Revised framework for resolution of stressed assets

Based on the RBI circular dated 12 February 2018

EY

Building a better working world

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Foreword

A new outlook toward restructuring

The Reserve Bank of India (RBI) came out with a revised framework for expeditious resolution of bad loans, harmonising the existing guidelines with the norms specified in the Insolvency and Bankruptcy Code (IBC). The new guidelines have specified framework for early identification and reporting of stressed assets.

RBI, vide its is Circular dated 12 February 2018, has charted a new direction for lenders and borrowers to resolve stress on their respective balance sheets. All the extant instructions till 12 February 2018 on resolution of stressed assets stand discontinued. All accounts, including the ones, where any of the schemes have been invoked but not yet implemented, are to be governed by the revised framework.

The longer-term implication of the Circular is similar to the IBC, i.e., drive a better corporate credit culture in the country, primarily by giving more powers to the lenders and disallowing defaulting promoters (as defined in Section 29A of the IBC) from getting their business back in change in control situations. However, as against the IBC, promoters can be stakeholders in a resolution plan. Further, the efficacy of resolution plans as well as credit appraisals would be better given the strict consequences around default and the IBC implications.

The shorter-term implications of the Circular are more severe on the already stressed banking system:

- Immediate provisioning in case of the stressed accounts, where any of the earlier RBI schemes have been invoked but not yet implemented
- Strict timeline of 180 days to find and complete (stringent requirements for completion) a resolution
- Weekly reporting to CRILC for defaults above INR50m and CRILC – The main report to be submitted monthly (vis-à-vis quarterly reporting earlier)
- Government may have to reconsider the bank recap amount as higher provisioning will require more capital support

Given this context, banks (especially public sector banks) are left with three options to resolve the stress:

- Find a resolution as per this Circular outside of the IBC in terms of a resolution plan, which would mostly involve a financial investor (ARC/distressed fund) as a minority partner
- File for insolvency proceedings against the borrower
- Sell a majority stake to an ARC/distressed fund or strategic buyers within 180 days

The public sector banking ecosystem is still probably not conducive enough to finding a market-driven solution for stressed cases (fear of 3Cs and different pricing expectations); hence, it is possible that instead of finding a resolution per this Circular, banks could prefer to sell their exposures to an ARC or file for insolvency proceeding under the IBC.

It is also in the interest of promoters to find a comprehensive solution much earlier than wait for a default to happen. Such solutions would be cheaper compared to a restructuring, where they may also be at a risk of losing their business.

Ex-RBI governor, Raghuram Rajan, had once suggested that distressed asset investors and corporate turnaround specialists should play a much bigger role in India. With the advent of the IBC and now this Circular, we could very well be moving in that direction at a much faster pace.

Abizer Diwanji

Partner & National Leader, Financial Services, Restructuring & Turnaround Services, EY

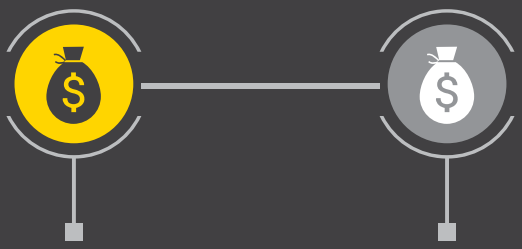
Key highlights
of the revised framework

- **Applicability** - Scheduled commercial banks (excluding RRBs) All India FI (EXIM, NABARD, NHB, SIDBI)
- **Repealed all earlier restructuring schemes** (CDR, JLF, SDR, S4A, flexible restructuring etc.)
- All lenders to **develop board-approved policies** for resolution of stressed assets under this framework
- For existing defaults, where resolution plan aggregate exposure is greater than **INR20b**, RP to be finalized within **180 days** from 1 March 2018
- Stringent implementation norms - **100% lender approval**, security creation/ perfection, capital structure changes to be achieved
- In case of change in ownership, Section 29A of the IBC to be adhered to
- **Independent credit evaluation** by credit rating agencies (CRA) introduced
- All cases where earlier **scheme invoked but not implemented** to fall under the **revised framework**
- If implementation of RP fails during "**specified period**," lenders to take borrower to the IBC
- Transaction of **sale and leaseback/refinancing** in foreign currency tantamount to restructuring

