

Dispute Resolution Hotline

February 16, 2018

ASPIRIN FOR STRESS RELIEF: RBI NOTIFIES REVISED FRAMEWORK FOR STRESSED ASSETS

- Revised framework for resolution of stressed assets notified
- Norms on early identification, reporting, and implementation of resolution plans strengthened
- Existing resolution methods including CDR, SDR, and S4A, withdrawn with immediate effect
- Repeat defaulters under RBI schemes and above INR 20 Billion accounts compulsorily mandated to be referred under the IBC

INTRODUCTION

The Reserve Bank of India ("RBI") has in the past, issued various instructions aimed at resolution of stressed assets in the economy, while also introducing certain specific schemes for resolution at different points of time. In view of the enactment of the Insolvency and Bankruptcy Code, 2016 ("IBC"), the RBI has substituted these existing instructions and schemes with a harmonised and simplified generic framework for resolution of stressed assets ("Revised Framework").

BACKGROUND

The increased focus on resolution of stressed assets has been a consistent theme over the course of the past year. All arms of the state, including the executive and regulatory bodies like RBI and Securities and Exchange Board of India ("SEBI"), have been taking measures to ensure that stressed assets are identified and resolved in the most efficient manner. The introduction of the IBC has been a significant step in this direction. The existing regime envisaged several¹ methods of resolution not requiring the initiation of liquidation proceedings ("Existing Schemes"). The effectiveness of the Existing Schemes suffered due to a fragmented system and multiplicity of options available to the debtor/lender. Further, lenders were not precluded from initiating proceedings for recovery of outstanding debts during the continuance of steps being taken under Existing Schemes. On the other hand, operational creditors could take action under the IBC, thus starting parallel remedial measures to the Existing Schemes. Suffice it to say, multiple proceedings/actions under various frameworks resulted in inevitable delay of resolution process.

In order to harmonize these conflicting methods of resolution, the RBI has come up with the Revised Framework, which will operate in conjunction with the IBC, rather than in isolation.

REVISED FRAMEWORK

The key highlights of the Revised Framework are as follows:

1. Early Identification and Reporting of Stressed Assets

- The Revised Framework places renewed importance on early identification of stressed assets, as well as timely collation of information on stressed assets by a central repository, which will enable the RBI to monitor the level of stress in the banking system more effectively.
- Thus, effective from the week ending February 23, 2018, lenders² are required to report to the Central Repository of Information on Large Credits ("CRILC"), on a weekly basis, all borrower entities in default with aggregate exposure ("AE") of INR 50 million and above.
- In addition, effective from April 1, 2018, lenders will be required to submit the CRILC – Main Report on a monthly basis, rather than a quarterly basis, as existed previously.

2. Resolution Plan

- The Revised Framework envisages the concept of a Resolution Plan ("RP"), which should not be confused with the resolution plan as defined in the IBC.
- All lenders now required to mandatorily put in place board approved policies for resolution of stressed assets under the Revised Framework. Lenders have not been defined under the Revised Framework, however, it is mentioned that generally they would include all scheduled commercial banks (excluding RRBs) and All India Financial Institutions.
- The Revised Framework provides for various methods of resolution that may be adopted in a RP, with special emphasis on restructuring. The Revised Framework defines "restructuring" to mean an act in which a lender, for economic or legal reasons relating to the borrower's financial difficulty, grants concession to the borrower, while also providing examples of what a restructuring may involve, along with a non-exhaustive list of indicators of

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- financial difficulty.
- In addition, all lenders are required to clearly document the RP, even if there is no change in any terms and conditions on which financial assistance had been provided by them. There is no clear guidance in respect to how this documentation should be maintained, whether minutes of meetings or notes in their internal documentation would suffice is yet to be seen.
 - This ensures that each lender has an internal policy based on the Revised Framework for resolution of stressed assets including reporting obligations. A uniform methodology across the banking system will give certainty to lenders as well as borrowers.

