

## MONETARY AND CREDIT INFORMATION REVIEW

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### POLICY

#### Debt Restructuring Mechanism for SMEs

As part of announcement made by the Hon`ble Finance Minister for improving flow of credit to small and medium enterprises (SMEs) the Reserve Bank has issued detailed guidelines for restructuring debt of all eligible small and medium enterprises. All commercial banks have been advised to implement the guidelines.

#### Eligibility

- The guidelines are applicable to entities which are viable or potentially viable as follows :
  - (i) All non-corporate SMEs irrespective of the level of dues to banks.
  - (ii) All corporate SMEs which are enjoying banking facilities from a single bank, irrespective of the level of dues to the bank.
  - (iii) All corporate SMEs which have funded and non-funded outstanding up to Rs.10 crore under multiple/ consortium banking arrangement.
- Accounts involving wilful default, fraud and malfeasance would not be eligible for restructuring.
- Accounts classified by banks as "loss assets" would not be eligible for restructuring.
- In respect of cases under the purview of the Board for Industrial and Financial Reconstruction (BIFR) banks should ensure completion of all formalities in seeking approval from BIFR before implementing the package.

#### Viability

Banks should decide on the acceptable viability benchmark, consistent with the unit becoming viable in 7 years and the repayment period for restructured debt not exceeding 10 years.

#### Treatment of Restructured Accounts

##### *'Standard' accounts*

a) A rescheduling of the instalments of principal alone, would not cause a standard asset to be classified in the sub-standard category, provided the borrower's outstanding is fully covered by tangible security. The condition of tangible security should, however, not be made applicable in cases where the outstanding is up to Rs.5 lakh, as the collateral requirement for loans up to Rs 5 lakh has been dispensed with for the small scale industries (SSI)/tiny sector.

b) A rescheduling of interest element would not cause an asset to be downgraded to sub-standard category subject to the condition that the amount of sacrifice, if any, in the element of interest, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved.

c) In case there is sacrifice involved in the amount of interest in present value terms, the amount of sacrifice should either be written off or provision made to the extent of the sacrifice involved.

#### *'Sub-standard'/'doubtful' accounts*

a) A rescheduling of the instalments of principal alone, would render a 'sub-standard'/'doubtful' asset eligible to continue in the 'sub-standard'/'doubtful' category for the specified period, provided the borrower's outstanding is fully covered by tangible security. The condition of tangible security would, however, not be made applicable in cases where the outstanding is up to Rs.5 lakh, as the collateral requirement for loans up to Rs 5 lakh has been dispensed with for SSI/ tiny sector.

b) A rescheduling of interest element would render a 'sub-standard'/'doubtful' asset eligible to continue in the sub-standard/'doubtful' category for the specified period, subject to the condition that the amount of sacrifice, if any, in the element of interest, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved.

c) In cases where the sacrifice is by way of write off of the past interest dues, the asset should continue to be treated as 'sub-standard'/'doubtful'.

#### *Provision*

a) Provision made towards interest sacrifice should be created by debit to profit and loss account and held in a distinct account. For this purpose, the future interest due as per the current benchmark prime lending rate (BPLR) in respect of an account, should be discounted to the present value at a rate appropriate to the risk category of the borrower (i.e., current PLR + the appropriate term premium and credit risk premium for the borrower-category) and compared with the present value of the dues expected to be received under the restructuring package, discounted on the same basis.

b) Sacrifice should be re-computed on each balance sheet date till satisfactory completion of all repayment obligations and full repayment of the outstanding in the account, so as to capture the changes in the fair value on account of changes in BPLR, term premium and the credit category of the borrower. Consequently, banks should provide for the shortfall in provision or reverse the amount of excess provision held in the distinct account.

c) The amount of provision made for non-performing assets (NPAs), should be reversed when the account is re-classified as a 'standard asset'.

#### **Additional Finance**

Additional finance, if any, should be treated as 'standard asset' in all accounts viz., standard, sub-standard and doubtful accounts, up to a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due under the approved restructuring package. If the restructured asset does not qualify for upgradation at the end of the above period, additional finance should be placed in the same asset classification category as the restructured debt.

#### **Upgradation**

The sub-standard/doubtful accounts which have been subjected to restructuring, whether in respect of principal instalment or interest, by whatever modality, would be eligible to be upgraded to the standard category after the specified period, i.e., a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms, subject to satisfactory performance during the period.

#### **Asset Classification**

During the specified one year period, the asset classification status of rescheduled accounts would not deteriorate if satisfactory performance of the account is demonstrated during the period. In case, however, satisfactory performance during the one year period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule. The asset classification would be bank-specific based on record of recovery of each bank, as per the existing prudential norms applicable to banks.

#### **Repeated Restructuring**

The special dispensation for asset classification would be available only when the account is restructured for the first time.

#### **Procedure**

- Based on these guidelines, banks should formulate a debt restructuring scheme for SMEs with the approval of their board of directors. While framing the scheme, banks should ensure that the scheme is simple to comprehend and at the minimum, includes parameters indicated in these guidelines.
- The restructuring would follow the receipt of such a request from the borrowing units.