Resolution plan outside the IBC

The resolution plan may involve any actions/plans/reorganization including, but not limited to:

- Regularization of the account by payment of all over dues by the borrower entity
- Sale of the exposures to other entities/investors,
- Change in ownership
- Restructuring



INR20b and above

- Non implementation of resolution plan within 180 days from the reference date; company required to be referred to the IBC
- Default during specified period - company to be referred under the IBC

Below INR20b

- Reference date to be announced by RBI

**Specified period means the period from the date of implementation by which atleast 20% of the outstanding principle debt as per RP and interest capitalization, if any has been repaid*

Revised regulatory and reporting framework

Asset classification and provisioning

- Downgrade to NPA
- IRAC to follow restructuring

Income recognition

- **Standard assets:** On accrual basis
- **NPA assets:** On cash basis

Upgradation

- No default in specified period
- And 20% of restructure principle and capitalized interest

Additional finance

- Account performing satisfactorily remains standard unless there is a default

Reporting and supervision

- **Trigger:** SMA Classification
- **Accounts (exposure INR50m+):** Monthly reporting (CRILC main report) on credit information and classification
- **Accounts in default (exposure INR50m+):** Weekly reporting to CRILC, starting 23 February 2018

Intent to conceal actual status/ ever-greening of stressed accounts will be subject to stringent supervisory/ enforcement action

Sale and leaseback

To be treated as restructuring, if:

- Seller is in financial difficulty
- More that 50% revenues interlinked
- 25% funded by existing lenders

Regulatory Exception (RBI & SEBI)

- Shares to be valued as per previously issued guidelines
- Acquisition of shares due to conversion is also exempted from regulatory ceilings/restrictions on capital market exposure

Change in control within 180 days

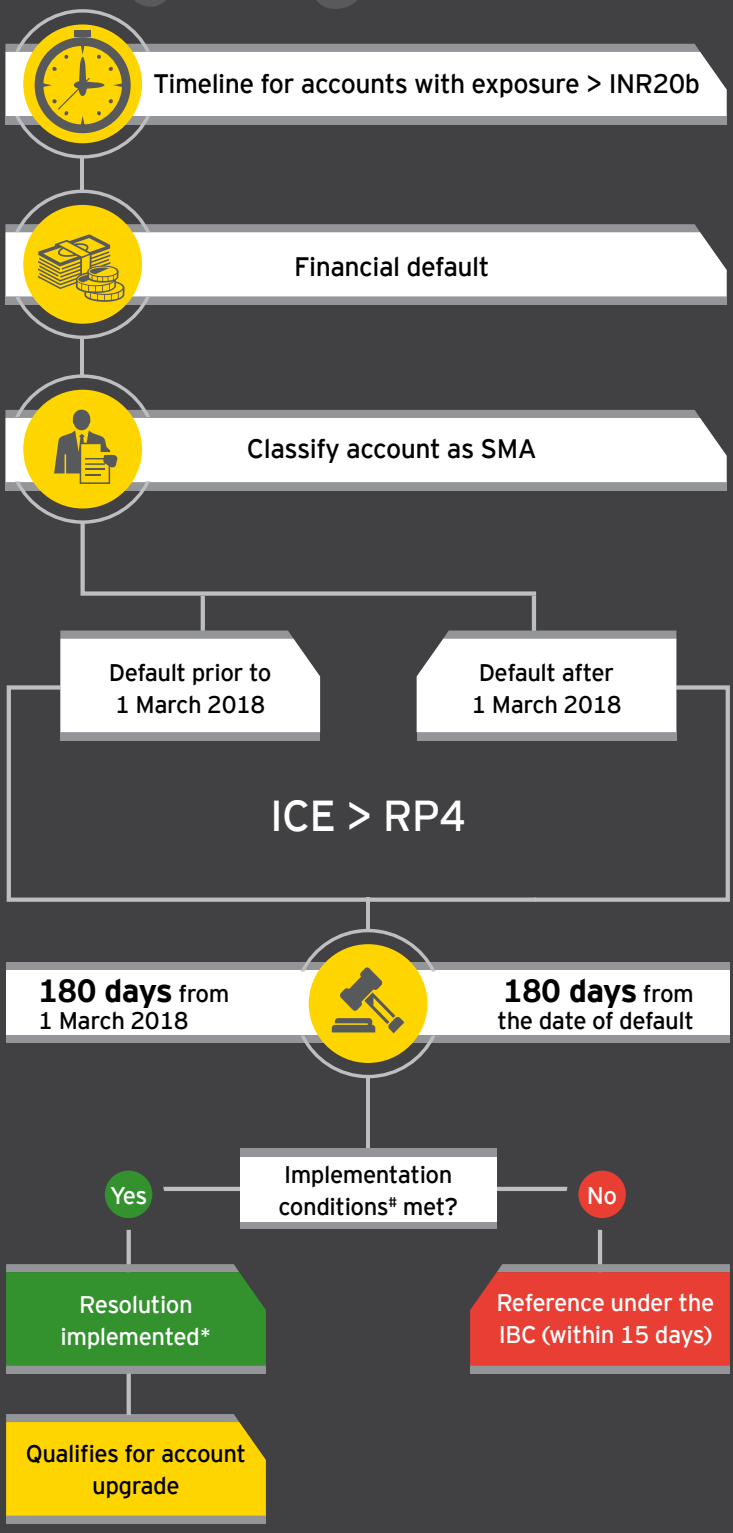
- Any change in control to any other acquirer not disqualified under Section 29A of the IBC would upgrade the account immediately
- Acquirer to be the single largest shareholder with minimum 26% of paid up equity and be in "control" as per definition of "control" in Companies Act 2013