3. Implementation of RP

- The RBI has provided definite criteria for determining the implementation of a RP. A RP will be deemed to be Implemented only if:
 - The borrower entity is no longer in default with any of the lenders;
 - If the resolution involves restructuring, then:
 - All related documentation, including execution of necessary agreements between lenders and borrower / creation of security charge / perfection of securities are completed by the lenders; and
 - The new capital structure and / or changes in the terms and conditions of the existing loans get duly reflected in the books of all the lenders and the borrower;
 - Where the AE of the borrower is INR 1 billion and above, the borrower's account receives a credit opinion of RP4 or better based on an Independent Credit Evaluation ("**ICE**") undertaken by a Credit Rating Agency ("**CRA**"); and
 - Where the AE exceeds INR 5 billion, two such credit opinions are obtained.
- The aforementioned requirement to procure an ICE will be applicable from the date of notification of the Revised Framework i.e. February 12, 2018, to all accounts of the designated size, even if they have already been restructured under the Existing Scheme.
- This ensures that mere formulation of a RP does not amount to compliance with the Revised Framework. The RP has to be converted into an implemented plan for the lender to be in compliance with Revised Framework.
- Interestingly, the Revised Framework categorically provides that the CRA are required to be directly engaged by the lenders, who are responsible for paying their fees. Further, ostensibly with a view to ensure that no adverse ICE opinions are swept under the carpet, the Revised Framework also provides that should lenders obtain ICE from more than the required number of CRA's, all such opinions are required to be RP4 or better for the RP to be considered for implementation.

4. Timelines for Special Accounts to be Referred to IBC

- The Revised Framework classifies a "Special Account" as one where the AE of the lenders on or after March 1, 2018 ("**Reference Date**") is INR 20 billion and above. The term includes accounts where resolution has already been initiated under Existing Schemes, as well as accounts classified as restructured standard assets under Existing Schemes.
- In the case of a Special Account, a RP is to be Implemented if the following were to happen:
 - If the Special Account stands in default as on the Reference Date, the RP will have to be Implemented within 180 days from the Reference Date;
 - If a default occurs after the Reference Date, the RP will have to be implemented within 180 days from the date of such first default.
- In case the RP is not implemented within the aforementioned timelines, lenders are required to initiate proceedings, either singly or jointly, under the IBC within 15 days from the expiry of the applicable timeline.
- If a RP is implemented within the aforementioned timelines, the concerned account would have to adhere to the RP without committing a default during a "Specified Period".³ In the event of a default during the Specified Period, lenders are required to commence insolvency proceedings, either singly or jointly, under the IBC within 15 days from the date of such default.
- If a RP is successfully implemented in respect of a Special Account, and thereafter, such Special Account does not commit a default within the Specified Period, such Special Account would stand classified as a standard asset. Any default occurring after the Specified Period would therefore be dealt with as **fresh default** for the purposes of the Revised Framework.
- Practically, we have seen that some of these Special Accounts which had been classified as standard under the Existing Schemes have also defaulted on the restructured payment plans. Under the Revised Framework, such Special Accounts would effectively stand within the purview of the resolution mechanism prescribed under the Revised Framework which includes the threat of initiation of proceedings under the IBC. This will also work to ensure that lenders compulsorily resolve these Special Accounts even if they have already been classified as "**standard**" under the Existing Schemes.
- While the aforementioned guidelines apply only in respect of Large Accounts, the Revised Framework records the intention of the RBI to release similar guidelines in respect of accounts ranging between INR 1 billion – 20 billion. Accordingly the treatment of these accounts under the Revised Framework is not very clear.
- It should however be noted that the aforementioned guidelines for Large Accounts are not applicable in respect of the accounts which have been specifically notified by the RBI for reference under the IBC by the respective lenders ("**Notified Accounts**").

5. Provisioning

Provisioning by lenders will continue to be done as per the asset classification norms provided in the Master Circular on Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances. However, provisioning in respect of Notified Accounts continues to be done in the manner as provided in the RBI notifications by which these accounts have been directed to be referred under the IBC.

6. Supervisory Review

Actions taken by lenders to conceal the actual status of accounts, including the consistent *evergreening* of stressed

accounts, has been one of the primary reasons for the huge NPA burden on the Indian banking system. While the Revised Framework uses strong language in respect of lenders taking any actions with a view to conceal the actual status of the accounts or evergreen the stressed accounts, it has possibly lost out on an opportunity to prescribe specific stringent action against such delinquent management by lenders, in conjunction with the promoters of errant companies.

