VOLUME 8

RBI ANNOUNCES RESOLUTION WINDOW FOR COVID-19 RELATED STRESS

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Introduction

On August 6, 2020, the Reserve Bank of India (“**RBI**”) issued a circular on ‘Resolution Framework for COVID-19-related Stress’ (“**Resolution Framework**”) providing for a resolution window under the existing RBI (Prudential Framework for Resolution of Stressed Assets) Directions 2019, dated June 7, 2019 (“**Prudential Framework**”), with a view to mitigate the financial stress faced by borrowers on account of the economic fallout of the COVID-19 pandemic.

The Prudential Framework provides for recognising incipient stress in loan accounts and a principle-based resolution framework for addressing such defaults in a normal scenario. However, any concession offered to a borrower under such a resolution framework leads to a downgrade in the asset classification of the borrower’s account, except in case of change in ownership in the prescribed manner.

Keeping in mind the significant risks posed to the financial stability of the borrowers in these unprecedented times, the RBI has introduced the Resolution Framework to enable lenders to implement a resolution plan in respect of eligible borrowers without change in ownership, as well as personal loans, while classifying such exposures as ‘standard’ subject to the prescribed conditions. The reference date for the outstanding amount of debt that can be considered for resolution under the Resolution Framework shall be March 1, 2020.

Given that the Prudential Framework is applicable to only certain specified categories of lending institutions, the applicability of the Resolution Framework has been broadened to include all Commercial Banks, Primary (Urban) Co-Operative Banks/State Co-Operative Banks/ District Central Co-Operative Banks, All-India Financial Institutions and Non-Banking Financial Companies (including Housing Finance Companies) (“**Lenders**”). Accordingly, exposures of lending institutions not covered by the Prudential Framework will also be included for any resolution under the Resolution Framework.

It is pertinent to note that all the norms as applicable to implementation of a resolution plan and the specific implementation conditions as set out in the Prudential Framework, shall continue to be applicable to any resolution plan implemented under the Resolution Framework.

Eligible Exposures

All borrowers/ facilities save and except the following categories, shall be eligible for the resolution process under the Resolution Framework (“**Eligible Loans**”):

1. Exceptions as specified under the Prudential Framework;

2. MSME borrowers whose aggregate exposure to the Lenders, collectively, is Rs. 25,00,00,000 (Rupees twenty five crore) or less, as on March 1, 2020;

3. Farm credit as mentioned in Master Direction issued by the RBI on priority sector lending;

4. Loans to primary agricultural credit societies, farmers' service societies and large-sized Adivasi multi-purpose societies for on-lending to agriculture;

5. Exposures of the Lenders to financial service providers, as defined in the Insolvency and Bankruptcy Code, 2016;

6. Exposures of the Lenders to central, state and local government bodies and body corporates established by an Act of Parliament or State Legislature; and

7. Exposures of housing finance companies where the account has been rescheduled in terms of para 2(1)(zc)(ii) of the Master Circular - The Housing Finance Companies (NHB) Directions, 2010 after March 1, 2020, unless a resolution plan under the Resolution Framework has been invoked by other Lenders.

The Lenders are required to formulate Board approved policies on implementation of viable resolution plans for eligible borrowers and ensure that the resolution under the Resolution Framework is extended only to borrowers having stress on account of COVID-19. Further, the aforesaid Board approved policy should set out the eligibility criteria for borrowers as well as the due diligence considerations to be fulfilled for evaluating the need for a resolution plan.

Resolution of Stress in Exposures other than Personal Loans

Eligible Loans, other than personal loans, classified as 'standard', but not in default for more than 30 (thirty) days with the relevant Lenders as on March 1, 2020, will be eligible for resolution under the Resolution Framework. The Lenders will have to continue to classify such accounts as 'standard' till the date on which the borrower and the relevant Lenders agree to proceed with a resolution plan.

Any resolution under the Resolution Framework has to be invoked anytime on or before December 31, 2020 and has to be implemented within a period of 180 (one hundred eighty) days from the date of invocation.

Single Lender Exposure

Where there is only one Lender with exposure to the borrower, the relevant Lender may take the decision regarding the request for resolution by such borrower, as per its Board approved policy.

Multiple Lender Exposure

In case of borrowers having exposures to multiple lenders, the following conditions will have to be complied with in connection with implementation of a resolution plan:

- The resolution process shall be treated as invoked only if the relevant Lenders representing 75% (seventy five percent) by value of the total outstanding credit facilities (fund based as well as non-fund based), and not less than 60% (sixty percent) by number, agree to invoke the same.

