

International Asset Reconstruction Company Pvt. Ltd.

Policy on Change in or Take-over of the Management of the Business of a Borrower

1. Objective of the Policy

Till recently there have not been many opportunities for ARCs to venture into the area of change in or take-over of management of borrowers. However, with the recent decision of RBI to permit originators to sell SMA2 assets, opportunities of revival and rehabilitation of units are expected to arise more frequently requiring ARCs to exercise their powers for changing or taking over the management. The present policy is framed to enable IARC to exploit such opportunities within the ambit of RBI guidelines and Sarfaesi Act (primarily Sections 9(a), 13(4b) and 15 of the Act).

2. Definitions

As advised by RBI, the expressions “change in management” and “take-over of management” will have the following meanings under this policy:

- a. “change in management” means effecting change by the borrower at the instance of IARC in the person who has responsibility for the whole or substantially whole of the management of the business of the borrower and / or other relevant personnel
- b. “Takeover of management” means taking over of the responsibility for the management of the business of the borrower with or without effecting change in management personnel of the borrower by the IARC

3. Purpose

IARC shall resort to change in or take-over of management of the business of the borrower only for the purpose of realisation of IARC’s dues from the borrower. This will be done subject to RBI guidelines and provisions of Sarfaesi Act.

On realisation of IARC’s dues in full, IARC shall restore the management of the business to the borrower.

4. Eligibility Conditions

IARC will effect change in or take-over of the management of the business of a borrower, only if:

- a. The amount due to it from the borrower is not less than 25% of the total assets owned by the borrower. (‘Total Assets’ means total assets as disclosed in its latest audited Balance Sheet immediately preceding the date of taking action.) and

- b. Where the borrower is financed by more than one secured creditor (including ARCs), secured creditors (including ARCs) holding not less than 75% of the outstanding security receipts agree to such action.

5. Grounds for effecting change in or takeover of management

Subject to the eligibility conditions mentioned in paragraph 4, IARC may effect change in management or take-over of the management of business of a borrower on any of the following grounds:

- (a) the borrower makes a willful default (please see explanation at the end of this paragraph) in repayment of the amount due under the relevant loan agreement/s;
- (b) IARC is satisfied that the management of the business of the borrower is acting in a manner adversely affecting the interest of the creditors (including IARC) or is failing to take necessary action to avoid any event which would adversely affect the interest of the creditors;
- (c) IARC is satisfied that the management of the business of the borrower is not competent to run the business resulting in losses / non- repayment of dues to IARC or there is a lack of professional management of the business of the borrower or the key managerial personnel of the business of the borrower have not been appointed for more than one year from the date of such vacancy which would adversely affect the financial health of the business of the borrower or the interests of IARC as a secured creditor;
- (d) the borrower has without the prior approval of the secured creditors (including IARC), sold, disposed of, charged, encumbered or alienated 10% or more (in aggregate) of its assets secured to IARC;
- (e) there are reasonable grounds to believe that the borrower would be unable to pay its debts as per terms of repayment accepted by the borrower;
- (f) the borrower has entered into any arrangement or compromise with creditors without the consent of IARC which adversely affects the interest of IARC or the borrower has committed any act of insolvency;
- (g) the borrower discontinues or threatens to discontinue any of its businesses constituting 10% or more of its turnover;
- (h) all or a significant part of the assets of the borrower required for or essential for its business or operations are damaged due to the actions of the borrower,
- (i) the general nature or scope of the business, operations, management, control or ownership of the business of the borrower are altered to an extent, which in the opinion of IARC, materially affects the ability of the borrower to repay the loan;
- (j) IARC is satisfied that serious dispute/s have arisen among the promoters or directors or partners of the business of the borrower, which could materially affect the ability of the borrower to repay the loan;

- (k) failure of the borrower to acquire the assets for which the loan has been availed of and utilization of the funds borrowed for other than stated purposes or disposal of the financed assets and misuse or misappropriation of the proceeds;
- (l) fraudulent transactions by the borrower in respect of the assets secured to the creditor/s.

