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RESERVE BANK OF INDIA
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**RBI/2012-13/**
**DBOD.BP.BC.No. /21.04.132/2012-13** January 31, 2013

All Scheduled Commercial Banks
(excluding RRBs)

Dear Sir,

**Review of Prudential Guidelines on Restructuring of Advances by Banks and Financial Institutions – Draft Guidelines**

Please refer to paragraphs 90 to 92 (extract enclosed) of the Second Quarter Review of Monetary Policy 2012-13 announced on October 30, 2012, wherein it was indicated that the draft guidelines on 'Review of Prudential Guidelines on Restructuring of Advances by Banks and Financial Institutions' in the light of the recommendations of the Working Group (WG) to Review the existing Prudential Guidelines on Restructuring of Advances (Chairman: Shri B. Mahapatra) will be issued by end-January 2013.

2. Accordingly, certain provisions of the existing guidelines contained in our circular DBOD.BP.BC.No.37/21.04.132/2008-09 dated August 27, 2008 and subsequent circulars issued on the subject have been revised and draft guidelines enumerating the existing instructions, recommendation(s) of the WG in that regard, and the proposed revised instruction(s) are given in the Annex.

3. Comments on the draft guidelines may please be emailed or sent to the Chief General Manager-in-Charge, Department of Banking Operations and Development, Reserve Bank of India, Central Office, Mumbai 400 001 on or before February 28, 2013.

Yours faithfully,

**(Deepak Singhal)**
Chief General Manager-in-Charge

Encls: as above.

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**Extract from Second Quarter Review of Monetary Policy 2012-13**

**Review of the Prudential Guidelines on Restructuring of Advances by Banks/Financial Institutions**

90. As indicated in the Monetary Policy Statement of April 2012, a Working Group (Chairman: Shri B. Mahapatra) reviewed the existing prudential guidelines on restructuring of advances by banks/financial institutions. The report of the Working Group was submitted in July and was placed on the website of the Reserve Bank inviting comments from the stakeholders.

91. The recommendations of the Working Group as also the comments/suggestions received in this regard are under examination and draft guidelines will be issued by end-January 2013. As an immediate measure, it has been decided to:

- increase the provision for restructured standard accounts from the existing 2.0 per cent to 2.75 per cent.

92. Detailed guidelines in this regard are being issued separately.

**Annex**

## Prudential Guidelines on Restructuring of Advances by Banks and Financial Institutions

### 1. Doing Away with Regulatory Forbearance

1.1 Existing guidelines in terms of paragraph 14.2 of the Master Circular on 'Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances' dated July 2, 2012 (MC on IRAC Norms) allow regulatory forbearance on asset classification of restructured accounts subject to certain conditions, i.e. standard accounts are allowed to retain their asset classification and NPA accounts are allowed to not deteriorate further in asset classification on restructuring.

1.2 In terms of paragraph 4.2.15.3 of MC on IRAC Norms dated July 2, 2012, asset classification benefit is also available on change of date of commencement of commercial operation (DCCO) for projects under infrastructure sector.

1.3 The WG recommended that the RBI may do away with the regulatory forbearance regarding asset classification, provisioning and capital adequacy on restructuring of loan and advances in line with the international prudential measures. However, in view of the current domestic macroeconomic situation as also global situation, this measure could be considered say, after a period of two years. Nevertheless, the WG felt that extant asset classification benefits in cases of change of DCCO of infrastructure project loans may be allowed to continue for some more time in view of the uncertainties involved in obtaining clearances from various authorities and importance of the sector in national growth and development.

1.4 RBI has decided to accept the above recommendation and give effect to this with effect from April 1, 2015. Accordingly, the extant asset classification benefits available on restructuring on fulfilling certain conditions will be withdrawn from that date. It implies that a standard account on restructuring would be immediately classified as sub-standard on restructuring as also the non-performing assets, upon restructuring, would continue to have the same asset classification as prior to restructuring and slip into

further lower asset classification categories as per the extant asset classification norms with reference to the pre-restructuring repayment schedule.

1.5 However, in accordance with the recommendation of the WG for continuing the extant asset classification benefit in cases of infrastructure projects on change of DCCO for some more time, such asset classification benefit would continue to be available in cases of infrastructure projects beyond April 1, 2015 till further review by RBI.