- In case of eligible SMEs which are under consortium/ multiple banking arrangements, the bank with the maximum outstanding should work out the restructuring package, along with the bank having the second largest share.

#### **Time Frame**

Banks should work out the restructuring package and implement it within a maximum period of 60 days from the date of receipt of requests.

#### **Review**

Banks should review the progress in rehabilitation and restructuring of SME accounts on a quarterly basis and keep their board informed.

#### **Disclosure**

Banks should display the debt restructuring scheme for SMEs on their website and also forward it to the Small Industries Development Bank of India (SIDBI) for placing on their web site.

Banks should also disclose in their published annual balance sheets, under 'Notes on Accounts, the total amount of assets, standard assets, sub-standard assets and doubtful assets of SMEs subjected to restructuring during the year.

#### **Definition of SMEs**

The Reserve Bank has defined SMEs in its circular of August 2005. The definition is reproduced below :

“At present, a small scale industrial (SSI) unit is an undertaking in which investment in plant and machinery, does not exceed Rs.1 crore, except in respect of certain specified items under hosiery, hand tools, drugs and pharmaceuticals, stationery items and sports goods, where this investment limit has been enhanced to Rs. 5 crore. A comprehensive legislation which would enable the paradigm shift from small scale industry to small and medium enterprises is under consideration of the Parliament. Pending enactment of the legislation, current SSI/tiny industries definition may continue. Units with investment in plant and machinery in excess of SSI limit and up to Rs. 10 crore may be treated as medium enterprises (ME). “

#### **OTS for SMEs**

The Reserve Bank has announced a one-time settlement (OTS) scheme for small and medium enterprises (SMEs) for recovery of NPAs below Rs.10 crore. The guidelines provide a simplified, non-discretionary and non-discriminatory mechanism which all public sector banks should uniformly implement. The guidelines are indicated below :

#### **Coverage**

- The guidelines would cover -
  - (a) All NPAs in the SME sector which have become doubtful or loss as on March 31, 2004 with outstanding balance of Rs.10 crore and below on the date on which the account was classified as doubtful.
  - (b) NPAs classified as sub-standard as on March 31, 2004, which have subsequently become doubtful or loss where the outstanding balance was Rs.10 crore and below on the date on which the account was classified as doubtful.
  - (c) Cases on which banks have initiated action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and also cases pending before courts/debt recovery tribunals (DRTs)/BIFR, subject to consent decree being obtained from the courts/DRTs/BIFR.
- The guidelines do not cover cases of wilful default, fraud and malfeasance.
- The last date for receipt of applications from borrowers would be as at the close of business on March 31, 2006. The processing under the revised guidelines should be completed by June 30, 2006.

#### **Settlement Formula**

(i) NPAs classified as doubtful or loss as on March 31, 2004 -the minimum amount that should be recovered would be 100 per cent of the outstanding balance in the account as on the date on which the account was categorised as doubtful.

(ii) NPAs classified as sub-standard as on March 31, 2004 which became doubtful or loss subsequently - the minimum amount that should be recovered would be 100 per cent of the outstanding balance in the account as on the date on which the account was categorised as doubtful, plus interest at the existing PLR from April 1, 2004 till the date of final payment.

## Payment

The settlement amount should preferably be paid in one lump sum. In cases where borrowers are unable to pay the entire amount in one lump sum, at least 25 per cent of the settlement amount should be paid upfront and the balance amount of 75 per cent should be recovered in instalments within a period of one year together with interest at the existing PLR from the date of settlement up to the date of final payment.

## Sanctioning Authority

The decision on the one-time settlement and consequent sanction of waiver or remission or write-off should be taken by the competent authority under the delegated powers. Any deviation from these settlement guidelines for any borrower would be made only by the board of directors.

## Reporting

Banks have been advised to give wide publicity through various means to the one-time settlement scheme and also to give notice by January 31, 2006 to the eligible defaulting borrowers to avail of the opportunity. Banks should also display the guidelines on their website.

### Branch Authorisation Policy Liberalised

With the objective of liberalising and rationalising the policy for authorisation of bank branches in India, the Reserve Bank has put in place a framework for a new branch authorisation policy which would be consistent with the medium term corporate strategy of banks and public interest.

Under the revised branch authorisation policy framework, the following aspects would be kept in view while processing the authorisation requests:

(a) While considering applications for opening branches, weightage would be given to the nature and scope of banking facilities provided by banks to common persons, particularly in underbanked areas, actual credit flow to the priority sector, pricing of products and overall efforts for promoting financial inclusion, including introduction of appropriate new products and the enhanced use of technology for delivery of banking services.

(b) The assessment would include policy on minimum balance requirements and whether depositors have access to minimum banking or "no frills" banking services, commitment to basic banking activity viz., acceptance of deposits and provision of credit and quality of customer service as, *inter alia*, evidenced by the number of complaints received and the redressal mechanism in place in the bank for the purpose.

