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Using Foreign Capital to Deal with Stressed Assets in India

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INSOL International is very pleased to publish a technical paper titled "Using Foreign Capital to Deal with Stressed Assets in India" by Dhananjay Kumar and Gautam Sundaresh of Cyril Amarchand Mangaldas, India.

The stressed asset situation in India continues to remain a cause of concern for the economy. One reason why this has been the case is due to the nature of lending by the public sector banks. Given that measures led by the Reserve Bank of India, (Central Bank) were largely unsuccessful, alternative options to manage the stressed asset situation such as asset sales and the use of foreign capital have risen in prominence.

This paper examines the regulatory framework that would affect foreign investment in India, the developments that have had a positive impact on foreign investment in stressed assets, some specific instances of foreign investment, and suggestions for the mitigation of current challenges for foreign investors.

INSOL International sincerely thanks Dhananjay Kumar and Gautam Sundaresh for carrying out extensive research and for writing this excellent technical paper.

June 2021

Using Foreign Capital to Deal with Stressed Assets in India

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1. Introduction

1.1 India's stressed asset problem and why foreign capital is required

India's stressed asset situation has regressed over the last decade, with the number of stressed assets doubling between 2013-2017.[2] The asset quality review (AQR) conducted by the Reserve Bank of India (RBI) during the second half of 2015 was highly revealing of the chronic nature of the problem. As indicated in the AQR, the problem is severely exacerbated by the nature of lending carried out by the public sector banks. The percentage of stressed assets held by public sector banks increased from approximtely 7% in 2010, to crossing the 14% mark in 2016.[3] Owing to certain remedial measures, this has been brought down to 9.7% as of September 2020, but it is expected to drastically increase to 16.2% by September 2021 on account of the COVID-19 induced economic crisis, operating on the current baseline macroeconomic assumptions.[4] After the completion of the AQR in 2015, the gross non-performing assets (NPAs) in the banking sector underwent a sharp year-on-year increase touching close to 8.5% in March 2016,[5] which was subsequently brought down to 7.5% by September 2020.[6] With the overall failure of the RBI led out-of-court debt restructuring schemes like the Corporate Debt Restructuring Scheme (CDR)[7] and The Strategic Debt Restructuring Scheme (SDR),[8] alternative options like asset sales and infusion of foreign capital have gained importance in addressing this problem. While the RBI has now repealed the multiple debt restructuring schemes that were earlier functioning in parallel, it has now introduced a comprehensive stressed asset resolution framework *vide* its circular issued on 7 June 2019.[9] At the same time, this entails various consequences for the existing management of debtor companies and stricter prudential requirements for banks. The importance of foreign capital in resolving India's stressed debt problem thus remains high.

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* The views expressed in this technical paper are the views of the authors and not of INSOL International, London.

1 Dhananjay is a partner and Gautam is a senior associate in the Restructuring and Insolvency practice at Cyril Amarchand Mangaldas. The authors thank their colleague Roma Bhojani for her assistance in this project. The views expressed in this paper are personal in nature and do not in any way represent the views of Cyril Amarchand Mangaldas.

2 Speech by Deputy Governor of RBI titled 'Some Ways to Decisively Resolve Bank Stressed Assets' on 21 February 2017 at the Indian Banks' Association Banking Technology Conference, Mumbai, available at: https://rbi.org.in/Scripts/BS_SpeechesView.aspx?Id=1035.

3 Key note address delivered by Shri N.S. Vishwanathan, Deputy Governor, Reserve Bank of India at Nation Conference of ASSOCHAM on "Risk Management, Key to Asset Quality" in New Delhi on 20 August 2016, available at: https://rbidocs.rbi.org.in/rdocs/Speeches/PDFs/ASSOCH0FB1F02A5B4242399E8AB78D888D79AC.PDF.

4 Financial Stability Report (Issue No. 22), published by the RBI in January, 2021.

5 Financial Stability Report (Issue No. 13), published by the RBI in June, 2016.

6 Financial Stability Report (Issue No. 22), published by the RBI in January, 2021.

7 This process was aimed at recovery for a defaulting company and its continuance as a going concern. The framework mandated promoters to personally guarantee the debt, infuse additional capital and lender consortiums reduced their debt burden by lowering interest rates or increasing maturity periods.

8 Through this process, banks became eligible for converting their outstanding loans into majority equity stakes if the CDR milestones were not met. Further, this process enabled banks to initiate a change in management of the company.

9 Reserve Bank of India, Prudential Framework for Resolution of Stressed Assets (7 June 2019), available at: https://rbidocs.rbi.org.in/rdocs/notification/PDFs/PRUDENTIALB20DA810F3E148B099C113C2457FBF8C.PDF.

2. Current regime

2.1 Regulatory framework for foreign investment

The broad framework for foreign investment into India is set out in the table below:

Investment Type	Permitted Investors	Additional Comments
Loans / Bonds	'Recognised lenders' are those that are resident in Financial Action Task Force (FATF) or International Organisation of Securities Commissions (IOSC) compliant countries, including on transfer of External Commercial Borrowing (ECB). Further, the following have also been specifically categorised as recognised lenders under the ECB framework: a) Multilateral and Regional Financial Institutions where India is a member country; b) Individuals are permitted as lenders if they are foreign equity holders or for subscription to bonds / debentures listed abroad; and c) Foreign branches / subsidiaries of Indian banks are permitted as recognised lenders only for foreign currency ECB (with certain exceptions).	Regulated under: a) The RBI Master Directions on ECB, Trade Credits & Structured Obligations; and b) Foreign Exchange Management (Borrowing and Lending) Regulations, 2018 Available routes: a) Automatic route; and b) Approval route. Maximum investment in financial year (automatic route) is USD 750 million. All-in-cost, minimum average maturity and general reporting requirements have also been specified. General end use restrictions: a) Investment in capital markets / acquisitions of Indian companies. b) Real estate activities. c) General corporate purpose, working capital purpose or repayment of existing rupee loans (with certain exceptions). d) On-lending for the abovementioned purposes (with certain exceptions). (For (c) and (d) above, there is no blanket end-use restriction but only a requirement for compliance with longer minimum maturity requirements).

