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Resolution framework for COVID-19 related stress

Analysis of RBI circular dated 6 August 2020 (within Prudential Framework dated 7 June 2019)

August 2020

Genesis

Mitigate COVID-19 impact	• COVID-19 has led to significant economic stress across sectors • Likely impact on long-term viability of companies due to disproportionate debt burden relative to cash flow generation ability
Asset classification downgrade in 7 June 2019 framework	• Resolution Plan (RP) implemented under 7 June 2019 Prudential Framework entails asset classification downgrade, except with change in ownership • Window of one-time restructuring under the existing promoters was needed with the benefit of account remaining standard
Need to support viable firms without impairing recovery process	• Widespread impact of the COVID-19 pandemic could impair entire recovery process, posing significant financial stability risks • Underlying theme of this resolution window is preservation of the soundness of the Indian banking sector

"In the light of experience with use of regulatory forbearance, necessary safeguards have been incorporated in the current resolution window, including prudent entry norms, defined boundary conditions, specific binding covenants, independent validation and strict post-implementation performance monitoring." – Shaktikanta Das, Governor, Reserve Bank of India

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Applicability and exceptions

Applicability

- Commercial banks (including small finance banks, local area banks and regional rural banks)
- Primary (urban) co-operative banks/state co-operative banks/ district central co-operative banks*
- All India term financial institutions (NABARD, NHB, EXIM Bank and SIDBI)
- All NBFCs including housing finance companies (HFCs)

*Exposures of these lending institutions, to which the Prudential Framework is not applicable, **shall** also be included for resolution under this facility.

Exceptions in addition to those provided in the Prudential Framework

- Borrowers with aggregate exposure of up to INR 25 crore as on 1 March 2020
- Exposure to financial service providers
- Exposure to HFCs where the account was rescheduled after 1 March 2020
- Exposure to state and central governments, farm credit and primary agricultural credit societies

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Broad principles

COVID-19 induced stress only eligible – falling within the lenders' board approved policy and should not be in default for more than 30 days prior to 1 March 2020 (reference date)

Accounts that do not fulfil eligibility conditions under this framework may continue to be considered for resolution under the **Prudential Framework (7 June 2019 circular)**

Limited time window: Resolution must be initiated prior to 31 December 2020 and must be implemented within 180 days from the date of invocation

Opportunity to implement a resolution plan for eligible corporate exposures while classifying such exposures as **standard**

Resolution plan to meet the **sector-specific financial parameters** to be notified by an expert committee and lender-specific board approved evaluation criteria

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Eligibility of borrowers

1. Borrower whose account was standard but not in default for more than 30 days with **any** lending institution i.e. **Standard and SMA-0.**

2. Accounts should continue to remain **standard till the date of invocation.**

3. **Multiple lenders:** Resolution process can be invoked by lenders representing 75% by value of total outstanding credit facilities **and** not less than 60% by number.

4. Inter creditor agreement (ICA) to be executed by lenders **within 30 days** from date of invocation. Failure to execute ICA leads to invocation getting lapsed and framework can never be invoked again.

5. **Date of invocation no later than 31 December 2020.**

6. If implementation is not done within **180 days from the date** of invocation, the option will be treated as lapsed and benefits available will be lost and fall back upon the Prudential Framework (7 June 2019).

7. **Lenders to the borrower,** other than lending institutions, as per this circular, may also be party to the ICA, if they so desire, to be fully bound by the stipulations of the ICA.

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Restructuring - Benchmark parameters

Restructuring can include

- Modification of terms of the advances/securities
- Alteration of payment period/mount/installments/ ROI and roll over of credit facilities
- Moratorium on debt servicing
- Sanction of additional credit facility/release of additional funds
- Conversion of debt into equity, non-convertible debt securities, etc.

However compromise settlements not permissible under this framework.

Role of expert committee

- RBI shall constitute an expert committee to be headed by KV Kamath
- Committee shall recommend a list of financial parameters and sector-specific benchmarks that need to be factored in for Resolution Plans
- Financial parameters shall cover aspects such as leverage, liquidity and debt serviceability
- Expert committee to also vet RPs for exposures > INR 1,500 crore to ensure compliance with processes

Permitted features of a resolution plan

Sanction of additional credit facilities to address financial stress of the borrower due to COVID-19, even if there is no renegotiation of existing debt.

Extension of the residual tenor of the loan, with or without payment moratorium, by a period of not more than two years.

Moratorium period, if granted, shall come into force immediately upon implementation of the resolution plan.

Assumptions of the plan and financial parameters at minimum should meet parameters decided by the expert committee.

Conversion of portion of debt into equity or other marketable, non-convertible debt securities, provided amortisation schedule and the coupon carried by such debt securities are similar to the terms of the debt held post implementation of the RP.

