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RESTRUCTURING IS THE WAY FORWARD – RBI CIRCULAR TO ADDRESS COVID-19 RELATED STRESS

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In continuation of Reserve Bank of India's (RBI) efforts to ease financial stress caused by the Covid-19 pandemic, the RBI issued the circular on the Resolution Framework for Covid-19 Related Stress dated 6 August 2020 (August 6 Circular). The August 6 Circular creates a limited time window for certain categories of borrowers affected by Covid-19 pandemic related business disruption to be allowed resolution plans in the nature of restructuring while permitting the borrower accounts to retain their status as 'standard'. This effectively would be a carve out from the RBI's circular on Prudential Framework for Resolution of Stressed Assets dated 7 June 2019 (June 7 Circular) which requires status downgrade of borrower accounts which are restructured under the same management until satisfactory performance threshold is met. This dispensation is intended to facilitate revival of real sectors and avoid impairment of the recovery process as well as the consequent risk on the financial stability in general.

Key provisions of the August 6 Circular are set out below:

Coverage: The August 6 Circular covers (i) all Commercial Banks (including Small Finance Banks, Local Area Banks and Regional Rural Banks), (ii) all Primary (Urban) Co-operative Banks/State Co-operative Banks/ District Central Co-operative Banks (iii) All India Financial Institutions, (iv) Non-Banking Financial Companies (including Housing Finance Companies) (collectively, Lending Institutions). The August 6 Circular covers an additional group of lending institutions, i.e. Local Area Banks, Regional Rural Banks and the cooperative banks which were specifically excluded under the June 7 Circular.

Applicability: The August 6 Circular is applicable only to eligible borrowers i.e. corporate persons or individuals, under stress 'on account of the Covid-19 pandemic'. The August 6 Circular stipulates that only those borrowers whose accounts were classified as 'standard' but not in default for more than 30 days with the Lending Institution as on the reference date, i.e. 1 March 2020 are eligible for resolution under the provisions of the August 6 Circular. The eligible borrowers' account should be continued to be classified as 'standard' until invocation of the resolution i.e. the date when the parties agree to proceed with a resolution plan. In this regard, the Lending Institutions are required to put in place a board-approved policy detailing the manner in which such Lending Institutions would determine the eligibility of the borrower covered under the August 6 Circular, assess the viability of a resolution plan proposed to be implemented including the objective criteria that may be applied while considering the resolution plan and the due diligence considerations to be followed to ascertain the necessity of implementing a resolution plan in each case.

Exclusions: The August 6 Circular expressly excludes credit facilities/ borrowers that have been excluded under the June 7 Circular i.e. restructuring in respect of projects under implementation involving deferment of date of commencement of commercial operations, rehabilitation of Micro, Small and Medium Enterprises (MSME), restructuring of loans in the event of a natural calamity. Additionally, the August 6 Circular stipulates that the following persons shall be excluded from its scope and ambit:

- MSME borrowers whose aggregate exposure to all its lending institutions collectively is INR 25 crore or less as on 1 March 2020;
- Farm credit listed under Master Direction - Priority Sector Lending - Targets and Classification dated 7 July 2016 or other relevant instructions as applicable to a specific category of Lending Institutions;
- Loans to Primary Agricultural Credit Societies (PACS), Farmers' Service Societies (FSS) and Large-sized Adivasi Multi- Purpose Societies (LAMPS) for on-lending to agriculture;
- Exposure to financial service providers (as defined under the Insolvency and Bankruptcy Act, 2016 (IBC));
- Exposures of lending institutions to Central and State Governments, Local Government bodies (such as 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 in terms of the Master Circular - The Housing Finance Companies (NHB) Directions, 2010 after 1 March 2020, unless a resolution plan under the August 6 Circular has been invoked by other Lending Institutions. The August 6 Circular clarifies that from the date of the circular, any resolution necessitated on account of the economic fallout of Covid-19, shall be undertaken only under the August 6 Circular.