		Note 1: All eligible borrowers can avail ECBs designated in Indian Rupees (INR) from Recognised Lenders (other than foreign branches / subsidiaries of Indian banks). Note 2: A specific exemption has been prescribed for potential bidders under the Insolvency Code in order to enable them to avail of ECB loans in order to participate in the Insolvency and Bankruptcy Code, 2016 (Insolvency Code) process and repay rupee term loans of the debtor company (other than from overseas branches or subsidiaries of Indian banks). This is however subject to receipt of RBI approval. Note 3: Eligible corporate borrowers who have availed rupee loans domestically for capital expenditure in manufacturing and infrastructure sector and which have been classified as "SMA-2" (a category of stressed loan classification upon a payment default of grater than 60 days) or NPA can avail ECB for repayment of these loans under any one-time settlement with lenders. Lender banks are also permitted to sell, through assignment, such loans to eligible ECB lenders, provided, the resultant ECB complies with all-in-cost, minimum average maturity period and other relevant norms of the ECB framework. Foreign branches / overseas subsidiaries of Indian banks are not eligible to lend for the above purposes.[10]
Equity and compulsorily convertible debentures or preference shares	A non-resident entity can invest in India, subject to the limits specified for Foreign Direct Investment (FDI) in specific sectors (except in those sectors / activities which are prohibited).	Regulatory framework: a) The FDI policy read with the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 and the RBI Master Directions on Foreign Investment in India provide a framework for direct investment into India. b) Depending on the sector and the mode of investment, investment can either be under the 'automatic' or 'approval route'. Investments under the automatic

[10] RBI press release dated 30 July 2019 entitled *'Reserve Bank relaxes end-use stipulations under External Commercial Borrowings Framework for Corporates and NBFCs'*.

		route do not require regulatory approval. c) Foreign Institutional Investors (FIIs) and Foreign Portfolio Investors (FPIs)[11] may invest in the capital of an Indian company. Earlier, FIIs were subject to the 'Portfolio Investment Scheme', which limited the individual holding of an FII to below 10% of the capital of the company. The aggregate limit for FII investment was 24% of the capital of the company. However, with effect from 1 April 2020, specific sector caps have been prescribed for FPIs in terms of investment limits by way of the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (issued by the Ministry of Finance on 17 October 2019). Companies may alter the investment limits in increments of certain prescribed slabs subject to a maximum of the respective sector cap through a board resolution and a special resolution of the general body. In a sector where FDI is prohibited, however, the aggregate limit is 24%. Note: On account of geopolitical tensions and the threat of "opportunistic takeovers / acquisitions of Indian companies due to the COVID-19 pandemic", the Indian Government has prescribed that entities from countries which share a land border with India can only invest under the approval route (including if the beneficial owner of the investment is situated in or is a citizen of such country).[12]
Debt securities (can be listed)	Foreign portfolio investors	Regulatory framework: a) Foreign Exchange Management Act, 1999 read with the Foreign Exchange Management (Debt Instruments) Regulations, 2019.

[11] The concept of FPI was brought about by merging the already existing classes of investors through which portfolio investments were made in India, i.e. Foreign Institutional Investors (FIIs), Qualified Foreign Investors (QFIs) and sub-accounts of the FIIs. FPIs are regulated under the SEBI (Foreign Portfolio Investors) Regulations, 2019, since there is investment into the domestic capital markets involved. However, since issuance of bonds to FPIs also amounts to a capital transaction between resident and non-resident in India, they also fall within the ambit of the RBI regulatory framework.

[12] Press Note No. 3 (2020 Series) issued by the Department of Promotion of Industry and Internal Trade.

		b) Companies Act, 2013. c) Securities Contracts (Regulation) Act, 1956. d) Depositories Act, 1996. e) Securities and Exchange Board of India (Debenture Trustee) Regulations, 1993. f) Securities and Exchange Board of India (Issue & Listing of Debt Securities) Regulations, 2008. g) Debt Listing Agreement (notified by the Securities and Exchange Board of India (SEBI) & entered into by the issuer with the relevant stock exchange(s)). h) SEBI (Foreign Portfolio Investors) Regulations, 2019. i) Applicable RBI / SEBI circulars issued from time to time, including: (i) RBI circulars on ‘Raising Money through Private Placement by NBFCs – Non-Convertible Debentures’; & (ii) SEBI circular entitled ‘Guidelines for Issue & Listing of Structured Products / Market Linked Debentures’. (iii) RBI circular on 'Investment by Foreign Portfolio Investors (FPI) in Debt’ (iv) RBI circular on 'Voluntary Retention Route for Foreign Portfolio Investors’ investment in debt'. j) Foreign Exchange Management (Borrowing and Lending) Regulations, 2018 (not applicable to FPI investment in Non-Convertible Debentures (NCDs), however). Note 1: Secured debentures cannot be issued for a term exceeding ten years. For

		infrastructure projects, however, the term cannot exceed thirty years. Note 2: FPI securities have the following end-use restrictions - investment in real estate business, capital markets, and purchase of land. Note 3: During the Union Budget announced in February 2021, the government announced a proposal to issue a 'Uniform Securities Code' which would consolidate the following legislations and underlying regulations: the SEBI Act, 1992, Depositories Act, 1996, Securities Contracts (Regulation) Act, 1956, and the Government Securities Act, 2007.