**2. General Provision on Restructured Standard Accounts**

2.1 In terms of circular DBOD.No.BP.BC.94/21.04.048/2011-12 dated May 18, 2011, banks are required to make a provision of 2.00 per cent on restructured standard accounts for different periods depending on the way an account is classified as restructured standard account, i.e. either *abinitio* or on upgradation or on retention of asset classification due to change in DCCO of infrastructure and non-infrastructure projects.

2.2 Till such time the regulatory forbearance on asset classification is dispensed with, in order to prudently recognise the inherent risks in restructured standard assets in the interregnum, the WG had recommended that the provision requirement on such accounts should be increased from the present 2 per cent to 5 per cent. This may be made applicable with immediate effect in cases of new restructurings (flow) but in a phased manner during a two year period for the existing standard restructured accounts (stock).

2.3 As an immediate measure, the RBI increased the provision on restructured standard accounts to 2.75 per cent from 2.00 per cent vide circular DBOD.No.BP.BC.63/21.04.048/2012-13 dated November 26, 2012. It has now been decided to increase the provision to 5 per cent in respect of new restructured standard accounts (flow) with effect from April 1, 2013 and in a phased manner for the stock of restructured standard accounts as on March 31, 2013 as under:

- 3.75 per cent – with effect from March 31, 2014 (spread over the four quarters of 2013-14)

- 5 per cent – with effect from March 31, 2015 (spread over the four quarters of 2014-15)

**3. Provision for Diminution in the Fair Value of Restructured Advances**

3.1 At present, in terms of paragraph 11.4 of MC on IRAC Norms dated July 2, 2012, detailed guidelines on the need for and method of calculation of diminution in the fair value of the restructured advances have been laid down.

3.2 The WG was of the view that the current instructions relating to calculation of diminution in fair value of accounts was appropriate and correctly captured the erosion in the fair value. Therefore, the same might be continued. It also recommended that the option of notionally computing the amount of diminution in the fair value of small accounts at 5 per cent of the total exposure at small/rural branches in respect of all restructured accounts where the total dues to bank(s) are less than rupees one crore, may be provided on a long term basis.

3.3 It has been decided to accept the recommendation; accordingly, the option of notionally computing the amount of diminution in the fair value of small accounts at 5 per cent of the total exposure at small/rural branches in respect of all restructured accounts where the total dues to bank(s) are less than rupees one crore would be available till a further review in this regard.

3.4 While the WG was of the view that the current instructions relating to calculation of diminution of fair value of accounts was appropriate and correctly captured the erosion in the fair value, it is learnt that on a few occasions there are divergences in the calculation of erosion in the fair value by banks. In terms of our extant instructions, the erosion in the fair value of the advance should be computed as the difference between the fair value of the loan before and after restructuring. Fair value of the loan before restructuring will be computed as the present value of cash flows representing the interest at the existing rate charged on the advance before restructuring and the principal, discounted at a rate equal to the bank's BPLR or base rate (whichever is applicable to the borrower) as on the date of restructuring plus the appropriate term premium and credit risk premium for the borrower category on the date of restructuring.

Fair value of the loan after restructuring will be computed as the present value of cash flows representing the interest at the rate charged on the advance on restructuring and the principal, discounted at a rate equal to the bank's BPLR or base rate (whichever is applicable to the borrower) as on the date of restructuring plus the appropriate term premium and credit risk premium for the borrower category on the date of restructuring.

3.5 Illustratively, divergences could occur if banks are not appropriately factoring in the term premium on account of elongation of repayment period on restructuring. In such a case the term premium used while calculating the present value of cash flows after restructuring would be higher than the term premium used while calculating the present value of cash flows before restructuring. Further, the amount of principal converted into debt/equity instruments on restructuring would need to be held under AFS and valued as per usual valuation norms. Since these instruments are getting marked to market, the erosion in fair value gets captured on such valuation. Therefore, for the purpose of arriving at the erosion in the fair value, the NPV calculation of the portion of principal not converted into debt/equity has to be carried out separately. However, the total sacrifice involved for the bank would be NPV of the above portion plus valuation loss on account conversion into debt/equity instruments. The promoters' sacrifice requirement would be based on the total sacrifice amount as calculated above.

