A Guide to Special Situations and Distressed Investments in India for International Investors

By **NIKHIL NARAYANAN**

Introduction

The enactment of the Insolvency and Bankruptcy Code 2016 ("**IBC**") and pressure on Indian banks from the Reserve Bank of India ("**RBI**") to clean up their balance sheets has created a distressed investments market in India. This has resulted in a wave of interest in India from distressed debt and special situations funds. However, while the scale of the opportunity and its potential are evident to most international funds, tackling this opportunity requires an understanding of the Indian regulatory landscape and will usually require engagement with the large state controlled banks in India. This article demystifies the Indian distressed debt and special situations market for international debt funds seeking to enter it.

Baseline Restriction—Restrictions on 'External' Commercial Borrowings

The starting point for any debt fund seeking to invest in India is the fact that participation in the Indian debt market by international lenders is still restricted by Indian exchange control laws and restrictions on the capital account convertibility of the Indian rupee. Specifically, the '*external commercial borrowing*' ("**ECB**") regulations contain restrictions that investors have historically found problematic. Although there has been some easing of the ECB regime on January 16, 2019, as a result of which international funds now qualify as permitted lenders (which was not the case earlier), a number of difficult issues remain such as caps on the cost of debt (meaning that the proper price of risk is still an issue) and the end-use restrictions amongst others. Therefore, direct lending under the ECB regime may still be unattractive to international investors in many cases.

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However, there are certain workarounds which utilize the limited exceptions to the ECB regime and other routes that the RBI has permitted to facilitate debt trading and some limited forms of lending, i.e., these exceptions permit lending and debt trading outside the constraints of the ECB regime.

Therefore, the first issue that an international investor will need to consider is the structuring of the most optimal 'route in' to the Indian market. This determination will be driven by a number of factors including: (a) its objectives (e.g., does the investor want to lend, to invest in equity linked securities along with debt securities, or to simply acquire an existing debt portfolio); (b) its willingness to satisfy Indian legal set-up requirements (i.e., does the investor have the appetite to set up a long-term platform for investment into India); and (c) whether or not the investor has local partners to help source and execute transactions in India.

The larger and more organized international investors that are active in the Indian market have invested the time and effort in setting up platforms with multiple limbs as discussed later in this article.

Non-Indian Rupee-Denominated Exposure

Many international investors start by seeking opportunities in dollar (or non-rupee) denominated debt to avoid the need to price in the expected depreciation of the rupee. Non-rupee lending more readily facilitates the benchmarking of the expected returns in India against investment opportunities elsewhere in the world.

Restrictions on Non-Rupee Denominated Debt
Indian exchange controls make it difficult to achieve the benefits of non-rupee denominated lending because, if the borrower is an Indian company, the debt will be subject to the ECB rules.

Apart from lending to, or acquiring the debt of an Indian borrower, an international investor could also seek to lend to or acquire the debt of an offshore affiliate denominated in dollars (or any other international currency). However, exchange control requirements might still apply. For instance, a pledge of Indian shares to secure the offshore lending is permitted, but the dollar funds cannot then flow into India (and RBI approval will be needed to create the pledge if the lender is not a bank). Other forms of security can be considered but, depending on the relationship between the borrower and the Indian group, various restrictions apply. Broadly speaking, the provision of security or credit support by an Indian company to secure the borrowing of an offshore affiliate is problematic.

Hedging by the Borrowers
The ECB regime requires that borrowers of foreign currency denominated loans under the ECB regime hedge 70% of their exposure (where the average maturity of the debt is under five years), effectively increasing the cost of debt by the hedging costs.

Hedging by Lenders
In 2015, the RBI permitted the issuance by Indian companies of rupee-denominated but dollar hedged bonds known as '*masala bonds*'. Although there was initial market interest in these instruments, the RBI subsequently imposed a number of conditions which have made them more difficult to use. It remains to be seen if these become more popular following the changes to the ECB policy on January 16, 2019 announced by the RBI.

Rupee Exposure

There are certain exceptions to the ECB regime that can be used by international debt investors to participate in the Indian market free from the problematic restrictions of the ECB regime.

