WHITE BLACK LEGAL LAW JOURNAL

ISSN: 2581-8503

Peer - Reviewed & Refereed Journal

The Law Journal strives to provide a platform for discussion of International as well as National Developments in the Field of Law.

WWW.WHITEBLACKLEGAL.CO.IN

 ISSN: 2581-8503

DISCLAIMER

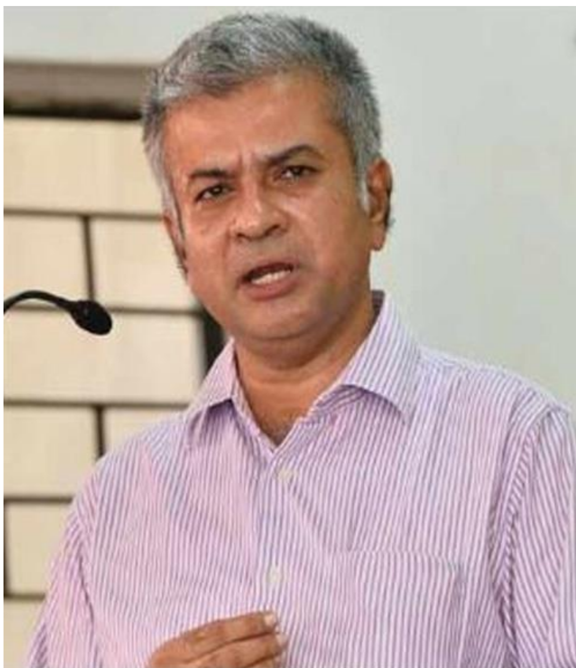
No part of this publication may be reproduced or copied in any form by any means without prior written permission of Editor-in-chief of White Black Legal – The Law Journal. The Editorial Team of White Black Legal holds the copyright to all articles contributed to this publication. The views expressed in this publication are purely personal opinions of the authors and do not reflect the views of the Editorial Team of White Black Legal. Though all efforts are made to ensure the accuracy and correctness of the information published, White Black Legal shall not be responsible for any errors caused due to oversight or otherwise.

WHITE BLACK
LEGAL

 ISSN: 2581-8503

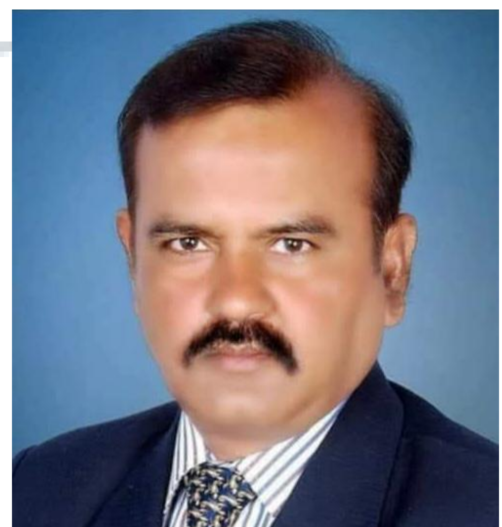
EDITORIAL TEAM

Raju Narayana Swamy (IAS) Indian Administrative Service officer



Dr. Raju Narayana Swamy popularly known as Kerala's Anti Corruption Crusader is the All India Topper of the 1991 batch of the IAS and is currently posted as Principal Secretary to the Government of Kerala . He has earned many accolades as he hit against the political-bureaucrat corruption nexus in India. Dr Swamy holds a B.Tech in Computer Science and Engineering from the IIT Madras and a Ph. D. in Cyber Law from Gujarat National Law University . He also has an LLM (Pro) (with specialization in IPR) as well as three PG Diplomas from the National Law University, Delhi- one in Urban Environmental Management and Law, another in Environmental Law and Policy and a third one in Tourism and Environmental Law. He also holds a post-graduate diploma in IPR from the National Law School, Bengaluru and a professional diploma in Public Procurement from the World Bank.

Dr. R. K. Upadhyay



Dr. R. K. Upadhyay is Registrar, University of Kota (Raj.), Dr Upadhyay obtained LLB , LLM degrees from Banaras Hindu University & Phd from university of Kota.He has succesfully completed UGC sponsored M.R.P for the work in the ares of the various prisoners reforms in the state of the Rajasthan.

 ISSN: 2581-8503

Senior Editor

Dr. Neha Mishra

Dr. Neha Mishra is Associate Professor & Associate Dean (Scholarships) in Jindal Global Law School, OP Jindal Global University. She was awarded both her PhD degree and Associate Professor & Associate Dean M.A.; LL.B. (University of Delhi); LL.M.; Ph.D. (NLSIU, Bangalore) LLM from National Law School of India University, Bengaluru; she did her LL.B. from Faculty of Law, Delhi University as well as M.A. and B.A. from Hindu College and DCAC from DU respectively. Neha has been a Visiting Fellow, School of Social Work, Michigan State University, 2016 and invited speaker Panelist at Global Conference, Whitney R. Harris World Law Institute, Washington University in St.Louis, 2015.

