

ASIAN DEVELOPMENT BANK

TAR:IND 36062

TECHNICAL ASSISTANCE

TO

INDIA

FOR

DEVELOPING THE ENABLING ENVIRONMENT FOR AND STRUCTURING

ASSET RECONSTRUCTION COMPANIES IN INDIA

October 2002

CURRENCY EQUIVALENTS

(as of 9 October 2002)

Currency Unit	–	Indian rupee/s (Re/Rs)
Re1.00	=	\$0.0207
\$1.00	=	Rs48.3400

ABBREVIATIONS

ADB	–	Asian Development Bank
AMC	–	asset management company
ARC	–	asset reconstruction company
ARF	–	asset reconstruction fund
NPA	–	nonperforming asset
TA	–	technical assistance

NOTE

In this report, "\$" refers to US dollars.

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I. INTRODUCTION

1. The Government of India has sought the Asian Development Bank's (ADB's) assistance to study the critical aspects of the proposed establishment of asset reconstruction companies (ARCs) in India. The technical assistance (TA) was proposed as a firm project during the Country Program Confirmation Mission in February 2002 and reconfirmed during the Country Programming Mission in May 2002.¹ The TA is in line with ADB's strategy of helping reduce vulnerabilities in India's financial sector that could place investments at risk, curtail economic growth, and endanger efforts to reduce poverty. The TA framework is shown in Appendix 1.

2. The nonperforming loans of banks and financial institutions in India as of March 2001 had reached approximately Rs548 billion (about \$11.2 billion) for public sector banks and roughly Rs240 billion (about \$5 billion) for other financial institutions. The high level of nonperforming loans has impaired the financial position of a number of public sector banks, weakened the financial capacity of other financial institutions, and has emerged as a major concern.

3. To facilitate the early resolution of nonperforming assets (NPAs) of banks and financial institutions, the Government is considering the extensive use of ARCs in India.

4. The Committee on the Financial Sector (Narasimham Committee 1991) first proposed an ARC as a means of tackling the burgeoning bad and doubtful accounts of financial institutions in India, viz., banking institutions as well as development finance institutions. An ARC was initially conceived to be an asset reconstruction fund (ARF) that would purchase the NPAs of banking institutions. However, the Government opted to simply recapitalize weak public sector banks and allow them to handle their own NPAs.

5. The second Narasimham Committee on Banking Sector Reforms (1998) reiterated its proposal but this time in the form of ARCs, inasmuch as banking institutions had already carried out recapitalization to some extent. It was proposed that ARCs would take over the NPAs of weak public sector banks by issuing and swapping their own bonds. The Government accepted the idea and in the union budget for 1998/99 encouraged a few banks with high levels of NPAs to undertake ARCs on an experimental basis. The Government set up a task force in July 1998 to study the possible modalities and to prepare an operating plan for establishing ARCs in India.

6. The Verma Committee (1999) that looked at the restructuring of weak public sector banks also proposed the disposal of NPAs as a critical component in the restructuring of weak public sector banks, but offered still another alternative structure comprising a financial restructuring authority, an ARF, and an asset management company (AMC). The financial restructuring authority was to be an independent government agency owning the ARF and appointing the AMC, and would approve and monitor specific bank restructurings. The ARF would acquire the NPAs of weak public sector banks, and the AMC—proposed to be a private sector company—would manage and dispose of the acquired NPAs for a fee.

7. After much deliberation on the various proposals, the consensus was reached: (i) a proposed ARC would be established as a majority-owned private sector entity, (ii) there would be multiple ARCs instead of a single centralized ARC, and (iii) a pilot ARC would be established under the existing legal framework and fast-tracked. Meanwhile, a high level committee was organized to consider whether it was feasible to establish an ARC under the existing legal

¹ The TA first appeared in *ADB Business Opportunities* (Internet edition) on 7 June 2002.

framework. The committee's response was positive; it was agreed that a pilot ARC be set up with equity contributed by major public sector and private sector banks and financial institutions in India. Invitations to participate were extended to multilateral financial institutions such as the International Finance Corporation, ADB, and the World Bank.² To provide the necessary legal underpinnings for ARCs, the Government passed the Securitization and Reconstruction of Financial Assets and Enforcement of Security Ordinance, 2002 (para. 11) that has yet to be confirmed by Parliament.