3.6 Banks are therefore advised that they should correctly capture the diminution in fair value of restructured accounts as it will have a bearing not only on the provisioning required to be made by them but also on the amount of sacrifice required from the promoters. Further, there should not be any effort on the part of the banks to artificially reduce the net present value of cash flows by resorting to any sort of financial engineering. Banks are also advised to put in place a proper mechanism of checks and balances to ensure accurate calculation of erosion in the fair value of restructured accounts.

**4. Criteria for Upgradation of Account Classified as NPA on Restructuring**

4.1 In terms of extant instructions contained in paragraph 11.2.3 of MC on IRAC Norms dated July 2, 2012, all restructured accounts which have been classified as non-performing assets upon restructuring, would be eligible for upgradation to the 'standard'

category after observation of 'satisfactory performance' during the 'specified period'. Further, 'specified period' and 'satisfactory performance' have been defined in the Annex 5 of the Master Circular ibid.

4.2 The WG recommended that 'specified period' should be redefined in cases of restructuring with multiple credit facilities as 'one year from the commencement of the first payment of interest or principal, whichever is later, on the credit facility with longest period of moratorium. Further, the WG also recommended that the accounts classified as NPA on restructuring by the bank should be upgraded only when all the outstanding loans/facilities in the account perform satisfactorily during this specified period, i.e. principal and interest on all facilities in the account are serviced as per terms of payment.

4.3 RBI has also observed that in some cases of restructuring with moratorium on payment of principal as well as major portion of interest, the accounts were upgraded on the basis of payment of interest on only a small portion of the debt, say FITL, for the specified period. Such account may still have its inherent credit weakness as payment of interest on a small portion of loans does not give evidence of 'satisfactory performance'.

4.4 It has been decided that the specified period should be redefined as a period of one year from the commencement of the first payment of interest or principal, whichever is later, on the credit facility with longest period of moratorium under the terms of restructuring package.

4.5 Consequently, standard accounts classified as NPA and NPA accounts retained in the same category on restructuring by the bank should be upgraded only when all the outstanding loan/facilities in the account perform satisfactorily during the 'specified period', i.e. principal and interest on all facilities in the account are serviced as per terms of payment during that period.

**5. Benchmarks on Viability Parameters**

5.1 As per extant instruction vide paragraph 11.1.4 of the MC on IRAC Norms dated July 2, 2012, no account will be taken up for restructuring by the banks unless the financial

viability is established and there is a reasonable certainty of repayment from the borrower, as per the terms of restructuring package. The viability should be determined by the banks based on the acceptable viability benchmarks determined by them, which may be applied on a case-by-case basis, depending on merits of each case. RBI had illustrated a few viability parameters in this regard, without giving any benchmarks for each parameter.

5.2 The WG recommended that RBI may prescribe the broad benchmarks for the viability parameters based on those used by CDR Cell; and banks may suitably adopt them with appropriate adjustments, if any, for specific sectors.

5.3 It is felt that broad benchmarks prescribed in this regard will be helpful to banks to devise their own benchmarks for viability. However, as different sectors of economy have different performance indicators, it will be desirable that banks adopt these broad benchmarks with suitable modifications.

5.4 Therefore, it has been decided that the viability should be determined by the banks based on the acceptable viability parameters and benchmarks for each parameter determined by them. Illustratively, the broad viability parameters may include the Return on Capital Employed, Debt Service Coverage Ratio, Gap between the Internal Rate of Return and Cost of Funds and the amount of provision required in lieu of the diminution in the fair value of the restructured advance. The benchmarks for the viability parameters adopted by the CDR Mechanism are given in the Appendix and individual banks may suitably adopt them with appropriate adjustments, if any, for specific sectors while restructuring of accounts in non-CDR cases.

**6. Viability Time Period**

6.1 Currently, time period for attaining viability has been prescribed as one of the conditions for special asset classification benefit on restructuring. For this purpose, paragraph 14.2.2 (ii) of the MC on IRAC Norms dated July 2, 2012 prescribes the condition that the unit should become viable in 10 years, if it is engaged in infrastructure activities, and in 7 years in the case of other units.

6.2 The WG felt that the prescribed time span of seven years for non-infrastructure borrowal accounts and ten years for infrastructure accounts for becoming viable on restructuring was too long and banks should take it as an outer limit.

6.3 In line with the WG's recommendation, it has been decided that in order to qualify for the special asset classification benefit banks should ensure that the unit taken up for restructuring achieves viability in 8 years, if it is engaged in infrastructure activities, and in 5 years in other cases.