7. Withdrawal of Extant Instructions

With the introduction of the Revised Framework, the erstwhile resolution mechanisms notified by the RBI namely, the Framework for Revitalising Distressed Assets, the CDR Scheme, Flexible Structuring of Existing Long Term Project Loans, the SDR Scheme, Change in Ownership outside SDR, and S4A stand withdrawn with immediate effect. By consequence, the JLF as an institutional mechanism for resolution of stressed accounts also stands discontinued. All accounts, including such accounts where any of the aforementioned schemes have been **invoked but not yet implemented**, shall now be governed by the Revised Framework, thereby making the Revised Framework retrospectively applicable in respect of such accounts. Considering the criteria for determining which scheme has been 'implemented' has been introduced only now by the Revised Framework, it will be interesting to see the treatment of the scheme that have been invoked but does not satisfy the criteria of being implemented under the Revised Framework.

ANALYSIS

While the Revised Framework is another step in the right direction by the Reserve Bank of India, which is intended to substitute the Existing Schemes, its interplay with the IBC remains questionable. The Revised Framework has possibly missed out on the opportunity to provide clarity on whether (a) proceedings under IBC can be initiated during pendency of restructuring under the Revised Framework; and (b) how the consequent statutory moratorium under IBC will affect restructuring under the Revised Framework. Some clarity in this regard is likely to be issued in the near future to alleviate any potential litigation.

Further, the Revised Framework provides for a special resolution mechanism where the AE of the lenders on or after March 1, 2018 is INR 20 billion and above ("Special Accounts"). "*Special Accounts*" includes even those accounts where there has already been a default and consequently have been restructured under one of the Existing Schemes. Some of these Debtors have, after availing of the Existing Schemes, either (a) defaulted again on the revised repayment schedules; or (b) may possibly default in the future ("**Repeat Defaulters**"). These Special Accounts including Repeat Defaulters are being provided an opportunity to either Implement a RP within 180 days of the default or be compulsorily referred to the NCLT under the IBC.

This special resolution mechanism is expected to be extended in some manner to accounts with an AE of INR 1 billion to INR 20 billion over the course of the next two years. However, till the time RBI announces such a reference date for implementing a RP in respect of such accounts, there appears to be no stringent timeline for implementing the RP for such accounts or for a compulsory reference under IBC for non-compliance with a RP. This has probably been done to ensure that the NCLT does not get over burdened with cases being referred by lenders and also because the RBI is taking a calibrated approach towards resolution of stressed assets by dealing with high value assets first.

Further, the Revised Framework declares borrowers who have committed frauds/ malfeasance/ wilful default as ineligible for restructuring. This appears to have been made in light of the Insolvency and Bankruptcy (Amendment) Act, 2017 notified on January 18, 2018. Also, the Revised Framework takes into account the exemptions provided under SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 and the SEBI (Substantial Acquisition of Shares and Takeovers), 2011 for restructurings carried out as per the regulations issued by RBI and provides that these exemptions will form a part of the revised prudential norms applicable to restructurings.

Also, the Revised Framework has specifically allowed Lenders to individually take steps to cure defaults in the borrower entity's account. This will have a significant impact on borrowings given by a consortium of lenders. This may, effectively, result in different lenders pursuing different actions such as change in control, proceedings under IBC, action under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 for the same account. Accordingly, the Revised Framework seems to have opened gates to various corrective steps which may defeat the purpose of streamlining the RP process.

On its own legs, the Revised Framework will work to ease the process and dissolve the confusion created under the Existing Schemes and will lend credibility and certainty to both lenders and borrowers in respect of resolution of stressed assets and consequences for non-compliance with the mechanisms prescribed under the Revised Framework.

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You can direct your queries or comments to the authors

¹ Such as the Joint Lenders Forum ("JLF"), Corporate Debt Restructuring ("CDR"), Strategic Debt Restructuring ("SDR") and the Scheme for Sustainable Structuring of Stressed Assets ("S4A").

² Lenders under the Revised Framework would generally include all scheduled commercial banks (excluding regional rural banks) and all India financial institutions.

³ The Revised Framework defines "Specified Period" as follows:

'Specified Period' means the period from the date of implementation of RP up to the date by which at least 20 percent of the outstanding principal debt as per the RP 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 RP.

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