

National Asset Management Company

A Concept

In this presentation...

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Two major challenges confronting Indian economy are **high NPAs in the banking system** and **stalled infrastructure projects**. The two are related.

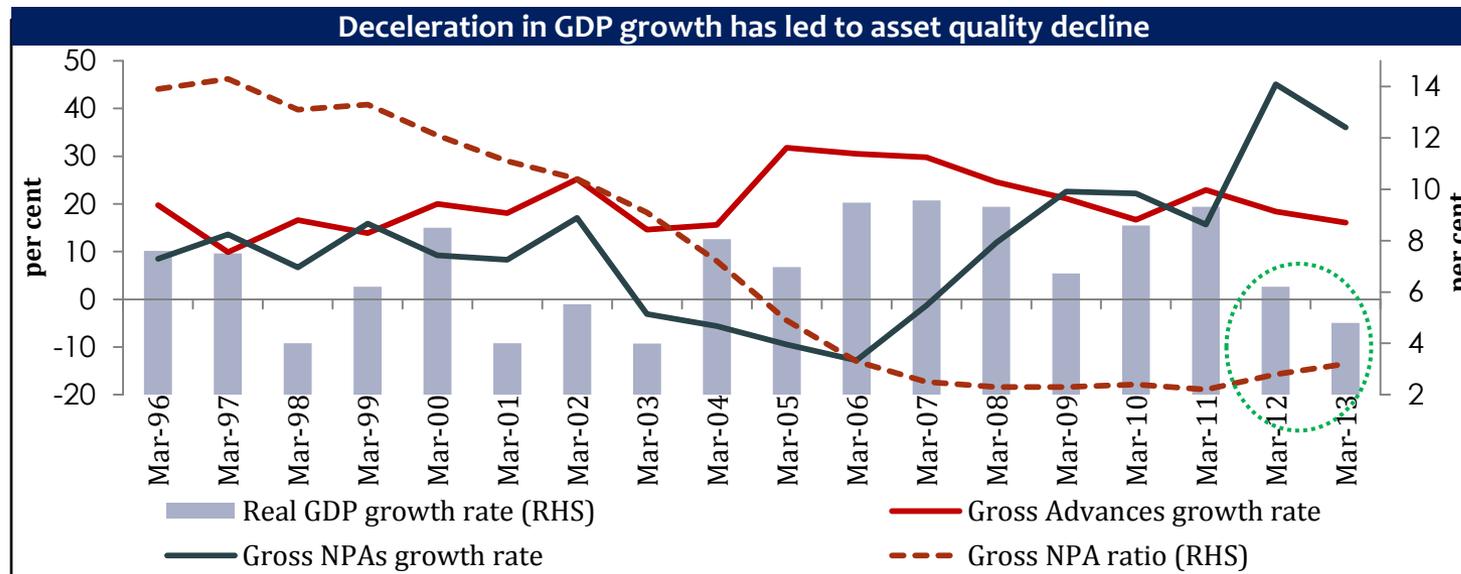
In order to address these challenges FICCI suggests setting up a **National Asset Management Company (NAMCO)** as a new special purpose asset management company (AMC) to take over stressed assets from the banking system **For recovery or rehabilitation**

We examine and present:

- NPA problem in Indian banking system – Current status
- Challenges for existing ARCs
- The need for specialized AMC
- International experience of Specialized Public AMC
- Proposed framework - structure, ownership and governance of NAMCO
- Key recommendations for the Government / RBI

NPA situation alarming, Restoring bank health essential

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Status

- ◆ Gross NPAs in total loans at a high of 4.4% as of Dec 31, 2013
 - Much higher for Public Sector Banks (SBI: 6.24%, Other Nationalized Banks: 4.55%)
- ◆ Level of Restructured Assets much higher
 - SBI around 4%, other Nationalized Banks over 7%
- ◆ Level of stressed assets in banking system (incl. Gross NPAs + Restructured Assets) ~ 15% of bank loans
 - Highest for Industrial Sector (especially Infrastructure)

Impact

- ◆ Impaired Banking system could impede revival of capex cycle
- ◆ Huge capitalization to fill the gap created by NPAs ~ Rs 5-10 trillion over next 5 years; significant fiscal drag

Need to look beyond existing ARCs to solve NPA issue

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Existing ARC
system
ineffective

India has 14 licensed Asset Reconstruction Companies (ARCs), of which 4 are active
However, there are some key challenges

- Lack of efficient/fast process of removing distressed assets from banks to ARCs
- ARC mechanism is not resulting in quick recovery or rehabilitation

Key Challenges faced by ARCs

Few NPA sale transactions by Banks; it is easier for banks to make referrals to CDR

ARCs making transactions at unrealistic high valuations to encourage banks; long term credibility risk for ARCs

Slow pace of aggregation; takes more than one year to aggregate consortium debt

Lack of investor appetite for SRs; over 90 percent of SRs currently held by selling banks themselves

Inadequate capital base of ARCs relative to the size of NPAs in the system

Lack of powers to change management (restrictions via section 15 of SARFAESI Act)

Why NAMCO?