II. ISSUES

8. A number of issues still need to be weighed carefully to ensure that ARCs as contemplated can operate successfully in the Indian environment. First, ARCs have been used successfully in other countries principally to address systemic bank restructuring, typically after a crisis in the financial sector, rather than as a permanent business.³ Evidence suggests that the use of asset management or reconstruction companies or distinct loan workout units has played an important role in resolving systemic difficulties in the banking sector and could be considered as part of best practice.⁴

9. Second, ARCs have typically been Government initiated and owned. Under what framework and incentive structure a private sector ARC should operate to ensure that Government objectives are met requires further study (para. 13).

10. Furthermore, to ensure the viability of the proposed ARCs and to facilitate their operation, a number of issues remain to be addressed. The issues relate to (i) the enabling legislation, (ii) taxation, (iii) asset valuation, (iv) effective operating structure for ARCs in India, and (v) regulatory framework for the operation of ARCs.

11. To respond to some of these issues, the Government passed Ordinance 2002, which is designed to facilitate the resolution of NPAs in the financial system. Among others, it provides for the following: (i) creation of ARCs, (ii) securitization of assets, and (iii) enforcement of security interest. The latter provides for (i) extension of the rights, benefits, permissions, exemptions, etc. over assigned loans or transferred securities to ARCs to enable ARCs to exercise powers accorded to banks and financial institutions with respect to asset reconstruction and securitized loans, including recourse to summary procedures for recovery of dues and to take over assets or management of defaulting borrowers; (ii) inapplicability of the provisions of

² The World Bank cannot participate in the equity of the proposed pilot ARC under its present Articles; International Finance Corporation and ADB (through its private sector window) agreed to consider the proposal. In the meantime, the Asset Reconstruction Company (India) Ltd. with an initial capitalization of Rs100 million has been set up with the participation of ICICI Bank, the Industrial Development Bank of India, and the State Bank of India. Other contributors named are IDBI Bank, HDFC Bank, and UTI Bank.

³ The Korea Asset Management Corporation, a state-owned agency for financial restructuring, now offers asset management and corporate restructuring as part of its regular business. Nonetheless, it was reported that the agency is envisaged to scale down its operations over time.

⁴ However, an ARC would only address the stock but not the flow problems of banking institutions; consequently, successful systemic bank restructuring has been accompanied by a comprehensive approach to reform that covers not only the operations of affected banks themselves, but the operating environment as well. Privatization, restructuring, and closure of state-owned banks, and state enterprises are typical responses that have proven fruitful in systemic bank restructuring (Dziobek, C. and Ceyla Pazarbasioglu. 1997. *Systemic Bank Restructuring: A Survey of 24 Countries*. Working Paper of the International Monetary Fund. Washington, D.C. See also Klingebiel, D. 2000. *The Use of Asset Management Companies in the Resolution of Banking Crises: Cross Country Experience*. The World Bank, Financial Sector Strategy and Policy Group).

the Sick Industrial Companies Act⁵ implemented by the Board of Industrial and Financial Reconstruction on loans transferred or assigned to an ARC with the concurrence of secured creditors representing not less than three fourths of the value of amount outstanding; (iii) ARCs' authority to dispose of a defaulting borrower's assets under the winding up provisions of the Companies Act, 1956; and (iv) setting up of a central registry.⁶ Ordinance 2002 also designates the Reserve Bank of India as the regulating authority.