The Indian regulatory regime provides for limits on both equity holding as well as debt investments into Indian entities. As can be seen from the table above, the ECB framework prescribes end-use restrictions for such borrowings and its position regarding foreign investment in the stressed asset market in India has also remained rather limited. Over and above the end-use restrictions prescribed for debt investments, some of the other restrictions under the ECB framework include the prohibition on availing of ECBs from Non-Recognised Lenders[13] and the prohibition on Indian companies refinancing rupee loans through ECBs availed from overseas branches / subsidiaries of Indian banks.[14]

2.2 Deficiencies in policy and regulatory framework

Although the RBI plays an active role in identifying and reporting areas of stress in the economy and publishes comprehensive Financial Stability Reports (FSRs) on a bi-annual basis, the Central Government has not responded exhaustively to address these issues. This can be seen from the fact that despite specific areas of stress being identified by the RBI on a regular basis, investment in these sectors has continued to remain highly restricted and regulated. For instance, the 2014 FSR indicated that infrastructure and aviation were among the most affected sectors. However, at the same time, foreign investment in aviation during this year was restricted to 49% in scheduled air transport services[15] and up to a maximum of 74% in non-scheduled air transport services.[16] These restrictions continued to apply even in 2015, despite the fact that advances under stress in the aviation sector had increased to 61% during this period and it had become the sector with the highest stress. To make matters worse, the applicable ECB framework during the years 2014 and

[13] Under Para 2.1(iv) of the Master Directions on External Commercial Borrowings, Trade Credit and Structured Obligations dated 26 March 2019 (updated as on 8 August 2019).

[14] RBI circular RBI/2013-14/568, DBOD. No. BP.BC.107/21.04.048/2013-14 dated 22 April 2013, read with RBI circular RBI/2013-14/585, A.P (DIR Series) Circular No.129.

[15] Under the 2014 FDI Policy, "Scheduled air transport service" means an air transport service undertaken between the same two or more places and operated according to a published timetable or with flights so regular or frequent that they constitute a recognisable systematic series, each flight being open to use by members of the public.

[16] Under the 2014 FDI Policy, "Non-Scheduled air transport service" means any service which is not a scheduled air transport service and includes cargo airlines.

2015 also permitted ECB for working capital in the civil aviation sector only under the 'approval' route and subject to a maximum limit of USD 1 billion for the entire civil aviation sector, and USD 300 million for individual airline companies.[17] The limit of 49% applicable to scheduled air transport continues to apply even today, despite the debilitating impact of the COVID-19 pandemic on the airline industry, while it is only the limit applicable to non-scheduled air transport that has been increased to 100% under the automatic route.[18]

3. Avenues for investment in stressed assets

3.1 The Foreign Portfolio Investment (FPI) route

Although foreign investment is highly restricted and regulated, there still exist avenues for foreign players to participate in the stressed asset market. One such avenue is the foreign portfolio investment route. Foreign Portfolio Investors (FPIs) usually invest in listed debt securities. This avenue for investment in the stressed asset sector has gained significance after the RBI permitted FPIs to acquire NCDs and bonds in companies under default.[19] *Vide* a circular issued in February of 2021,[20] the RBI has now also exempted FPI investment in bonds under default from the minimum residual maturity requirements, short-term investment limits and investor limits that they were earlier subject to. These exemptions have also been extended to certain other types of 'exempted securities', including security receipts and debt instruments issued by asset reconstruction companies, and debt instruments issued under a resolution plan under the Insolvency Code. Non 'exempted security' investments, however, remain subject to the overall limits[21] prescribed for corporate debt from time to time and the relevant disclosures being made by the FPI to the debenture trustee with regard to the terms of the offer. The earlier minimum residual maturity period applicable to FPI investment in corporate bonds of three years[22] has also now been reduced to one year[23] (subject to the condition that 'short-term investments' (with residual maturity of up to one year) in corporate bonds by an FPI shall not exceed 30% of the total investment of that FPI in corporate bonds). There is now also a 50% concentration limit of FPI investment (including investment by 'related FPIs') in any issue of corporate bonds.[24]

Besides this, the RBI also notified a separate 'voluntary retention route' for FPI investment in debt on 24 May 2019,[25] which exempts compliance from macro-prudential and other regulatory norms ordinarily applicable to FPI debt investments (including any minimum residual maturity requirements, concentration limits or single / group investor-wise limits applicable to corporate bonds), provided such FPIs voluntarily commit to retain a required minimum percentage of their investments in India for a period of time.[26] The overall investment cap applicable to the VRR route is INR 1,50,000 Crores.

[17] Paragraph I(B)(v)(i) of 2014 Master Circular on External Commercial Borrowings and Trade Credits and Paragraph I(B)(i) of the 2015 Master Circular on External Commercial Borrowings and Trade Credits.
[18] Schedule I of the Foreign Exchange Management (Non-Debt Instruments) Rules, 2017.
[19] RBI circular RBI/2015-16/253, A.P. (DIR Series) Circular No.31.
[20] RBI Circular RBI/2017-18/199, A.P. (DIR Series) Circular No. 31, updated up to 26 February 2021.
[21] Currently at INR. 5.41 lakh crore.
[22] RBI's Sixth Bi-Monthly Monetary Policy Statement, 2014-15, issued on 3 February 2015.
[23] RBI circular RBI/2017-18/199 A.P (DIR Series) Circular No. 31 dated 15 June 2018 (updated up to 23 January 2020).
[24] RBI Circular RBI/2017-18/199, A.P. (DIR Series) Circular No. 31, updated up to 26 February 2021.
[25] RBI Circular RBI/2018-19/187, A.P. (DIR Series) Circular No. 34 dated 24 May 2019 (updated up to 23 January 2020).
[26] The minimum retention route has been prescribed to be three years or as decided by RBI for each allotment by tap or auction.

3.2 The Asset Reconstruction Company (ARC) route

Another such avenue for investment into the stressed asset market is through foreign investment in Asset Reconstruction Companies (ARCs).[27] ARCs are permitted to issue security receipts linked to the recovery of underlying loan assets and to form trusts to acquire NPAs from banks and financial institutions. The regime for investment into ARCs was liberalised in 2016 and FDI is now permitted up to 100% under the automatic route, and FPIs can hold up to 100% of each tranche of security receipts issued by ARCs.[28] However, the total equity shareholding of an individual FPI in an ARC is still subject to the maximum limit of 10%. ARCs are also required to maintain the lower of either: (i) a minimum owned fund amount of at least INR 100 crores,[29] or (ii) at least 15% of the total financial assets acquired / to be acquired on an aggregate basis.[30] It is also relevant to note that ARCs can provide support finance to borrowers only to the extent of 25% of the monies raised from investors for that borrower. While there is no restriction if the ARC is providing funding to the borrower from its own funds, many of the ARCs find it hard to raise funds for such loans.

