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IL&FS' resolution success lies in 'horses for courses' strategy

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NEWS ANALYSIS

KOTAK MAHINDRA VICE chairman and managing director Uday Kotak was bang on when he said in a recent media interview that there should be a rethink on the group resolution mechanism under the Insolvency and Bankruptcy Code that is yielding a resolution value of around 20-30%.

Policymakers should listen to Kotak as he has walked the talk. Sample this: Under his chairmanship at the Infrastructure Leasing and Financial Services (IL&FS), the resolution process raked in 62% of the ₹99,000 crore owed to banks, mutual funds, pension funds and others.

So, the big question: What went right for IL&FS and wrong for others? Three key reasons: A sense of security among public interest board members by providing them with immunity; a sense of freedom by allowing them to create their own set of processes; and a moratorium that ensured that institutions were unable to hack into the process of recovery by forcefully claiming their dues in tranches while the process of the resolution was underway.

First, the process of setting up a public interest board vis-a-vis an administrator overlooking the process and providing them immunity provided a major differentiation. In its very first communication with the NCLT, the new board wrote: "No actions are to be initiated against the members of the new board, without prior approval of the NCLT, for past actions of the suspended directors or any officers of IL&FS and the past wrongs of the suspended directors and officials of IL&FS," the communication said.

Second, providing freedom to the new board so that bold decisions could be taken without the fear of future litigation. The new board was able to make its own rules, instead of simply following the IBC process. The formation of a public interest board meant that all the stakeholder's interests were taken into account. Also, the idea was to optimise value for everyone instead of simply getting rid of the asset.

Consequently, the board could quickly come up with a list of green, amber and red companies. This, effectively, meant that everyone had clarity about the assets that could be monetised, restructured or liquidated and the underlying exercise could be completed, according to this classification. At the same time, there was a kind of 'bad bank' where all the bad assets were clubbed.

Comparatively, resolutions of other non-banking financial companies (NBFCs) such as Reliance Capital, DHFL, Yes Bank and SREI are governed by uniform IBC norms. Therefore, the recovery is driven by an administrator using banking norms to fix niche NBFC problems, one of the reasons resulting in significantly reduced recovery for these assets.

Third, moratorium from repayment. The new board was able to set up a system where October 15, 2018, was considered the cut-off date for all accumulated losses. More importantly, banks were asked not to deduct their portions from the deposits being made from the running business.

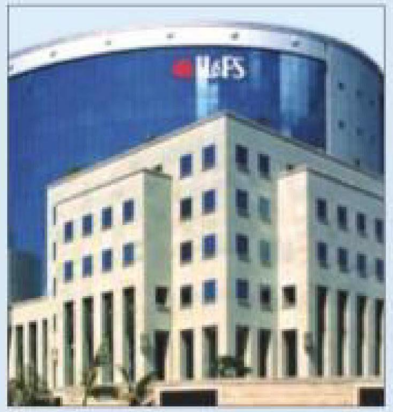
The board had to approach the court when nine banks started unauthorised withdrawals of around ₹800 crore from their escrow accounts to recover their debt.

"By prohibiting some select lenders from forcefully recovering dues in bits-and-pieces, the IL&FS board was able to keep the businesses as "going concerns", ensure execution of resolution as planned and implement a plan to pay interim dividend to all class of creditors. Without the moratorium, it would be mayhem for every business entity under the group," said an industry source.

Earlier this month, IL&FS commenced distribution by paying ₹623.38 crore, on an interim basis, to the secured lenders/secured financial creditors of RMGL Bank.

The total claims of these lenders were ₹715 crore which translates into a recovery of 83%. And even unsecured creditors like provident funds, which don't get anything under the IBC process, are expected to recover 10%-20% of their money in the overall interim distribution framework approved by the courts.

In essence, IL&FS' resolution success, much like the Satyam Computers' quick and efficient sale to Tech Mahindra after former chairman B Ramalinga Raju admitted to 'cooking the books' is a good example of how the system, if done through a proper thought process, can resolve serious problems effectively.



RESOLUTION MODEL

- The group resolution mechanism under the IBC is yielding a resolution value of around 20-30%
- The IL&FS' resolution success is a good example of how the system, if done through a proper thought process, can resolve serious problems