Cosmetic repair: on inter-creditor agreement

Indian banks trying to sell their troubled assets now have one less hurdle to cross. A group of banks, including public sector, private sector and foreign banks, signed an inter-creditor agreement on Monday to push for the speedy resolution of non-performing loans on their balance sheets. According to the agreement, a majority representing two-thirds of the loans within a consortium of lenders should now be sufficient to override any objection to the resolution process coming from dissenting lenders. Minority lenders who suspect they are being short-changed by other lenders can now either sell their assets at a discount to a willing buyer or buy out loans from other lenders at a premium. The inter-creditor agreement is aimed at the resolution of loan accounts with a size of 50 crore and above that are under the control of a group of lenders. It is part of the “Sashakt” plan approved by the government to address the problem of resolving bad loans. Over the last few years, Indian banks have been forced by the Reserve Bank of India to recognise troubled assets on their books, but their resolution has remained a challenge. According to banker Sunil Mehta, who headed a panel that recommended the plan, disagreement between joint lenders is the biggest problem in resolving stressed assets. The government hopes that the holdout problem, where the objections of a few lenders prevent a settlement between the majority lenders, will be solved through the inter-creditor agreement.

Such an agreement may persuade banks to embark more quickly on a resolution plan for stressed assets. This is an improvement on the earlier model, which relied solely on the joint lenders’ forum to arrive at a consensus among creditors. It is, in fact, logical for joint lenders who want to avoid a deadlock to agree on the ground rules of debt resolution prior to lending to any borrower. But the obligation on the lead lender to come up with a time-bound resolution plan can have unintended consequences. Banks may be compelled to engage in a quick-fire sale of stressed assets due to arbitrary deadlines on the resolution process. This will work against the interests of lenders looking to get the best price for their stressed assets. Also, it is often in the interest of the majority of creditors to take the time to extract the most out of their assets. Meanwhile, the biggest obstacle to bad loan resolution is the absence of buyers who can purchase stressed assets from banks, and the unwillingness of banks to sell their loans at a deep discount to their face value. Unless the government can solve this problem, the bad loan problem is likely to remain unresolved for some time to come.

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