If the investor is seeking to simply gain access to distressed debt portfolios, the most common way of achieving this is by investing in securitized instruments known as security receipts ("**SRs**") issued against non-performing loans acquired by debt aggregation vehicles known as '*asset reconstruction companies*' ("**ARCs**"). Alternatively, investors can make equity investments in Indian shadow banks, known as non-banking finance companies ("**NBFCs**"), that aggregate loans. The former is more common and advantageous. Synthetic exposure may, in certain circumstances, also be possible, subject to certain restrictions.

If, on the other hand, the goal is to lend, then there are only a few routes to achieve this, which operate as exceptions to the debt restrictions discussed above. The main possibilities are subscription to straight bonds known as '*non-convertible debentures*' ("**NCDs**") (although the RBI's concentration rules have made this more difficult as discussed further below) or establishing an '*alternative investment fund*' vehicle ("**AIF**"), which is permitted to subscribe for debt instruments.

The various possibilities are discussed further below.

The 'FPI Route'/'ARC Route' to Acquire Rupee-Denominated Debt

If the strategy is simply to acquire an existing rupee-denominated distressed debt portfolio (rather than to lend), then a commonly used technique is to invest in SRs issued by an ARC against portfolios of distressed debt acquired by them. This route has continued relevance even after the easing of the ECB regime in January 2019.

FPI registration

This route requires the investor to register as a '*foreign portfolio investor*' ("**FPI**"), which is a type of investor registration regulated by the Securities and Exchange Board of India ("**SEBI**") (although the registration process is dealt with by local banks known as depositary participants).

Tax structuring considerations

The other factor relevant to FPI registration is tax structuring. A new investor will want to factor tax structuring into its timetable.

> Historically, attempts at reorganizations led by banks have been disorganized, with investors being provided with insufficient information and stop-start processes with no clear timelines.

Withholding on interest on the SRs can be expensive and range from 20–40%, but investments routed through treaty jurisdictions can benefit from preferential treaty rates. For interest withholding, jurisdictions such as Mauritius, Luxembourg, UAE, Ireland, and Hong Kong all offer favorable treatment (although for Hong Kong, at the date of publication, the treaty has not yet come into force). There is also still uncertainty as to the tax treatment of any redemption premium. In this regard, the taxability of capital gains may also be of relevance and other jurisdictions have more favorable capital gains treatment under their treaties, e.g., Netherlands and France.

The choice of jurisdiction is not normally based on the treaty treatment alone. The general anti-avoidance regime in India means that the fund will need to have genuine substance in the relevant jurisdiction. This factor, along with the need for there to be local registration (as discussed above), means that a better way to approach this would be to start with the jurisdictions in which the fund has a meaningful presence and then triangulate which of those jurisdictions is optimal.

Practical issues in dealing with ARCs

There are a small number of ARCs relative to the market size and an even smaller sub-set of them are well-capitalized. Therefore, most international funds must deal with a small sub-set of market participants who act as '*gatekeepers*'.

Apart from difficult conflict of interest related issues and the leakage of fees to the ARCs, other challenges may arise. For instance, the RBI rules require ARCs to hold at least 15% of the SRs that they issue. Therefore, an international investor cannot gain exposure to the entire distressed debt portfolio acquired by a third-party ARC.

Further, particularly in light of the tight funding conditions prevailing at the date of publication of this article, many ARCs do not have the funds to acquire the 15% holding interest. Market participants have evolved various funding models, but these are largely untested from a regulatory standpoint.

Use of NBFCs to Lend in Rupees or Acquire Rupee-Denominated Debt Portfolios

NBFCs, although regulated, are not treated as banks and are permitted to lend and to acquire distressed debt portfolios. Over the past few years, NBFCs have emerged as a key source of credit, particularly in relation to highly leveraged (although perhaps not distressed) borrowers in India. However, these NBFCs are now facing their own funding issues in the wake of recent defaults by IL&FS, one of the largest NBFCs in India, but the main considerations as far as international investors are concerned are set out below.

Historically, it was possible for FPIs to lend to NBFCs in the form of straight bonds known as NCDs. These proceeds were used to fund on-lending by the NBFCs. However, this route is now more difficult to use as recent investment limits on each tranche and concentration rules make it difficult for most funds to lend to NBFCs. The alternative is for an investor to fund an NBFC by investing in its equity. This has become easier as historic minimum capitalization requirements from a foreign direct investment perspective have been removed, as have the limitations on the activities that NBFCs with foreign investment can undertake. However, distributions from an NBFC to overseas investors by way of dividend is tax inefficient as they are subject to tax leakage of 20.56% at the Indian company level (and this cannot be mitigated through the use of tax treaties).