- An inter creditor agreement ("**ICA**") will have to be signed by all the Lenders, within 30 (thirty) days from the date of invocation of the resolution process. Lending entities, other than those covered under the Resolution Framework, can also sign the ICA and agreed to be bound by it. The ICA should provide mechanisms for dispute redressal and information sharing inter se the Lenders.

- If Lenders representing at least 75% (seventy five percent) by value, and not less than 60% (sixty percent) by number, do not sign the ICA within the aforesaid timeline then the invocation will lapse and the resolution process cannot be invoked again in respect of such borrower under the Resolution Framework.

- Lenders, who sign the ICA within the aforesaid timeline, shall keep provisions from the date of implementation of the resolution plan as per the extant income recognition and asset classification ("**IRAC**") norms immediately before implementation, or 10% (ten percent) of the total debt held by the ICA signatories post implementation of the plan (residual debt), whichever is higher.

- Lenders failing to sign the ICA within the aforesaid timeline shall, immediately upon the expiry of the aforesaid timeline, keep provisions of 20% (twenty percent) of the debt on their books as on that date (carrying debt), or the provisions required as per the extant IRAC norms, whichever is higher.

- In cases where the invocation lapses as aforesaid, the Lenders which had earlier agreed for invocation of the resolution process but did not sign the ICA will have to hold 20% (twenty percent) provisions on their carrying debt.

- All receipts and repayments by the borrower (having consortium/ multiple banking arrangements), as well as all additional disbursements to such borrower as part of the resolution plan, shall be routed through an escrow account maintained with one of the Lenders. Such escrow account should be operated in the manner set out in the escrow agreement to be entered into between the Lenders and the escrow bank.

Expert Committee

The RBI will be constituting an Expert Committee, which will recommend the financial parameters required to be factored into the assumptions that form part of each resolution plan, and the sector specific benchmark ranges for such parameters. These parameters will cover aspects related to leverage, liquidity, debt serviceability, etc.

Large Exposures

Resolution plans for accounts where the aggregate exposure is Rs.100,00,00,000 (Rupees one hundred crore) and above at the time of invocation of the resolution process, shall require an independent credit evaluation by one credit rating agency authorised by the RBI under the Prudential Framework.

Resolution plans, where the aggregate exposure of the Lenders at the time of invocation of the resolution process is Rs. 1500,00,00,000 (Rupees one thousand five hundred crore) and above, will be vetted by the Expert Committee. However, the Expert Committee's scope will be to verify whether all requisite processes have been followed by the parties concerned without interfering with the commercial judgment exercised by the Lenders.

Features of the Resolution Plan

A resolution plan may involve any action, including sale of the exposure to other entities, change in ownership and restructuring, except compromise settlements which will continue to be governed by the provisions of the Prudential Framework or the extant instructions, if any, applicable to the specific category of Lenders. The resolution plan can also include sanctioning of additional facilities even if there is no renegotiation of the existing debt.

Lenders can allow extension of the residual tenor of the facility, with or without payment moratorium, by a period not more than 2 (two) years. Such moratorium period will come into force immediately upon implementation of the resolution plan.

It is pertinent to note that the revised assumptions that form part of the resolution plan should at least factor in the financial parameters decided by the Expert Committee as mentioned above.

Conversion of debt into securities

A resolution plan may provide for conversion of a portion of the debt into equity or other marketable, non-convertible debt securities issued by the borrower. However, in such cases the amortisation schedule and the coupon on such debt securities should be similar to the terms of the debt held on the books of the Lenders post implementation of the resolution plan.

The valuation of the equity instruments issued by the borrower upon conversion shall be as per the Prudential Framework and that of the debt securities issued by the borrower shall be as per the Master Circular - Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by Banks dated July 1, 2015 (as amended from time to time), or other relevant instructions as applicable to any specific category of Lenders. In the event, the Lenders convert any portion of the debt into any other security, the same shall collectively be valued at Re.1 (Rupee one).

Resolution of Stress in Personal Loans

The Resolution Framework provides for resolution of stress in personal loan accounts classified as 'standard', but not in default for more than 30 (thirty) days with the relevant Lenders as on March 1, 2020. However, the Resolution Framework does not cover personal loans extended to the staff/ officers of the relevant Lenders.

The Lenders have to continue to classify such loan accounts as 'standard' till the date on which the borrower and the relevant Lenders agree to proceed with a resolution plan. Any resolution under the Resolution Framework has to be invoked anytime on or before December 31, 2020 and has to be implemented within a period of 90 (ninety) days from the date of invocation.