Ms. Sumiti Ahuja

Ms. Sumiti Ahuja, Assistant Professor, Faculty of Law, University of Delhi,

Ms. Sumiti Ahuja completed her LL.M. from the Indian Law Institute with specialization in Criminal Law and Corporate Law, and has over nine years of teaching experience. She has done her LL.B. from the Faculty of Law, University of Delhi. She is currently pursuing Ph.D. in the area of Forensics and Law. Prior to joining the teaching profession, she has worked as Research Assistant for projects funded by different agencies of Govt. of India. She has developed various audio-video teaching modules under UGC e-PG Pathshala programme in the area of Criminology, under the aegis of an MHRD Project. Her areas of interest are Criminal Law, Law of Evidence, Interpretation of Statutes, and Clinical Legal Education.

Dr. Navtika Singh Nautiyal

Dr. Navtika Singh Nautiyal presently working as an Assistant Professor in School of law, Forensic Justice and Policy studies at National Forensic Sciences University, Gandhinagar, Gujarat. She has 9 years of Teaching and Research Experience. She has completed her Philosophy of Doctorate in ‘Intercountry adoption laws from Uttranchal University, Dehradun’ and LLM from Indian Law Institute, New Delhi.

 ISSN: 2581-8503

Dr. Rinu Saraswat

Associate Professor at School of Law, Apex University, Jaipur, M.A, LL.M, Ph.D,

Dr. Rinu have 5 yrs of teaching experience in renowned institutions like Jagannath University and Apex University. Participated in more than 20 national and international seminars and conferences and 5 workshops and training programmes.

Dr. Nitesh Saraswat

E.MBA, LL.M, Ph.D, PGDSAPM
Currently working as Assistant Professor at Law Centre II, Faculty of Law, University of Delhi. Dr. Nitesh have 14 years of Teaching, Administrative and research experience in Renowned Institutions like Amity University, Tata Institute of Social Sciences, Jai Narain Vyas University Jodhpur, Jagannath University and Nirma University.
More than 25 Publications in renowned National and International Journals and has authored a Text book on Cr.P.C and Juvenile Delinquency law.

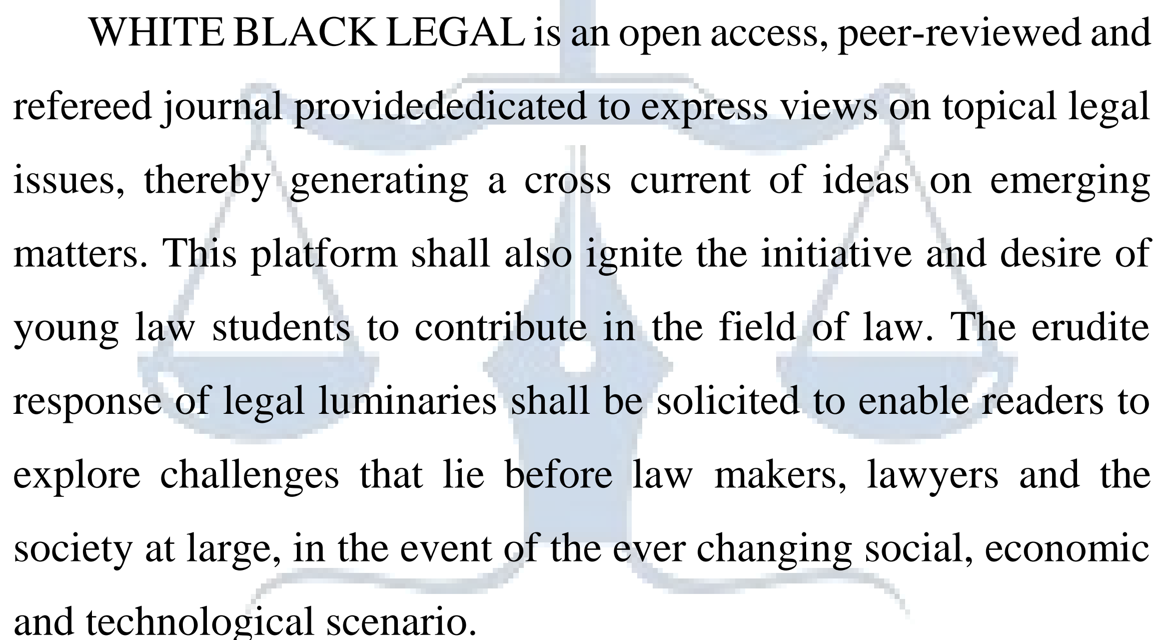
Subhrajit Chanda

BBA. LL.B. (Hons.) (Amity University, Rajasthan); LL. M. (UPES, Dehradun) (Nottingham Trent University, UK); Ph.D. Candidate (G.D. Goenka University)

Subhrajit did his LL.M. in Sports Law, from Nottingham Trent University of United Kingdoms, with international scholarship provided by university; he has also completed another LL.M. in Energy Law from University of Petroleum and Energy Studies, India. He did his B.B.A.LL.B. (Hons.) focussing on International Trade Law.

