RBI issues revised framework on resolution of stressed assets

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MUMBAI I DELHI I BENGALURU I KOLKATA

Introduction

On February 12, 2018, the Reserve Bank of India ("**RBI**") announced a revised framework for resolution of stressed assets by scheduled commercial banks and all-India financial institutions ("**Revised Framework**").

With the introduction of the Revised Framework, all extant instructions on resolution of stressed assets such as Framework for Revitalising Distressed Assets, Corporate Debt Restructuring Scheme, Flexible Structuring of Existing Long Term Project Loans, Strategic Debt Restructuring Scheme (SDR), Change in Ownership outside SDR, and Scheme for Sustainable Structuring of Stressed Assets (S4A) stand withdrawn with immediate effect. Accordingly, the Joint Lenders' Forum has also been discontinued.

All loan accounts, including those accounts where any of the aforesaid schemes have been invoked but not yet implemented, will now be governed by the Revised Framework.

However, restructuring in respect of projects under implementation involving deferment of date of commencement of commercial operations, will continue to be covered under the extant guidelines.

The Revised Framework has been formulated to provide for a harmonised and simplified generic framework for resolution of stressed assets in view of the enactment of the Insolvency and Bankruptcy Code, 2016 ("**IBC**").

Resolution plan

Lenders are required to formulate policies approved by their board of directors for resolution of stressed assets, including the timelines for resolution.

Immediately upon occurrence of a default in the loan account with any lender, all lenders (singly or jointly) are required to initiate steps to cure the default.

The resolution plans ("**Plan**") may involve any actions/ plans/ reorganization, including regularisation of the account by payment of all overdues by the borrower, sale of the exposures to other entities/ investors, change in ownership, or restructuring.

All lenders should clearly document the Plan even if there is no change in any terms and conditions.

Implementation of the Plan

A Plan will be deemed to be 'implemented' only if the following conditions are fulfilled:

a. the borrower is no longer in default with any of the lenders;

b. in the event the Plan involves restructuring –
   i. all necessary documentation, including execution of necessary agreements between the lenders and the borrower, creation and perfection of security are completed by all lenders; and

ii. the new capital structure and/ or changes in the terms or conditions of the existing loan gets duly reflected in the books of all the lenders and the borrower.

Plans in respect of large accounts

In case of large accounts (i.e., accounts where the aggregate exposure of lenders is Rs. 1 billion and above), if the Plan involves restructuring/ change in ownership it would require independent credit evaluation ("**ICE**") of the residual debt (i.e. aggregate fund based and non-fund based debt envisaged to be held by all the lenders as per the Plan) by credit rating agencies ("**CRAs**") specifically authorised by RBI for this purpose.

Accounts with aggregate exposure of Rs. 5 billion and above will require two ICEs and the other accouts will require one ICE. Plans which receive a credit opinion of RP4 or better for the residual debt from the CRAs will be considered for implementation.

This requirement of ICE will be applicable to restructuring of all large accounts implemented from the date of the Revised Framework, even if the restructuring is carried out before March 1, 2018 ("**Reference Date**").

Timelines for implementation in case of large accounts

For loan accounts with aggregate exposure of the lenders at Rs. 20 billion and above on or after the Reference Date, including accounts where resolution has been initiated under any of the existing schemes, the Plan is required to be implemented within the following timelines:

a. If the default has occurred as on the Reference Date, 180 days from the Reference Date;

b. If the default occurs after the Reference Date, 180 days from the date of first default.

If a Plan is not implemented within the timelines mentioned above, the lenders will file an insolvency application, singly or jointly, under the IBC within 15 days from the expiry of the aforesaid timeline.

Where the Plan involves restructuring or change in ownership and is implemented within the aforesaid period of 180 days, the account should not be in default at any point of time during the specified period[1]. If the account is in default at any point of time during the specified period, the lenders will file an insolvency application, singly or jointly, under the IBC within 15 days from the date of such default

For other large accounts where the aggregate exposure of the lenders is below Rs. 20 billion but equal to or more than Rs. 1 billion, RBI will be announcing, over a two-year period, reference dates for implementing the Plan. However, this transition arrangement will not be available for borrowers in respect of which specific instructions have already been issued by RBI to banks for reference under IBC.

[1] 'Specified period' means the period from the date of implementation of the Plan up to the date by which at least 20% of the outstanding principal debt as per the Plan and interest capitalisation sanctioned as part of the restructuring, if any, is repaid.Provided that the specified period cannot end before one year from the commencement of the first payment of interest or principal (whichever is later) on the credit facility with longest period of moratorium under the terms of the Plan.