12. However, while Ordinance 2002 is decidedly a positive step, it still leaves a number of unresolved issues, among them the following three. (i) Given the size of the NPAs and the consequent investment requirements, it is likely that the required amounts cannot be raised domestically and would require involvement of international investors; however, international financial institutions without domestic branches do not appear to be covered by the definition of secured creditors, and foreign lenders, except for the International Finance Corporation would not ordinarily appear to have the benefit of remedies for recovering debt under Ordinance 2002. The guidelines for investment in debt securities place a cap on such investments by foreign institutional investors and may also have to be revisited. Furthermore, a security receipt is allowed as a form of investment under Ordinance 2002, but is not considered an eligible form of investment by foreign institutional investors. (ii) Consortium lending is a common feature of loans in India. However, the handling of intercreditor agreements with prescribed percentages is not clear; no distinction is made between first and second mortgages and it is not clear whether the consortium is defined in terms of the liability or the asset secured. (iii) Indian borrowers have raised objections to the perceived bias against borrowers under Ordinance 2002, and lenders' liability to prevent abuse by creditors is being mooted.

13. Further study is needed concerning (i) the tax treatment for sold and assigned assets with respect to the applicability of the stamp duty, sales tax, and the capital gains tax; (ii) the implications of acquiring financial assets through the issue of debentures on vesting, transfer of title to the assets, etc.; (iii) valuation of NPAs and valuation techniques to employ with them (iv) the effective operating structure for the ARCs; and (v) the regulatory framework to govern ARC operations, e.g., prudential norms, guidelines for asset acquisition and implementing regulations, and the appropriate regulatory authority. A number of issues arise with respect to the proposed operating structure of ARCs. One is the incentive of public sector banks to dispose of their NPAs. Private sector ARCs are expected to bargain for the lowest possible price in acquiring NPAs from banking institutions. Public sector banks are likely to face criticism if they sell assets below their book values. Consequently, they would need to be insulated from harassment suits and public criticism,⁷ or indemnified in case of legal actions arising from the normal discharge of their duties. On the other hand, ARCs can create moral hazards for public sector banks whose balance sheets are cleansed with the transfer of bad assets. A clear restructuring strategy would be essential to accompany debt/asset resolution that will address the underlying causes that gave rise to the NPAs in the first place. Another issue relates to the private nature of the ARC. Being private, ARCs would naturally look for a quick turnaround for acquired NPAs and would purchase only the more promising NPAs off the books of banking

⁵ The provisions allow borrowers to seek rehabilitation under the Act and delay the foreclosure process. The above amendment will allow the ARC to act unimpeded should assets be transferred to it where the defaulting borrower has not sought relief under the Act.

⁶ ADB's TA (ADB. 2002. *Technical Assistance to India for Secured Transactions Reform*. Manila) will help design the architecture for a modern computerized registration system for all security interests on movable property and build capacity for the operation of the proposed system.

⁷ One approach is to set up a separate body composed of reputable persons drawn from the Government and the private sector that would review and vet the price negotiated between a bank and the ARC for the sale of the NPAs. This was the approach taken in the Philippines during banking restructuring in the 1980s.

institutions. This would defeat the purpose of the Government concept of an ARC acting as a “nursing home” where distressed enterprises are restructured or rehabilitated.

III. THE TECHNICAL ASSISTANCE

A. Purpose and Output

14. The TA will help the Government design and formulate an effective ARC that will meet the objectives of early resolution of the high level of NPAs of public sector banks and other financial institutions as part of the effort to reform the Indian financial system.

15. The TA will (i) review best practices in the operation of ARCs, particularly, private sector ARCs in other countries where they have operated; (ii) define the critical factors that have led to the success of ARCs in the past and relate them to the Indian situation, in the process pinpointing the gaps and deficiencies in the enabling environment in India for the model ARC as currently formulated and conceived in India, and recommend possible approaches and options that could enhance the operation of ARCs in India; (iii) recommend an operating framework under which the ARC could function and meet the various concerns (paras.12 and 13) while meeting the Government’s objectives; (iv) define the appropriate role of Government under the proposed framework, particularly with respect to required Government support; (v) recommend a workable incentive structure for the ARC, based on best practice and given the existing legal and tax framework and proposed changes, to facilitate its work; (vi) recommend proven practical valuation techniques and methods that can be employed to arrive at an objective value for the NPAs (could include auction of assets, etc.); (vii) in consultation with Indian authorities and financial institutions that may be involved in the future operation of the ARCs, prepare a feasibility study and operating plan indicating how a model ARC in the Indian setting will operate; and (viii) recommend an appropriate regulatory framework for ARCs in India and the process to enable the regulatory authority to effectively oversee the ARCs’ operations.