India has seen a sharp rise in the number of stressed asset funds and ARCs involving foreign participation that have been set up with the primary purpose of investing in distressed companies capable of a turnaround. The various players that have set up, or are in the process of setting up stressed asset funds or ARCs include, *inter alia*, Blackstone – through an acquisition of a stake in International Asset Reconstruction Company,[31] Piramal Enterprises - in association with Bain Capital Credit (India Resurgence Fund),[32] Brookfield - as a joint venture with State Bank of India and Housing Development Finance Corporation Limited (HDFC),[33] *Caisse de dépôt et placement du Québec* (CDPQ) – through investment in Edelweiss Asset Reconstruction Company, and U.S. private equity giant Apollo Global Management LLC - in association with ICICI Venture (the private equity arm of ICICI Bank).[34] Other early investors into India also included SSG Capital, which acquired 49% of Asset Care and Reconstruction Enterprise,[35] and IFC, which invested in Encore Asset Reconstruction Co. Pvt. Ltd. in January 2015.[36]

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[27] ARCs are registered under the SARFAESI Act, which empowers them to acquire NPAs from banks and specified NBFCs. The ARCs in turn undertake recovery measures. The permitted activities of ARCs include acquisition of financial assets from banks / FIs / ARCs for reconstruction, purchase of assets from NBFCs and transfer to and acquisition from other ARCs. It is debatable whether debt securities listed on a stock exchange can also be acquired by an ARC as holders of such debt securities have not been included in the list of entities from whom ARCs can acquire NPAs.

[28] RBI Notification no. FEMA.372/2016-RB.

[29] This requirement was brought about vide RBI notification dated 28 April 2017 (bearing reference no. RBI/2016-17/295) and ARCs are required to comply with the same by 31 March 2019.

[30] Securitisation Companies and Reconstruction Companies (Reserve Bank) (Amendment) Guidelines and Directions, 2004 issued *vide* Notification No.DNBS,4/CGM (OPA)-2004 dated 29 March 2004.

[31] Joel Rebello, Blackstone sees opportunity in India's distress, to invest $150 million
, Economic Times (9 April 2018), available at: https://economictimes.indiatimes.com/markets/stocks/news/blackstone-sees-opportunity-in-indias-distress-to-invest-150-million/articleshow/63675221.cms?from=mdr.

[32] Bruhadeeswaran R, *Piramal Enterprises forms joint venture with Bain for asset reconstruction biz*, VCCircle (20 July 2017), available at: https://www.vccircle.com/piramal-enterprises-forms-joint-venture-with-bain-for-asset-reconstruction-biz.

[33] *Brookfield, SBI and HDFC teaming up for a mega ARC, expected to invest up to $1 billion*, The Economic Times (23 September 2020), available at: https://economictimes.indiatimes.com/industry/banking/finance/banking/brookfield-sbi-and-hdfc-teaming-up-for-a-mega-arc-expected-to-invest-up-to-1-billion/articleshow/78265955.cms.

[34] Saloni Shukla, *ICICI Bank, Apollo Global tie up for asset reconstruction company*, The Economic Times (2 August 2016), available at: http://economictimes.indiatimes.com/industry/banking/finance/banking/icici-bank-apollo-global-tie-up-for-asset-reconstruction-company/articleshow/53498542.cms.

[35] Sangita Mehta, *Hong Kong firm SSG Capital Management buys 49% in ACRE for Rs. 41 crore*, Economic Times (25 November 2014), available at: http://economictimes.indiatimes.com/industry/banking/finance/hong-kong-firm-ssg-capital-management-buys-49-in-acre-for-rs-41-crore/articleshow/45265801.cms.

[36] Ahemad Shaikh, *IFC to Invest in Encore Asset Reconstruction Company*, DealCurry (9 January 2015), available at: http://www.dealcurry.com/2015019-IFC-To-Invest-In-Encore-Asset-Reconstruction-Company.htm.

4. Developments having a positive impact on foreign investment in stressed assets

4.1 Liberalisation of the ARC regime

Although the liberalisation of the ARC regime commenced in 2013 and was certainly a step in the right direction, it has not had the desired outcome. This has been the case largely due to the fact that foreign sponsors and shareholders continued to remain restricted by a maximum holding limit of 50% in ARCs and investors remained uncomfortable with the idea of investing without adequate control to protect their interests.[37] This 50% limit was however done away with by way of an amendment[38] to the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), in 2016, and sponsors are now permitted to hold 100% in an ARC subject to meeting a 'fit and proper' test. In 2019, the RBI permitted ARCs to purchase financial assets from other ARCs on a peer-to-peer basis provided that these transactions are in cash.[39] Further, in order to ensure greater transparency in the sale of stressed assets by banks to ARCs and other stressed debt players, the RBI issued specific guidelines in this regard on 1 September 2016.[40] As per these guidelines (which are revised from time to time), banks are required to lay down detailed policies and guidelines with regard to the sale of stressed assets to ARCs, which should cover, *inter alia*, the assets to be sold, valuation procedure to be followed and delegation of powers to functionaries regarding sale of assets. In addition to this, banks are also required to follow certain additional protocols, including internal listing of the specific financial assets for sale to other institutions, ensuring active involvement of the head office of the bank for early identification of stressed assets, public solicitation by way of bids to as many buyers as possible and ensuring adequate time for due diligence by prospective buyers. There have also been restrictions (including a floor on provisioning) imposed on investment by banks in security receipts backed by assets sold by them.[41] Given that a lion's share of the NPAs belong to public sector banks, who have traditionally been comfortable with ARCs, such companies may continue to play a role in dealing with Indian stressed assets. Having said that, there have been hiccups experienced in a few recent cases in respect of the ability of an ARC to act as a resolution applicant for a company in insolvency resolution under the Insolvency Code.[42] This has caused another shadow on the efficacy of the ARCs to participate widely in the resolution of stressed assets.