(c) The need to induce enhanced competition in the banking sector at various locations.

(d) Regulatory comfort would encompass -

- compliance with not only the letter of the regulation but also whether the bank's activities are in compliance with the spirit and underlying principles of the regulation;
- the activities of the banking group and the nature of relationship of the bank with its subsidiaries, affiliates and associates; and
- quality of corporate governance, proper risk management systems and internal control mechanisms.

The existing system of granting authorisations for opening individual branches from time to time, would be replaced by a system of giving aggregated approvals, on an annual basis, through a consultative and interactive process. The Reserve Bank would discuss with individual banks their branch expansion strategies and plans over the medium term. The medium term framework and specific proposals would, to the extent possible, cover the opening/closing/shifting of all categories of branches/ offices including ATMs. The authorisations given on an annual basis would be valid for one year from the date of communication.

These policy parameters would also be applicable to foreign banks, in addition to the criteria which are specific to foreign banks. While the branch expansion of foreign banks would be considered keeping in view India's commitments at the World Trade Organisation (WTO), ATMs would not be included in the number of branches for such computation.

All branch authorisation applications from banks would, henceforth, be examined in detail in the light of the new policy framework which would be implemented with due flexibility. Banks may submit their proposals for the one year period to the Reserve Bank along with their medium term plans. As a transitional arrangement the Reserve Bank would, however,

consider urgent requests, if any, received from banks for processing their applications already submitted to it and would approve, on a case-by-case basis, those which are considered to be broadly in consonance with the new policy framework.

The Reserve Bank has also decided to rationalise the extant categories of branches and simplify other procedures relating to authorisation of branches.

## **BANKING**

### **Gold Metal Loan**

The Reserve Bank has decided to permit banks nominated to import gold to extend gold (metal) loans to domestic jewellery manufacturers, who are not exporters of jewellery. The permission is subject to the condition that any gold loan borrowing/or other non-funded commitments taken by banks for providing gold loans to domestic jewellery manufacturers would be taken into account for the purpose of overall ceiling (presently 25 per cent of Tier I capital) in respect of aggregate borrowing for non-export purposes. Gold loans extended to exporters of jewellery would continue to be out of the 25 per cent ceiling.

Accordingly, banks may extend gold (metal) loans to domestic jewellery manufacturers provided that -

- (i) The tenor of the gold loan does not exceed 90 days.
- (ii) Interest charged to the borrowers is linked to the international gold interest rate.
- (iii) The gold borrowings would be subject to normal reserve requirements.
- (iv) The loan would be subject to capital adequacy and other prudential requirements.
- (v) End-use of the gold loan is ensured and 'know your customer' (KYC) guidelines are adhered to.
- (vi) Any mismatch arising out of the gold borrowings and lendings is within the prudential risk limits approved by the nominated bank's board.
- (vii) The overall risks in granting gold loans are carefully assessed and a detailed lending policy is laid down with the approval of the board.

Presently, nominated banks can extend gold (metal) loans to exporters of jewellery who are customers of other scheduled commercial banks, by accepting stand-by letter of credit (LC) or bank guarantee (BG) issued by their bankers in favour of the nominated banks subject to authorised banks' own norms for lending and other conditions stipulated by the Reserve Bank. As a further liberalisation measure, it has been decided to extend this facility to domestic jewellery manufacturers also, subject to the conditions that -

- (a) The stand-by LC/BG is extended only on behalf of domestic jewellery manufacturers and covers at all times the full value of the quantity of gold borrowed by these entities. The stand-by LC/BG is issued by a scheduled commercial bank in favour of a nominated bank only and not to any other entity which may otherwise be having permission to import gold.
- (b) The bank issuing the stand-by LC/BG (only inland letter of credit/bank guarantee) should do so only after carrying out proper credit appraisal. The bank should ensure that adequate margin is available to it at all times consistent with the volatility of gold prices.
- (c) The stand-by LC/BG facilities are denominated in Indian rupees and not in foreign currency.
- (d) The stand-by LC/BG issued by the non-nominated banks would be subject to extant capital adequacy and prudential norms.
- (e) Banks issuing stand-by LC/BG should carefully assess the overall risks in granting these facilities and lay down a detailed lending policy with the approval of their board.

The Reserve Bank has further clarified that -

- The exposure assumed by the nominated bank extending the gold (metal) loan against the stand-by LC/BG of another bank would be deemed as an exposure on the guaranteeing bank and attract appropriate risk weight as per the extant guidelines.
- The transaction should be purely on a back-to-back basis i.e., nominated banks should extend the gold (metal) loan directly to the customer of a non-nominated bank, against the stand-by LC/BG issued by the latter.
- Gold (metal) loans should not involve any direct or indirect liability of the borrowing entity towards foreign suppliers of gold.

- Banks should calculate their exposure and compliance with prudential norms daily by converting into rupee the gold quantity by crossing London AM fixing for gold/US dollar rate with the rupee-dollar reference rate announced by the Reserve Bank.
- There would be no change in the existing policy on lending against bullion.

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