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LAW & POLICY UPDATE

BANKING & FINANCE

RBI's one-time loan recast move gives India Inc a lifeline

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Reserve Bank of India (**RBI**) vide notification dated August 6, 2020, on Resolution Framework for COVID-19 related Stress (**Resolution Framework**) has provided a window under the RBI (Prudential Framework for Resolution of Stressed Assets) Directions 2019, dated June 7, 2019 (**Prudential Framework**) to enable lenders to implement a resolution plan (**RP**) in respect of eligible borrowers, without a change in ownership, while classifying such exposures as standard assets subject to specified conditions. The resolution window facility is available only to the Covid-19 related stressed assets.

Key terms of the Resolution Framework

- **Eligibility of borrowers** – The following categories of borrowers are covered under the Resolution Framework:
  - For resolution of stress in Personal Loans: Individual borrowers accounts which were classified as standard but not in default for more than 30 days with the lending institution as on March 1, 2020.
  - For resolution of other exposures: Borrower accounts which were classified as standard but not in default for more than 30 days with any lending institution as on March 1, 2020.
  - Following categories of borrowers/credit facilities shall not be eligible for a RP under the Resolution Framework:
    - MSME borrowers whose aggregate exposure to lending institutions collectively, is INR 25 crore or less as on March 1, 2020
    - Farm credit as listed in Paragraph 6.1 of master direction FIDD.CO.Plan.1/04.09.01/2016-17 dated July 7, 2016 (as updated) or other relevant instructions as applicable to a specific category of lending institutions
    - Loans to primary agricultural credit societies, farmers' service societies, and large-sized Adivasi multi-purpose societies for on-lending to agriculture
    - Exposures of lending institutions to financial service providers
    - Exposures of lending institutions to central and state governments; local government bodies (eg. municipal corporations); and, body corporates established by an act of parliament or state legislature
    - Exposures of housing finance companies where the account has been rescheduled
- **Implementation of RP – Personal loans**
  - The RP under the Resolution Framework may be invoked latest by December 31, 2020, and must be implemented within 90 days from the date of invocation
  - The RP may include rescheduling of payments, conversion of any interest accrued or to be accrued into another credit facility, or granting of moratorium based on the assessment of income streams of the borrower subject to a maximum of 2 years
  - The RP shall be deemed to be implemented only if
    - All the required documents have been executed between the lender and the borrower, in consonance with the RP
    - The changes in the terms and conditions of the loans are duly reflected in the books of the lender
    - The borrower is not in default with the lender as per the revised terms

- **Implementation of the RP – Other exposures**
  - The RP under the Resolution Framework may be invoked latest by December 31, 2020, and must be implemented within 180 days from the date of invocation
  - In case multiple lenders are involved, approval of 75% of the lenders by value and 60% of the lenders by number must have been obtained
  - Inter Creditor Agreement (**ICA**) shall be required to be executed by all lending institutions within 30 days from the date of invocation
  - The RP may involve any action/plan/reorganization including but not limited to regularisation of the account by payment of all over dues by the borrower entity, sale of the exposures to other entities/investors, change in ownership and restructuring, conversion of a portion of the debt into equity or other marketable, non-convertible debt securities except the compromise settlements which shall continue to be governed by the provisions of the Prudential Framework
  - The RP may also include sanctioning of additional credit facilities to address the financial stress of the borrower on account of Covid19 even if there is no renegotiation of existing debt
  - Prior to the implementation of the RP, it shall be vetted by the expert committee where the aggregate exposure of the lending institutions at the time of invocation of the resolution process is INR 1500 crore and above
  - The RPs must be independently rated where the aggregate exposure is INR 100 crore or above, by at least 1 credit rating agency authorized by RBI under the Prudential Framework
  - In the accounts involving consortium or multiple banking arrangements, the RP shall also provide all the receipts of the borrower, all repayments by the borrower including the additional disbursements as part of the RP by the lending institutions and shall be routed through an escrow account maintained with one of the leading institutions
- **Asset classification and provisioning**
  - In case a RP is implemented, the asset classification of loan accounts classified as standard may be retained as such upon implementation, whereas the accounts which may have slipped into Non-performing Asset (**NPA**) between invocation and implementation may be upgraded as standard as on the date of implementation of the RP
  - In respect of personal loans, the lending institutions shall keep provision from the date of implementation, which is higher of the provision held as per the master circular - Prudential norms on income recognition, asset classification and provisioning pertaining to advances bearing DBR.No.BP.BC.2/21.04.048/2015-16 dated July 1, 2015, as amended from time to time (IRAC Norms) before implementation or 10% of the renegotiated debt exposure of the lending institution post-implementation
  - The lending institutions which has signed the ICA within 30 days of invocation shall keep provision from the date of implementation, which is higher of the provision held as per the IRAC Norms immediately before implementation or 10% of the total debt held by the ICA signatories post-implementation of the RP
  - The lending institutions which did not sign the ICA within 30 days of invocation shall keep the provision of 20% of the debt in their books or the provision required as per the extant IRAC Norms, whichever is higher
  - If the RP is not implemented within 180 days from invocation, provisions as per the Prudential Framework shall be required to be maintained
- **Post implementation performance**
  - In the case of personal loans, the asset classification after the implementation of the RP shall be governed by the IRAC Norms or other relevant instructions as applicable to the specific category of lending institutions
  - For other exposures, any default by the borrower with any of the ICA signatory during the monitoring period (as defined in Resolution Framework) shall trigger a review period of 30 days. Further, if the default persists after the end of the review period, the asset classification of the borrower with all the lending institutions (including who did not sign the ICA) shall be downgraded to NPA from the date of implementation of the RP or the date from which the borrower had been classified as NPA before the implementation of the RP, whichever is earlier
- **Disclosure requirements**
  - Quarterly, half-yearly and annual disclosures in the financial statements (as the case may be) shall be made by the lenders in the prescribed format till all exposures on which RP was implemented are either fully extinguished or completely slips into NPA, whichever is earlier
  - Further, the credit reporting of borrowers where the RP is implemented shall be done as 'restructured' if the RP involves renegotiations

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Our Viewpoint

With stringent conditions and timelines, the scheme is designed to give banks more time to raise capital and address the impact of the Covid-19 pandemic on their loan portfolios. With the suspension of the Insolvency & Bankruptcy Code, this scheme would provide significant relief to the banking sector and enable small businesses to address the present liquidity challenges without necessarily diluting promoter stake or losing control of their business."