June 10, 2019

FRAMEWORK FOR RESOLUTION OF STRESSED ASSETS – THE NEW REGIME!

WHERE IT ALL STARTED?

After the circular on Resolution of Stressed Assets – Revised Framework dated February 12, 2018 ("**Feb 12 Circular**") issued by the Reserve Bank of India ("**RBI**") was struck down by the Supreme Court of India ("**SC**") in its entirety in April, the RBI has released fresh guidelines to deal with bad loans on Friday – June 07, 2019 ("**New Framework**") pursuant to multiple rounds of discussions with stakeholders. While, the principal terms of the Feb 12 Circular remain intact in the New Framework, we note that the New Framework also draws a lot of parallels to the Insolvency and Bankruptcy Code Act, 2016 ("**IBC**"). Set out are the key features of the New Framework.

TAKE AWAYS FROM THE NEW FRAMEWORK

- Applicability of the New Framework:

    - The New Framework applies to (a) Scheduled Commercial Banks; (b) All India Term Financial Institutions; (c) Small Finance Banks; (d) Systemically Important Non-Deposit taking NBFCs; and (e) Deposit taking NBFCs.

    - The New Framework is applicable to resolve loan accounts maintained with (a), (b) and (c) above, with exposure of INR 2,000 Crores and above from June 7, 2019. For loan accounts of INR 1,500 Crores and up to INR 2,000 Crores, the revised norms will be applicable from January 1, 2020. The RBI has stated that it will announce the applicability date for loan accounts below INR 1,500 Crores in due course ('**Reference Date**').

    - The New Framework **will not** apply to borrowers for whom specific instructions have already been issued for initiation of insolvency proceedings under IBC. Further, borrowers who have committed frauds/malfeasance/wilful default will remain ineligible for restructuring.

- Cancellation of all earlier schemes: The New Framework replaces all the previous restructuring circulars.

- What the Lenders need to do?

    - The New Framework leaves the decision to the banks on the manner in which the resolution is to be implemented.

    - Lenders are required to have a board-approved policy for resolution of bad loans.

    - If any of the lenders have reported the default of the borrower, all the lenders are required to undertake a *prima facie* review of the borrower account within 30 days from the date of default (the "**Review Period**"), commencing from the Reference

Date with respect to the accounts mentioned herein above. In the case of cash credit accounts, the Review Period will start from the 31st day of default.

- All the lenders are required to execute an inter-creditor agreement (**ICA**) during the Review Period to lay out the ground rules for finalization and implementation of the resolution plan. The ICA is also required to ensure protection for dissenting creditors.

➢ The undoing of the Pocket Veto: The Feb 12 Circular mandated that a resolution could only be arrived at unanimously. Essentially even a single lender could block the resolution. In contrast, the IBC allows for a more flexible approach where only two-thirds majority is required for passing a resolution plan. The New Framework does not stipulate a requirement of a 100% consensus of lenders. Lenders with 75% by value and 60% by number can proceed with the resolution plan (**RP**). However, the RP is required to provide for payment of not less than realisable value to dissenting creditors.

➢ "One Day" Reporting Still Applicable: The Feb 12 Circular mandated lenders to report defaulting accounts on a weekly basis which led to borrowers becoming 'defaulters' even if they had defaulted in their payments by just one day. This rule still continues. The defaulting accounts are to be reported as special mention actions – SMA-0, SMA-1 and SMA-2. We understand that most lenders were being cautious and had continued with the reporting obligations set out in the Feb 12 Circular.

➢ Resolution Process: The Feb 12 Circular mandated lenders to proceed under IBC after the expiry of 180 days from default, if no resolution was reached. The New Framework provides that during the Review Period, the lenders may decide on the resolution strategy, including the nature of the RP and the approach for implementation of the RP. The New Framework states that since default with any lender is a lagging indicator of financial stress faced by the borrower, it is expected that the lenders initiate the process of implementing a RP even before a default. The lenders are required to implement the RP within 180 days from the completion of the Review Period. This effectively means that the lenders will have a total of 210 days from the commencement of the Review Period. In our experience, the loan recovery efforts weaken when lenders have to mandatorily start insolvency proceedings. Pursuant to the New Framework, lenders may also choose to initiate legal proceedings for insolvency or recovery. The requirement to undertake mandatory proceedings under IBC is no longer applicable.

➢ Higher Provisioning: Any intent to evergreen stressed accounts by lenders will be subjected to stringent actions including higher provisioning & monetary penalties. In case of failure by the lenders to implement a viable resolution plan within the 210-day period, they will have to make additional provisions of 20% on the bad loan. Currently, banks have to make 15% provision of the loan amount after 90 days of default. Essentially, the revised norms take the total provisions to 35%. Further, if there is still no resolution within 365 days, the lenders will have to make another 15% provisions, taking the total to 50% - same as the provisions required once a lender proceeds with resolution under the IBC. However, on implementation of RP including change in ownership, such additional provisioning can be reversed as per the terms of the New Framework. Any additional finance approved under the RP will continue to be treated as 'standard' during the monitoring period.

➢ Up-gradation: As recommended by the Indian Banks' Association to the RBI, the amount to be repaid for upgradation has been reduced from 20% to 10% of the outstanding principal debt including all debt like instrument and including optional structures, in the New Framework. Further, the lenders may upgrade the account in case of change of ownership on receipt of RP4 (i.e. debt facilities/instruments having moderate degree of safety regarding timely servicing of financial obligations and carry moderate credit risk), however, provisioning will be reversed only after end of monitoring period subject to satisfactory performance during such time.

- Section 29A here as well: In case of change in ownership of the borrowing entities, credit facilities of the concerned borrowing entities may be continued/upgraded as 'standard' after the change in ownership is implemented, either under the IBC or under the New Framework. In case of any change in ownership being implemented under the New Framework, the classification as 'standard' shall be subject to the conditions that the lenders shall conduct necessary due diligence in this regard and clearly establish that the acquirer is not a person disqualified in terms of Section 29A of the IBC.

This is an update for general information purposes only and does not constitute legal advice. Please contact us if you require further clarifications on this subject.

Vineetha M.G.
Partner, Mumbai
vineetha@samvadpartners.com

Khyati Sanghvi
Partner, Mumbai
khyati@samvadpartners.com

BENGALURU CHENNAI HYDERABAD MUMBAI NEW DELHI

www.samvadpartners.com