Refinancing in different currency

To be treated as restructuring, if:

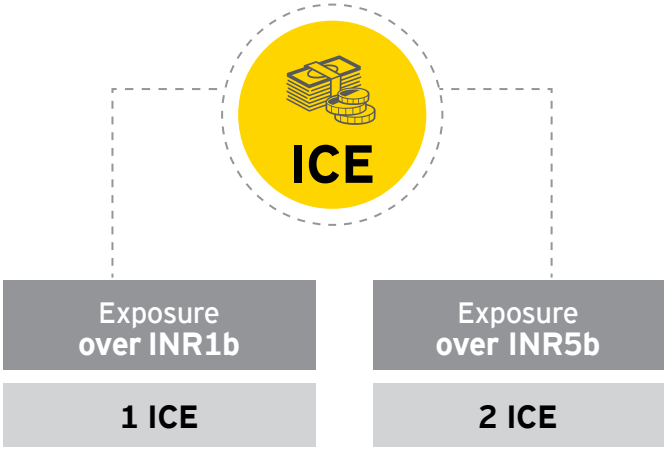
- Borrower in financial difficulty
- Refinancing of RTL, from lenders part of Indian banking system in the form of guarantees /LCs/letters of comfort
- Rupee loans to refinance FC borrowings/export advances
- Companies will not be able to raise debt to repay Indian lenders through SBLC issued by foreign branches of Indian banks

Resolution plan



*After implementation of the resolution plan but before completion of the specified period, if a default happens, lenders to file insolvency petition against the borrower

Key concepts and introduction of Independent credit evaluation

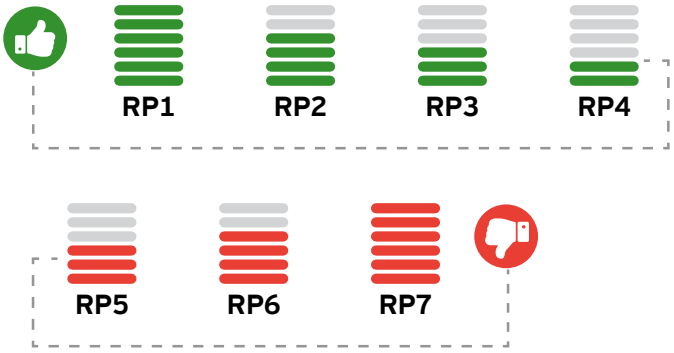


CRAs shall be directly engaged by the lenders and payment of fee shall also be made by the lenders