 ISSN: 2581-8503

ABOUT US



WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal providededicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

IMPACT OF NON-PERFORMING ASSETS ON FINANCIAL STABILITY OF BANKS UNDER CORPORATE LAW

AUTHORED BY - SHRADDHA SRIVASTAVA[1]

Abstract

The corporate law in India has introduced numerous amendments in the Indian banking sector in the recent years in order to enhance its financial stability and governance. These changes have made significant transformation in the sector. This necessitates an examination of the implications these legislative changes have on the financial resilience of banks. In Emerging economy like India, the overall health of the financial system is dependent on the stability of banks. To ensure that banks remain resilient against economic shocks, it is crucial that the role of regulatory framework is highlighted and the required capital adequacy is maintained. In regards to liquidity regulation 'one-size-fits-all' ideology is not optimal in regards to stability of banks.

Introduction

The financial landscape in India has been the number one witness to the exceptional and extraordinary challenges and the subsequent regulatory growth and reforms in the past few years. Financial stability has become a great concern for the regulators and policymakers in India. In order to address the structural and fundamental weaknesses and to promote clear communication and foster transparency, the amendments in corporate law have proved to be an integral part in this crusade to fortify the financial framework of the banks. The purpose of these legislative actions is to lessen the involved risks in improving the corporate governance and to make sure that the financial institutions remain sustainable in the longer run. The operational framework within which the banks operate is shaped by corporate law. The provisions of corporate law also influence the governance structures of the banks including their risk management behavior.

Financial stability could be understood as "the smooth functioning of the key elements that

[1] Research Scholar, University Of Lucknow

make up the financial system".[2] When understood on personal level, financial stability could be demonstrated in the capacity of a financial institution to streamline their economic operations to mitigate risks and withstand financial disruptions. The principal intention for understanding this is to throw some light on the direct and indirect impact that the amendments in corporate law would have on the financial stability of banks. At the same time, financial instability would mean "the unwillingness of the financial institutions to channel funds to profitable investment opportunities, non-arrival of payments on time, and deviation of asset prices from their fair value".[3]

Banks have always been instrumental in the economic growth of any country. The four largest banks in operation globally are Chinese banks which helped China achieve economic superpower status. The statistics of World Bank put India in third position in regards to the GDP purchasing power parity, also termed as PPP.[4] The first two spots are taken by China and United States. In the economic growth of Asia, India is also the second major contributor. Currently at its inflection point, a massive number of businesses and individuals are ready to enter the formal financial market in India given the "positive demographic dividend, a new taxation system, and modern digital infrastructure".[5]

Non performing assests

According to the Prudential Norms of the Reserve Bank of India, "an asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank".[6] Non-performing assets (henceforth referred as NPAs) or non-performing loans (NPLs) are terms which have often been interchangeably used to refer to "loans that do not meet their stated principal and interest repayments".

When the Reserve Bank of India introduced prudential norms in order to reform the regulatory system of the banking sector by way of asset classification and income recognition, assts or loans were classified into "standard, sub-standard and doubtful". This helped with maintaining the capital adequacy ratio of banks and in turn making the banking system in the country strong.

---

[2] F. Wim Duisenberg, The Contribution of the Euro to Financial Stability, GLOBALIZATION OF FINANCIAL MARKETS AND FINANCIAL STABILITY—CHALLENGES FOR EUROPE, 37 (2001).
[3] Roger Ferguson, Should Financial Stability be an explicit Central Bank Objective?, FRB (2002).
[4] Yashika Chakarwarty & Divya Verma Gakhar, Impact of bank competition on financial stability- a study on Indian banks, CS (2023).
[5] Ibid.
[6] Rakesh Mohan, Financial Sector Reforms in India: Policies and Performance Analysis, 40 (12) EPW (2005).

The "Narasimham Committee on Banking Sector Reforms" which was appointed in December of 1997 recommended specifying the criteria which was used to classify NPAs. As per the 2005 Master Circular of RBI, "*a non-performing asset (NPA) is a loan or an advance where;*

(i) *interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan,*

(ii) *the account remains 'out of order', in respect of an Overdraft/Cash Credit.*

(iii) *the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,*

(iv) *a loan granted for short duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for two crop seasons.*

(v) *a loan granted for long duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for one crop season*".

To this definition, the RBI Master Circular 2014 added, "*(vi) the amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitization transaction undertaken in terms of guide lines on securitization dated February 1, 2006.*

(vi) *in respect of derivative transactions, the overdue receivables representing positive mark to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment*."