Prudential norms

Asset classification

In the event of restructuring, accounts classified as 'standard' are required to be downgraded to 'sub-standard' assets. The non-performing assets ("**NPAs**") would continue to have the same asset classification as prior to restructuring. The asset classification, in both cases, will continue to be governed by the ageing criteria as per extant asset classification norms.

The standard assets which are classified as NPAs and NPAs which are retained in the same category on restructuring can only be upgraded when all outstanding facilities demonstrate satisfactory performance (i.e. no default in payment) during the specified period.

In case of large accounts, the credit facilities of the borrower are additionally required to obtain investment grade rating (i.e. BBB- or better) at the end of specified period by CRAs. Accounts with aggregate exposure of Rs. 5 billion and above will need to obtain two ratings and other accounts will require one rating.

If the account fails to demonstrate satisfactory performance during the specified period, the accounts shall immediately on the occurrence of a default be reclassified as per the repayment schedule existing before restructuring. Any upgrade in the future for such defaulting accounts will be dependent on implementation of a fresh Plan and demonstration of satisfactory performance thereafter.

The funded interest term loan ("**FITL**"), debt and equity instruments created by conversion of part of principal or unpaid interest is required to be placed in the same asset classification category in which the restructured advance has been classified. Such FITL, debt and equity instruments shall be valued as per usual valuation norms and marked to market.

If there is a change of ownership of the borrower, its loans will continue to be classified or may be upgraded as standard after the change in ownership is implemented (either under IBC or Revised Framework) subject to the conditions prescribed under the Revised Framework.

Provisioning norms

Provisioning in respect of the accounts restructured under the Revised Framework will be as per the asset classification provided in the Master Circular on Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances dated July 1, 2015 ("**Master Circular**"). However, in case of accounts restructured prior to February 12, 2018 under any of the earlier schemes the provisioning will continue to be held as per requirements specified thereunder.

In case of change of ownership of the borrower, the amount of provisions held by the bank against such accounts as on date of change in ownership can be reversed only after satisfactory performance is shown during the specified period.

Income recognition

In respect of restructured accounts classified as standard assets, the interest income can be recognised on accrual basis and in respect of restructured accounts classified as NPAs, the interest income will be recognised on cash basis.

However, in case of accounts where additional finance is provided if the pre-restructuring facilities were already classified as NPA, the interest income will be recognised only on cash basis unless the restructuring is accompanied by change of ownership.

Additional finance

Additional finance granted to borrower under the Plan (including any resolution plan approved under IBC) will be treated as standard asset during the specified period under the approved Plan. However, this would be subject to the account performing satisfactorily during the specified period. If the account fails to demonstrate satisfactory performance, such additional finance granted will be placed in the asset classification category as the restructured debt.

Regulatory exemptions

Exemption has been provided in case of acquisition of shares upon to conversion of debt to equity during a restructuring process from regulatory ceilings/ restrictions on capital market exposures, investment in para-banking activities and intra-group exposure. Such acquisition of shares will require reporting to RBI and disclosure by banks in notes to accounts in annual financial statements.

In reference to the requirements under regulation 70(5)(a) and 70(6)(a) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, the issue price of equity will be lower of (i) or (ii) below:

i. the average of the weekly high and low of the volume weighted average price of the related equity shares quoted on the recognised stock exchange during the 26 weeks preceding the reference date[2] or the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the 2 weeks preceding the reference date, whichever is lower; and

ii. book value which is to be calculated (per share) from the audited balance sheet as on March 31st of the immediate preceding financial year (without considering revaluation reserves, if any) adjusted for cash flows and financials post the earlier restructuring, if any. The balance sheet shall not be more than a year old. In case the audited balance sheet as on March 31st of the immediate preceding financial year is not available the total book value of the borrower company shall be set at Re.1.

For the purposes of the requirements under regulation 10(1)(ia)(a) of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, in case of selling of equity instruments acquired by banks as part of restructuring process, the selling price can be a negotiated

[2] 'reference date' shall be the following:
(i) in case of conversion of debt into equity, the date on which bank approves the restructuring scheme;
(ii) in case of conversion of convertible securities into equity, the date on which the bank approves such conversion;
(iii) in case of issuance of fresh shares to new promoter, the date of signing biding agreement between the bank and the new promoter;
(iv) in case of sale of equity held by banks pursuant to conversion or invocation of pledge, the date on which the share purchase agreement between the bank and new promoter is executed.

price. However, the selling price cannot be lower than the fair value which shall be the higher of (i) and (ii) below:

i. the average of the weekly high and low of the volume weighted average price of the related equity shares quoted on the recognised stock exchange during the 26 weeks preceding the reference date or the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the 2 weeks preceding the reference date, whichever is higher; and

ii. book value per share to be calculated from the company's latest audited balance sheet (without considering revaluation reserves, if any) adjusted for cash flows and financials post the earlier restructuring, if any.

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