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Interest Compounding Pulling Down Recovery in IBC Cases

Creditors have been able to get back a higher proportion of the principal; data does not reflect true picture, say bankers

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Mumbai: As the debate rages about poor recoveries from the bankruptcy resolution process, it appears that the compounding of interest is the factor pulling down the recovery ratio rather than the recovery of principal.

The addition of penal interest and other charges in stressed accounts have brought down recovery ratios even though recovery of the principal amount has been high.

In the recently-concluded resolution of JBF Petrochemicals where GAIL (India) emerged as the winning bidder with a ₹2,015-crore offer, banks took a 64% haircut on their total dues of ₹5,628 crore. However, when compared to the principal of ₹4,000 crore, the haircut was much smaller as banks managed to recover over 50% of their principal.

In some large cases, for example, the Bhushan Power and Steel account which was part of the initial list of 12 cases sent by the Reserve Bank of India to the bankruptcy court, the interest was more than double the principal that was due. It is estimated that out of the dues of ₹47,158 crore, less than half or about ₹20,000 crore were the principal dues.

The data is important in the context of falling recoveries in bankruptcy cases. Latest data from the Insolvency and Bankruptcy Board of India (IBBI) showed that financial creditors' recovery from defaulters was down to 36% of admitted claims in FY23 from 54% seen in FY18 and FY19 — the first two years after the law came into force.

Bankers said the recovery rates do not give a complete picture. "Some accounts have been NPA for many years with interest charged inflated to a degree where recovery could never have been 100%. So I think to judge the success of IBC against those metrics is not fair at all," said Bank of Baroda CEO Sanjiv Chadha in an interview last month.

Bankers say the total claims by financial creditors in any account also include penal interest and other dues which inflate the outstanding. "Banks have to take into account all dues so with penal interest, bank guarantee dues are also added. In infrastructure cases it also includes interest during construction which are exempt from payment but taken as due in case of a default," said a senior banker.

Another senior banker said that the recovery calculation is very different in the case of a one-time settlement where the settlement is done only on outstanding principal dues and interest is not taken into account.

To be certain, banking works under the concept of the time value of money which is why interest both on the lending as well as deposit side has to be taken into account.

"₹100 today is not the same as ₹100 after say three years... For any objective financial evaluation, this time value of money represented by the cost of capital has to be factored in the decision-making process," said banking veteran Hari Hara Mishra.

Right Metric

Compounding interest pulling down recovery

In the recently settled JBF Petro banks recovered **36%** of their dues. But compared to principal the recovery was **50%**

Data is important in the context of falling recoveries from bankruptcy cases in the recent past