**7. Incentive for Quick Implementation of Restructuring Package**

7.1 In terms of extant instruction contained in paragraph 14.2.1 of MC on IRAC Norms dated July 2, 2012, during the pendency of the application for restructuring of the advance with the bank, the usual asset classification norms would continue to apply. However, as an incentive for quick implementation of the package, if the approved package is implemented by the bank as per the following time schedule and subject to fulfilment of certain conditions, the asset classification status may be restored to the position which existed when the reference was made to the CDR Cell in respect of cases covered under the CDR Mechanism or when the restructuring application was received by the bank in non-CDR cases:

(i) Within 120 days from the date of approval under the CDR Mechanism.
(ii) Within 90 days from the date of receipt of application by the bank in cases other than those restructured under the CDR Mechanism.

7.2 In case of non-CDR restructurings, asset classification benefit is available in case the restructuring package gets implemented within 90 days from the *date of receipt of application*. As 90 days period after receipt of application is considered insufficient for properly ascertaining the viability of the account, the WG recommended that the period for quick implementation under non-CDR mechanism including SME Debt Restructuring mechanism should be increased to 120 days from the *date of application*.

7.3 Accordingly, it has been decided that the incentive for quick implementation of the restructuring package in non-CDR cases would henceforth be available, if the approved

package is implemented by the bank within 120 days from the date of receipt of application.

**8. Roll over of Short-Term Loans**

8.1 As per existing instruction contained in Sl. No. (iv) under 'Key Concepts' in Annex 5 to Master Circular on IRAC Norms dated July 2, 2012 a restructured account is defined as one where the bank, for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower concessions that the bank would not otherwise consider. Restructuring would normally involve modification of terms of the advances/securities, which would generally include, among others, alteration of repayment period /repayable amount/the amount of instalments/rate of interest (due to other than competitive reasons). In view of this definition, any roll-over of a short term loan will be considered as 'restructuring'.

8.2 The WG recommended that RBI may clarify that the cases of roll-over of short term loans, where proper pre-sanction assessment has been made, such roll-over is allowed depending upon the actual requirement of the borrower and no concession has been provided due to weakness of the borrower, then these might not be considered as restructured accounts. However, if such accounts are rolled-over for more than 2 times, then third roll-over onwards the account would have to be treated as a restructured account.

8.3 It has been decided to accept the recommendation.

**9. Asset Classification Benefits on Restructuring of Infrastructure Project Loans - Jurisdictional Limits**

9.1 As per the existing instruction contained in paragraph 4.2.15 of MC on IRAC Norms dated July 2, 2012, certain relaxations regarding asset classification are extended on change in date of commencement of commercial operation (DCCO) for Infrastructure Projects. Relaxations are also extended regarding tangible security as a condition for asset classification benefit on restructuring of bank financing to infrastructure sector. At present no jurisdictional limit is stipulated for availing of above relaxations and as a

result, this benefit is available to all infrastructure projects irrespective of their location, i.e. whether in India or abroad.

9.2 The WG was of the view that the above relaxations in restructuring guidelines be permitted for infrastructure projects in view of the importance of infrastructure development in our country. Accordingly, it has been decided that the asset classification benefit available to infrastructure projects on change of DCCO as per the extant instructions will be henceforth available only in cases of projects implemented in India for infrastructure sector.

**10. Promoters' Sacrifice**

10.1 In terms of extant instruction contained in paragraph 14.2.2.(iv) of MC on IRAC Norms dated July 2, 2012, one of the conditions for eligibility for regulatory asset classification benefit on restructuring is that promoters' sacrifice and additional funds brought by them should be a minimum of 15 per cent of banks' sacrifice. The term 'bank's sacrifice' means the amount of "erosion in the fair value of the advance". It is also prescribed that promoters' sacrifice may be brought in two instalments and it may be brought in different forms as indicated therein.

10.2 The WG recommended that RBI may consider a higher amount of promoters' sacrifice in cases of restructuring of large exposures under CDR mechanism. Further, the WG recommended that the promoters' contribution should be prescribed at a minimum of 15 per cent of the diminution in fair value or 2 per cent of the restructured debt, whichever is higher.