B. Methodology and Key Activities

16. The consultants, working closely with the Government, through the Executing Agency, will familiarize themselves with the concept of the pilot ARC that will be established and the rationale behind the specific design concept, the changes in legislation under Ordinance 2002, and the objectives of the Government for establishing ARCs in India. With this understanding, and considering best practices and consultation with various stakeholders, the consultants will help redesign the ARC that could serve as the basic model for future ARCs. The critical elements of the exercise will be (i) defining the operating framework that will address present concerns regarding the proposed ARC and ensuring that Government objectives are met, (ii) determining alternative structures that could work in India, (iii) strengthening the legal framework to allow ARCs to operate smoothly in India, (iv) defining the incentive structure to facilitate ARC operations, and (v) proving the viability of the proposed ARC.

17. In parallel, a review will be conducted to better understand the extent and nature of NPAs of the target or selected public sector banks and other financial institutions. With data from this review and known best practices, the consultants will determine the various approaches, valuation methods, mechanisms, and strategy that will be needed to resolve the NPAs effectively. The nature of the NPAs will also determine the type of expertise that the ARCs will need to manage the NPAs to be acquired. The information will also form the basis for developing a restructuring study and estimating the extent of recapitalization that may be

needed for the affected public sector banks and other financial institutions. Other options may be considered as a result of the review.

18. The support of the Government and regulatory authorities—particularly in providing the required data and information and improving the consultants' understanding of the Indian environment and the deep-seated concerns within and without the Government regarding the proposed ARCs—and the cooperation of the target or selected public sector banks and other financial institutions will be crucial to the efficient undertaking and successful completion of the TA.

C. Cost and Financing

19. The total cost of the TA is estimated at \$1,000,000 equivalent, comprising \$673,000 in foreign currency cost and \$327,000 equivalent in local currency cost. ADB will finance the entire foreign exchange cost plus \$127,000 equivalent of the local currency cost. ADB will finance the TA on a grant basis from the ADB's TA funding program. The Government will provide the balance amounting to \$200,000 equivalent for counterpart staff, office accommodation, and other logistical support requirements. The details of the cost estimates are in Appendix 2.

D. Implementation Arrangements

20. The Ministry of Finance, Department of Economic Affairs (Banking Division) will be the Executing Agency for the TA. It will provide suitable office space, counterpart staff, and other facilities and support services to enable the consultants to accomplish their work.

21. ADB will engage the services of an international consulting firm in collaboration with domestic consultants to provide the required consulting services totaling 32 person-months: 18 international, and 14 domestic. The terms of reference of the consultants are in Appendix 3. The consulting firm will be selected and engaged in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for engaging domestic consultants.

22. The consultants will submit an inception report within 2 weeks from the start of services. A midterm report that contains the consultants' initial findings and the work plan for the succeeding months until TA completion will be submitted to ADB and the Government at the end of 3 months. A draft final report will be submitted to ADB and the Government at the end of 6 months. The Government, the consultants, and ADB will hold a tripartite meeting within 15 days from receipt of the draft final report to discuss the report. Comments from the Government and ADB will be taken into account in finalizing the draft final report that is to be submitted within 15 days of the tripartite meeting. An electronic copy of the report and at least five hard copies of each will be submitted to ADB and the Government. The TA is expected to start in December 2002 and be completed by June 2003.

IV. THE PRESIDENT'S DECISION

23. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$800,000 on a grant basis to the Government of India for Developing the Enabling Environment for and Structuring Asset Reconstruction Companies in India, and hereby reports this action to the Board.

TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Goal Facilitate the early resolution of nonperforming assets (NPAs) of public sector banks and other financial institutions in India as part of the ongoing reform of the Indian financial sector</p>	<p>Reduction of NPAs in current portfolio of selected/target public sector banks and other financial institutions</p> <p>Restructuring plans for weak public sector banks and other financial institutions</p>	<p>Reserve Bank of India (RBI) reports</p> <p>Annual reports of target public sector banks and other financial institutions</p>	<p>No consensus is reached on appropriate design for the proposed asset reconstruction company (ARC)</p> <p>Government support is inadequate to move ARC concept forward.</p>
<p>Purpose Assist the Government design and formulate ARCs that can operate effectively in the Indian environment</p>	<p>Completed feasibility study and operating plan for proposed ARC</p> <p>Establishment of ARCs in India</p>	<p>Consultants' report</p> <p>Government feedback</p>	<p>Political commitment to restructure public sector banks and other financial institutions is weak.</p> <p>Policy changes are inadequate to meet the required reform of the financial system, and underlying causes of poor banking performance by affected public sector banks are not adequately addressed.</p>

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
	<p>Sale of assets acquired by ARCs</p> <p>Development by ARCs of an active secondary market for acquired assets</p>	<p>Annual report of ARCs and other published reports</p> <p>Published reports; studies on Indian capital market</p> <p>RBI and Government reports and published reports</p>	
<p>Outputs</p> <p>Operating framework for ARCs in India</p> <p>Alternative structures for ARCs in India</p> <p>Enhanced legal framework for ARCs</p> <p>Incentive structure to apply to ARCs</p> <p>Possible demand for supply of NPAs/acquired assets for ARCs and for the secondary market, respectively</p>	<p>Determination of various critical elements that would facilitate the effective operation of ARCs in India following wide consultations with stakeholders and considering best practices</p>	<p>Consultant's reports</p> <p>Published reports; studies on Indian capital market</p> <p>RBI and Government reports and published reports</p>	<p>Clear understanding of various parameters surrounding the effective performance of ARCs in India is not reached.</p>

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Workout approaches to existing NPAs of target public sector banks and other financial institutions</p> <p>Practical alternative valuation methods and techniques that may be utilized by ARCs</p> <p>Suitable mechanisms for disposing of NPAs to ARCs and ARCs to secondary market holders</p> <p>Feasibility study for proposed ARC</p> <p>Feasibility report and operating plan are reviewed, discussed among stockholders, and submitted</p> <p>Operating plan for proposed ARC</p> <p>Estimate of recapitalization requirement of target public sector banks and other financial institutions</p>	<p>Various alternatives laid down</p> <p>Possible mechanisms to facilitate NPAs disposal considering legal, regulatory, tax, and operational aspects are considered and pinpointed.</p> <p>Aggregate requirement for recapitalization is estimated based on reasonable assumptions</p>	<p>Consultant's reports</p>	

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Activities/Inputs</p> <p>Government support for ARCs in India and guidelines based on priorities and plans</p> <p>Develop the enabling environment for ARCs</p> <p>Present to Parliament required changes to the legal framework, tax regime, and incentive structure necessary to facilitate the operation of ARCs in India</p> <p>Consultants' services</p>	<p>Required outputs are delivered on time and meet Government and ADB requirements</p>	<p>Reports from India Resident Mission (INRM)</p> <p>Government and newspaper reports</p> <p>Communications with Executing Agency</p> <p>Consultants reports and Mission and INRM monitoring</p>	<p>Lack of cooperation of concerned Government agencies and parties</p>

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Conduct wide consultation among various stakeholders (legal, operational, taxation, incentives, etc.) regarding concerns about the operation of the proposed private sector ARC</p> <p>Compare with best practices the proposed structure, approaches, and processes to be followed by the proposed private sector ARC</p> <p>Analyze portfolios of target or selected public sector banks and other financial institutions</p> <p>Prepare feasibility study and operating plan for proposed model private sector ARC</p> <p>Study recapitalization requirements and possible restructuring options for target public sector banks and other financial institutions</p>		<p>Consultants' reports and feedback from the Government and other stockholders</p> <p>Consultants' reports</p>	<p>Various stockholders do not cooperate</p> <p>Access to information on portfolios of banks and other financial institutions is restricted</p> <p>Limited data and poor access to required information</p>

COST ESTIMATES AND FINANCING PLAN
(\$)