If lenders obtain ICE from more than the required number of CRAs, all such ICE opinions shall be RP4 or better

ICE symbols*

Degree of safety of timely servicing of debt obligations/risk of default



*ICE symbols defined in annexure on page 11

Resolution deemed to be implemented if:

a) No default persists

b) If restructured –

(i) 100% approval

(ii) All related documentation, execution agreements and security documents/ perfection are completed by all lenders

(iii) Changes in new capital structure/new terms reflected in books of lenders and borrowers

Specified period:

- Atleast 20% debt (Principle & Interest) is repaid from date of implementation of RP
- Such period cannot end before one year from the commencement of first repayment, on the credit facility with the longest period of moratorium under RP

Asset classification

During the implementation period, usual asset classification norms to continue. The process of re-classification of an asset should not stop merely because resolution plan is under consideration.

Fresh default

Any default in payment after the expiry of the specified period shall be reckoned as a fresh default.

Prudential norms

Largely unchanged from prior regime

Asset classification on restructuring	▶ Immediate downgrade to NPA ▶ After restructuring, extant IRAC norms to follow
Conditions for upgrade	▶ No default in specified period (account will not upgrade till 20% of obligations are repaid or completion of 1 year, whichever is later) ▶ For large accounts* , ratings# of credit facilities of the borrower should be at an investment grade of BBB- or better at the end of specified period
Provisioning	▶ Extant guidelines to apply ▶ Provisions under earlier schemes to continue till account becomes standard
Income recognition	▶ Standard assets: On accrual basis ▶ NPA assets: On cash basis
No upgrade for conversion of debt to equity/debt instruments	▶ Quoted equity/debt instrument shall be valued at mark to market, else balance sheet value (without considering the revaluation reserve); if balance sheet value unavailable, entire portfolio shall be valued at INR1
Additional finance	▶ Account performing satisfactorily (no default in payment during specified period): Standard ▶ Account not performing satisfactorily: NPA
Change in ownership	▶ Upgrade available – For change in ownership (under framework/the IBC) ▶ Acquirer to hold at least 26% (29A applicable) and should be the single largest shareholder ▶ New promoter shall be in "control" of the borrower entity as per the Companies Act 2013/ SEBI regulations/ Accounting Standards

*Aggregate exposure of lenders INR1b and above;

Normal ratings provided by CRAs

Practical applicability and impact on current cases

Case in point	Implications
Cases that were referred to SDR and shares have been issued however, 26% stake sale is pending to the new investor	▶ SDR repealed and since no moratorium available, provisioning to be made with retrospective effect ▶ If debt is more than INR20b, then timelines to be adhered to and reference to the IBC will be applicable thereafter
Requirement of viability parameters like DSCR, Techno-economic viability study etc.	Prerogative of Credit Rating Agencies
Framework is exempted for the cases referred by RBI to NCLT	Guidelines not applicable on the cases that were referred by RBI to NCLT; however, cases that did not get admitted should be covered under this framework
Implementation timelines for cases below INR20b	RBI to announce the dates for implementation over a period of two years
Upgradation of the account after the specified period	After satisfactory performance of the account, account to be upgraded if 20% of the debt is repaid; similarly, if the debt was converted into equity instrument, then it will also be upgraded

Impact on current cases

Cases currently under the IBC

- ▶ No impact of the revised framework

SDR invoked but not implemented

- ▶ SDR guideline repealed, thus no share transfer
- ▶ Provisioning as per IRAC guidelines

SDR under implementation (investor onboarding in process)

- ▶ SDR has been repealed; hence, account classification will be as per IRAC guidelines
- ▶ Lenders can still induct a new investor under the new framework; account will be upgraded on induction of new investor and completion of requirements as per para 5 of the Circular
- ▶ However, investors are now subject to meeting the requirements as per Section 29A of the IBC

