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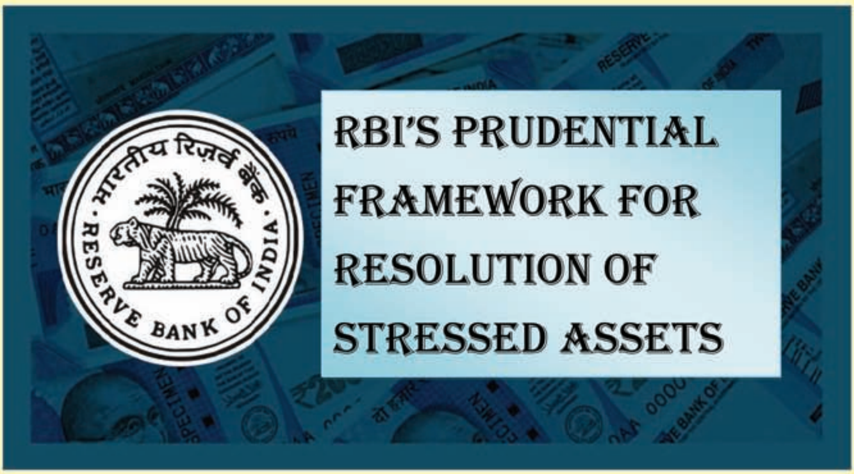

JULY 2019

Theme 332

"RBI's Prudential Framework for Resolution of Stressed Assets"

28th Year of Publication

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SIB STUDENTS' ECONOMIC FORUM

JULY, 2019

Theme No: 332: **RBI's Prudential Framework for Resolution of Stressed Assets**

A well informed customer will make the policy makers as well as organizations which produce goods and render services more responsive to the customer needs. This will also result in healthy competition among organizations and improve the quality of its products.

The "SIB Students' Economic forum" is designed to kindle interest in the minds of younger generation. We highlight one theme in every monthly meeting of the "Forum". Topic of discussion for this month is "**RBI's Prudential Framework for Resolution of Stressed Assets Directions 2019**".

The RBI has issued updated guidelines on 7th June 2019 about resolving stressed assets. Revision became necessary when the Supreme Court struck down the existing guidelines in April this year. The new guideline on resolution of stressed assets is named as Prudential Framework for Resolution of Stressed Assets Directions 2019.

Revised Framework for Resolution of Stressed Assets (2018)

The circular completely revamped the rules set to tackle non-productive assets. It came at a time the banking sector's profitability was taking a hit, bad loans had spiraled to a whopping Rs 10 lakh crore, and the PNB scam was beginning to unravel. The Revised Framework (2018) contained a strict time-line for banks to resolve outstanding Corporate stressed assets (NPAs) within 180 days. Otherwise, banks have to ensure that Corporate debt undergoes tough insolvency proceedings under the IBC Act. An even tougher sub clause in the framework was to treat default of even one day as NPAs. Or in other words, a company will be treated as a defaulter even if it missed the repayment schedule by one day.

The New Framework - Prudential Framework for Resolution of Stressed Assets (2019)

The Prudential Framework for resolution of stressed assets was expected to address the tough provisions contained in the previous guidelines especially in the wake of the Supreme Court verdict. As expected, the new guidelines contain several relaxed norms. The most important one is that it will give lenders 30 days to review a borrower's account before labelling it as a non-performing asset (NPA) in case of default.

Though the content of the previous revised framework (February 12th, 2018) and the newly issued prudential framework differs slightly, the purpose remains the same in both ie., management of stressed assets in the banking system. Basically, both frameworks on Resolution of Stressed Assets covers set of guidelines issued by the RBI as a circular to banks to manage their stressed assets (NPAs).

What has changed?

	Revised Framework for Resolution of Stressed Assets (2018)	**Prudential Framework for Resolution of Stressed Assets (2019)**
1.	The Stressed assets norms were applicable only for Banks	Norms are applicable to -a) Banks other than RRB(s)b) Small Finance Banks as well as NBFC's
2.	Mandatory reference to IBC after 180 days of default for accounts with aggregate exposure of Rs. 2000 Crores and above to lenders.	Now, reference under IBC is not mandatory. However, based on the supervisory review, RBI shall continue to issue directions for filing insolvency application under IBC on case to case basis.
3.	Default of even one day had to be reported and acted upon	Lenders are given review period of 30 days to start working on resolution plan from day of default
4.	Resolution Plan (RP) may be approved as per their respective Board policies.	May be approved by lenders representing **75%** in value of O/s debt (FB+NFB) & **60%** by number of lenders joined under ICA - Inter Creditor Agreement, which is newly introduced under the scheme.
5.	Delayed implementation of RP was not envisaged.	Additional Provisioning to be given for delayed implementation. (Addn. 20% if RP implemented beyond 180 days from end of Review Period and Addn. 15% if RP implemented beyond 365 days from start of Review Period)
6.	No Incentive for implementation of RP	Reversal of additional provisioning after asset classification upgrade / recovery / resolution as per Circular.
7.	Up gradation of account upon 20% repayment of o/s principal debt and interest capitalization sanctioned as per RP	Up gradation of account upon 10% repayment of o/s principal debt as per RP but excluding pure equity instruments
8.	No differentiation for Working Capital defaults in SMA classification	Prudently tweaked to exclude Working Capital defaults with longevity of upto 30 days. (SMA 0 classification is not required)
9.	Time-line of 180 days for cases with Aggregate Exposure (AE) of >/= Rs 2000 Cr.	Defined time-line of 180 days for cases with Aggregate Exposure (AE) of >/= Rs 2000 Cr.However, for the exposure bracket of Rs [1500-2000] Crores, reference date is 1st Jan 2020.