Additionally, NBFCs also have certain concentration norms which may, depending on the circumstances, apply. This may make their usage challenging in larger deals, so NBFC lending will then need to be combined with lending under other permitted routes.

Therefore, if an investor is willing to set up a more permanent structure to lend in rupees or to acquire debt before it is distressed, then an NBFC structure will be relevant. However, if the intention is to use NBFCs simply to aggregate distressed debt, they may not necessarily be the best vehicle to do so. Therefore, this is not a commonly used route for international funds other than a few funds who have a long-term strategic interest in India.

Rupee Lending Through Domestic High Yield Bonds
Until early in 2018, it was common for foreign investors with an FPI registration to subscribe to NCDs issued by Indian companies (as opposed to by NBFCs, as discussed above). The RBI had treated these as falling outside the ECB restrictions and a large market in these instruments emerged, subject to certain aggregate market capacity restrictions.

However, this market quickly reached the aggregate issuance capacity cap imposed by the RBI. The RBI addressed this, but then also imposed a more problematic set of restrictions in April and May 2018, restricting the exposure of any investor (and its group entities) to no more than 50% of any tranche of NCDs. This means that entirely 'captive' lending arrangements are not possible and that the FPI will need to syndicate out half its exposure. More significantly, any single international investor (or its group) cannot have exposure to any borrower exceeding 20% of its overall FPI exposure, which makes it difficult for the newer funds without large portfolios to use this route. Therefore, unless the ongoing RBI consultation (which proposes the replacement of these restrictions with 'voluntary' holding commitments by FPIs) leads to a change, the use of NCDs may not be viable for every fund.

Rupee Lending Through Convertible Instruments
Subject to foreign direct investment regulations, international investors can freely invest in instruments that compulsorily convert into equity because the RBI does not view these as debt. Any instruments that optionally convert into equity are treated by the RBI as debt and are subject to the ECB requirements.

The period of compulsory convertibility is lengthy (up to 30 years for infrastructure companies and up to 10 years for other companies), so if an investor intends to hold the instrument only for a short time period, this could be used to make a debt investment if no other routes are available. Also, compulsorily convertible instruments present a useful way for special situations investors to seek the upside of any revaluation of any distressed borrower if it emerges from its distressed situation and can also be useful to achieve '*loan to own*' structures.

Lending Through Alternative Investment Funds or a Foreign Venture Capital Investment Registration
The issues with the lending techniques set out above have resulted in some creative structures to facilitate lending outside of the regulatory constraints of the ECB Regime and the recent issues that apply to NCDs. Although not conceived as lending vehicles, pooled investment vehicles known as AIFs, that are registered with the SEBI, have been used to facilitate rupee lending by international investors free from the constraints of the ECB regime which remain. While there is no express restriction on these entities being captive vehicles, involving local partners or co-investors would help preempt any potential objection from the SEBI.

The permitted holdings by AIFs depend on the category of registration sought, but historically, a number of the more established distressed platforms in India have been registered as '*category 2*' AIFs, meaning that they can invest primarily in instruments issued by unlisted companies (including debt securities where the fund is set up as a debt fund) without leverage and cannot have any 'single name' exposure greater than 25% determined by reference to its investible funds.

A similar (but less common) technique involves the international investor procuring a '*foreign venture capital investor*' ("**FVCI**") registration. This registration, which takes approximately six to eight months to procure, allows the foreign investor to subscribe for optionally convertible debentures. However, there are some disadvantages as compared to AIFs. For instance, FVCIs are required to invest two-thirds of their funds in unlisted equity or equity-linked securities and the remaining one-third can be invested in debt. Since equity-linked securities includes optionally convertible instruments, this would allow for complete debt allocation if properly structured. However, this has not been commonly used to structure debt funds, as it is unclear whether a pure-play debt strategy would be viewed by the SEBI as being '*venture capital*' and also because FVCIs are only permitted to invest in certain permitted sectors of the economy (no such restriction applies to AIFs).