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Effective resolution of NPAs requires:

- ▶ A specialized ARC to address specialized nature of the problem i.e. revival of large infrastructure / corporate NPAs with immense impact on economy
- ▶ Specialized skills to ensure speedy recovery or rehabilitation of the stressed assets
- ▶ Adequate capitalization to absorb large volume of NPAs in the system
- ▶ Transactions at realistic valuation
- ▶ Encouragement to the banks – from the regulator and /or the government to aggressively sell stressed assets
- ▶ Government support

Key Learnings from International Experience (I)

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Prevention rather than Crises Response is better

Much better, less expensive, and less disruptive to proactively establish specialised AMC
e.g. Malaysia and Taiwan

Government Support is essential

Direct government funding or issuance of government guaranteed bonds has been a common characteristics of AMCs established to deal with NPAs in most countries

AMC should be set with clear objectives

Thailand had single objective: rehabilitation and restructuring of all viable assets and not liquidation.
Korea had mixed objective and was less successful

Special powers are required to make acquisition, resolution effective

In most countries, AMCs were created through special acts of the government which gave them adequate powers to deal with the situation

One Time, Large Scale NPA Transfer

In all cases, a one time large scale NPA transfer to the AMC took place. This reduces the burden on the banking system and enables banks to resume lending

Key Learnings from International Experience (II)

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Easy Aggregation & Consolidation

All effective AMC's had ability to aggregate and consolidate loans to any one borrower from all lenders in the system to be able to deal with the situation in a decisive and expeditious manner

Additional funding often required

In case of rehabilitation of viable projects, additional funding to complete them and to provide working capital is necessary. Such funding can be provided by the banks on higher terms compared to the existing lenders. E.g. Debtor in Possession (DIP) financing in the US

Valuation at fair market value

It is very important to transfer the assets at fair market value rather than at inflated values. In some cases put/call or upside/downside sharing methods were used but were not effective.

Create Secondary Market

It is very helpful to create a liquid secondary market for securities issued by the AMC to attract additional capital in the system and for risk sharing. Successful e.g. KAMCO

Limited government intervention key to success

Danahatra, Malaysia was successful as it was relatively free from government control with many non-government directors representing industry, banking associations, etc.

NAMCO – Proposed Framework

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RBI to **create a new category of Special Purpose ARCs** focused on large NPAs, restructured loans, and other potential stressed assets primarily in **infrastructure sector**

Designed to deal with the current stock of large NPAs and restructured loans on **a one time basis**

Existing ARCs will continue to deal with the normal flow of the current and future NPAs in all areas including corporate, real estate, MSME, Retail, etc.

NAMCO

- ▶ Requires Government/Reserve Bank of India **sponsorship but no capital injection or guarantees**
- ▶ Does not require any new legislation, but some modification of existing regulations
 - **NAMCO not to be a Public Sector Undertaking**
- ▶ Deals with large loans in infrastructure and a few other industries
- ▶ Focuses on rehabilitation rather than liquidation

Special Purpose ARC Framework

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NAMCO will be de Novo Company which will seek **RBI registration as a Special Purpose ARC.**

PSU Bank ownership in NAMCO will be less than 50%

Funding

Minimum Net Owned Fund (Capitalization) of Rs 2,500 cr

Selling bank to commit to up to 25% of sale price as additional loans for rehabilitation/ completion of projects

Can convert up to 50% of loans into equity and inject additional equity/ preference capital if required

Valuation and Payments

Fair price determined by an independent valuer

ARCs to issue SRs of longer tenor, up to 12 year

Asset Criteria

Acquisition of assets under Power, Roads, Other Infrastructure, Steel, Telecom

Focus on large NPAs and restructured loans (threshold minimum size of about Rs 2,000 cr)

Other Features

Banks allowed to amortize loss on sale of stressed assets to special ARCs over 5 years

Special purpose ARCs can set up other specialized vehicles such as dedicated debt fund

RBI to encourage Banks to sell distressed assets to special purpose ARCs

Capitalisation, Secondary Market and Governance

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Capitalisation

- ▶ NAMCO to be established under supervision of Ministry of Finance (MoF), with a large capital base with Net Owned Funds of Rs 2,500 Cr
- ▶ MoF to encourage PSU Banks to take up to 49.9% equity ; balance equity from private sector banks and other private financial institutions
- ▶ In addition to equity , NAMCO will raise capital by issuing long term bonds of Rs 2,500 Cr subscribed by the Banking Sector

Total target capital base: Rs 5,000 cr

Secondary Market

- ▶ NAMCO will endeavor to create a secondary market for Security Receipts
- ▶ Indian Institutional Investors and Foreign Investors could participate in this market

Governance

- ▶ The Board of NAMCO will consist of representatives from **banking sector, infrastructure financing, rehabilitation** and other related areas

Action Agenda

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For Government

Take necessary administrative steps, in consultation with the regulator, to allow creation of the 'special purpose' ARC

Encourage public sector banks to participate in the equity of NAMCO (up to 49.9%); provide support to the management of NAMCO in raising remaining equity capital from private sector

Actively support establishment of high quality Board of Directors with the right skills and capabilities

Encourage public sector banks to transfer their large ticket stressed assets in specified industries to NAMCO

Facilitate flow of foreign capital into SRs by making necessary administrative and / or legislative changes

For RBI

Take necessary administrative and/ or legislative steps, in consultation with the government, to allow creation of the 'special purpose' ARC

Encourage banks to transfer their large ticket stressed assets to NAMCO

Provide necessary forbearance to the banks to amortize the losses incurred upon transfer of assets to NAMCO at fair market value over a longer tenor

Facilitate flow of foreign capital into SRs by making necessary administrative and / or legislative changes