The Supreme Court in *Heavy Engineering* case held that "*The regulatory framework put in place by the Reserve Bank of India concerning classification of assets as NPAs, being in the nature of subordinate legislation, is mandatory and binding on all banks. This classification is not discretionary; rather, it is a statutory obligation of banks that flows from Section 21 and Section 35A of the Banking Regulation Act, 1949*".[7]

Reasons behind the recent increase

The rise of NPAs in the banking sector of India has been a growing concern. The following can be considered as some interrelated factors:

1. Aggressive lending: The years from 2004 to 2009 have witnessed a significant amount of economic growth in India. This growth could be attributed to the increase in the infrastructural development and the subsequent consumer demand. The response of banks to this economic growth was to aggressively extend credit in sectors like real

[7] Standard Chartered Bank v. Heavy Engineering Corporation Ltd., (2019) 9 SCC 263.

estate, manufacturing and infrastructure. Though the strategy seemed beneficial in the beginning, however, many projects faced challenges like:

a. Many infrastructure projects faced hurdles in respect to regulatory guidelines, issues in acquisition of land and in regard to environmental clearances. These hurdles resulted in delay in project completion. This in return meant that the borrowers had struggle in generating revenue with which they were supposed to pay their debts.
b. This inability to deliver projects to expected time and the subsequent lack of income generation gave rise to defaults. This resulted in financial stress to both the lender, i.e., banks and the borrower.

2. Relaxed lending norms: In the chase of growth, the banks made changes in the standards that they adhered to while lending money. This in turn had an adverse effect on their risk assessment processes. There were instances where banks forgo their due diligence and failed to correctly assess the financial health of the borrower. Some banks also placed much reliance on the collateral which was kept rather than the evaluation of the borrower.
3. Economic slowdown: After the 2008 global economic crisis, there was reduction in business profitability in India which impacted NPAs. There was disruption in the export sector which revealed the interconnectedness the global economic events share with the performance of domestic business.

Banks And Non Performing Assests: Overview

Before 1991, the Indian Banks were not following any uniform accounting practices in relation to "income recognition, classification of assets, provisioning for non-performing assets, and valuation of securities held in a bank's portfolio." This meant that the legal framework had heavy reliance on civil suits under Contract Act, 1872 and Transfer of Property Act, 1882. In the case of Damodar Prasad[8], the opinion of Supreme Court on banking practices was that "*banking transactions constitute a significant part of commercial dealings, and certainty in such transactions is of paramount importance. The right of appropriation must therefore be exercised in a manner that promotes such certainty while protecting the legitimate interests of both parties.*"

In the case of *Kalyani Agro*, the Andhra Pradesh High Court said that "*The petitioners cannot*

[8] Bank of Bihar v. Dr. Damodar Prasad, Air 1969 SC297.

question the action of the bank while it is taking steps to realize the loan amount. The declaration of the petitioner's loan account as NPA cannot be treated as coercive action."[9]

Key Principles To Define "Financial Stability"

There is no universally accepted definition for "financial stability". The concept of financial stability is very different from monetary stability. To define a strong financial system, one has to look at its capacity to prevent financial crises and in the unavoidable circumstance that they arise, then to lessen their effects and shield the real economy from their consequences. The production, consumption and investment are hindered by ineffective financial institutions and markets which would eventually jeopardize the inclusive economic growth and development goals of the nation. Maintaining the integrity of the national payment system is essential for ensuring overall stability.[10]

The path to understand a working definition of financial stability, a more comprehensive and inclusive approach is required where several fundamental principles can be discerned and kept in mind.

The first principle to understand a working definition of financial stability is that it is an expansive concept which incorporates various elements of the financial system which includes infrastructure, institutions, and markets. Both private and public entities engage in markets and play crucial roles in essential components of the financial infrastructure, such as the legal system and the official frameworks governing financial regulation, supervision, and oversight.[11] There is active participation by the government in markets which involve borrowing, hedging risks, implementing monetary policy in order uphold monetary stability, and managing payments and settlement systems.

Due to the intricate connections the elements of the financial system has—whether anticipated or actual—in any single component has the power to jeopardize overall stability, necessitating a comprehensive systemic viewpoint. In a financial system, stability or instability may arise at any moment from the actions of private entities, official institutions, or a combination of both, occurring either concurrently or in succession.

[9] M/s Sri Kalyani Agro Products & Ors. v. Union of India, W.P No. 3059 of 2021.
[10] Reserve Bank of India, Report on Currency and Finance, 1998-99.
[11] Douglas Diamond & Raghuram G. Rajan, Liquidity Risk, Liquidity Creation, and Financial Fragility: A Theory of Banking, 109 JPE 287(2001).

The second principle is that financial stability encompasses not only the effective fulfillment of role in resource and risk allocation, the mobilization of savings, and the facilitation of wealth accumulation, development, and growth, but also ensures that the payment systems across the economy operate efficiently.[12] This includes all forms of payment mechanisms, whether official or private, retail or wholesale, and formal or informal. In essence, financial stability significantly intersects with what is commonly considered a crucial aspect of monetary stability.

The uniformity allows consumers to make informed decisions about their purchases and helps businesses in setting prices and managing their finances.[13] The ability to express monetary value in a consistent manner is central for economic planning and forecasting.

