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Comprehension Test Questions for SBI PO Mains, IBPS PO Mains, and RBI Grade B Exams.

Passage No 135

Direction: Read the following passage carefully and answer the questions that follow.

The deadline for the completion of the resolution process under the Insolvency and Bankruptcy Code (IBC), 2016 for the first set of cases taken up has neared or even passed. The IBC provides for a time limit of 180 days (extendable by 90 days) once a case of default is brought and if no resolution plan drawn up under the supervision of a resolution professional can be agreed upon, liquidation must follow to recover whatever sums are possible. While the NCLT has considered a number of cases since its constitution, its role assumed importance when, on 13 June 2017, the Reserve Bank of India (RBI) mandated proceedings against 12 large defaulters, holding accounts with outstanding amounts of more than Rs 5,000 crore, of which at least 60% had been classified as non-performing as of 31 March 2016. These bad loans accounted for around 25% of the non-performing assets (NPAs) recognised at that time.

In most cases, the estimated value of assets on liquidation is low, and does not capture the true value of the company. Put simply, the aggregate of the individual value of a set of stripped assets tends to be much lower than the value of those assets when combined for production. So, if the IBC process and the intervention of the NCLT lead, through bidding, to an offer of a takeover by a third party which is acceptable to the creditors, the recovery against bad loans technically written off by financial creditors would be much higher. Since this was to occur in a time-bound fashion, it seemed to be a significant initiative to address the NPA problem in the banking system. The IBC was combined with legislative amendments that strengthened the powers of the RBI to order the launch of proceedings to recover the loans gone bad. These measures, it was argued, through enforced resolution or liquidation if necessary, offered a way in which the **abysmal** record of recovery could be corrected and the pressure on the government to bail out banks with taxpayers' money could be reduced. In the case of 11 public sector banks out of a total of 21, of the loans technically written-off between April 2014 and December 2017, recovery rates varied from nil to just above 20%, and in the case of another three, the rate ranged between 23% and 29%. The average recovery rate for all 21 banks was a pathetic 10.8%. By facilitating and accelerating the recovery effort, the IBC process was expected to raise the rate significantly.

The context in which this new strategy was launched needs recalling. Unlike the period prior to the 1990s, the NPAs that accumulated in the books of banks in recent years were not equitably distributed across different categories of borrowers, big and small, priority and non-priority. Rather, because of a change in the lending strategy during the period of the credit boom after 2003, the NPAs are now concentrated in the hands of large borrowers, primarily corporate borrowers.

The initial experience with the first phase of this multistep process involving the recognition, technical write-off and provisioning, and recovery of NPAs, is revealing for a number of reasons. First, in cases where the assets on offer were of special interest to particular bidders, the rates of recovery have been rather high. This was true of the acquisition of Bhushan Steel by Tata Steel and of Electrosteel by Vedanta. Bhushan Steel owed its financial creditors around Rs 56,000 crore, whereas the Tata Steel bid returned Rs 35,200 crore upfront to the financial creditors, besides giving them a 12.3% stake in the company in lieu of returning the remaining debt. That was substantial relative to the estimated liquidation value of Rs 15,000 crore to Rs 20,000 crore, and far better than the average 10% recovery rate reported on aggregate write-offs in the recent past. The

Tatas clearly had a special interest in the deal since its valuation of the company was far higher than that of JSW Group, the other keen bidder. The latter offered the creditors only Rs 29,700 crore.

The evidence that the assets were valuable despite the defaults emerged also from the battle between bidders who were often taken to the courts. Essar Steel, one of the largest defaulters with around Rs 44,000 crore in questionable debt, when put up for sale, **elicited** expressions of interest from five bidders. Interestingly, besides Tata Steel, Arcelor Mittal, Vedanta, Sumitomo, and Steel Authority of India, the interested parties include the Ruias, who are the original promoters of Essar Steel.

This effort of the defaulting promoters to regain control of the companies concerned at a discount did muddy the water. The original IBC bill did not prevent promoters from making bids for resolution at the NCLT. Some justified the Ruia bid on the grounds that extraneous factors may have led to distress for no fault of the original promoters. But, if the Committee of Creditors (CoC) has taken the firm to the NCLT, it is clearly because they saw the incumbent management as incapable of resolving the crisis faced by the firm. And, if promoters regain control, much of the debt their company owes will be forgiven, with the losses being carried by the financial and operational creditors. Recognising the **travesty** involved, the government was forced to amend the IBC bill to prohibit promoters from bidding under the NCLT process.



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1. Why was the IBC Bill amended to stop promoters from regaining control of their companies?

I. The Committee of Creditors did not see the original management fit enough to carry on functioning.

II. The losses would be carried by the financial and operational creditors.

III. It would have led to the promoters regaining control of their companies without repaying the full amount of the loans taken.

A. Only II B. Only I and II C. Only II and III D. Only I E. All of the above

2. Which of the following is/are true as per the passage?

I. Essar Steel evoked interest even from its promoters when it was put up for sale.

II. Bhushan Steel was acquired by the JSW Group for Rs 32,500 crore.

III. The average recovery rate for the 21 banks (public plus private) was 10.8%.

A. Only II B. Only I and II C. Only II and III D. Only I and III E. None of the above

3. What was the experience of the IBC process for companies which were of special interest to bidders?

I. The rate of recovery was much better than the average recovery rate.

II. Competition between bidders to take over the defaulting company.

III. The liquidation value of the assets would have been higher than the recovered value.

A. Only II B. Only III C. Only I and II D. Only I and III E. None of the above

4. What is/are the main difference between the NPAs today and the NPAs of 1990s?

I. The NPAs are equally distributed across priority and non-priority sectors today than in 1990s.

II. The NPAs today are concentrated among large corporate borrowers.

III. The NPAs today are more prevalent in Public Sector Banks while in the 1990s they were concentrated in both private and public sector banks.

