

Bankruptcy code is positive for banks: Moody's

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Says proposed new rules address several key inefficiencies in the current resolution regime

New Delhi, May 26:

The new bankruptcy code is credit positive for banks as it would improve recovery of assets and address several key inefficiencies in the current resolution regime, Moody's Investors Service has said.

It will also significantly boost the bargaining power of creditors against large debtors for resolution of distressed assets, the international credit rating agency said in a report.

"The current weak legal framework for asset resolution has been a key structural credit weakness for Indian banks. The proposed new rules address several key inefficiencies in the current resolution regime," said Srikanth Vadlamani, a Moody's Vice-President and Senior Credit Officer.

Unified framework

In the just released report titled 'Bankruptcy Law is Credit Positive for Indian Banks, but Challenges Remain', Moody's said that the new code has introduced a unified framework to replace the current collection of separate laws drafted in piecemeal fashion across overlapping jurisdictions.

This report, authored by Vadlamani, also highlighted that the bankruptcy code has reduced the threshold for creditors to invoke the insolvency resolution process (IRP).

Besides giving creditors overriding authority to approve terms of any restructuring package, the new code has limited the duration of the IRP to 270 days, after which a company will be automatically liquidated.

The new code also paves the way for introduction of third-party insolvency professionals (IP) as intermediaries to oversee the IRP, replacing the debtor's existing management and operate the company as a going concern upon initiation of an IRP.

These features are positive for Indian banks because they will act as an incentive for corporate borrowers to avoid loan default and improve the recovery of assets, the Moody's report said.

In addition to increasing the influence of banks over the restructuring process, the mandated replacement of the existing management during the process should act as a key disincentive for debtors to default in the first place, it added. Moreover, the limited timeframe strengthens the banks' bargaining power over delinquent borrowers.

The constraints

However, the report also points out that significant infrastructure constraints need to be overcome before the framework can become fully operational.

The report concludes that the new law may only have limited scope in addressing the current asset quality issues facing Indian banks.

In particular, banks will still have limited avenues available to dispose of distressed assets, and will in general remain reluctant to make appropriate haircuts to reflect their current weak operating conditions, the report added.

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