Asset Reconstruction Companies : Review of the Regulatory Framework

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The extant regulatory framework for Asset Reconstruction Companies (**"ARCs"**) has been amended by the Reserve Bank of India (**"RBI"**), *vide* its notification titled *'Review of Regulatory Framework for Asset Reconstruction Companies (ARCs)'* dated 11th October 2022 (**"Framework"**).

Key Changes:

Some of the key changes brought about by the Framework are as follows:

- The Framework modifies the *erstwhile* guidelines on the *reconstruction of financial assets through settlement of dues payable by the borrowers*.
  - Going forward, settlement of dues with a borrower shall be done only after the examination of the proposal by an independent advisory committee (**"IAC"**).
  - The IAC, after assessing the financial position of the borrower, the time frame available for recovery of the dues from the borrower, projected earnings and cash flows of the borrower and other relevant aspects, shall provide its recommendation to the board of directors of the ARC (**"BoD"**).
  - The BoD shall evaluate such recommendations and available options, and accordingly may decide to settle the dues with the borrower.
  - The BoD is required to record any significant variation on the valuation of the securities at the time of acquisition of the financial asset as against the realisable value assessed while settlement.
  - The IAC is also required to make specific recommendations in cases where settlement is not in lump sum with the borrower.
- Earlier, promoters of the defaulting company / borrowers or guarantors were allowed to buy back their assets from the ARC, subject to the fulfillment of certain conditions. **Now, these exemptions have been withdrawn.** The ARCs are instead required to ensure compliance with Section 29A of the Insolvency and Bankruptcy Code, 2016 (as amended) in dealing with prospective buyers.
- ARCs are permitted to undertake activities of a resolution applicant provided that, *inter alia* the ARC has a minimum net owned fund (**"NOF"**) of INR 10,000,000,000/-.
- Any ARC obtaining a certificate of registration on or after the date of the Framework shall not be permitted to commence business without having a minimum NOF of INR 3,000,000,000/-. The revised minimum NOF is to be achieved in a phased manner with the end date being 31st March 2026.
- ARCs are required to invest in security receipts (**"SRs"**) at a minimum of either 15% of the transferors' investment in the SRs or 2.5% of the total SRs issued, whichever is higher, of each class of SRs issued by them under each scheme on an ongoing basis till the redemption of all the SRs issued under such scheme.
- Subject to the fulfillment of certain conditions, ARCs are permitted to deploy their available surplus funds in short-term instruments such as money market mutual funds, certificates of deposit and corporate bonds / commercial papers having a short-term rating equivalent to the long-term rating of AA- or above by an eligible credit rating agency.
- Certain measures have also been introduced to improve corporate governance standards in ARCs. These include, *inter alia* the requirement to constitute an audit committee and nomination and remuneration committee of the board of ARCs.

Conclusion:

ARCs play a vital role in the management of distressed financial assets of banks and financial institutions. The above modifications are on account of the growing requirements of the financial sector and untapped potential of ARCs to resolve stressed assets. The Framework also aims to strengthen the transparency and improve the corporate governance standards of ARCs.

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