Item	Foreign Exchange	Local Currency	Total Cost
A. Asian Development Bank Financing^a			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants	583,900	0	583,900
ii. Domestic Consultants	0	111,000	111,000
b. International and Local Travel			
i. International Travel	15,000	0	15,000
ii. Domestic Travel	0	4,300	4,300
2. Communications, Translations, and Reports	7,500	0	7,500
3. Representative for Contract Negotiations	5,000	0	5,000
4. Contingencies	61,600	11,700	73,300
Subtotal (A)	673,000	127,000	800,000
B. Government Financing			
1. Local Counterpart Staff	0	120,000	120,000
2. Office Accommodation, Facilities, and Equipment	0	50,000	50,000
3. Supplies, Utilities, and Other Logistical Support	0	30,000	30,000
Subtotal (B)	0	200,000	200,000
Total	673,000	327,000	1,000,000

^a Financed from Asian Development Bank's technical assistance funding program.
Source: Asian Development Bank estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

A. International Consultants

1. Asset Reconstruction (Management) Company Expert (7 person-months)

1. The consultant will act as the team leader, guide and oversee the overall execution of the technical assistance (TA) and ensure the delivery of required outputs. The consultant must have extensive experience and exposure in financial sector restructuring and in structuring and operating asset reconstruction (management) companies (ARCs). Previous experience in India's banking and financial sector will be an advantage. The specific tasks follow.

- (i) Define the critical factors that need to be met for a private sector ARC to operate effectively considering the lessons of experience and best practices.
- (ii) After consultations with the private sector, determine an appropriate framework in the Indian context under which a private ARC can operate effectively, with adequate safeguards and checks and balances, addressing the current major concerns of all stakeholders, the Government, public sector banks, other financial institutions, the regulatory authorities, those intending to set up ARCs and the general public.
- (iii) Recommend alternative structures (i.e., should it be formed as a fund, company, public/private partnership, a Government agency, subsidiary of banks, etc.), defining the pros and cons of each, using the findings in (i) and (ii).
- (iv) Define possible services that the ARC may offer—acquisition and disposition of nonperforming assets (NPAs), loan workouts either preparatory to asset disposition or as a distinct service for a fee, financial and operational restructuring for banks and corporations, valuation of assets, securitization, etc., collateral management to maintain asset values, act as a collection agency etc., and such other services that may be relevant to the ARC's operations and market needs.
- (v) Prepare an organizational plan for the proposed ARC, defining minimum capital requirements, ownership structure, organizational structure, management and staffing and specialist requirements, and key functional areas, among others.
- (vi) Prepare a feasibility study, with corresponding sensitivity analyses of key variables, to prove the viability of the proposed ARC considering the recommended framework, structure, operating requirements, and target market and expected market demand/supply considerations for the products. Set up performance benchmarks and determine its corporate life.
- (vii) Prepare an operating plan for the proposed ARC.

2. Workout Specialist (7 person-months)

2. The consultant will have an extensive background in undertaking workouts, corporate restructuring, and asset disposition; and broad knowledge of innovative solutions to the

structuring of asset sales. Previous experience in India and other developing countries of Asia on financial/loan restructuring will be an advantage.

- (i) Review the NPAs of selected/target public sector banks and other financial institutions in consultation with the Government and regulatory authorities; prepare a portfolio analysis to determine the nature of businesses involved (types of industries, geographic locations, products, etc.) and how much assets may be disposed off expeditiously, the nature and extent of workouts that may be needed, NPAs that may require extended rehabilitation; and estimate realizable values of residual assets, if any, and assets that may be beyond recovery and should be written off.
- (ii) From the foregoing analysis, determine the types of experts that the proposed ARCs would require to facilitate and undertake the disposition of potential assets to be acquired.
- (iii) Recommend appropriate approaches for handling the resolution of these assets—sale of assets to ARCs; whether loan workouts should be undertaken by the banks and other financial institutions themselves or by the ARCs, guided by the experiences of other countries and best practice; and the capability of the target public sector banks and other financial institutions themselves to undertake loan workouts with available expertise and experience; or whether separate loan workout units should be formed, etc.
- (iv) After reviewing the nature of the NPAs, recommend suitable mechanisms for disposing of them—auction, direct sale, securitizations, etc.—ensuring the transparency and impartiality of the process.
- (v) After consultation with local and international accounting and audit firms based in India, regulatory authorities, banking institutions, and institutional investors, recommend practical valuation techniques that can be employed in the Indian environment.
- (vi) Advise the Government on whether it would be appropriate to restrict target NPAs to NPAs in a few select banks and other financial institutions, and to only the core NPAs and exclude new or more recent ones; in consultation with the Government, prepare an analysis of the approximate supply of NPAs for ARCs and potential demand for these NPAs that are to be disposed of in the secondary market for these NPAs.
- (vii) Recommend ways for developing a secondary market for acquired assets in India.
- (viii) Assist the asset reconstruction company expert in preparing the feasibility study for the proposed ARC.
- (ix) Estimate the possible recapitalization requirements of the target public sector banks and other financial institutions based on the expected amount of NPAs that could be disposed of readily and the possible timetable for asset resolution.