Use of Derivatives to Gain Exposure to Indian Distressed Debt Portfolios

Investors can also explore synthetic solutions to gain exposure to Indian debt. There are various regulatory issues involved (as discussed further below) and hence these structures are more likely to be a short-term solution for international investors that have not had the time to secure an FPI registration in the event of a fast-moving opportunity, or that wish to 'test' the Indian market before establishing a long-term structure.

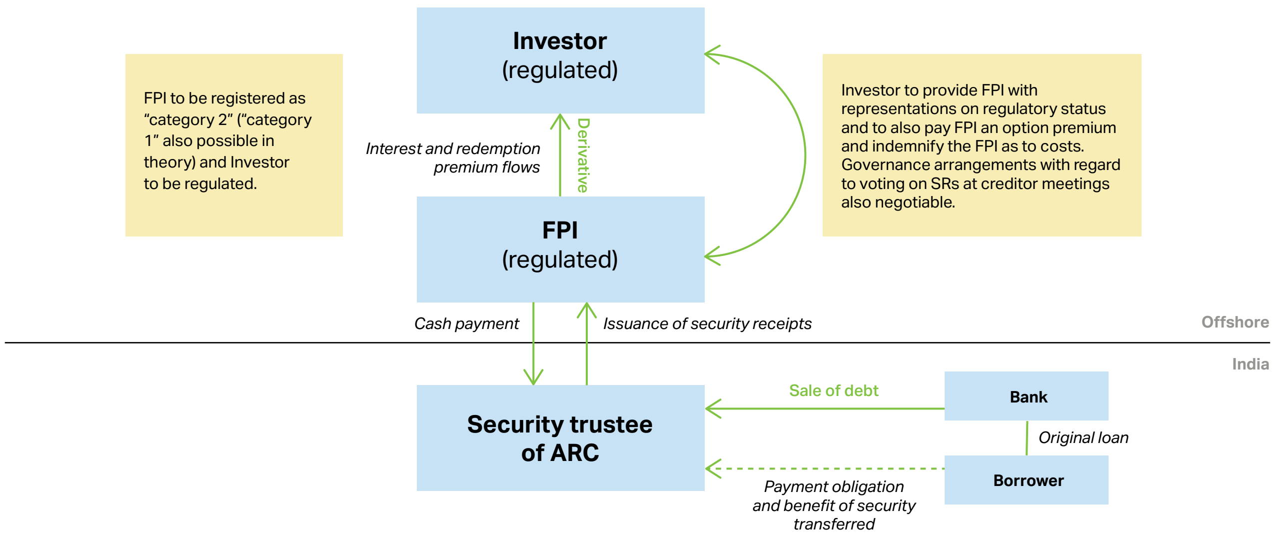
This route involves a category 2 FPI issuing '*offshore derivative instruments*' against acquired debt to an international investor. The international investor will need to be regulated and the issuing FPI will want representations confirming this. Negotiation of these representation letters can take time and that should be factored into any timing expectations. The FPI regulations refer to indirect interests as well, so funds participating through a multi-layered derivative structure will still need to consider this carefully. Various disclosure obligations also arise.

In the past, many promoters have extracted value from their companies at the expense of shareholders and creditors. In this regard, there is value in securing related party transaction restrictions, robust information rights and working with a trusted local partner who can carefully monitor investments.

The other issue that is topical in relation to these derivative structures relates to the withholding treatment on interest or any other returns on the investment received by the FPI. The focal point is whether the offloading of exposure by the FPI through derivatives will affect its ability to retain any favorable tax treaty treatment. For instance, certain treaties require that for the treaty provisions to apply, the recipient must be the beneficial owner of such interest. The structure also needs to be robust enough to withstand a challenge under the Indian general anti-avoidance rules.

Currently, there are no easy answers to these issues and much will come down to the specific details of what is proposed and various deal specific factors. FPIs sometimes seek tax indemnities, passing on the ultimate risk to the funds investing in the derivative instruments. Therefore, it is critical that such funds form an informed view on any tax risk and factor in any incremental tax leakage into their financial modeling.

