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BANKING & FINANCE: RBI ISSUES REVISED FRAMEWORK ON RESOLUTION OF STRESSED ASSETS

RBI vide its circular ("**Circular**") dated February 12, 2018 ("**Revised Framework**") has overhauled the extant stressed asset resolution framework – thereby ensuring that lenders and borrowers have to put their act together to have a robust time bound implementation plan in order to recover stressed assets outside the legal regime of the Insolvency & Bankruptcy Code ("**IBC**"). Effectively, the Revised Framework is designed to make the IBC as the Sword of Damocles for defaulting large account holder (exposure of Rupees 20 Billion upwards) to execute binding agreements, and take all such other steps as prescribed, within 180 days from March 01, 2018.

Below, are identified the key features of the new Revised Framework:

A) Withdrawal of Extant Resolution Schemes

The Circular has overhauled the existing regulatory framework and harmonises the pathway to the initiation of insolvency process under the IBC. It has withdrawn all the current institutional mechanism of resolution of assets under stress such as the Joint Lenders Forum (JLF), SDR and S4A schemes. The Circular mandates that current stress asset accounts which were under the earlier resolution framework will have to be implemented under the Revised Framework. By making the resolution under the Revised Framework focussed on a time-bound implantation regime with any delay leading to the automatic insolvency proceedings under the IBC, gives way to a finality to effectively deal with stressed assets

B) On-time detection of Stressed Accounts

From April 01, 2018, for those defaulting loan accounts with aggregate exposure of INR 50 Million upwards, Banks will have to issue a CRILC – Main Report to the Central Repository of Information on Large Credits (CRILC) on a monthly basis which was required to be submitted on a quarterly basis under the earlier regulatory framework. To identify early detection of stressed accounts, the frequency period of other reporting by the Banks to the CRILC has also been intensified on a weekly basis

C. Reference to IBC for Large Accounts

1. The Banks have to set up policies for resolution of stressed assets and fulfil certain implementation conditions as prescribed in the Revised Framework which prescribes for a structure with regard to the implementation of the resolution plan for stressed accounts (i.e. "**Resolution Plan**"). The Banks have been given wide discretion to design the Resolution Plan including restructuring schemes and

change of ownership and control.

2. The Revised Framework directs that borrower entities having large accounts with aggregate exposure of 20 Billion upwards (the "**Large Accounts**") which are defaulter of its loan accounts and have not implemented the Resolution Plan within 180 days effective from March 01, 2018 (defined as the "**reference date**") would be mandated to be forced into insolvency processes under the IBC. In case of borrowers who have defaulted after March 01, 2018 the reference date will be as from the date of default.

D. Eligible Borrowing Entities & Implementation Conditions

1. The Banks can undertake restructuring or any other form of resolutions for those loan account having a minimum credit rating of RP4 (moderate risk to default). A system of independent credit evaluation (ICE) has been established to conduct credit taking by RBI authorised credit rating agencies.

2. The "deemed" implementation conditions of a Resolution Plan is prescribed as follows:
   A. The borrower entity is no longer in default with any of its lenders.

   B. Execution of binding agreements and other documentation such as perfection of security interest as an outcome of the class of resolution plan which involves restructuring.

   C. The restructured resolution plans, must be reflected in the books of lender(s) and the borrower(s). Similar time bound implementation plans below 20 Billion will be announced by the RBI shortly.

E. Consequences of failure of Resolution Plan

1. The consequences of failure of the Resolution Plan on account of default of payment obligation by the Borrower Entity, will trigger the insolvency process under the IBC Code within 15 days of the date of default.

2. For aforesaid, the default should occur during the currency of the "Specified Periods". The Specified Period has been prescribed as the later of following:

3. any period of time between the date of implementation till at least 20% of the outstanding principal debt including interest capitalization is repaid as under restructured scheme;

4. a period of one year from the commencement of first payment of the loan (principal or interest whichever is later) under the new restructured credit facility with the longest period of moratorium under the terms of the Resolution Plan.

F. Non-Applicability

The RBI has prescribed through the Revised Framework fresh prudential norms for the banks with exemption being given to revival of MSMEs who shall continue to be guided as per earlier RBI Circulars.

G. Exemptions

1. The fresh Prudential Norms also provide certain clarifications related to exemptions under other regulator regimes such as the SEBI (ICDR Regulations & the Take Over Code) for those cases of restructuring schemes which deals with conversion of debt to equity or other convertible securities or fresh issuance of shares. Essentially the reference date to be taken for the 180 days long stop for

implementation of the restructuring scheme has been underpinned to (i) in the case of conversion of convertible securities to the date on which the bank approves the scheme and (ii) in the case of fresh issue of shares on the date of signing of binding agreements.

2. In the instance that the restructuring scheme would include the bank selling its securities to the acquirers, the selling price of such securities shall not be negotiated below the fair value which shall be the higher of the conditions mentioned in Clause 24 of the Annexure 1 (Prudential Norms) of the Revised Framework.

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After the consolidation of the multiple statutes under the Insolvency & Bankruptcy Code and institutionalizing the insolvency regime through the NCLT regime, the RBI's drive to consolidate the regulatory framework through the Revised Framework is an overall indicator to the international community that India has stepped up to clean up its huge distressed assets problem. However, there are a few hits and misses post the Revised Framework announcements which are as follows:

a. The 180-day diktat for lenders to work out a deal with the defaulting borrowers could be the right set up to introduce the “pre-pack insolvency” deals and/or “rescue lending” mechanism with institutional global insolvency fund specialists and other institutional investors such as private equity players – however the IBC and the Revised Framework have not provided the necessary provisions to legitimise such pre-pack arrangements. In absentia, the institutional reengineering of dealing with stressed sale appears less innovative or futuristic.

b. Robust reporting mechanism such as CRILC Reporting empowers the RBI to recognise defaults early and will enable it to direct lenders to underpin borrowing entities to have more skin in the game to cooperate with the lenders in putting up a speedy resolution plan or lose control of their companies as they will have only 180 days cooling period before the insolvency regime takes over.

c. With the Revised Framework, the NCLT’s ability to handle an overload of insolvency matters given its current infrastructure bandwidth is highly circumspect.

d. The 180-day gun on the head is limited to defaulting Large Accounts only; for other defaulting accounts above INR 1 Billion, the RBI has taken a two-year period to announce corrective measures which may impact a certain pool of investors (with lower budgets) from participation in the distressed sale market.

e. Innovative concepts like “Specified Periods” have been deployed for default payment to be sustainable by the borrowers however the systemic safeguards have been provided for not giving any second chance for the Promoters to avoid triggering creditor in control as under the insolvency process under the IBC.

f. Aligning the other regulatory impacts such as the SEBI Take Over Code and ICDR Regulations for having effective restructuring schemes is commendable however from deal making perspective, intervening on the selling process of the securities to be linked to “fair value”, like in the case of bank selling its securities to the acquirers, may raise issues on over valuation of stressed assets which may not yield the comparable returns. This may deter the foreign investors from investing in such assets in India, given that the hair-cuts in case of stressed assets in other jurisdictions are higher than in India.

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