4.2 INR ECB bonds

Another positive change has come by way of the introduction of rupee denominated bonds raised under the ECB route (popularly known as 'masala bonds'). In September 2017, the RBI excluded masala bonds from the general investment limits applicable to corporate bonds.[43] Masala bonds are now also considered INR ECBs under the new ECB framework. Permission to issue rupee

[37] Ruchir Sinha & Abhinav Harlalka, *100% Foreign Investment in ARCs: Finally There?*, available at: http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/100-foreign-investment-in-arcs-finally-there.html?no_cache=1&cHash=f0ad22277bb0ddd46e04a3e1b5ab5045.

[38] Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016.

[39] RBI Notification no. RBI/DNBR/2018-19/22 dated 28 June 2019.

[40] *Vide* notification no. RBI/2016-17/56 (DBR.No.BP.BC.9/21.04.048/2016-17).

[41] Progressive provisioning if more than 10% of SRs are backed by sold assets and issued under securitisation w.e.f from 1 April 2017. The provisioning requirement on SRs is the higher of: a) provisioning rate required in terms of net asset value declared by ARCs; and b) provisioning rate as applicable to the underlying loans, assuming that the loans notionally continued in the books of the bank.

[42] Gopika Gopakumar, *Insolvency Resolution Plans by ARCs won't get RBI's approval*, Hindustan Times (26 September 2020), available at: https://www.hindustantimes.com/business-news/insolvency-resolution-plans-by-arcs-won-t-get-rbi-s-approval/story-xyrBxUZIJqfRpuH5GxgqhP.html.

[43] *Vide* notification no. RBI/2017-18/65 (A.P. (DIR Series) Circular No. 06).

denominated bonds is accorded to all Indian corporates that are eligible to raise ECBs. The RBI had amended the framework applicable to masala bonds in 2017,[44] reducing the applicable minimum maturity period from a period of five years to three years[45] and introducing an all-in-cost ceiling (of 300 basis points over the prevailing yield of Government of India securities of corresponding maturity). With the introduction of the new ECB framework in 2019, these requirements have been brought in line with those applicable to INR ECBs (with the all-in-cost ceiling now being 450 basis points over the prevailing Government securities yield and the minimum average maturity period being different for different sectors and end-uses).

4.3 Alternative Investment Funds (AIF)

The capital control regime has also seen other positive developments in recent years. One such development has been permitting foreign investment in alternative investment funds (AIFs).[46] AIFs have the advantage of being permitted to invest in all sectors without being bound by sector restrictions and caps imposed under the FDI framework. Category I and Category II AIFs have been extended a 'pass through' status, meaning that the income earned by such investment funds are exempted from tax liability, the income being taxed in the hands of the unit-holder instead. Towards the beginning of 2017, SEBI also removed restrictions on FPIs investing in unlisted debt securities in India. In May 2018, the RBI also notified Category II and Category III AIFs as eligible 'qualified buyers' that can invest in security receipts issued by ARCs.[47]

4.4 Enforcement – listed debt securities

Changes to the SARFAESI Act in 2016[48] also extended the benefit of this statute to holders of listed debt securities,[49] thereby bringing parity between Indian institutional lenders and investors in debt securities. Thus, foreign investors are increasingly opting for the NCD route, which is now accorded greater protection for security enforcement under the SARFAESI Act.

4.5 The Insolvency and Bankruptcy Code, 2016

The real game-changer for foreign investors has been when the Insolvency Code came into effect from December 2016. The Insolvency Code has changed the landscape of the insolvency and corporate resolution regime in India, which was previously highly convoluted, time consuming and plagued with uncertainty.[50] In fact, the World Bank estimated that creditors in India are typically only able to recover 26 cents on the dollar in liquidation situations, with proceedings spanning more than

[44] *Vide* notification dated 7 June 2017, bearing reference no. RBI/2016-17/316.

[45] However, the maturity period was retained at five years for masala bonds having an INR equivalent value of USD 50 million in a financial year.

[46] An AIF is any fund established or incorporated in India which is a privately pooled investment vehicle that collects funds from sophisticated investors, whether Indian or foreign, for investment in accordance with a defined investment policy for the benefit of investors. This was done through amendments to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2015 and Foreign Exchange Management (Permissible Capital Account Transactions) (Fourth Amendment) Regulations, 2015, which have been notified *vide* Notification No. FEMA 345/2015-RB dated 16 November 2015, G.S. No. 859 (E) dated 16 November 2015 and Notification No. FEMA 355/2015-RB dated 16 November 2015 and G.S.R. No. 858 (E) dated 16 November 2015 respectively.

[47] Reserve Bank of India notification dated 16 May 2018 bearing reference no. 'DNBR (PD-ARC) No. 07/ ED(SS)-2018'.

[48] This is a statute providing self-help remedies to creditors while enforcing their security without intervention of the notoriously slow Indian courts.

[49] By way of the Enforcement of Security Interest and Recovery of Debt Laws and Miscellaneous Provisions (Amendment) Act, 2016 issued *vide* Gazette Notification dated 16 August 2016.

[50] Shefali Anand, *Investors Bank on India's Distressed Debt*, The Wall Street Journal (13 May 2016), available at: http://www.wsj.com/articles/investors-bank-on-indias-distressed-debt-1463141980.

four years on average. Prior to the Insolvency Code, the Indian legal framework for dealing with distressed situations comprised a hodgepodge of legislations that were largely mismatched. A significant aspect of the Insolvency Code, especially for foreign investors, is that it envisages a shift from a recovery-based regime to one that is focused on resolution and puts the company's creditors into the driver's seat. Hitherto the management and owners of companies exercised an unhealthy autonomy leaving creditors helpless and in the dark, due to the immense asymmetry of information. The Insolvency Code is also an attempt to streamline the entire implementation of the insolvency process and to introduce strict timelines for the same, by creating a 180-day window (extendable by a maximum of 90 days, with an outer limit of 330 days for cases involving litigation) during which a moratorium applies on all actions against the company and during which the company's creditors are required to invite and approve a resolution plan for the company.

Up till December 2020, it was reported that over 4117 cases had been initiated under the Insolvency Code, out of which 2018 were still ongoing, 308 had been successfully resolved and 1112 were closed by liquidation.[51] This goes to show the confidence displayed by the market in the effectiveness of the Insolvency Code.

