessary dispute. We will be living in a fools' paradise. I am your professional valuer. I want State Bank to keep giving me business, I will value it very high.

Dr. M. S. Sahoo: I think, she is making a slightly different point. She is probably asking as to why do you require disclosure of liquidation value? There are arguments for and against and this issue is under consideration. The law provides that the operational creditors have a priority in payment and they need to be paid at least the liquidation value. When a prospective resolution applicant submits a resolution application, he should know how much he has to provide towards claims of operational creditors and dissenting financial creditors. How does he know unless he knows the liquidation value?

Anshula Kant: I get your point but I am still not comfortable with this situation because…

Dr. M. S. Sahoo: Please place yourself in the shoes of a resolution applicant. Would you not like to know how much of funds you infuse into the company would be used up to pay operational creditors and dissenting financial creditors and how much would be left with you for business operations of the company.

Anshula Kant: In fact, I am not in disagreement with paying the operational creditors, but why to pay liquidation value to the dissenting financial creditors upfront.

Dr. M. S. Sahoo: That is the law. We have to comply with it. The law has a rationale. A creditor, who walks out, can take liquidation value leaving the organizational capital for stakeholders who stay back with the corporate debtor. This should serve as a disincentive for a financial creditor to opt for liquidation and thereby promote resolution over liquidation.

Siby Antony: And personally I feel it is a good point there because it actually encourages everybody to go for the resolution.

Uday Kotak: We will take one last question and then wrap up.

Suhail Nathani My name is Suhail Nathani and I am lawyer and aspiring economist.

Uday Kotak: Wow, I thought Economics was the art of imperfect science.

Suhail Nathani: So, this is a question for everybody out there generally. We need to come with one object of the statute which is to maximize returns to the creditors leaving aside the debate on liquidation and enterprise value. When we are doing that, we are disqualifying a class of bidders who have the propensity based on empirical evidence to bring the best bid to the table. We are doing this because doing otherwise would be a moral hazard or we don't want this to repeat itself. I just put this for everybody's consideration that you can never legislate moral objectives in law. The second issue is that if somebody has done something wrong as Dr. Sahoo said and if SEBI has barred him, then why will I allow him to come into the market? Note that none of these promoters have been taken to the legal process, either under the criminal law or the Companies Act or anything for syphoning the money. So you are eliminating a very valuable class of bidders by having this blanket ban.

Uday Kotak: Okay. What I will request from the panelists is, a response to his question and then your final comments. Maybe we will start from the extreme left and move this way.

Siby Antony: That is what, I mentioned this. Actually a blanket ban perhaps will have impact on a large number of small and medium assets, but not on larger assets. Maybe a few will get sold at very good price in the competition but a very large number of them may get impacted. That is what I mentioned: it should be left to the COC.

Dr. M. S. Sahoo: I beg to differ given the objective of the Code in its long title, which is maximization of value of the assets of the corporate debtor, and thereby for all stakeholders and not for creditors alone. Further, let me make it clear that moral hazard is not a moral issue at all. It is a pure economic issue. It is present versus the future. Do we want to close the deal today and repeat every 3 years, with successive haircuts of 50%? Or we close deal by a resolution that can last. We do not wish to incentivize the debtor to impose repeated haircuts on creditors only because it may offer a promise of lower haircut. It is choice between a credible and competent person who can deliver vis-à-vis a person who is unlikely to deliver given their track records.

Renuka Sane: So I think we need to look at this process in the long run and very often especially on this promoter ordinance as we call it, we are sort of worrying about the guys coming in today and putting in frameworks which are going to last for a long time. In fact, I sort of differ with Dr. Sahoo here, because I think by barring a large class of people we are setting the precedent for many years to come and many years later the situation of why the promoter finds himself as a one year NPA may be very different from why he finds himself today. In that sense, I would agree with you that we need to be careful in how we create structures that will provide these incentives for many players to go forward and we need to be careful on all fronts.

Ajay Piramal: I think we have to just be a little patient in this whole IBC. It is a new law, it is a major reform that is taking place. As Dr. Sahoo said, let it evolve over time. I think we are in the right direction and I feel it is a major change which was required in the system. We have done it and it will evolve. We will go through evolution and everywhere in the world it has happened. That is what I want to conclude with.

Uday Kotak: Okay. With that I will just add my last two bits. First, I completely agree that in many ways the formation of the Insolvency and Bankruptcy Code is about preservation, development and growth of national assets, lot of them which have got stuck and are therefore not performing to produce returns for the country. I think that is the larger purpose of this whole enactment, to really make these assets perform and produce for the benefit of users and create value for the nation. That is the broad overriding approach of this. And within that, I think we are going through, as I said at the beginning of my discussion, this period where this is like a Bollywood movie, we are at intermission stage and as they say story is still left. So with that let us wrap this up.

Notes

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