The framework of the August 6 Circular is covered in four broad parts:

- Part A - deals with conditions for resolution of personal loan;
- Part B - deals with conditions for resolution of other eligible borrowers;
- Part C - deals with prudential treatment of the exposures in respect of which resolution plans are implemented under the August 6 Circular; and
- Part D - deals with disclosure requirements.

Part A - Resolution of Personal Loans

Unlike the June 7 Circular which primarily focused on the large stressed accounts, the August 6 Circular provides an exhaustive framework for the resolution of stress in relation to personal loans. Under the August 6 Circular, the expression 'personal loans' refers to loans given to individuals which include (a) consumer credit, (b) education loan, (c) loans for immovable properties (e.g., housing loans), and (d) loans for investment in financial assets (shares, debentures, etc.). However, the credit facilities provided by Lending Institutions to their own personnel/staff are excluded from the ambit of the circular. The key features in relation to resolution of personal loans under the August 6 Circular are as under:

Timeline for Invocation and completion: A resolution under the August 6 Circular may be invoked no later than 31 December 2020 and must be implemented within 90 (ninety) days from the date of invocation. Given that most personal loans would be

with a single Lending Institution, the timeline for implementation of the resolution plan seems practicable.

Types of Resolution Plans: The resolution plans for personal loans may include rescheduling of payments, conversion of any interest accrued or to be accrued into another credit facility, granting of a moratorium, etc. based on an assessment of income streams of the borrower, subject to a maximum of two years, etc. Correspondingly, the overall tenor of the loan may also get modified commensurately. The moratorium period, if granted, shall come into force immediately upon implementation of the resolution plan.

Date of Implementation: The August 6 Circular stipulates that a resolution plan is deemed to be implemented only if all the following conditions are satisfied:

- execution of all related documentation including security documentation;
- the changes in the terms or conditions of the loans are reflected in the books of the Lending Institutions; and
- the borrower is not in default with the Lending Institution as per the revised terms.

Part B - Resolution of Other Exposures

The provisions of this part are applicable to exposures of Lending Institutions other than those covered in Part A, i.e. loans to eligible corporates. The key features are elucidated below:

Determination of Resolution Plan: In the event, there is only one Lending Institution with exposure to the borrower, the decision regarding the request for a resolution by the borrower may be taken by the Lending Institution in accordance with the board-approved policy of the said Lending Institution and within the contours of the August 6 Circular. For this purpose, the date of invocation shall be the date on which both the borrower and Lending Institution agree to proceed with a resolution plan. However, in the event there are multiple Lending Institutions with exposure to the same borrower, the resolution process shall be treated as invoked in respect of such borrower when the Lending Institutions representing 75% by value of the total outstanding credit facilities (fund based and non-fund based) and not less than 60% per cent by number agree (Majority Lenders) to invoke the process.

Timeline for Invocation and Completion: A resolution under the August 6 Circular may be invoked no later than 31 December 2020 and must be implemented within 180 (one hundred and eighty) days from the date of invocation.

Contours of the Inter-creditor Agreement: Similar to the June 7 Circular, the August 6 Circular also stipulates the requirement of execution of an inter-creditor agreement (ICA) amongst the Lending Institutions and execution of the ICA within a maximum period of 30 (thirty) days from the date of invocation. In cases where the ICA is not executed within 30 (thirty) days from the date of invocation, the invocation will be treated as lapsed, and no further invocation shall be permitted under the August 6 Circular.

As regards lenders other than the Lending Institutions, RBI has clarified that such lenders can also be a party to the ICA. Unlike the June 7 Circular, in the August 6 Circular RBI has clearly laid out its position on the inter-creditor disputes vis-à-vis the resolution plan. The August 6 Circular categorically provides that in the event there is any dispute among the signatories of the ICA regarding the resolution process, the same shall only be settled as per the provisions of the ICA. The RBI shall not intermediate any such disputes *inter se* the creditors. Further, the Lending Institutions are required to ensure that the ICA contains a dispute redressal mechanism that clearly lays down the recourse

available to a signatory to the ICA who wants to raise a dispute. In addition, the ICA should also contain suitable mechanisms for information sharing amongst Lending Institutions during and after implementation of the resolution plan.