S4A cases (under implementation) /CDR cases

- ▶ Current provisioning to be as per normal IRAC guidelines
- ▶ New resolution plan needs to be put in place as per the revised framework
- ▶ For restructuring cases, definition of "specified period" has been revised
- ▶ Provisioning as per IRAC norms

Refinancing cases

- ▶ Refinancing of project loans has been repealed

In summary

- Clear direction to lenders to be more proactive in identifying and resolving all stressed accounts, and that too in a time-bound manner
- Framework aims to drive a more robust resolution of the stress versus kicking-the-can-down-the-road solution; governance structures set to improve for promoters tying up with ARCs/ distressed funds
- Adds more strength to ongoing drive to create a better credit culture in the country
- Promoters should also proactively seek to address liquidity challenges much before actual default happens
- Financiers can have deferred commitment schemes to fund 20% of revised principal and interest after one year on satisfactory performance and put in incremental capital to back a revival plan now
- Better credit appraisal processes as banks would now have to factor in contingencies to tide over uncertainties which bring about day 1 defaults

- Higher provisioning for lenders on existing default cases, further constraining their ability to lend
- Additional capital (in addition to recap amounts identified by the Government) will be required for select banks
- Stringent implementation requirements will make it difficult to close resolution plan within 180 days, leading to many cases going to the IBC
- Higher number of cases going to the IBC will further stretch NCLT infrastructure, leading to delays in admission of insolvency applications and approval of resolution plans
- Lenders will have to devote more resources for the resolution of stressed cases

Annexure

ICE Symbols	Definition
RP1	Debt facilities/instruments with this symbol are considered to have the highest degree of safety regarding timely servicing of financial obligations. Such debt facilities/instruments carry lowest credit risk.
RP2	Debt facilities/instruments with this symbol are considered to have high degree of safety regarding timely servicing of financial obligations. Such debt facilities/instruments carry very low credit risk.
RP3	Debt facilities/instruments with this symbol are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such debt facilities/instruments carry low credit risk.
RP4	Debt facilities/instruments with this symbol are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such debt facilities/instruments carry moderate credit risk.
RP5	Debt facilities/instruments with this symbol are considered to have moderate risk of default regarding timely servicing of financial obligations.
RP6	Debt facilities/instruments with this symbol are considered to have high risk of default regarding timely servicing of financial obligations.
RP7	Debt facilities/instruments with this symbol are considered to have very high risk of default regarding timely servicing of financial obligations.

Acronym	Definition
CRA	Credit rating agency
Aggregate	Fund and non-fund based facilities
RP	Resolution plan being approved by all the lenders
ICE	Independent credit evaluation
IBC	Insolvency and Bankruptcy Code 2016
CRILC	Central Repository of Information on Large Credits
ARC	Asset Reconstruction Company
RRB	Regional Rural Banks
IRAC	Income Recognition, Asset Classification and Provisioning pertaining to Advances
SMA	Special Mention Account

Acronym	Definition
DSCR	Debt Service Coverage Ratio
NCLT	National Company Law Tribunal
SDR	Strategic Debt Restructuring
CDR	Corporate Debt Restructuring

Term	Definition
Aggregate exposure	Fund and non-fund based facilities
Default	Non-payment of debt when whole or part becomes due and payable and is not repaid by the debtor For revolving facilities like cash credit, "default" means outstanding balance remaining in excess if sanctioned limit or drawing power, whichever is lower, for more than 30 days
Residual debt	Total fund and non-fund based debt as per the proposed resolution plan even under consortium funding or outside consortium

About EY's Restructuring and Turnaround practice

More than 100 debt and operational restructuring assignments delivered in India with a total debt impact of around **US$100 billion**

Working closely with the government to implement changes

First to successfully work on all the scheme introduced by Government or RBI to deal with NPLs (SDR, S4A, IBC)

100 + knowledge sharing sessions on policy/regulations update for clients

Ability to provide completely integrated services

Belief in open and honest communication with clients

Sensitive of changing times or providing deliverable on time

High on advocacy. Consistently issuing thought leadership documents, industry papers and conducting conferences for clients

around **150** people

08	Partners/Executive Directors /Associate Partners
15	Directors/Senior Managers
24	Managers
52	Seniors
42	Staffs/Assistants