Explanation in respect of “Willful Default”:

For the purpose of this paragraph, willful default in repayment of amount due, includes -

- a) Non-payment of dues despite adequate cash flow and availability of other resources, or
- b) Routing of transactions through banks which are not lenders/ consortium members' so as to avoid payment of dues, or
- c) siphoning off funds to the detriment of the defaulting unit, or misrepresentation / falsification of records pertaining to the transactions with IARC

The decision, as to whether the borrower is a willful defaulter or not, shall be made by IARC keeping in view the track record of the borrower and not on the basis of an isolated transaction/incident which is not material. The default to be categorized as willful must be intentional, deliberate and calculated.

6. Procedure for effecting change in or take-over of management

- (a) IARC shall carry out due diligence exercise and record the details of the exercise, including the findings on the circumstances which had led to default in repayment of the dues by the borrower and why the decision to change in or take-over of the management of the business of the borrower has become necessary
- (b) IARC shall constitute an Independent Advisory Committee (IAC) consisting of professionals having technical/finance/legal background to assist IARC in the process. The members of the IAC will not be connected with the affairs of IARC in any manner and will not receive any pecuniary benefit from IARC except for services rendered for acting as member of IARC
- (c) The IAC will assess the financial position of the borrower, time frame available for recovery of the debt from the borrower, future prospects of the business of the borrower and other relevant aspects and recommend to IARC whether it may resort to change in or take-over of the management of the business of the borrower and whether such action would be necessary for effective running of the business leading to recovery of its dues
- (d) The Board of Directors of IARC, including at least two independent directors, will deliberate on the recommendations of the IAC and consider the various options available for the recovery of dues before deciding whether under the existing circumstances the change in or take-over of the management of the business of the borrower is necessary and the decision will be specifically included in the minutes.

- (e) IARC shall identify suitable personnel / agencies, who can take over the management of the business of the borrower by formulating a plan for operating and managing the business of the borrower effectively, so that the dues of IARC may be realized from the borrower within the time frame.
- (f) Such plan will also include procedure to be adopted by the IARC at the time of restoration of the management of the business to the borrower in accordance with paragraph 3 above, borrower's rights and liabilities at the time of change in or take-over of management by the IARC and at the time of restoration of management back to the borrower, rights and liabilities of the new management taking over management of the business of the borrower at the behest of IARC. It will be clarified to the new management by IARC that the scope of their role is limited to recovery of dues of IARC by managing the affairs of the business of the borrower in a prudent manner.
- (g) IARC shall give a notice of 60 days to the borrower indicating its intention to effect change in or take-over of the management of the business of the borrower and calling for objections, if any.
- (h) The objections, if any, submitted by the borrower shall be initially considered by the IAC and thereafter the objections along with the recommendations of the IAC shall be submitted to the Board of Directors, who will pass a reasoned order within a period of 30 days from the date of expiry of the notice period, indicating the decision of IARC regarding the change in or take-over of the management of the business of the borrower, which shall be communicated to the borrower.

7. Legal and procedural aspects

The procedural aspects as stipulated in the Sarfaesi Act (more specifically Section 15) will be complied with. The said Section also details the effects, consequences and responsibilities arising from the taking over of management by an SC/RC. These include automatic vacation of office by the earlier Board of Directors and annulment of any existing management contract. However, it may be pointed out that the aggrieved party would be able to challenge the actions taken by the SC/RC in DRT and higher legal fora. Moreover, unlike in the matter of taking physical possession of secured assets, there is no provision in the Act for making a request to DM or CMM to take and hand over possession to the SC/RC. In view of these, and looking at the delays currently faced in the legal fora, the process of take-over is unlikely to be smooth. Exceptions can be in cases where the promoters are taken into confidence and come forward to cooperate with the process in the long term interest of the borrowing entity.

Consequently, at least in the initial stages, this policy may be more like an enabling provision, which will need to be tested and improved upon as we gain experience in the first few cases.

8. Other aspects

- (a) Borrowers will be made aware of the policy by placing a copy of the same on the website of IARC

- (b) Policy may be modified with the approval of the Board of Directors, in which case the modifications will be notified to the borrower(s) affected by such change
- (c) IARC will report to Reserve Bank of India, as part of the periodical reports laid down by RBI, all cases where IARC has taken action to cause change in or take-over of the management of the business of the borrower for realization of its dues from the borrower
- (d) Policy will be reviewed and updated periodically with the approval of the Board

Place: Mumbai
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