Constitution of Expert Committee: It has been further stipulated that a committee (Expert Committee) headed by Shri K. V. Kamath shall be formed to make recommendations to the RBI on the required financial parameters, along with the sector-specific benchmark ranges for such parameters, to be factored into resolution plans which would be allowed under the August 6 Circular (Recommendations). These parameters would cover aspects related to *inter alia* leverage, liquidity, debt serviceability. The Expert Committee shall also vet the resolution plans to be implemented under the August 6 Circular in respect of large accounts where the aggregate exposure of all Lending Institutions to an eligible borrower exceeds INR 1,500 crore. The Expert Committee shall verify that all the processes have been followed by the parties concerned as required under the August 6 Circular without interfering with the commercial judgment of the lenders. The RBI will notify the parameters within 30 (thirty) days of receiving them from the Expert Committee.

Key Features of the Resolution Plan: The resolution plan contemplated under August 6 Circular may contain the following features and such other minimum parameters suggested by the Expert Committee:

- an action plan / reorganization including regularisation of the account by payment of all over dues by the borrower, sale of the exposures to other entities / investors, change in ownership, sanction of additional facilities and restructuring except compromise settlements which shall continue to be governed by the provisions of the June 7 Circular or the relevant instructions, if any, applicable to specific category of Lending Institutions where the June 7 Circular is not applicable.
- conversion of debt into equity or other marketable, non-convertible debt securities issued by the borrower, provided that post implementation, the amortisation schedule and the coupon carried by such debt securities are similar to the debt held on the books of the Lending Institutions.
- extension of the residual tenor of the loan, with or without payment moratorium, by a period of not more than 2 (two) years. Any moratorium contemplated under a resolution plan shall come into force immediately upon implementation.

Credit Rating and Escrow Mechanism: The resolution plan in respect of accounts where the aggregate exposure of the Lending Institutions at the time of invocation of the resolution process is INR 100 crore and above, shall require an independent credit evaluation by any one credit rating agency authorised by the RBI under the June 7 Circular. Further, in the event of multiple banking arrangements, the borrower and the Lending Institutions are also required to enter into an escrow arrangement with one of the Lending Institutions for routing of the cash flows. The Lending Institutions shall enter into formal agreement to record the duties and responsibilities of the escrow manager and the Lending Institutions, as well as the enforcement mechanisms.

Part C - Asset Classification and Provisioning

Like the June 7 Circular, the August 6 Circular also provides for a detailed asset classification and provisioning norms as set out below:

- If additional finance has been sanctioned to the borrower to meet interim liquidity requirements, the account will be classified as 'standard' till the implementation of the resolution plan, even if the additional finance is sanctioned before the resolution plan is implemented. However, if the resolution plan is not implemented within the timelines under August 6 Circular, the asset classification for the additional finance

shall be as per the actual performance of the borrower with respect to the additional finance or the rest of the credit facilities, whichever is worse.

- If a resolution plan is implemented as per the timelines, then the asset classification of borrowers' accounts classified as standard may be retained as such upon implementation. In the event the account of the borrower gets downgraded from standard to non-performing asset (NPA) between the invocation and implementation of the resolution plan, the account may be upgraded to standard, as on the date of implementation of the plan.

Further, the August 6 Circular also provides for provisioning norms required to be followed while implementing a resolution plan under the August 6 Circular. The key features of the same as under:

Implementation of Resolution Plan	Provisioning
For Personal Loans	Higher of (i) provisioning as per the extant the Master Circular on Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances (IRAC) norms immediately before implementation, or (ii) 10% of the renegotiated debt exposure of the lending institution post-implementation of the resolution plan.
Other Cases (for Lending Institutions executing the ICA)	Higher of (i) provisioning as per the extant IRAC norms immediately before implementation, or (ii) 10% of the total debt including issued debt securities, held by the Lending Institutions post implementation of the resolution plan.
Other Cases (for Lending Institutions not executing the ICA or where the invocation has lapsed)	Higher of (i) provisioning as per the extant IRAC norms immediately before implementation, or (ii) 20% of the debt on their books.

