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All Scheduled Commercial Banks
(excluding RRBs)
All-India Term-lending and Refinancing Institutions
(Exim Bank, NABARD, NHB and SIDBI)

Dear Sir,

Review of Prudential Guidelines - Revitalising Stressed Assets in the Economy

The Reserve Bank of India has issued various guidelines aimed at revitalising the stressed assets in the economy. The measures taken by the Reserve Bank include Strategic Debt Restructuring Mechanism, Framework to Revitalise the Distressed Assets in the Economy, Revisions to the Guidelines on Restructuring of Advances by Banks, Flexible structuring of Long Term Project Loans and amendments to guidelines on Sale of Financial Assets to Securitisation Companies (SC) / Reconstruction Companies (SC).

2. On a review of these guidelines, and based on feedback received from stakeholders, it has been decided to partly modify, and also clarify, some aspects of the guidelines, as given in the Annex. The revisions will take prospective effect.

Yours faithfully,

(Sudarshan Sen)
Principal Chief General Manager

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हिंदी आसान हैं, इसका प्रयोग बड़ाइए

Annex

Part A - Strategic Debt Restructuring (SDR) Scheme

1. The Strategic Debt Restructuring (SDR) has been introduced with a view to ensuring more stake of promoters in reviving stressed accounts and providing banks with enhanced capabilities to initiate change of ownership, where necessary, in accounts which fail to achieve the agreed critical conditions and viability milestones. Therefore, banks should consider using SDR *only* in cases where change in ownership is likely to improve the economic value of the loan asset and the prospects of recovery of their dues. In this regard, the instructions in paragraph 3(i) of circular dated June 8, 2015 on SDR on the issue of triggering invocation of SDR must be scrupulously followed. It is reiterated that the trigger for SDR must be non-achievement of viability milestones and /or non-adherence to 'critical conditions' *linked to the option of invoking SDR*, as stipulated in restructuring agreement, and SDR cannot be triggered for any other reason.

2. Paragraph 3.vii of the above-mentioned circular prescribes that *henceforth, banks should include necessary covenants in all loan agreements, including restructuring, supported by necessary approvals/authorisations (including special resolution by the shareholders) from the borrower company, as required under extant laws/regulations, to enable invocation of SDR in applicable cases'.* Further, paragraph 7 of the circular on Revitalising Distressed Assets dated September 24, 2015 advises that JLF will have the option to initiate SDR to effect change of management of the borrower company in cases of failure of rectification or restructuring as a CAP as decided by JLF, subject to compliance with the stipulated conditions. We reiterate the above mentioned guidelines and advise that necessary covenants should also be part of rectification arrangement.

3. Paragraph 3.xiv.a of the above mentioned circular prescribes that the 'new promoter' (to whom the lenders divest their equity) should not be a person/entity/subsidiary/associate etc. (domestic as well as overseas), from the existing promoter/promoter group. It is reiterated that banks should exercise the necessary due diligence in this regard.

4. Banks should explore the possibility of preparing a panel of management firms/individuals having expertise in running firms/companies who could be considered for managing the companies till ownership is transferred to the new promoters. Banks may consult IBA and other industry bodies in this regard.

5. In no case should the current management be allowed to continue without the representatives of banks on the Board of the company and without supervision by an entity/person appointed by the banks.

6. The general principle of restructuring should be that the shareholders bear the first loss rather than the lenders. Accordingly, personal guarantees/commitments obtained from existing promoters should also cover losses incurred by lenders. Therefore, banks should devise an appropriate mechanism as per the bank's board approved policy towards invocation/release of personal guarantees and this should be based on the principle of reasonable satisfaction of lenders' claims. This could include pledge of the existing promoters' share in favour of the lenders if not already done. In any case, personal guarantees should be released only after transfer of ownership and/or management control to the new promoters.