A. Only III B. Only I and II C. Only II and III D. Only II E. None of the above

5. Why was the IBC process combined with legal powers?

- I. To enable carrying out resolution or liquidation as per the need of the situation.
- II. To decrease the pressure on government to bail banks out.
- III. To improve the recovery rates on loans.

A. Only II B. Only I and III C. Only II and III D. Only I and II E. All of the above

6. Which of the following is/are some of the features of the cases referred to the NCLT by the RBI on June 13th 2017?

- I. The cases comprised of large defaulters with amounts outstanding of more than Rs 5000 crore.
- II. These cases made up about 20% of the total NPAs.
- III. The promoters of these companies were accused of having embezzled funds over many years.

A. Only II B. Only I and II C. Only I D. Only II and III E. All of the above

7. Why would recovery via the IBC process and NCLT be more profitable than simply selling off/ liquidating the company?

- A. The total value of assets when combined for production is lower than the value of individual assets.
- B. Liquidation captures the true value of the assets, which is lower than the market value.
- C. The total value of individual assets is lower than the value when the assets are combined for production.
- D. Being bound by time constraints limits the capability of the banks to recover the true value of assets.
- E. None of the above

Correct Answers

1	2	3	4	5	6	7
E	D	C	D	E	C	C

Explanations:

1. Refer to: 'The original IBC bill did not prevent promoters from making bids for resolution at the NCLT. Some justified the Ruia bid on the grounds that extraneous factors may have led to distress for no fault of the original promoters. But, if the Committee of Creditors (CoC) has taken the firm to the NCLT, it is clearly because they saw the incumbent management as incapable of resolving the crisis faced by the firm. And, if promoters regain control, much of the debt their company owes will be forgiven, with the losses being carried by the financial and operational creditors.'

All of the statements are correct.

Hence, option E is correct.

2. Refer to:

'Essar Steel, one of the largest defaulters with around Rs 44,000 crore in questionable debt, when put up for sale, elicited expressions of interest from five bidders.... parties include the Ruias, who are the original promoters of Essar Steel.'

I is correct.

'The acquisition of Bhushan Steel by Tata Steel and of Electrosteel by Vedanta. Bhushan Steel owed its financial creditors around Rs 56,000 crore, whereas the Tata Steel bid returned Rs 35,200 crore upfront to the financial creditors, besides giving them a 12.3% stake in the company in lieu of returning the remaining debt.'

II is incorrect.

'Between April 2014 and December 2017, recovery rates varied from nil to just above 20%, and in the case of another three, the rate ranged between 23% and 29%. The average recovery rate for all 21 banks was a pathetic 10.8%.'

III is correct.

Hence, option D is correct.

3. Refer to:

'the rates of recovery have been rather high. This was true of the acquisition of Bhushan Steel by Tata Steel and of Electrosteel by Vedanta. Bhushan Steel owed its financial creditors around Rs 56,000 crore, whereas the Tata Steel bid returned Rs 35,200 crore upfront to the financial creditors, besides giving them a 12.3% stake in the company in lieu of returning the remaining debt. That was substantial relative to the estimated liquidation value of Rs 15,000 crore to Rs 20,000 crore, and far better than the average 10% recovery rate reported on aggregate write-offs in the recent past.'

'The evidence that the assets were valuable despite the defaults emerged also from the battle between bidders who were often taken to the courts.'

I and II are correct.

III is opposite of the correct answer and is incorrect.

Hence, option C is correct.

4. Refer to: 'The context in which this new strategy was launched needs recalling. Unlike the period prior to the 1990s, the NPAs that accumulated in the books of banks in recent years were not equitably distributed across different categories of borrowers, big and small, priority and non-priority. Rather, because of a change in the lending strategy during the period of the credit boom after 2003, the NPAs are now concentrated in the hands of large borrowers, primarily corporate borrowers.'

I is opposite of what has been stated in the passage.

II is correct.

III has not been mentioned in the passage and is incorrect.

Hence, option D is correct.

5. Refer to: 'The IBC was combined with legislative amendments that strengthened the powers of the RBI to order the launch of proceedings to recover the loans gone bad. These measures, it was argued, through enforced resolution or liquidation if necessary, offered a way in which the abysmal record of recovery could be corrected and the pressure on the government to bail out banks with taxpayers' money could be reduced. In the case of 11 public sector banks out of aThe average recovery rate for all 21 banks was a pathetic 10.8%. By facilitating and accelerating the recovery effort, the IBC process was expected to raise the rate significantly.'

As per the fragments highlighted above, all the statements are correct.

Hence, option E is correct.

6. Refer to:

'While the NCLT has considered a number of cases since its constitution, its role assumed importance when, on 13 June 2017, the Reserve Bank of India (RBI) mandated proceedings against 12 large defaulters, holding accounts with outstanding amounts of more than Rs 5,000 crore, of which at least 60% had been classified as non-performing as of 31 March 2016. These bad loans accounted for around 25% of the non-performing assets (NPAs) recognised at that time.'

I is correct.

II is incorrect as per the fragment highlighted above.

III has not been mentioned and is incorrect.

Hence, option C is correct.

7. Refer to: 'Put simply, the aggregate of the individual value of a set of stripped assets tends to be much lower than the value of those assets when combined for production. So, if the IBC process and the intervention of the NCLT lead, through bidding, to an offer of a takeover by a third party which is acceptable to the creditors, the recovery against bad loans technically written off by financial creditors would be much higher'

As per the fragment highlighted above, option C is correct.

Option A is the opposite of the correct statement.

Options B and D have not been mentioned anywhere.

Only Option C matches.

Hence, option C is correct.





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