Started in **2012**

External panel of Industry experts, CFO, CEO, COO, IPs

More than **5000 hours** in last 12 months spent in training the team

5 registered Insolvency professionals (IPs) and few more in pipeline

We have proven methodology for your services, with ready repository of templates

Qualifications: CA, MBA, Engineers, CFA, lawyers, CS, Insolvency professionals

Sector / industry specialization is core to our team strength

Geographical presence with team in all major cities of India

100 + quote in media in last six months

EY offices

Ahmedabad

2nd floor, Shivalik Ishaan
Near C.N. Vidhyalaya
Ambawadi
Ahmedabad - 380 015
Tel: + 91 79 6608 3800
Fax: + 91 79 6608 3900

Bengaluru

6th, 12th & 13th floor
"UB City", Canberra Block
No.24 Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 4027 5000
+ 91 80 6727 5000
+ 91 80 2224 0696
Fax: + 91 80 2210 6000

Ground Floor, 'A' wing
Divyasree Chambers
11, O'Shaughnessy Road
Langford Gardens
Bengaluru - 560 025
Tel: +91 80 6727 5000
Fax: +91 80 2222 9914

Chandigarh

1st Floor, SCO: 166-167
Sector 9-C, Madhya Marg
Chandigarh - 160 009
Tel. +91 172 331 7800
Fax: +91 172 331 7888

Chennai

Tidel Park, 6th & 7th Floor
A Block (Module 601,701-702)
No.4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: + 91 44 6654 8100
Fax: + 91 44 2254 0120

Delhi NCR

Golf View Corporate Tower B
Sector 42, Sector Road
Gurgaon - 122 002
Tel: + 91 124 464 4000
Fax: + 91 124 464 4050

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: + 91 11 6671 8000
Fax + 91 11 6671 9999

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
NOIDA - 201 304
Gautam Budh Nagar, U.P.
Tel: + 91 120 671 7000
Fax: + 91 120 671 7171

Hyderabad

Oval Office, 18, iLabs Centre
Hitech City, Madhapur
Hyderabad - 500 081
Tel: + 91 40 6736 2000
Fax: + 91 40 6736 2200

Jamshedpur

1st Floor, Shantiniketan Building
Holding No. 1, SB Shop Area
Bistupur, Jamshedpur - 831 001
Tel: +91 657 663 1000
BSNL: +91 657 223 0441

Kochi

9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 304 4000
Fax: + 91 484 270 5393

Kolkata

22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: + 91 33 6615 3400
Fax: + 91 33 2281 7750