Financial stability, from the above discussion, refers to the resilience that the financial system shows, including banks, markets and institutions, in order to withstand shocks and to maintain the smooth functioning of the economy. A compromised financial stability can lead to a loss of confidence in the currency which would result in increased volatility and potential crises.[14]

To compare financial stability and monetary framework would mean from the above discussion that a stable financial environment will foster confidence in the currency, while a stable monetary framework will ensure that the currency retains its value over time. When combined, these elements will create a robust foundation for economic growth and prosperity, highlighting the importance of maintaining both financial and monetary stability in a dynamic and interconnected global economy.[15]

The third principle emphasizes that the concept of financial stability is not limited to merely avoiding financial crises; it also includes the ability of the financial system to recognize, manage, and mitigate imbalances before they escalate into significant threats to itself or to the wider economy. A well-functioning and resilient financial system would imbibe this proactive approach as it is facilitated by self-correcting mechanisms and the discipline imposed by market forces. There is a nuanced policy-related trade-off in this framework. That is to say, to

[12] Y.V. Reddy, Financial Stability: the Indian Experience, RBI Bulletin (2004).
[13] Garry Schinasi, Private Finance and Public Policy, IMF working paper 04/120 (2004).
[14] Haldane & V. Saporta, Financial Stability and Macroeconomic Models, FSR, Bank of England (2004).
[15] R. Mohan, Financial Sector Reforms, RBI Bulletin (2004).

enhance the resilience of the system, these elements work together and ensure that potential issues are addressed even before they can develop into systemic risks. This makes sure that a systemic risk would not jeopardize the entire financial landscape.

On one hand, allowing market mechanisms to operate freely can empower the system to self-correct and adapt to emerging challenges. This reliance that is put on market forces can cultivate innovation and encourage responsible risk-taking. This is because the participants in the financial system would be correctly incentivized in order to identify and address vulnerabilities on their own.

On the other hand, there are circumstances in which timely and effective intervention by policymakers is necessary to maintain stability. For example, during periods of heightened uncertainty or distress, liquidity injections into the markets may be required to restore confidence, stimulate risk-taking, and prevent a downward spiral that could lead to a broader economic crisis. Thus, it is important for the policymakers to navigate this trade-off in a diligent manner. That is there must be proper balance between the need for market discipline with the urgent need of timely intervention. The right balance needs to be achieved because excessive reliance on market mechanisms without adequate oversight would not only lead to the accumulation of risks but overly aggressive intervention would also stifle market dynamics and inhibit the natural self-correcting processes that contribute to long-term stability.

The goal is to form a financial environment that is resilient and adaptable and one which is capable of withstanding shocks while also fostering sustainable growth and stability in the economy. The multi-faceted concept of financial stability includes both preventive measures and remedial actions which aim at maintaining a robust financial system.

The preventive aspects include proactive strategies which are designed to mitigate risks before they escalate into crises. For example, the implementation of regulatory frameworks, conducting stress tests, and ensuring adequate capital buffers for financial institutions.

On the other hand, a remedial aspect focuses on addressing issues after they arise. For example, the interventions like bailouts, liquidity support, or restructuring efforts to restore confidence and functionality within the financial system.

The fourth critical principle underlies financial stability and the relationship it shares with the real economy. This principle emphasizes that the health of financial markets and institutions should be evaluated not in isolation but in terms of their potential effects on broader economic activity. For instance disruptions in financial markets like the temporary closure of a bank or heightened volatility in asset prices may seem distressing; they do not automatically translate into a threat to financial stability. Such disruptions would be viewed as manageable or even normal occurrences within a dynamic economic landscape, if there was no expectation that they would have significant negative repercussions on overall economic performance.

While understanding the fluctuations in financial market, one should recognize the role played by competitive dynamics among institutions, the effective processing and dissemination of new information, and the natural self-correcting mechanisms inherent in the economic system. Additionally, to maintain financial stability it is important that the economic system has some self-regulating features. The normal tendency of the market is to correct itself over time, as participants react to imbalances and inefficiencies. This self-correction is seen through the lens of shifts in investment strategies, changes in consumer behavior, or adjustments in credit availability. As a result, it could be understood that while certain events may cause short-term disruptions, at the same time they can also pave the way for longer-term stability and growth. The disruptions in financial markets or institutions need to be assessed in light of their potential impact on economic activity as it is important to recognize that not all fluctuations mean a threat to stability. In order to foster a resilient financial system that can withstand shocks while supporting sustainable economic growth it is important to understand the underlying dynamics of financial markets and the self-correcting nature of the economy.

WHITE BLACK
LEGAL

A fifth principle, which aligns with those previously mentioned and reflects the inherent dynamism of finance, posits that financial stability should be understood as existing along a continuum. A more illustrative example is the health of an organism, which similarly exists on a continuum. A healthy organism typically has the capacity to strive for an enhanced state of health and well-being, with a wide and multi-faceted range of what is considered normal. Furthermore, not all conditions of ill-health (or illness) are critical, systemic, or life-threatening. Some illnesses, even those that are temporarily severe, can enable the organism to maintain productive functionality and may even have a purifying effect, ultimately leading to improved health.