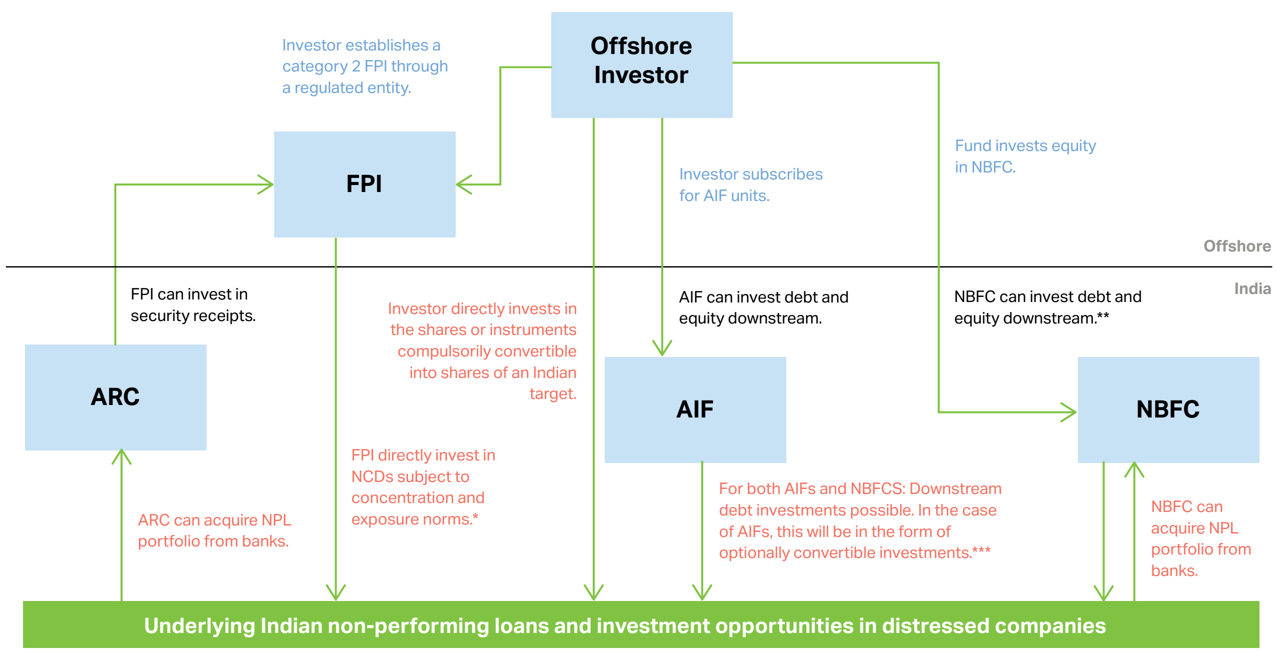
Illustration of the Derivative Structure



Diversified Approach

Although this may not be appropriate for international funds participating in the Indian market opportunistically, funds with a longer-term interest in the Indian market have set up diversified platforms that allow them to come at opportunities from multiple angles. An example of the various possibilities is set out in the diagram below.

Illustration of a Diversified Investment Strategy



* No more than 50% investment in any NCD issuance and 20% per corporate exposure limits, although the RBI has published a recent consultation paper suggesting that it might in the future be prepared to move away from this to a voluntary retention regime.

** NBFCs can invest equity downstream too, but having received foreign investment, that will be subject to certain rules on "downstream investments". There may also be debt and equity concentration limits depending on the circumstances.

*** Category 2 AIFs cannot invest more than 25% of the investible funds in any one company and category 3 AIFs cannot invest more than 10% of the investible funds in any one company.

Summary of Routes In

Getting the structuring right is the critical piece in any distressed or special situations investment involving India. To help simplify the menu of choices, the table below highlights the main routes in and the key considerations in respect of each route.