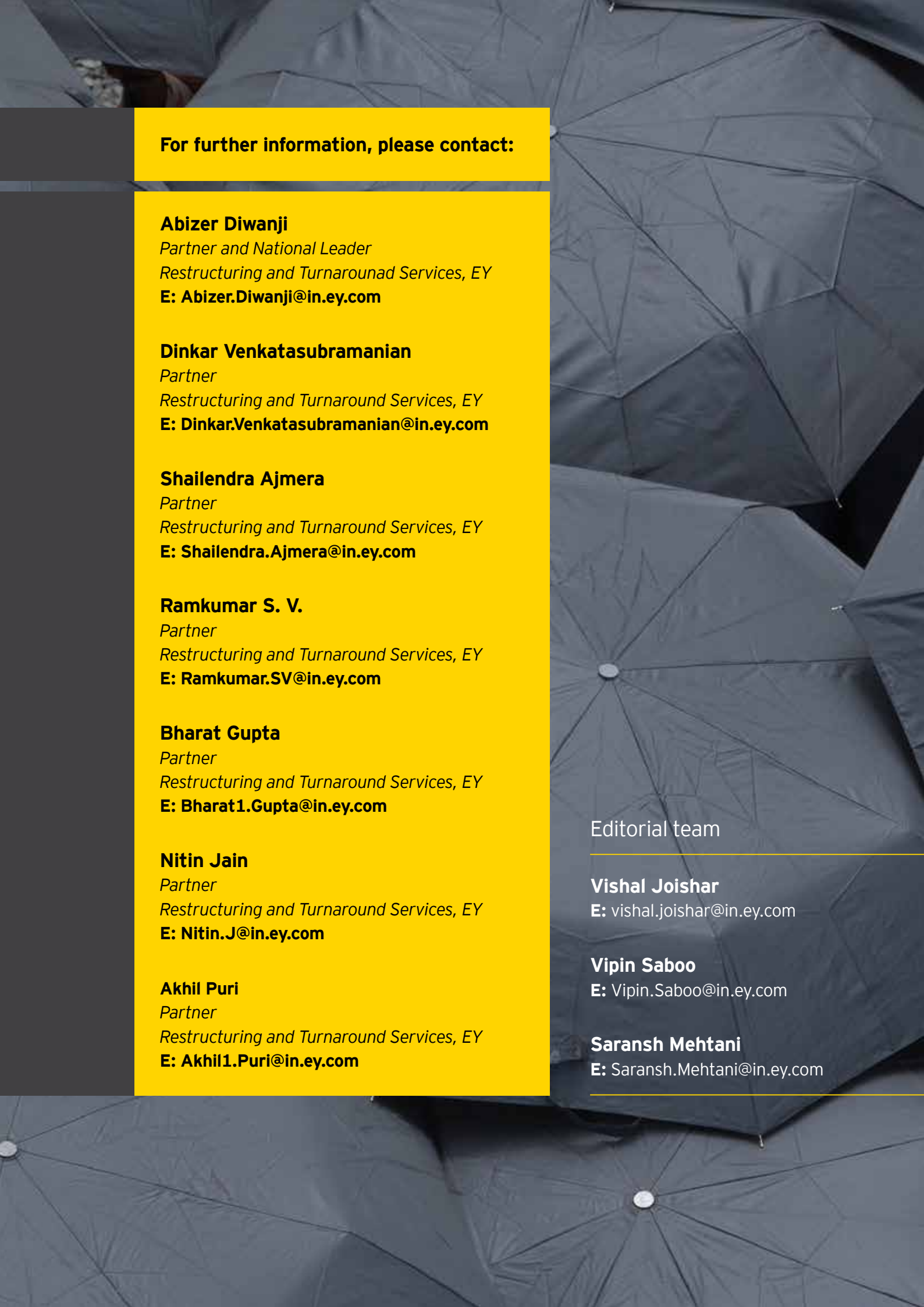
Mumbai

14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000
Fax: + 91 22 6192 1000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000
Fax: + 91 22 6192 3000

Pune

C-401, 4th floor
Panchshil Tech Park
Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 6603 6000
Fax: + 91 20 6601 5900



For further information, please contact:

Abizer Diwanji
Partner and National Leader
Restructuring and Turnarounad Services, EY
E: Abizer.Diwanji@in.ey.com

Dinkar Venkatasubramanian
Partner
Restructuring and Turnaround Services, EY
E: Dinkar.Venkatasubramanian@in.ey.com

Shailendra Ajmera
Partner
Restructuring and Turnaround Services, EY
E: Shailendra.Ajmera@in.ey.com

Ramkumar S. V.
Partner
Restructuring and Turnaround Services, EY
E: Ramkumar.SV@in.ey.com

Bharat Gupta
Partner
Restructuring and Turnaround Services, EY
E: Bharat1.Gupta@in.ey.com

Nitin Jain
Partner
Restructuring and Turnaround Services, EY
E: Nitin.J@in.ey.com

Akhil Puri
Partner
Restructuring and Turnaround Services, EY
E: Akhil1.Puri@in.ey.com

Editorial team

Vishal Joishar
E: vishal.joishar@in.ey.com

Vipin Saboo
E: Vipin.Saboo@in.ey.com

Saransh Mehtani
E: Saransh.Mehtani@in.ey.com

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@EY_India EY|LinkedIn YouTube EY India EY India careers ey_indiacareers