10.3 Accordingly, it has been decided that promoters' sacrifice and additional funds brought by them should be a minimum of 15 per cent of banks' sacrifice or 2 per cent of the restructured debt, whichever is higher. This stipulation is the minimum and banks may decide on a higher sacrifice by promoters depending on the riskiness of the project and promoters' ability to bring in higher sacrifice amount. Further, such higher sacrifice may invariably be insisted upon in larger accounts, especially CDR accounts.

**11. Conversion of Debt into Equity / Preference Shares**

11.1 At present vide paragraphs 15.1, 15.2 & 15.3 of MC on IRAC Norms dated July 2, 2012, there is no regulatory cap on the percentage of debt which can be converted into equity/preference shares on restructuring of advances, subject to adherence to statutory requirement under Section 19 of the BR Act 1949 and relevant SEBI regulations.

11.2 The WG recommended that conversion of debt into preference shares should be done only as a last resort and such conversion of debt into equity/preference shares should, in any case, be restricted to a cap (say 10 per cent of the restructured debt). It also recommended that any conversion of debt into equity should be done only in the case of listed companies.

11.3 It has been decided to accept the recommendation.

**12. Right of Recompense**

12.1 In terms of existing instruction contained in paragraph 5.7 under Annex 4 of the MC on IRAC Norms dated July 2, 2012 all CDR approved packages must incorporate creditors' right to accelerate repayment and borrowers' right to pre-pay. The right of recompense should be based on certain performance criteria to be decided by the Standing Forum.

12.2 The WG recommended that CDR Standing Forum/ Core Group may take a view as to whether their clause on ‘recompense’ may be made somewhat flexible in order to facilitate the exit of the borrowers from CDR Cell. However, it also recommended that in any case 75 per cent of the amount of recompense calculated should be recovered from the borrowers and in cases of restructuring where a facility has been granted below base rate, 100 per cent of the recompense amount should be recovered.

12.3 The WG also recommended that the present recommendatory nature of ‘recompense’ clause should be made mandatory even in cases of non-CDR restructurings.

12.4 Accordingly, it has been decided that all restructuring packages must incorporate ‘Right to recompense’ clause and it should be based on certain performance criteria of

the borrower. In any case minimum 75 per cent of the recompense amount should be recovered by the lenders and in cases where some facility under restructuring has been extended below base rate, 100 per cent of the recompense amount should be recovered.

**13. Personal Guarantee of Promoters**

13.1 As per the extant restructuring guidelines, personal guarantee by the promoter is one of the necessary conditions (pargraph 14.2.2 of MC on IRAC Norms dated July 2, 2012) for the asset classification benefit except when the unit is affected by external factors pertaining to the economy and industry.

13.2 As stipulating personal guarantee will ensure promoters' "skin in the game" or commitment to the restructuring package, the WG recommended that obtaining the personal guarantee of promoters be made a mandatory requirement in all cases of restructuring, i.e. even if the restructuring is necessitated on account of external factors pertaining to the economy and industry. It also recommended that corporate guarantee cannot be a substitute for the promoters' personal guarantee.

13.3 Accordingly, it has been decided that promoters' personal guarantee should be obtained in all cases of restructuring and corporate guarantee cannot be accepted as a substitute for personal guarantee. However, corporate guarantee can be accepted in those cases where the promoters of a company are not individuals but other corporate bodies or where the individual promoters cannot be clearly identified.

**Appendix**

**Broad benchmarks for the viability parameters**

i. Return on capital employed should be at least equivalent to 5 year Government security yield plus 2 per cent.

ii. The debt service coverage ratio should be greater than 1.25 within the 5 years period in which the unit should become viable and on year to year basis the ratio should be above 1. The normal debt service coverage ratio for 10 years repayment period should be around 1.33.

iii. The benchmark gap between internal rate of return and cost of capital should be at least 1 per cent.

iv. Operating and cash break even points should be worked out and they should be comparable with the industry norms.

v. Trends of the company based on historical data and future projections should be comparable with the industry. Thus behaviour of past and future EBIDTA should be studied and compared with industry average.

vi. Loan life ratio (LLR), as defined below should be 1.4, which would give a cushion of 40% to the amount of loan to be serviced.

$$LLR = \frac{\text{Present value of total available cash flow (ACF) during the loan life period (including interest and principal)}}{\text{Maximum amount of loan}}$$