One interpretation of viewing financial stability in this manner is that ensuring financial stability does not necessarily entail that every segment of the financial system must consistently function at optimal levels; it allows for the system to operate on a "spare tire" basis occasionally. This metaphor suggests that just as a spare tire can be used in emergencies without being the primary means of transportation, certain parts of the financial system can underperform temporarily without jeopardizing the overall stability of the system.

The notion of a continuum is pertinent because finance inherently involves uncertainty and is dynamic—encompassing both inter-temporal and innovative aspects. From this, it could be understood that financial conditions are not static. They evolve over time and can be influenced by a multitude of factors. The interaction of the various interconnected and evolving components of the financial system like infrastructure, institutions, and markets is complex.

Therefore, financial stability is based on expectations and is dynamic in nature. It relies on various elements of the system performing adequately, but not necessarily at peak efficiency all the time. It is important to note that a thing which signifies stability at a particular moment could be easily perceived as more or less stable at another time depending upon the different facets of the economic landscape it influenced.

Additionally, financial stability can be understood as compatible with diverse combinations of the conditions of its constituent elements. This means the robustness of financial institutions, i.e., “their ability to withstand shocks and maintain operations during periods of stress”. It is important to note that a financial market in liquid and well-functioning state can absorb shocks more effectively than illiquid ones.

Additionally, the stability of financial market is contingent upon the efficacy of various components of the financial infrastructure like payment systems, clearinghouses, and regulatory frameworks. If the overall framework is resilient and adaptable to changing circumstances financial stability can still be achieved even when certain elements are not performing at their best.

Recent Amendments In Banking Sector

A. Amendments in the Insolvency and Bankruptcy Code

To address the "non-performing assets" (NPAs) and "corporate debt resolution" the Insolvency and Bankruptcy Code has been seen as a fundamental reform. With the recent amendments in the said law, significant power enhancement has been done in relation to resolution professionals.

1. 2018 Amendment provisions
   a. Homeward limitation removal: before the amendments made in 2018, the regulation for resolution regarding insolvency and bankruptcy was governed by a rigid 270 day period. Significant challenges were created owing to this regulation like, incomplete resolution process and value erosion of stressed assets. It also did not provide sufficient time to complex cases.

      After the limitation was removed, the resolution professional had more discretion as guidelines for flexible yet time-bound proceedings were established.

      While clarifying the expanded powers of the resolution professional, the Supreme Court established guidelines by observing the following,"*The 270-day period prescribed under Section 12 of the IBC is a time limit and not a strict bar to the resolution process. The National Company Law Tribunal (NCLT) has the discretion to extend the period if sufficient cause is shown and the resolution process is progressing effectively…While the time limit is important, it cannot become a procedural barrier to genuine resolution efforts. The underlying objective of the IBC is resolution, not liquidation. The 270-day period is a guideline, not a strait jacket. When substantial progress is being made in the resolution process, technical adherence to the time limit should not defeat the larger objective of corporate rescue.*"[16]

      The removal of the limitation has made way for the law to handle multi-layered corporate structures. It has also made significant contributions to the valuation process of asset.

   b. Prevention of manipulation of resolution process: there were repeated occurrences where the promoters have tried to regain control by using the resolution process. Therefore, the amendments provided for an "exclusion

[16] Committee of Creditors of Essar Steel India Limmited v. Satish Kumar Gupta, (2019) 12 SCC 1.

criteria" where the defaulting promoters were prohibited from placing a bid for their companies. The class of people who were excluded includes, the willful defaulters, entities who have unresolved financial defaults and promoters who have non-performing assets. This not only encouraged new investors but also new strategic buyers by creating a resolution ecosystem which is transparent.

2. Innovations of 2020 amendments
   a. Suspension of proceedings: Section 10A in the Insolvency and Bankruptcy Code which reads as following, "*no application shall be filed for initiation of corporate insolvency resolution process against any corporate debtor during the period from 25th March, 2020 till 24th September, 2020*" was inserted in the light of COVID-19, suspends the initiation of fresh insolvency proceedings. Also any defaults as the result of the pandemic were to be specifically addressed.
   b. Alternative resolution mechanism: for the Micro, Small and Medium Enterprises, commonly referred to as MSMEs, Chapter III-A was introduced to enable speedier and streamlined corporate restructuring. It specifies the minimum default threshold. It is a pre-approved resolution plan which reduces the intervention by National Company Law Tribunal also known as NCLT.
3. Considerations of Default and Moratorium
   a. Moratorium: it prevented premature bankruptcies and therefore, fresh insolvency proceedings were suspended.
   b. Default: for a brief period of COVID-19, temporary exclusion was granted. This exclusion meant that there were no technical defaults during the pandemic.
4. Mechanisms for Creditor Protection
   a. Interim Finance Protection: Section 5(15) of the IBC reinforces that "*interim finance means any financial debt raised by the resolution professional during the insolvency resolution process period and such other debt as may be notified*". It was classified to be considered a part of the resolution process costs. "Interim finance providers enjoy special protection to encourage continued business support during resolution process".[17]

[17] Andhra Bank v. M/s Sterling Biotech Ltd. & Ors., 2019 SCC OnLine NCLAT 1007.