Consideration	Mezzanine/high yield lending (INR)	Acquiring security receipts	Direct lending (USD)	Direct lending (INR) via NBFC	Direct lending (INR) via platform (AIF - category 2)	Derivative exposure
Concept	Investor secures FPI registration and invests in NCDs.	Investor secures category 2 FPI registration and invests in security receipts issued by the security trustee to an ARC.	ECB lending that is compliant with the RBI's rules. International investors will now qualify as permitted lenders.	Listed NCD holders have enhanced enforcement rights, but upon bankruptcy, a moratorium will affect this.	Investor sets up and invests in AIF, along with partners, and AIF invests in debt instruments.	Exposure to underlying Indian debt acquired by a category 2 FPI.
What is it used for?	Can be used to provide INR funding to Indian borrowers.	Cannot be used to lend; can only be used to gain exposure to distressed debt portfolios.	Can be used to provide dollar/non-rupee funding.	Broad usage in providing rupee financing.	High yield lending to as part of a '*platform*' structure.	This is used as a short-term solution to gain economic exposure to an Indian debt portfolio; it does not provide Indian borrowers with funding.
Security?	Due to exchange control considerations, the security is customarily in favor of a local security trustee. Listed NCD holders have enhanced enforcement rights, but upon bankruptcy, a moratorium will affect this.	Security will be in favor of a domestic security trustee. ARCs have enhanced enforcement rights, but upon bankruptcy, a moratorium will affect this.	If the loan is ECB compliant, then the overseas lender can take direct security over Indian assets. There may still be practical advantages to appointing a local security agent.	The NBFC will hold the security and any benefit will flow up to the investor via dividends (assuming it makes an equity investment into the NBFC).	AIF trust/LLP can benefit from security (provided the manager and sponsor of the AIF are resident, the AIF will be treated as domestic, even if the majority of its capital is from non-Indian investors).	No direct security, but subject to any tax withholding, the derivative holder will normally benefit from all flows, including as a result of security enforcement.
Key issues	The recent RBI concentration norms have made this much harder to use. However, the RBI has initiated market consultations on a replacement "voluntary" regime. Investors will need to monitor developments here.	The fact that it cannot be used to lend means that this may not be useful in all cases. Investors will need to negotiate robust investor protection rights with the ARC. Investors will need to diligence the ability of ARCs to fund their 15% SR holding requirement.	ECB funding is unlikely to be used often; the various restrictions make it unattractive. Hedging requirement on domestic borrower adds to the costs.	Useful for INR lending, but the investor will need to make an equity investment into the NBFC first.	100% captive AIFs, although not restricted, may create regulatory issues. Modified pass through treatment on tax (withholding of 10% applies to foreign unit-holders, unless the relevant tax treaty provides otherwise, in which case the treaty rate will apply).	Investor will need to be regulated.
Pros	Commonly used. Simple way of lending. Flexibility as to terms and end use of funds.	Commonly used. SRs are liquid instruments.	Allows for direct security. Dollar lending protects against FX depreciation risk.	NBFCs can participate in a broad range of financing activities.	Increasingly being considered by international investors. Flexibility as to investments. Provided the manager and sponsor are resident, capital is treated as domestic.	Provides a short-term solution for investors who want to "test" the market without the time and expense of setting up investment platforms or seeking investment registrations.
Cons	Returns are in INR and therefore exposed to exchange rate volatility, which then needs to be priced in. Recent concentration and diversification requirements make this more challenging for new investors, although as indicated above, the position here may evolve.	Cannot be used for new lending. No direct "seat at the table" for investors in creditor committee meetings in bankruptcy. Value leakage because of fees passed on to the ARC. There are a limited number of ARCs serving the needs of multiple debt investors. This can cause practical issues. In the current market, not all ARCs are able to fund their 15% holding requirement.	Conditions are extremely onerous and make its usage unattractive, e.g., cap on the cost of debt and end-use restrictions.	Investors will need to invest equity into NBFCs to gain exposure and suffer dividend tax leakage on their returns.	Will take 3-4 months to set up and finding local managers and sponsors mean that this is more suited to investors with a long-term interest in India.	Position with regard to taxation is currently evolving. Investor will need to be regulated and certain disclosure requirements will apply. Negotiating the representation letters with the FPI counter-party may take time.

Undertaking Distressed Investments

In addition to entry routes, an international investor will also need to consider its investment strategy and which of its techniques can be replicated in the Indian market. The answer to those questions will depend, in part, upon the stage at which the investment is contemplated and what the overall investment objective is.

Pre-Insolvency Investment
The primary advantage of investing prior to the commencement of formal insolvency proceedings is that the process is often a privately negotiated arrangement (although it is also possible to restructure debts through a court approved scheme), with a lower probability of litigation as compared to the highly litigated bankruptcy environment.