- Valuation of debt securities as per Master Circular on Valuations dated 1 July 2015
- Valuation of equity instruments same as defined in 7 June 2019 Prudential Framework
- In case of conversion of debt to any other security – collective valuation to be INR 1

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Other salient features

Independent credit evaluation

- Aggregate exposures > INR 100 crore needs to be rated by an independent rating agency with at least RP4

Credit reporting

- Borrower's credit history shall be governed by the policies as applicable to restructured accounts

Escrow account mechanism

- Escrow account to be maintained mandatorily for RP under consortium or multiple banking with lending institution for all receipts, repayments as well as all additional disbursements, if any
- Enforcement mechanisms for escrow manager through an agreement to ensure smooth operations and timely disbursement by lending institutions

Disclosures

- Lenders to make appropriate disclosures according to prescribed formats in their financials
- Lending institutions to report the "restructured" status of the account if the implemented resolution plan involves renegotiations that would be classified as restructuring under the 7 June Prudential Framework

Asset classification

- **Additional finance**
  - **Between invocation and implementation of RP** — Standard irrespective of performance
  - **Subsequently, if RP is not implemented** — As per actual performance or classification of rest of credit facilities whichever is worse
- **Existing credit facilities**
  - **If RP is implemented** — Standard classification to be retained; or upgraded to standard for accounts slipped into NPA post invocation
  - **If RP is not implemented** — As per the actual performance of the borrower under IRAC from date of NPA

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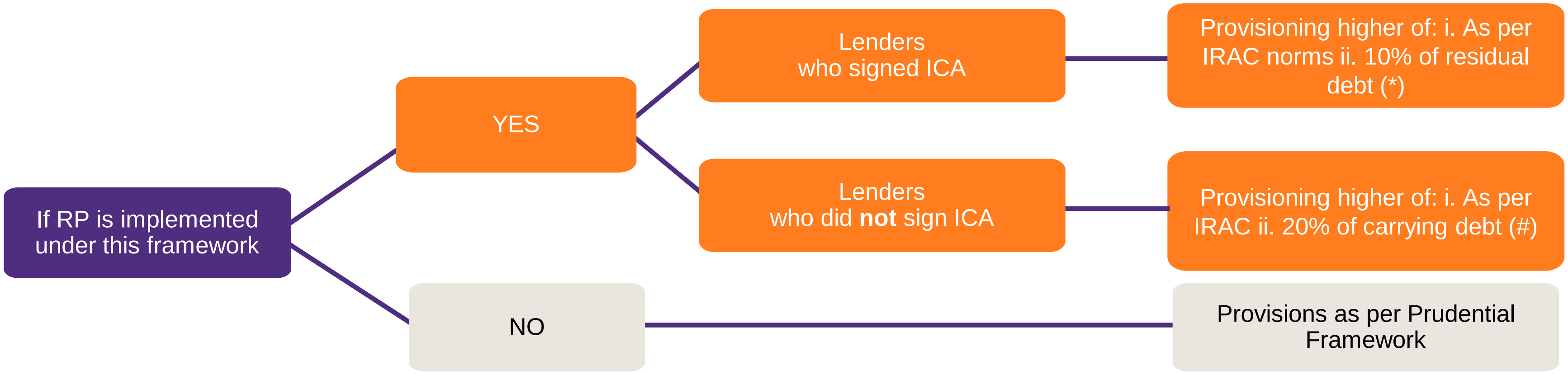
Provisioning

Any additional provisions held by lenders under the Prudential Framework on account of delayed implementation of resolution plans, may be reversed at the time of invocation under this facility.



(*) Residual debt - Total debt including debt securities issued post implementation
(#) Carrying debt - Debt on the lender's books as on expiry of 30 days for signing of ICA

- Additional provisions held under COVID-19 Regulatory Package - RBI circular dated 17 April 2020 with respect to such borrowers may be utilised to meet provision requirements under this facility.
- In case **threshold for ICA signing is not met,** lending institutions to hold 20% provision on their carrying debt, who did not sign ICA despite agreeing for invocation.

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Reversal of provisioning

Lending institutions that signed ICA within 30 days of invocation subject to account not slipping into NPA subsequently

- 50% of provisions may be written back upon the borrower paying at least 20% of the residual debt
- Remaining 50% may be written back upon the borrower paying another 10% of the residual debt

Lending institutions that do not sign ICA

- 50% of the provisions may be reversed upon repayment of 20% of the carrying debt
- Other 50% may be reversed upon repayment of another 10% of the carrying debt, subject to maintaining required IRAC provisions

Post implementation performance

Any default during the monitoring period by the borrower with any of the lending institutions shall trigger a fresh review period of 30 days

Monitoring period until payment of 10% of the residual debt subject to minimum of one year from commencement of first payment of interest or principal (whichever is later) on the credit facility with longest period of moratorium

Asset classification of the **borrower shall be downgraded to NPA** with all lender even if in default with one lender at the end of the review period

Further upgradation shall be **subject to implementation of a fresh RP** under the Prudential Framework

Upon completion of the monitoring period without being classified as NPA, the asset classification norms will revert to the criteria laid out as per IRAC

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Our view

- Framework objective for COVID-19 affected borrowers and addresses lenders' concern on asset downgrade and provisioning
- Comprehensive guideline applicable to diverse lending institutions, encompassing debt realignment as well as additional funding support
- Resolution within 180 days a challenging task, going by past precedence of JLF frameworks
- Flexibility towards structuring the plan within overall parameters, which are yet to be notified
- Thrust on arriving consensus among lenders through ICA execution and related penal provisioning
- Asset classification and provisioning benefits for timely invocation and implementation of RP
- Vetting of large RPs by expert committee will provide additional comfort to lending institutions
- Implementation conditions for RP to follow the 7 June Prudential Framework
- Introduction of escrow account feature to enhance enforcement and oversight for lenders

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