



SEMINAR ON DEBT RESTRUCTURING AND SECURITISATION

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Compromise and OTS



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COMPROMISE AND ONE TIME SETTLEMENT

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Road map for seminar

Presentation

- Compromise & OTS 60 mins
- Questions and Answers 20 mins

Compromise

Lenders perspective

- NPA's - The hard realities of lending
- Reduction in NPA's are directly linked to profitability, liquidity and capital adequacy
- Release of funds blocked in NPA ensure recycling of funds, the basic raw material for banks.
- NPA reduction reduces charge on the future profits
- Higher NPA's attracts more intrusive scrutiny by regulators.
- Higher NPA's increases the cost of borrowings to Banks
- Cleaning up of bank balance sheet.

Successful compromise helps in saving time (economic commodity)

- Protracted legal proceedings do not factor the opportunity cost of benefits in early recovery
- Helps in cases where Borrowers are untraceable
- Legal flaws in documents are noticed at the time of filing of suit.

Borrowers perspective

- Get rid of liability by paying minimum possible amount – the General Mantra
- Enable them to distribute unencumbered family property amongst family members
- To erase the stigma of defaulters and retain position in the social ladder
- Psychological factors
- Peer pressure

Basic principles underlying compromise settlement

- Compromise amount $<$ original debt as covenanted
- Compromise amount = Banks sacrifice + Full and final payment

OR

- Compromise amount = Writing off of some principal amount along with interest + Sacrifice (amount banks let go) + Original loan amount

Cardinal rules of banks while entering into compromise settlement

- Recovery of dues are endeavored up to maximum extent
- Compromise figure is arrived after appropriation of securities wherein bank has a lien
- Possession - physical/ constructive on pledged item is also tried to be liquidated first
- Actual hypothecated stock- if there is ease and availability to wrest control and enforce a sale
- Likelihood of Legal enforceability i.e by SARFAESI or DRT- decrees (status of legal proceedings)
- Running Units- higher recovery can be expected
- Defaulting Units, If they are associate of reputed groups- higher recovery expected

Cardinal rules of banks while entering into compromise settlement

- Are sources of funds for compromise ascertainable
- Are the reasons for account becoming NPA genuine
- Does the borrower has the capacity to make upfront payment
- Will the borrower adhere to the terms of compromise

FAILURE TO THE COMPROMIS PACKAGE BRINGS
BACK THE RECOVERY PROCEEDINGS TO THE
EARLIER STATUS

*“The Money received for any compromise is always
received with the legend without prejudice”*

Application of PV concept in amount of compromise proposal

RBI instructions

“ Banks should while selling NPA’s work out the net present value of the estimated cash flows associated with realizable value of the available securities net cost of realization. The sale price should not be lower than the net present value of realizable value of securities.”

CHECKLIST WHILE EXAMINING THE COMPARISON OF CASH FLOWS

- Timing of cash flows
- Frequency of cash flows
- Rate of interest taken for the exercise while comparing the relative cash flows

One Time Settlement scheme

- Because of Chronic NPA's which plague banking system
- High number of accounts having lower outstanding
- Started initially as a one time measure for cleaning bank's balance sheet
- Straight jacketed approach, no discretion permitted
- To reduce the burden of genuine borrowers whose units/ventures have failed because of extraneous factors
- Segment group is pre targeted like Agricultural OTS, SME OTS, etc
- Initiated by RBI, and then followed by banks promoting own schemes.

Legal aspects of compromise and the court

- Compromise is arrived at the time when legal proceedings are at the “mandatory over “stage
- The legal Case in most cases would generally be at decree or execution of decree stage
- Court then takes upon itself to take the compromise further on the accepted terms and conditions of borrowers and lenders
 - Rule 3 of Civil Procedure Code list out procedure for compromise of suits through intervention of court
- Court compromise settlement are in law agreements for novation and remission as per section 62 and 63 of ICA

Legal aspects of compromise and the court

- Out of court settlements should be approved by courts above recovery proceedings are on.
- Compromise agreement require ROC registration and registration with ROA

FINAL ANALYSIS

- Compromise is similar to give and take in real life , in banking it relates to settling a financial liability.
- Successful compromise should be a win-win situation to all concerned.
- Negotiation is the main key but it is a long drawn process
- Successful negotiation is dependent on the main three factors:
 1. Authority to take the decision
 2. Ultimate time taken to arrive at the decision
 3. Level of information sharing

The Flip side of Compromise/ OTS

- Demonstrative effort is lost
- Promoters allegation of favoritism/ nepotism
- Compromises are in subjective realm
- Trial by media in case of high profile borrowers
- Dilution of deterrent in society.
- Too many lenders spoil the broth (the compromise as each bank has its own views on the matter)
- Compromise / OTS is the last resort in reducing NPA hence they are done at a very late stage.

QUESTION AND ANSWER SESSION