4.6 Restructuring schemes

The RBI introduced a new 'Prudential Framework for Resolution of Stressed Assets' on 7 June 2019, to replace an earlier framework introduced in February 2018 that was struck down by the Supreme Court. This framework mandates Indian lenders to enter into an inter creditor agreement on occurrence of payment default to decide on a plan for restructuring of the debt and provides for a thirty day 'review period' in this regard. All decisions pertaining to the restructuring require majority consent of the lenders and such decisions are binding on all lenders. Foreign creditors can also become a party to the inter-creditor agreement (ICA) and participate in the resolution process.

Specifically for listed debt security holders, SEBI has specified that the debenture trustee is required to enter into the ICA where a majority of investors express their consent to do so (majority is determined by not less than 75% of investors by value of outstanding debt and 60% by number at ISIN level).[52] Procedurally, the debenture trustee is required to send a notice to the investors within three days of the event of default seeking positive consent for signing the ICA. In this respect, the debenture trustee may form a representative committee of investors to participate in the ICA. The debenture trustee may sign the ICA only if doing so and agreeing to the resolution plan is in the interest of investors and in compliance with applicable securities law. The debenture trustee is free to exit the ICA without any consequences if the resolution plan imposes conditions that are not in accordance with securities regulations, or the resolution plan is not finalized within 180 days from the end of the review period, or if the terms of the resolution plan are contravened by any of the signatories to the ICA.

5. Instances of foreign investment into India

5.1 Essar-Rosneft

Notwithstanding the many barriers to foreign investment in stressed assets in India, there have been instances where such investment has been made with considerable success. An example of this in the recent past was the investment by the Russian oil giant Rosneft along with a consortium

[51] Economic Survey 2020-21 (Volume-2).
[52] SEBI Circular dated 13 October 2020 bearing reference no. 'SEBI/HO/MIRSD/CRADT/CIR/P/2020/203'.

led by Trafigura and United Capital Partners in Essar Oil in 2017, with a transaction value of USD 12.9 billion, making it the largest FDI deal into India as well as the largest outbound acquisition by Russia. The investment resulted in a significant reduction of the Essar Group's debt, which had aggregated to over INR one lakh crore in the fiscal year 2015[53] and worked towards enabling the regularisation and deleveraging of the Group's interest payments. Although the company claims that the decision to enter into the deal was purely commercial, it is no secret that the Essar Group had been under tremendous pressure from its lenders to reduce its debt burden.[54] In fact, upon the deal having fully materialised, the CEO of ICICI Bank, commented on the development stating that "it was a significant step in the process of deleveraging the balance sheets of Indian corporates and that ICICI Bank had been working closely with the Essar Group to help them deleverage their stressed balance sheets".[55]

5.2 GMR group

Another such example is the investment of Tenaga Nasional (Malaysia's largest power utility player) in a select portfolio of GMR Energy's assets for USD 300 million in May 2016. This deal was a result of GMR's long struggle with softer-than-expected demand and heavy debt accumulation due to years of aggressive expansion. This situation resulted in the company's lenders becoming very anxious and applying pressure on GMR to divest its assets in order to repay loans. After the deal closed, GMR announced that it would use the proceeds of the deal to tackle its debt, which stood at over INR 410 billion at the time.[56] Investments into the GMR group were also made by the Kuwait Investment Authority to the tune of INR. 2000 crore in December 2015, by way of foreign currency convertible bonds.

5.3 Bond issuances

The Hyderabad based Greenko Group also raised over USD 500 million in August 2016 through the issuance of 'green bonds'. The issuance was intended to enable Greenko to pay off its shareholder loans among meeting its other requirements. Subscribers to the bonds included private banks, fund managers and providential funds located across Europe, the USA and Asia.[57]

Very recently, in March 2021, Kesoram Industries issued junk-rated rupee bonds (D rated by Crisil) yielding 21% and these securities were bought by investors such as the Goldman Sachs Group, Cerberus Capital Management and Edelweiss Financial Services Ltd. This was a rare issuance in the Indian market wherein borrowers usually have a rating of AA or higher and it reflects the growing interest of foreign investment in stressed assets in India.[58]

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[53] *See* Credit Suisse's House of Debt Report, 2015.

[54] Kishor Kadam, *Essar Oil-Rosneft deal: Why it is a lost opportunity for Indian companies*, FirstPost (17 October 2016), available at: http://www.firstpost.com/business/essar-oil-rosneft-deal-why-it-is-a-lost-opportunity-for-indian-companies-3055986.html/amp.

[55] *See* Kishor Kadam, *Essar Oil-Rosneft deal: Why it is a lost opportunity for Indian companies*, FirstPost (17 October 2016), available at: http://www.firstpost.com/business/essar-oil-rosneft-deal-why-it-is-a-lost-opportunity-for-indian-companies-3055986.html.

[56] Krishna N. Das, *Debt-heavy GMR sells power stake to Malaysian utility*, Reuters (10 May 2016), available at: http://in.reuters.com/article/india-gmr-malaysia-tenaga-nasional-idINKCN0Y01LJ.

[57] Saikat Das, *Greenko raises $500 million via India's first high-yield green bond issuance*, available at: http://economictimes.indiatimes.com/markets/stocks/news/greenko-raises-500-million-via-indias-first-high-yield-green-bond-issuance/articleshow/53648517.cms.

[58] *Goldman, Cerberus buy rare Indian junk-bond by Kesoram Industries offering 21%*, Mint (16 March 2021), available at: https://www.livemint.com/companies/news/goldman-cerberus-buy-rare-indian-junk-bond-by-kesoram-industries-offering-21-11615894910373.html.

5.4 Refinancing

Similarly, companies have relied on foreign investment in order to refinance loans with terms they are having difficulty abiding by. One such example is the refinancing carried out by GMR infrastructure with respect to the Delhi International Airport Private Limited, in which the company's subsidiary GMR Airport and Germany's Fraport AG are shareholders. The company floated bonds that received bids worth USD 3.4 billion, making it the largest single tranche bond issuance of 2016. The funds were raised by the company in order to retire its high-cost rupee term loans and to repay foreign currency loans amounting to over USD 90 million.[59] In December 2019, the creditors of RattanIndia Power Limited also assigned debt aggregating to INR 6,574 crores to new lenders led by Goldman Sachs and Varde Partners (through Aditya Birla ARC Ltd.) for a consideration of INR 4,050 Crores.[60] This was the first successful restructuring under RBI's new framework under the 7 June 2019 circular and one of the largest undertaken without a change in management.