What corrections were made by the RBI to address the Supreme Court verdict?

The SC while asserting that the RBI doesn't have the power under section 35AA of the RBI Act, said that the Central Bank can only direct banking institutions to initiate the Insolvency Code, if two conditions precedent are specified:

(i) that there is a Central Government authorisation to do so; and

(ii) that it should be in respect of specific defaults

To accommodate this verdict, the new Prudential Framework has made the following corrections:

1. Banks have the choice to go/or not to go for insolvency on corporate default.
2. RBI will give directions on specific defaults in future based on the Prudential Framework 2019.

What are the primary fundamental principles underlying the regulatory approach for resolution of stressed assets?

1. Early recognition and reporting of default in respect of large borrowers by banks, FIs and NBFCs.
2. Complete discretion to lenders in respect of design and implementation of Resolution Plans (RP), in supersession of earlier resolution schemes (S4A, SDR, 5/25 etc.), subject to the specified timeline and independent credit evaluation.
3. A system of disincentives in the form of additional provisioning for delay in implementation of RP or initiation of insolvency proceedings.
4. Signing of Inter-Creditor Agreement (***ICA***) by all lenders to be mandatory, which will provide for a majority decision making criteria.

What are the Key Points of the new RBI circular?

- ❖ Scope is widened to include (a) Small Finance Banks, (b) Systematically Important NBFC (non-Deposit taking) & (c) NBFCs (Deposit taking) besides SCBs (excl. RRB) & All India Term Financial Institutions.
- ❖ Once a borrower is reported to be in default by any lender, they may review the borrower's account within 30 days from the day of default.
- ❖ Lenders should follow a Board approved policy for resolution of bad loans.
- ❖ RBI introduced provision for approval of resolution plan under ICA (Inter Creditor Agreement) by creditors representing 75 percent by value of total outstanding credit facilities and 60 percent of lenders by number.
- ❖ Lenders must resolve default accounts with aggregate exposure over Rs 2000 crore within 180 days.
- ❖ The Joint Lenders' Forum (JLF) as mandatory institutional mechanism for resolution also stands discontinued.
- ❖ The framework has made it mandatory for banks to identify signs of incipient stress in loan accounts and classify stressed assets as Special Mention Account (SMA),

immediately on default. Even a single day's default in debt servicing would require reporting to the RBI and implementation of Resolution Plan.

The accounts would be classified according to this time table:

SMA Sub- Categories	Basis for classification – Principal or interest payment or any other amount wholly or partly overdue between
SMA-0	1-30 days
SMA-1	31-60 days
SMA -2	61-90 days

In the case of revolving credit facilities like cash credit, the SMA sub – categories will be as follows

SMA Sub- Categories	Basis for classification – Outstanding balance remains continuously in excess of the sanctioned limit of drawing power, whichever is lower, for a period of:
SMA-1	31-60 days
SMA -2	61-90 days

- ❖ In addition, the lenders shall submit a weekly report of instances of default by all borrowers (with aggregate exposure of Rs 50 million and above) by close of business on every Friday, or the preceding working day if Friday happens to be a holiday," RBI said in its circular.
- ❖ Account up gradation upon 10% repayment of the sum of outstanding principal debt as per the RP and interest capitalization sanctioned as part of the restructuring.
- ❖ For borrowers with exposure between Rs 1,500 crore and Rs 2,000 crore, the new norms will be made applicable from January 1, 2020, while for loans up to Rs 1,500 crore, the same will be announced in due course.
- ❖ RBI also warned that any action by lenders to conceal the actual status of accounts or evergreening the stressed accounts, will be subjected to stringent supervisory/ enforcement actions.

As per Moody's Investor Service, the Reserve Bank of India's revised framework for the resolution of stressed assets is Credit Positive, because it brings back the need for focus on timely resolution of such assets, and the build up of loan loss provisioning against those assets.

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