Securing lender cooperation
The initial issue that any investor will face is securing lender cooperation. For instance, securing any changes to the security package or any variation of lender rights as part of a restructuring will need the consent of the other lenders. Historically, outside of project finance and a few other transactions, inter-creditor agreements have not been common in the Indian market. Further, legacy lender forums aimed at collective action, such as the '*joint lender forum*', have not proved to be effective. Recently, a number of banks agreed a standard inter-creditor agreement to deal with distressed and special situations. The effect of this remains to be seen, and two concerns remain.

First, the terms of the standard inter-creditor agreement have been criticized by ARCs. Although ARCs can accede to the agreement, the agreement restricts them from selling their exposure to other ARCs. Since ARCs are an active part of the Indian distressed eco-system, this remains a gap.

Second, the jury is still out as to whether this will change the behavior of the public sector (i.e., state owned) banks which dominate the Indian banking system. Historically, attempts at reorganizations led by banks have been disorganized, with investors being provided with insufficient information and stop-start processes with no clear timelines.

Cooperation with promoters/controlling shareholders
Pre-insolvency investments typically involve some degree of 'working together' with the promoters of the debtor company.

As the separation of ownership and management is often missing in India, diligence on the promoter (including from a reputational risk perspective) is as important as diligence on the underlying business or assets.

Second, in the past, many promoters have extracted value from their companies at the expense of shareholders and creditors. In this regard, there is value in securing related party transaction restrictions, robust information rights and working with a trusted local partner who can carefully monitor investments.

Third, it is important to ensure that the investment is structured so as not to rule the investor 'offside' in any future insolvency situation that may arise. For instance, under Section 29A of the IBC, being a 'promoter' of, or in the management or control of, an insolvent company may render the investor ineligible to participate either in the insolvency resolution process or in liquidation. The restriction also applies to concert parties and connected persons of the promoters. While there are certain carve outs to the ineligibility rules in relation to financial investors, an investor should still seek to mitigate the risk through careful structuring and by monitoring the health and affairs of the company in India (including through a local partner).

In this regard, a question that often arises is whether a minority shareholding combined with affirmative voting rights in relation to investor protection matters would put them in control of the corporate debtor. The Supreme Court in *Arcelor Mittal India Private Limited v Satish Kumar Gupta* (the "**Essar Judgment**") has clarified a number of principles. The Supreme Court indicated that it would be willing to pierce the corporate veil to ascertain the true identity of those in control, but held that control is to be determined on the basis of *de jure* and *de facto* control. The mere power to block special resolutions does not in itself amount to control but clearly a pattern of exercise of controls will be a concern. Also, even if an investor is itself not deemed to be in control of a borrower, it may still be treated as acting jointly or in concert with another party who is, so the concern is not entirely addressed.

Pre-insolvency transactions
The IBC has imported the concepts of preferential transactions, transactions at an undervalue and extortionate credit transactions from the United Kingdom, with provisions very similar to those in the Insolvency Act 1986 in England and Wales. Therefore, any restructuring (e.g., disposal of assets, restructuring any debt or alterations to the capital structure) in the shadow of insolvency will need to be considered from that perspective, with supporting independent valuation reports and expert advice, and other common-sense protections, being obtained.

With respect to restructuring through schemes of arrangement, as with England and Wales, the IBC states that undertaking a transaction pursuant to a court approved scheme does not in and of itself protect a transaction from being considered a preference (though the valuation requirements that apply to schemes in India offer some structural protection). There is no corresponding provision in respect of transactions at an undervalue, which suggests that such transactions may be relatively less prone to challenge if undertaken through a scheme.

Ability to enforce security and/or take control of a borrower

Under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests Act 2002 ("**SARFAESI Act**"), certain lenders including ARCs, qualifying NBFCs and debenture trustees of listed NCDs constitute '*qualifying lenders*', conferring on them enhanced debt recovery rights, such as the ability to enforce security without the involvement of a court and the ability to take control of the borrower (although the latter is rarely used). Lenders that are not qualifying lenders can, of course, enforce their security rights, but the process is likely to take longer.

Under the IBC, once an insolvency process commences, a moratorium is imposed upon creditor rights, including rights under the SARFAESI Act. Therefore, qualifying lenders will need to have initiated and completed their SARFAESI sales prior to the occurrence of an insolvency trigger (which may be difficult to achieve in practice if the investment is made when the borrower is already distressed).