5.5 Real estate sector and other investments

December 2015 saw another such successful investment into the real estate space, by the Singaporean sovereign wealth fund GIC Pte Ltd in DLF India, to the tune of INR 19.9 billion. This investment provided immense relief to DLF India, a company whose net debt accounted for more than half of the combined debt of India's six largest real estate developers.[61] Further, the KKR Group has also made investments into distressed Indian companies. These include KKR & Co.'s investment into Sunteck Realty Ltd., a developer of luxury condominiums in India[62] and its investment in JBF Industries Ltd, a leading manufacturer of polyester value-chain products in mid-2015. The investments in JBF were made by way of an acquisition of a 20% equity stake as well as investments into zero-coupon convertible preference shares with close to 15% voting rights in JBF Global Pte. Limited, a Singapore based unlisted subsidiary.

Another such instance is the rescue of Shree Renuka Sugars by Wilmar International in 2018. The company was earlier facing large losses which resulted in an increase in its debt. In order to resolve this issue, the promoters of Shree Renuka Sugars entered into a deal with Wilmar International, a Singapore based entity in the agriculture sector whereby its Indian subsidiary Wilmar Sugar Holding acquired 27% of the stake in Shree Renuka Sugars.[63] At this point, the promoters retained the controlling stake in Renuka Sugars. Subsequently, in 2017, the debt of Renuka Sugars rose to INR 6500 crores.[64] As a result, the promoter exited the company and Wilmar infused an additional USD $118 million and agreed to guarantee a debt of INR 2700 crores. On conclusion of the debt restructuring in 2018, Wilmar held 58% of the equity of Renuka Sugars and thus became the

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[59] Mohit Bhalla & Saikat Das, *GMR airport arm raises $522 million from international investors via bond issue*, Economic Times (22 October 2016), available at: http://economictimes.indiatimes.com/markets/bonds/gmr-airport-arm-raises-522-million-from-international-investors-via-bond-issue/articleshow/54978479.cms.

[60] *Debt of RattanIndia Power acquired by Goldman Sachs, Varde Partners*, BusinessLine (31 December 2019), available at: https://www.thehindubusinessline.com/companies/debt-of-rattanindia-power-acquired-by-goldman-sachs-varde-partners/article30439885.ece.

[61] Pooja Thakur Mahrotri, *KKR Swoops in as Distress in India's Property Market Worsens*, Bloomberg (2 March 2016), available at: https://www.bloomberg.com/news/articles/2016-03-02/kkr-swoops-in-as-distress-in-india-s-property-market-worsens.

[62] Pooja Thakur Mahrotri, *KKR Swoops in as Distress in India's Property Market Worsens*, Bloomberg (2 March 2016), available at: https://www.bloomberg.com/news/articles/2016-03-02/kkr-swoops-in-as-distress-in-india-s-property-market-worsens.

[63] *Wilmar arm takes control of Renuka Sugars, Business Line* (9 March 2018), available at: https://www.thehindubusinessline.com/companies/wilmar-arm-takes-control-of-renuka-sugars/article23009892.ece.

[64] *Id*.

majority shareholder of the company.[65]

5.6 Financial services sector

There have also been recent instances of financial rescue using foreign capital in the financial services sector in India. For instance, the Union cabinet approved a scheme of amalgamation in November 2020 for Singapore based DBS Bank to merge with Lakshmi Vilas Bank, a 94-year-old private bank which was facing an insurmountable bad loan build-up. The merger happened after RBI took over control of the bank after its NPAs had reached about one-fourth of its total book in 2020.[66] DBS Bank infused approximately USD 350 million as part of the scheme.

In another such instance relating to the non-banking financial sector, SSG Capital, based out of Hong Kong, has taken over debt ridden Altico Capital, a Non-Banking Financial Company (NBFC) focused on real estate financing. The restructuring plan of SSG Capital provides for payment of about 70% of the debts owed to banks.[67] According to the structure proposed in the plan, loan assets of Altico will be transferred to an entity that will be controlled by SSG Capital.[68] This is one of the biggest restructurings taking place outside the framework of the Insolvency Code. This restructuring is significant in the NBFC sector, which has in the past few years witnessed a sudden wave of NPAs and bad loans.

5.7 Resolutions under the Insolvency Code

Foreign entities have also participated in resolution processes under the Insolvency Code for purposes of taking over distressed Indian companies that have defaulted on their debts. One of the most significant matters under the Insolvency Code has been the take-over of Essar Steel India Limited by a joint venture of ArcelorMittal India Private Limited and Nippon Steel Corporation. The total acquisition cost for the deal was nearly $ 7 billion, resulting in a recovery of 92% of the total claims of the creditors. This was a landmark matter as one of the earliest cases resolved under the Insolvency Code and set a strong precedent. The process also witnessed several rounds of litigation by the bidders and promoters, which went right up to the Supreme Court on several instances and clarified several aspects relating to the functioning of the Insolvency Code.

Another such instance is US based private equity firm Blackstone's acquisition of Trident Hotel of the Oberoi Group for about USD 80 million. Out of this, about USD 50 million was to be paid upfront to workmen and the creditors of Trident, and USD 25 million was infused towards capital expenditure.[69] This was notably the first acquisition by Blackstone under the framework of the Insolvency Code.

Another instance of participation by a US based hedge fund was Deccan Value Investors' (DVI) successful bid for Amtek Auto under the Insolvency Code, with an investment of approximately

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[65] Sucheta Dalal, *Jet Airways vs Renuka Sugars: How not to handle a bad situation*, Money Life (26 April 2019), available at: https://www.moneylife.in/article/jet-airways-vs-renuka-sugars-how-not-to-handle-a-bad-situation/56995.html.