3. Legal/Tax Expert (4 person-months)

3. The consultant will have broad experience in setting up and operating ARCs, particularly, the legal, regulatory, and tax aspects. Knowledge of India's legal and tax system will be an advantage.

- (i) Review the existing legal environment, particularly, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Ordinance 2002, considering proposed amendments to existing laws; and determine if further improvements, if any, are required for ARCs to be able to operate with facility. More specifically, address unresolved issues concerning foreign institutional investments regarding distressed assets and debt securities, implication of Ordinance 2002 for consortium lending and intercreditor agreements; and ensure fair treatment for borrowers and safeguard against potential abuse by lenders under the proposed lenders' liability.
- (ii) On the basis of best practice and a comparative study of incentive structures of ARCs in other countries, recommend an appropriate incentive structure for the proposed ARCs, particularly with respect to the present tax regime; and provide a professional opinion and bases regarding the applicability of various taxes such as the stamp duty, sales tax, and capital gains tax on the proposed activities of the ARCs.
- (iii) Consider indemnification clauses to protect legitimate authority in the normal discharge of their duties in disposing of bank NPAs.
- (iv) Assist the Government draft any proposed amendment—and recommend the most suitable route to put the amendments into effect—to existing laws should such changes be required on the basis of the review of and proposed incentive structure.
- (v) Taking into account comparative regulatory frameworks and the Indian situation, draft and recommend appropriate regulations to govern the operations of ARCs in India, in consultation with regulatory authorities. Considering best practice, recommend an appropriate regulatory authority for ARCs in India.

B. Domestic Consultants

1. Accounting/Loan Supervision Expert (7 person-months)

4. The expert should have extensive and long experience in loan/project supervision in a major financial institution in India, preferably with a chartered accountant background, and connected with a domestic accounting and audit firm. The tasks include the following:

- (i) Assist the international workout specialist in reviewing the NPAs of the target public sector banks and other financial institutions.
- (ii) Assist the international workout specialist in preparing the portfolio analysis, giving advice on suitable approaches to corporate restructuring based on local experience.

- (iii) Advise the international workout specialist on valuation methods acceptable in India and discuss the possibility of introducing other methods or innovations.
- (iv) Assist the international workout specialist estimate the possible demand for assets and likely secondary market for the assets.
- (v) Assist in preparing the feasibility study for the proposed ARC.

2. Legal/Tax Expert (7 person-months)

5. The expert preferably should be a member of a local reputable law firm, with an extensive background on tax and legal practice concerning bankruptcy/foreclosure proceedings, asset disposition and sales, securitization, etc. The tasks include the following:

- (i) Assist the international legal/tax expert in reviewing the legal/tax environment of ARCs and provide the legal background of relevant local studies, data, and information that could facilitate the review.
- (ii) Determine alternative routes for effecting legal/tax changes that may be needed, and recommend the most efficient approach.
- (iii) Assist the international legal/tax expert draft proposed legal/tax amendments, if any.
- (iv) Advise the consulting team on the legal/tax implications of various activities that may be decided for the ARC to undertake.
- (v) Determine the most efficient route in establishing the proposed ARC and the process as well as legal/documentary requirements for its establishment.