Other techniques

Techniques used in other markets, such as debt-to-equity swaps and payments-in-kind, are possible in India but require the cooperation of the promoters, as preferential allotments of shares (i.e., non-pre-emptive issuances) need a special resolution (approved by 75%) of shareholders.

Investments as Part of the Insolvency Process

Participation in the process

The IBC introduces a cash flow test of corporate insolvency, i.e., a corporate debtor defaulting on a debt of at least INR 100,000 (approximately USD 1,393) which, once triggered, allows management, operational or financial creditors to trigger an insolvency process. During the pendency of the corporate insolvency process, there is a moratorium in relation to claims and litigation against the corporate debtor. An insolvency resolution professional manages the corporate debtor and seeks to resolve the debtor's position, usually by inviting bids for '*resolution plans*' that must be approved by 66% by value of the financial creditors and then approved by the National Company Law Tribunal within a period of 180 days (extendable by a further 90 days).

International investors can participate in this corporate insolvency process either as bidders (or by providing funding to bidders) or as creditors on the creditor committee. Given the exchange control restrictions set out above, many international investors have only indirect access to creditor committees through SRs or offshore derivative structures. The governance rights negotiated with the holder of the ARC or the holder of the debt may provide some comfort on recovery strategies that the ARC pursues in the committee meetings and information access.

Creditor recoveries

The law on creditor recoveries in India is still evolving. Although there have been various judgments dealing with certain aspects of this (for instance, the *Binani Industries* judgment), there still remain a number of areas of uncertainty. The market is currently awaiting the outcome of a current case being heard before the Supreme Court (the *Swiss Ribbons* case). This judgment, that is expected in early 2019, may provide the answers to certain open questions. In any event, investors will need to seek advice on the most current case law before making an investment.

Claims unaffected by the moratorium

Lenders will also want to consider the availability of personal guarantees issued by promoters or other persons. Following a recent ordinance and decision of the Supreme Court, third-party guarantees remain unaffected by the moratorium and lenders can, therefore, enforce their rights in this regard.

Liquidation Possibilities
The corporate debtor is subject to compulsory liquidation if the insolvency process fails. This presents an interesting investment opportunity. It is currently not possible to '*cherry pick*' assets in an insolvency process under the IBC. However, that possibility certainly exists in liquidation. Also, the liquidation valuation of assets may be considerably lower than in the resolution process. However, the practicalities of a liquidation process mean that this is still new and difficult territory. An investor may therefore benefit from the experience of a local partner.

Closing Thoughts

Although the macro picture in relation to distressed debt opportunities in India is undoubtedly compelling, translating that into an Indian investment portfolio requires time and effort.

That said, international funds considering the market should not be unduly concerned as to the issues discussed in this article. Other emerging markets have exchange controls and similar practical issues with state run lenders. India has imported an English style insolvency regime which has had decades to develop and is testing it in an accelerated manner in large and complex insolvencies. It is therefore unsurprising that there are some teething issues.

Partly as result of the high levels of interest in India by international debt funds and other market participants, solutions are emerging to some of the access issues as highlighted in this article and the market is growing in sophistication. The judiciary has also been broadly supportive of the new insolvency regime and the regulator, the Insolvency and Bankruptcy Board of India, is willing to engage with the market. Therefore, for international funds that are willing to invest the time and effort in understanding the market and that are able to find the right local partners and advisers, the Indian market remains an exciting one. ■

▼ **Nikhil Narayanan** is an M&A partner at Khaitan & Co. with extensive international and cross-border experience, having advised corporate clients, financial sponsors and investment banks on high value and often market leading M&A and ECM transactions, both in London and in India. He regularly advises international corporate clients and private equity funds on cross-border public and private M&A transactions and joint ventures. In addition, he is recognized as one of the market leaders in relation to distressed investments, having advised a number of mezzanine, special situations and distressed funds and global investment banks on distressed investments in India. He has also authored a number of publications in this space. Nikhil received his MBA from London Business School and was a Merrill Lynch Scholar, his BCL from St. Catherine's College, Oxford University and was a Radhakrishnan Scholar and his BA and LLB, with Honors, from the National Law School of India University. Nikhil is ranked as a leading lawyer in Asia by Asialaw and Legal 500 says that he is "*very commercial*" and "*offers immediate solutions*".