Reversal of provisioning: The August 6 Circular provides for a mechanism for reversal/ adjustments of the provisions made either under the June 7 Circular or the under RBI's Covid-19 Regulatory Packages dated 27 March 2020 (as amended or revised):

Particulars	Reversal
Personal loans and other cases where the Lending institutions have executed the ICA	Reversal of 50% of the provisioning on payment of the 20% of the residual debt and balance on payment of 10% of the residual debt (in all cases without the account slipping into NPA subsequently)
Accounts where the Lending Institutions have not executed the ICA	Reversal of 50% of the provisioning on payment of the 20% of the carrying debt and balance on payment of 10% of the carrying debt, subject to required IRAC provisions being maintained

Post implementation compliances: For personal loans, post implementation of the resolution plan, the subsequent asset classification shall be as per the IRAC norms or other relevant instructions as applicable to a specific category of Lending Institutions. For all the other cases, any default by the borrower with any of the signatories of the ICA during the monitoring period (which is until repayment of 10% of the residual debt or one year from commencement of repayment, whichever is longer) shall trigger a review period of 30 days. If the default continues after the expiry of the review period, the asset classification with all Lending Institutions will be classified as an NPA.

Part D – Disclosures and Credit Reporting

The Lending Institutions are required to make adequate disclosures in the format provided in the August 6 Circular till all exposures pertaining to which resolution plan was implemented is either fully extinguished or completely slips into NPA, whichever is earlier. Further, the credit reporting of the borrowers where the resolution plan has been implemented under the August 6 Circular shall reflect as 'restructured', if the account involves renegotiations that would be classified as restructuring under the June 7 Circular.

CONCLUSION

With the suspension of Sections 7, 9 and 10 of the IBC earlier this year on account of Covid-19, the June 7 Circular was the key framework available for collective resolution of stressed assets. However, since the June 7 Circular pre-dates Covid-19 and disincentivizes banks to approve resolution plans/ restructurings without change of control, it was widely expected that RBI would allow some relaxation in its resolution framework on a one-time basis to allow restructuring necessitated in the wake of financial stress caused on account of outbreak of Covid-19. This would also be in continuity to the loan moratorium announcements made by RBI since March this year, albeit with limited time for invocation and implementation, as prescribed under the August 6 Circular. The limited period window means that the stakeholders would now need to speed up the process of agreeing on the inter-creditor mechanism and work out a resolution plan within the timelines prescribed. This makes the role and recommendations of the Expert Committee constituted by the RBI very crucial in terms of showing direction to the lenders on the way forward in dealing with requests for resolution under the August 6 Circular.

It will be interesting to see how the eligibility conditions to get the relief under the August 6 Circular are interpreted by the courts, as it is currently applicable only in relation to those borrowers that were not in default for more than 30 days as on 1 March 2020 with any Lending Institutions. This introduces an element of subjectivity which could get challenged by others facing stress if they are left out from the scope of this August 6 Circular, similar to the disputes raised by the stakeholders in respect of the RBI's COVID-19 Regulatory Package. While interpreting the RBI's COVID-19 Regulatory Package, the Courts have in general taken a more considerate and accommodative approach to even allow situations which may not fall within the scope of RBI's COVID-19 Regulatory Package as against a literal interpretation to deny relief to the affected parties.

Overall, the announcements made by RBI paves the way forward for dealing with distress caused in the real sector and its impact on the Lending Institutions/ financial system in general, as a direct consequence of Covid-19. It would be relevant to note that the success of this regime introduced by RBI would also depend on co-operation by the institutional/foreign creditors/investors who are not covered by the August 6 Circular and are currently in a stand-still mode on account of suspension of the IBC. If that situation changes, the field could still remain open for forcing change of control through the insolvency process and in a way makes it imperative that the IBC remains

suspended beyond six months for this new regime to settle down and be used effectively by lenders to support businesses in distress.

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