B. The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970

The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 has undergone several legislative changes that have significantly impacted the banking sector in India. Below are the key legislative changes cited word for word from the Act:

1. Establishment of Corresponding New Banks: "On the commencement of this Act, there shall be constituted such corresponding new banks as are specified in the First Schedule." (Section 3(1))
2. Transfer of Undertakings: "On the commencement of this Act, the undertaking of every existing bank shall be transferred to, and shall vest in, the corresponding new bank." (Section 4)
3. General Effect of Vesting: "The undertaking of each existing bank shall be deemed to include all assets, rights, powers, authorities and privileges and all property, movable and immovable, cash balances, reserve funds, investments and all other rights and interests in, or arising out of, such property as were immediately before the commencement of this Act in the ownership, possession, power or control of the existing bank." (Section 5(1))
4. Payment of Compensation: "Every existing bank shall be given by the Central Government such compensation in respect of the transfer... to the corresponding new bank of the undertaking of the existing bank as is specified against each such bank in the Second Schedule." (Section 6(1))
5. Power of Central Government to Make Scheme: "The Central Government may make a scheme for the transfer...of any undertaking from an existing bank to a corresponding new bank." (Section 9)

These provisions highlight how the act facilitates the restructuring process within the banking sector by allowing for smoother transitions and ensuring that operational continuity is maintained during such changes. The act also emphasizes government involvement in managing transitions effectively while addressing financial stability concerns.

Impact of Recent Legislative Changes

Recent amendments to banking laws in India have profound implications for the financial stability of banks, particularly in light of the evolving economic landscape. The following key legislative changes significantly influence how banks operate and manage their financial health:

Banking Companies (Acquisition and Transfer of Undertakings) Act

The Banking Companies (Acquisition and Transfer of Undertakings) **Act** has been pivotal in reshaping the banking sector. This amendment allows public sector banks (PSBs) to access capital more flexibly, which enhances their capacity to withstand economic shocks. By enabling the establishment of corresponding new banks, this act facilitates a smoother transition for existing banks undergoing restructuring or mergers. The provisions within this act ensure that the assets and liabilities of existing banks are effectively transferred, thereby maintaining operational continuity and stability during transitions.

National Asset Reconstruction Company Limited (NARCL)

The establishment of the National Asset Reconstruction Company Limited (NARCL) is a strategic initiative aimed at addressing the growing issue of non-performing assets (NPAs) within the banking sector. By focusing on improving asset quality, NARCL seeks to restore confidence in the banking system. This initiative is crucial as it allows banks to offload bad loans, thereby enhancing their balance sheets and overall financial health. The NARCL's role in asset reconstruction is expected to mitigate risks associated with NPAs, ultimately contributing to greater financial stability across the sector.

Privatization Initiatives

The Indian government's move towards privatizing certain public sector banks has sparked significant debate regarding its implications for financial stability. While privatization aims to improve efficiency and competitiveness within the banking sector, it raises concerns about the potential reduction in government support during crises. The transition from public ownership to private management may lead to shifts in risk appetite and governance structures, which could impact financial stability if not managed carefully. The challenge lies in ensuring that privatized banks maintain robust risk management practices while navigating market pressures.

Regulatory Oversight Enhancements

Recent legislative changes have also strengthened regulatory oversight mechanisms within the banking sector. Enhanced powers granted to the Reserve Bank of India (RBI) allow for more rigorous monitoring and intervention capabilities concerning bank operations. This includes the ability to impose stricter capital adequacy requirements and conduct comprehensive stress tests on banks. Such measures are designed to ensure that banks are better prepared for potential economic downturns, thereby safeguarding overall financial stability.

Corporate Governance Reforms

Corporate governance reforms introduced under recent amendments emphasize transparency, accountability, and ethical management practices within banks. These reforms are critical for fostering investor confidence and ensuring that banks operate within a framework that prioritizes financial stability. Improved governance structures help mitigate risks associated with mismanagement and promote sustainable growth within the banking sector. By aligning corporate governance practices with international standards, Indian banks are better positioned to navigate challenges while maintaining stability. In summary, recent legislative changes in India have introduced mechanisms aimed at enhancing the financial stability of banks through improved capital access, asset management, regulatory oversight, and corporate governance practices. As these reforms continue to unfold, their effectiveness will be pivotal in shaping a resilient banking environment capable of withstanding future economic challenges.

