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New Framework for Stressed Assets

The Reserve Bank of India ("**RBI**"), on 12 February 2018, released a revised framework resolution for restructuring of stressed assets. The new framework puts an end to the series of schemes introduced since 2001 such as the Corporate Debt Restructuring **("CDR")** scheme, the Strategic Debt Restructuring **("SDR")** scheme, Scheme for Sustainable Structuring of Stressed Assets **("S4"),** Guidelines on Joint lender Forum **("JLF")**, Prudential Guidelines on Restructuring of Advances.

Clearly the earlier schemes were not as viable as RBI/the banks would have liked. With the new framework there is an endeavour to stream-line the restructuring options and processes. However, the timelines have become stricter. Will the new framework succeed - only time will tell.

The new framework anticipates the banks will work more strictly as failure to take actions may require on higher provisioning of stressed accounts and also monetary penalties.

The reporting under the new framework for the banks begins from 23 February 2018 and thereafter on a monthly basis from 1 April 2018.

Some of the main features of the new framework are set-out below:

1. Mechanism for identification and reporting of stressed accounts:-

Classification of stressed assets to be done immediately on default unlike the old regulations where the banks waited for 90 days to classify the account as Non-Performing Assets **("NPA")**. The basis for the classification of the stressed accounts is now required to be made under three categories as Special Mention Accounts –

a. SMA-0 (for default between 1 to 30 days);
b. SMA-1 (for default between 31 to 60 days); and
c. SMA-2 (for default between 61 to 90 days).

This requirement may sharply increase in NPA provisioning and impact the profitability of the banks.

2. Resolution Plan

The banks are required to put-in place a Board approved policy for Resolution Plan **("RP")** of stressed assets. The RP will be deemed to be implemented only if the borrower is no longer in default, the necessary documents are executed and the conditions of restructuring that may have effect in the books of the banks are duly reflected.

In the event the RP requires the change of ownership for the stressed accounts with an exposure beyond Rs.1 billion and above **("Large Accounts")** the banks are required to obtain an independent credit evaluation from a credit rating agency.

3. Large Accounts

The provisions relating to Large Accounts have been divided into two parts. Part 1 for accounts with an aggregate exposure of Rs. 20 billion or above **("Category A Large Accounts")** and Part 2 for the accounts with an aggregate exposure of Rs. 1 billion or above but below Rs. 20 billion **("Category B Large Accounts")**.

For the implementation of the RP for Category A Large Accounts the timeline has been set of 180 days from the reference date (i.e. 1 March 2018) or first default (if the default is after 1 March 2018).

In the event the RP is not implemented within the said period the banks will have to file an application under Insolvency and Bankruptcy Code 2016 **("IBC")** within 15 days of the expiry of the timeline.

For the implementation of RP of Category B Large Accounts RBI will announce the reference date over a period of 2 years.

The above provision makes it mandatory for the banks to take action under IBC if the RP fails to be implemented. Therefore the banks need to consider loosing their rights under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 **("SARFAESI")** upon filing of an application under IBC.

4. Prudential Norms

The new framework stipulates the revised prudential norms for assets classification as NPA, additional finance, provisioning, conversion of debt, change in ownership, refinancing of exposures in different currency, etc.

5. Other Provisions

- The banks will have to supervise the accounts more strictly as any failure in meeting the timelines or taking any actions may have impact on higher provisioning of stressed accounts and also monetary penalties.

- The banks will have to make disclosures in its financial statements relating to the RP(s) implemented for which the detailed guidelines will be issued separately.
- The new framework is not be applicable to:-
  a. Micro Small Medium Enterprises **("MSMEs")** and they will continue to be guided under the circular of 17 March 2016; and
  b. in case where the borrower has committed frauds/malfeasance/ wilful default. However, the banks are allowed to take a view on restructuring in case of change of promoters/management.
- The new framework is applicable on to the Scheduled Commercial Banks (excluding Regional Rural Banks) and financial institutions like Exim bank, NABARD, NHB and SIDBI. It appears that the framework is not presently applicable to NBFCs. This may be a stumbling block in case where the consortium include financial institutions not covered and NBFCs which form part of existing JLFs.

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