The resolution plans may include rescheduling of payments, conversion of interest accrued/ to be accrued into another credit facility, or, granting of moratorium, based on an assessment of income streams of the borrower, subject to a maximum of 2 (two) years.

The resolution plan will be deemed to be implemented only after all the necessary documentation is completed, the revised terms are reflected in the books of the relevant Lenders and the borrower is not in default as per the revised terms.

Asset Classification and Provisioning

If a resolution plan is implemented in accordance with the Resolution Framework, the asset classification of the concerned borrowers' accounts classified as 'standard' may be retained as such upon implementation of the plan. Borrowers' accounts which may have slipped into 'non-performing assets' ("**NPAs**") between the invocation and implementation of the resolution plan can be upgraded as 'standard', as on the date of implementation of the plan.

Additional credit facilities provided to borrowers in respect of whom the resolution process has been invoked, if sanctioned even before implementation of the plan in order to meet the interim liquidity requirements of the borrower, can be classified as 'standard' till implementation of the plan regardless of the actual performance of the borrower with respect to such facilities in the interim.

If the resolution plan is not implemented within the stipulated timeline, the asset classification of such additional credit facilities will be as per the actual performance of the borrower with respect to the same or the rest of the credit facilities, whichever is worse.

In respect of personal loans where a resolution plan is implemented, the Lenders shall keep provisions from the date of implementation of the resolution plan as per the extant IRAC norms immediately before implementation, or 10 percent of the renegotiated debt exposure of Lenders post implementation (residual debt), whichever is higher.

Any additional provisions maintained by the Lenders in terms of the RBI's circular on 'COVID-19 regulatory Package', dated April 17, 2020, to the extent not already reversed, can be utilised for meeting the provisioning requirements under the Resolution Framework.

Further, any additional provisions maintained in terms of the Prudential Framework can be reversed at the time of invocation of the resolution plan under the Resolution Framework. However, if the plan is not implemented within 180 (one hundred eighty) days from its invocation, the provisions as per the Prudential Framework will have to be maintained as if a resolution process was never invoked under the Resolution Framework.

Reversal of provisions

In case of personal loans, half of the provisions can be written back upon the borrower paying at least 20% (twenty percent) of the residual debt without slipping into NPA post implementation of the plan, and the remaining half can be written back upon the borrower paying another 10% (ten percent) of the residual debt without slipping into NPA subsequently.

In case of resolution of exposures other than personal loans, the provisions maintained by the ICA signatories can be reversed in the manner as mentioned above. However, in respect of the non-ICA signatories, half of the provisions can be reversed upon repayment of 20% (twenty percent) of the carrying debt, and the other half can be reversed upon repayment of another 10% (ten percent) of the carrying debt, subject to the required provisions as per the extant IRAC norms being maintained.

Performance post implementation of plan

In case of personal loans, after implementation of the resolution plan, the subsequent asset classification will be governed as per the extant IRAC norms or other relevant instructions as applicable to the specific category of Lenders.

In case of exposures other than personal loans, any default by the borrower with any of the ICA signatories during the monitoring period will trigger a review period of 30 (thirty) days. For this purpose, 'monitoring period' means the period starting from the date of implementation of the resolution plan till the borrower pays 10% (ten percent) of the residual debt, subject to a minimum of 1 (one) year from the commencement of the first payment of interest or principal (whichever is later) on the credit facility with the longest moratorium period.

In the event the borrower is in default with any of the ICA signatories at the end of the aforesaid review period, the asset classification of the borrower with all the Lenders, including the non-ICA signatories, will be downgraded to NPA from the date of implementation of the resolution plan or the date from which the borrower had been classified as NPA before implementation of the plan, whichever is earlier.

If the monitoring period is over without the account being classified as NPA, the asset classification norms will revert to the criteria laid out in the extant IRAC norms or other relevant instructions as applicable to the specific category of Lenders.

Disclosures and Credit Reporting

Lenders are required to make necessary disclosures in their quarterly/ half-yearly/ annual financial statements as per the prescribed formats, as applicable, in respect of accounts where resolution a plan is implemented.

Further, the credit reporting by the Lenders in respect of borrowers where a resolution plan is implemented should reflect the "restructured" status of the account if the resolution plan involves renegotiations that would be classified as restructuring under the Prudential Framework.

This update has been contributed by Aastha (Partner), Swaraj Singh Narula and Arhat Chhabra (Associates).

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