Treatment of restructured accounts

Ref DBS.FID No. C-19 /01.02.00/2000-01

March 28 , 2001

<u>To All-India Term Lending and Refinancing Institutions</u>

Dear Sir,

<u>Treatment of restructured accounts</u>

Please refer to paragraph 3 of our circular letter DBS.FID. No. C-16/ 01.02.00/ 2000-01 dated 7 February 2001 advising that the instructions relating to the regulatory treatment of restructured accounts would be conveyed shortly. The matter has since been examined and we advise as under.

2. In terms of our circular FIC No.841/01.02.00/93-94 dated 28 March 1994, and FIC No.08/01.10.00/96-97 dated 27 February 1997, addressed to all-India term lending institutions and FIC No.640/01.10.00/95096 dated 7 March 1996, and FIC.No.09/01.10. 00/96-97 dated 21 March 1997, addressed to the refinancing institutions, the financial institutions were advised, *inter alia*, that the standard assets where the terms of loan agreement relating to interest and principal have been renegotiated or rescheduled after commencement of production are required to be classified as sub standard and can be upgraded only after one year of satisfactory performance. It has, however, been represented to us that the foregoing stipulations deter the financial institutions from restructuring of standard and sub standard loan assets even though the modification of terms might not jeopardise the assurance of repayment of dues from the borrower. The present norms have, therefore, been reviewed in the light of the international best practices and the BIS guidelines in the matter and it has been decided to effect certain changes in the norms relating to restructuring / rescheduling / renegotiation of terms of the standard and sub-standard loan assets, as detailed in the following paragraphs.

3. In the context of restructuring of the accounts, the following stages at which the restructuring / rescheduling / renegotiation of the terms of loan agreement could take place, can be identified:

(a) before commencement of commercial production;

(b) after commencement of commercial production but before the asset has been classified as sub standard,

(c) after commencement of commercial production and the asset has been classified as sub standard.

In each of the foregoing three stages, the rescheduling, etc., of principal and/or of interest could take place, with or without sacrifice, as part of the restructuring package evolved.

4. The prudential treatment of the accounts, subjected to restructuring / rescheduling / renegotiation of terms, would be governed by the following norms:

4.1 <u>Treatment of restructured standard accounts</u>

a. A rescheduling of the instalments of principal alone, at any of the aforesaid first two stages would not cause a standard asset to be classified in the sub standard category provided the loan/credit facility is fully secured.

b. A rescheduling of interest element at any of the foregoing first two stages 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. For the purpose, the future interest due as per the original loan agreement 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 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.

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

4.2 <u>Treatment of restructured sub-standard accounts</u>

a. A rescheduling of the instalments of principal alone, would render a sub-standard asset eligible to be **continued** in the sub-standard category for the specified period, **provided** the loan/credit facility is **fully secured**.

b. A rescheduling of interest element would render a sub-standard asset eligible to be **continued** to be classified in **sub standard** 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. For the purpose, the future interest due as per the original loan agreement 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 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.

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

The sub-standard accounts at (a), (b) and (c) above, which have been subjected to restructuring, etc, whether in respect of principal instalment or interest amount, by whatever modality, would be eligible to be **upgraded to the standard category** only 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, subject to satisfactory performance during the period. The amount of **provision** made earlier, net of the amount provided for the sacrifice in the interest amount in present value terms as aforesaid, could also **be reversed** after the one-year period.

During this one-year period, the sub-standard asset will not deteriorate in its classification if satisfactory performance of the account is demonstrated during the period. In case, however, the 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**.

Restructuring of doubtful/loss assets

5. The extant instructions relating to doubtful/loss assets which are subsequently classified as sub-standard consequent to restructuring/renegotiations/rescheduling will remain unchanged. Accordingly, the reversal of provisions made or amount written off till the asset becomes eligible to be classified as performing asset, will continue to be NOT permitted, as hitherto. Such sub-standard assets, if subsequently subjected to restructuring/renegotiations/rescheduling, would be governed by the norms of paragraph 4 above.

Applicability

6. The foregoing norms for restructuring, etc., of standard and sub-standard assets would be applicable, in **supercession of the existing RBI norms** in respect of such assets **in so far as they relate to restructuring/ rescheduling / renegotiation** of the terms of the loan agreement. All other prudential guidelines relating to income recognition, asset classification and provisioning would remain unaltered.

7. The foregoing changes in the norms would be applicable only to the standard and sub-standards accounts which are subjected to restructuring / rescheduling / renegotiation of terms, subsequent to the date of issue of these instructions.

<u>Disclosure</u>

8. The Financial Institutions should also disclose in their published Annual Accounts the total amount of loan assets as also of the sub standard assets, separately, which have been subjected to restructuring, etc. This disclosure would be in addition to the disclosures required to be made as per our circular DBS.FID. No. C-18/01.02.00/2000-01 dated 23 March 2001.

<u>General</u>

9. All standard and sub-standard accounts subjected to restructuring, etc., and covered under paragraph 4 above, would continue to be eligible for fresh financing of funding requirements, by the lenders as per their normal policy parameters and eligibility criteria.

10. Please acknowledge receipt.

Yours faithfully,

(K. C. Bandyopadhyay)
Chief General Manager