[66] Prathamesh Mulye, *India's central bank steps in to rescue a small 93-year-old-bank*, Quartz India (18 November 2020), available at: https://qz.com/india/1912359/rbi-proposes-lakshmi-vilas-bank-merger-with-dbs-bank-india/.

[67] Joel Rebello & Saikat Das, *Altico set to surrender NBFC license as restructuring nears climax*, Economic Times (8 February 2021), available at: https://economictimes.indiatimes.com/markets/stocks/news/altico-set-to-surrender-nbfc-license-as-restructuring-nears-climax/articleshow/80753471.cms?from=mdr.

[68] *Id.*

[69] CR Sukumar, *Blackstone gets NCLT nod to acquire trident Hotel for Rs. 585 crore,* The Economic Times (14 February 2020), available at: https://economictimes.indiatimes.com/industry/services/hotels-/-restaurants/blackstone-gets-nclt-nod-to-acquire-trident-hotel-for-rs-585-crore/articleshow/74133431.cms?from=mdr.

USD 400 million.[70] Subsequent to being declared the successful bidder by the creditors and the insolvency court, however, DVI invoked the *force majeure* clause in its resolution plan due to the slump in the automobile industry as a result of the Covid-19 pandemic, and indicated its ability to implement the resolution plan.[71] The move by DVI has been challenged by the creditors of Amtek Auto.

6. Suggestions for the mitigation of current challenges for foreign investors

6.1 Asset Reconstruction Company (ARC) regime

Despite the recent moves towards liberalisation of the framework applicable to ARCs, the competitiveness and flexibility of ARCs is hampered by a requirement that they have to pay up to 15% of total risk weighted assets purchased by them upfront, and only the balance amount can be paid by way of security receipts. This has led to a situation wherein ARCs are unable to live up to their potential and contribute to the reduction of stress in the economy. In the first two quarters of the financial year 2016-17, for instance, ARCs purchased loans worth only INR 20,000 crore, one-fifth of what was put-up for sale in the market.[72] Although the sale of loans to ARCs has picked up since, it has not increased drastically.[73] It is imperative that the Government recognises that this requirement is one that is self-defeating and works towards revising it at the earliest. Further, the Government must also bring about policy reforms to ensure that ARCs are unable to recoup their investments without security receipt holders having first received their face value, in order to protect the interests of foreign investors.[74]

6.2 Foreign Portfolio Investors (FRI) regime

The Government should also consider revising the restrictions on 'Category II FPIs'[75] from issuing or subscribing to overseas derivative instruments (ODIs). Although this restriction has been defended on the basis that money being routed through India in a manner that circumvents the regulatory framework should be discouraged,[76] it acts to further disincentivise foreigners from looking towards India as a destination for investment. The Government must not resort to pre-

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[70] Suresh P Iyegar, *Deccan Value hits out at Amtek Auto RP for 'going against IBC spirit and letter'*, The Business Line (5 October 2020), available at: https://www.thehindubusinessline.com/companies/deccan-value-hits-out-at-amtek-auto-rp-for-going-against-ibc-spirit-and-letter/article32776161.ece.

[71] Abhimanyu Sharma, *SC drops contempt case against US- based hedge Deccan Value Investors, with conditions*, Times Now (23 February 2021) available at: https://www.timesnownews.com/business-economy/companies/article/sc-drops-contempt-case-against-us-based-hedge-fund-deccan-value-investors-with-conditions/724034.

[72] Vishwanath Nair, *Why banks can't find buyers for stressed assets*, Livemint (4 August 2016), available at: http://www.livemint.com/Industry/89KzK7gb0GPH0z5zIkEPwN/Why-banks-cant-find-buyers-for-stressed-assets.html.

[73] *ARCs must be strengthened if they are to be* effective (15 December 2019), available at: https://www.thehindubusinessline.com/opinion/editorial/arcs-must-be-strengthened-if-they-are-to-be-effective/article30312901.ece#.

[74] Ashish Pandey, *The Indian banking system: A ticking time bomb*, Ideas for India (13 May 2016), available at: http://www.ideasforindis.in/article.aspx?article_id=1632.

[75] Category II FPIs have been defined under the SEBI FPI Regulations to include all the investors not eligible as Category I FPIs, such as (i) appropriately regulated funds not eligible as Category-I foreign portfolio investor; (ii) endowments and foundations; (iii) charitable organisations; (iv) corporate bodies; (v) family offices; (vi) Individuals; (vii) appropriately regulated entities investing on behalf of their client, as per conditions specified by the Board from time to time; and (viii) Unregulated funds in the form of limited partnership and trusts. Under the Regulations, an applicant incorporated or established in an International Financial Services Centre is deemed to be appropriately regulated.

[76] *See* for e.g. Adhithya Srinivasan, Richie Sancheti & Kishore Joshi, *Foreign Portfolio Investors Regulations Notified - Significant Departure from the Existing Foreign Institutional Investor Regime*, NDA Hotline (20 January 2014), available at: http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/fpi-regulations-significant-departure-from-the-existing-fii-regime.html?no_cache=1&cHash=bdc25c5317a1a25179f42f3feae60772.

liberalisation era patterns of policy making if it intends to ensure a constant uptick in the Indian economy, while simultaneously combating the deeply entrenched stressed assets problem. It must also simultaneously make clear-cut policy decisions in order to resolve India's ease-of-doing-business concerns, like the permitting of assured returns and exit by foreign equity investors.

6.3 Alternative Investment Funds (AIF) regime

The AIF framework also needs some reconsideration. There are also additional restrictions on certain categories of AIFs, for instance Category II AIFs (primarily private equity and debt funds) are prohibited from participating in large-pooled domestic savings, precluding even pension funds and insurance companies from such investments. 'Category III' AIFs have also been excluded from being accorded 'pass-through' status despite recommendations to the contrary made by the Narayana Murthy Committee.[77] These restrictions again reek of over-protectionism and do little to help decrypt the Indian framework and provide assurance to foreign investors. Further, it will also be an important step to permit Indian managed AIFs to directly buy stressed assets (i.e. without partnering with an ARC), which they are currently not permitted to do.

[77] Report submitted by Alternative Investment Policy Advisory Committee, available at: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1453278327759.pdf.

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