Understanding The Interplay

The interplay between corporate law and the financial stability of banks in India is multifaceted and essential for the health of the financial system. Recent legislative changes have significantly bolstered the regulatory framework governing banks, which has led to improved capital management and risk assessment practices. However, several challenges persist, particularly concerning moral hazard associated with government support for public sector banks (PSBs). Ongoing reforms aimed at enhancing corporate governance and risk management are crucial for ensuring that Indian banks can effectively navigate future economic uncertainties while maintaining stability.

A. Strengthening Regulatory Framework

The recent modifications to banking legislation have strengthened the regulatory structure overseeing banks in India. A significant aspect of this is the implementation of Basel III standards, which require banks to uphold elevated capital adequacy ratios, thereby ensuring they possess adequate capital reserves to mitigate potential losses. This regulatory improvement is designed to bolster banks' resilience against economic disturbances and diminish the risk of systemic breakdowns. Additionally, the Reserve Bank of India (RBI) has augmented its supervisory capacity, facilitating more stringent oversight of banking operations and risk management strategies. Collectively, these initiatives enhance the robustness of the banking sector, enabling it to endure financial pressures.

B. Challenges of Moral Hazard

Despite these advancements, the issue of moral hazard remains a significant concern, particularly in the context of PSBs. The expectation of government support during crises can lead to riskier behavior among bank management, as the safety net may encourage excessive risk-taking. This moral hazard can undermine financial stability by fostering an environment where banks engage in imprudent lending practices, potentially leading to higher levels of non-performing assets (NPAs). Addressing this challenge requires a careful balance between providing necessary support to PSBs and enforcing strict accountability measures to mitigate risk-taking behaviors.

C. Importance of Corporate Governance

Corporate governance plays a pivotal role in ensuring the financial stability of Indian banks, serving as a foundational pillar that supports the integrity and resilience of the banking system. In an era marked by rapid economic changes and increasing globalization, the need for robust governance frameworks has never been more critical. These frameworks are essential for fostering transparency, accountability, and ethical practices within banking operations, which are vital for maintaining the trust of stakeholders, including customers, investors, and regulatory bodies. Recent reforms in the Indian banking sector have underscored the significance of establishing strong governance structures that align with international best practices.

These reforms aim to address the challenges posed by a dynamic financial landscape, where banks are not only competing with one another but also facing pressures from non-banking financial institutions and Fintech companies. By adopting governance practices that meet global standards, Indian banks can enhance their operational efficiency and risk management capabilities, thereby positioning themselves favorably in the international arena. Sound corporate governance is instrumental in mitigating the risks associated with mismanagement, which can lead to significant financial losses and reputational damage.

By implementing clear policies and procedures, banks can ensure that their operations are conducted in a manner that is both ethical and compliant with regulatory requirements. This, in turn, helps to build investor confidence, as stakeholders are more likely to invest in institutions that demonstrate a commitment to good governance.

Furthermore, public trust in the banking sector is bolstered when banks are perceived to operate transparently and responsibly, which is essential for maintaining a stable financial environment. As banks continue to grow in size and complexity, becoming increasingly interconnected with global financial markets, the reinforcement of governance standards becomes even more crucial. The interconnectedness of financial institutions means that the failure of one entity can have far-reaching implications for the entire system. Therefore, it is imperative to establish governance frameworks that not only address internal controls and risk management but also promote collaboration and communication among various stakeholders. This holistic approach to governance can help protect against potential crises, ensuring that banks are better equipped to navigate challenges and uncertainties in the financial landscape.

In conclusion, the importance of corporate governance in the Indian banking sector cannot be overstated. By prioritizing the development and implementation of strong governance frameworks, banks can enhance their resilience, foster investor confidence, and ultimately contribute to the overall stability of the financial system. As the banking sector continues to evolve, ongoing commitment to ethical practices and accountability will be essential in safeguarding the interests of all stakeholders and ensuring sustainable growth in the years to come.

D. Risk Management Practices

The implementation of effective risk management practices is vital for ensuring long-term financial stability. Banks are increasingly required to conduct comprehensive stress tests and maintain adequate liquidity buffers to prepare for potential economic downturns. The focus on asset-liability management (ALM) is also gaining prominence as banks strive to balance their funding sources with their lending activities effectively. By adopting proactive risk management strategies, Indian banks can better navigate uncertainties while minimizing the impact of adverse economic conditions.

Conclusion

A country's growth trajectory is positively influenced by a stable banking system as it initiates a multiplier effect which leads to breakthrough in the economic growth. As the banking landscape in India continues to evolve, a proactive approach to regulation and oversight will be essential in safeguarding the integrity of the financial system. The interplay between

corporate law and banking stability is critical; thus, ongoing reforms must prioritize enhancing corporate governance, addressing moral hazard issues, and strengthening risk management practices. By doing so, Indian banks can ensure they are well-equipped to handle future challenges while contributing positively to the overall economic stability of the country. The commitment to fostering a resilient banking environment will ultimately play a crucial role in supporting sustainable economic growth in India.