7. In partial modification of the paragraph 3. xiii of the above-mentioned circular *on the issue of divestment of banks' holding in favour of a 'new promoter',* it has been decided that the asset classification benefit will be available to the lenders provided they divest a minimum of 26% of the shares of the company (and not necessarily 51% ab initio as required hitherto) to the new promoters within the stipulated time line of 18 months and the new promoters take over management control of the company. Lenders would thus have the option to exit their remaining holdings gradually, with upside as the company turns around. Lenders should, however, grant the new promoters the 'Right of First Refusal' for the subsequent divestment of their remaining stake.

8. In terms of extant instructions, JLFs are required to adhere to certain prescribed timelines during SDR process. In partial modification of the extant instructions, it is advised that the JLF can have flexibility in the time taken for completion of individual activities up to conversion of debt into equity in favour of lenders (i.e. up to 210 days from the review of achievement of milestones/critical conditions) as per the SDR

package approved by JLF. It is also clarified that the benefit of 'stand-still' in asset classification will apply from the reference date itself. However, if the targeted conversion of debt into equity shares does not take place within 210 days from the review of achievement of milestones/critical conditions, the benefit will cease to exist. Thereafter, the loans will be classified as per the conduct of the account as per the extant Income Recognition, Asset Classification and Provisioning norms.

9. Para 8 of the circular dated June 8, 2015 on 'SDR Scheme' prescribes the following:

> *Equity shares acquired and held by banks under the scheme shall be exempt from the requirement of periodic mark-to-market (stipulated vide Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by Banks) for the 18 month period indicated at para 3(xi).*

However, there is a possibility of banks facing a cliff-effect of provisioning at the end of the 18 month period on account of mark-to-market requirement (if a part of the equity shares are retained) and/or on account of recognising loss on sale of equity shares to the new promoters. In view of this, it has been decided that banks should periodically value and provide for depreciation of these equity shares as per IRAC norms for investment portfolio. Banks will, however, have the option of distributing the depreciation on equity shares acquired under SDR, over a maximum of four calendar quarters from the date of conversion of debt into equity i.e., the provisioning held for such depreciation should not be less than 25% of the depreciation during the first quarter, 50% of the depreciation as per the current valuation during the second quarter, and so on. Furthermore, banks desiring to have a longer period for making provisions, say 6 quarters, can start making ex-ante provisions in anticipation of MTM requirement, from the reference date itself.

10. Para 3.xiii of the circular dated June 8, 2015 on 'SDR Scheme' prescribe the following:

> *JLF should divest their holdings in the equity of the company as soon as possible. On divestment of banks' holding in favour of a 'new promoter', the asset classification of the account may be upgraded to 'Standard'. However, the quantum of provision held by the bank against the said account as on the date of divestment, which shall not be less than what was held as at the 'reference date', shall not be reversed.*

It is possible that the lenders may not be able to sell their stake to new promoters within the 18 month period, thus revoking the 'stand-still' benefit, which may result in sharp deterioration in the classification of their remaining loan exposures from what prevailed on the 'reference date'. In order to avoid the cliff effect of resultant provisioning, banks should build provisions such that, by the end of the 18 month period from the reference date, they hold provision of at least 15 per cent of the residual loan. The required provision should be made in equal instalments over the four quarters. This provision shall be reversed only when all the outstanding loans/facilities in the account perform satisfactorily during the 'specified period' (as defined in the extant norms on restructuring of advances) after transfer of ownership/management control to new promoters.

11. The guidelines contained in paragraph 3 and 6 will also be applicable to cases where change in ownership has been carried out under the circular DBR.BP.BC.No.41/21.04.048/2015-16 dated September 24, 2015 on Prudential Norms on Change in Ownership of Borrowing Entities (Outside Strategic Debt Restructuring Scheme). In addition, paragraph 7 of this circular will also be applicable to such cases subject to the condition that lenders along with the new promoters should hold at least 51 per cent of the paid up equity capital of the borrower company.

12. In terms of Paragraph 5 of the circular dated June 8, 2015, pricing formula under Strategic Debt Restructuring Scheme has been exempted from the Securities and Exchange Board of India (SEBI) (Issue of Capital and Disclosure Requirements) Regulations, 2009 subject to certain conditions. Further, in the case of listed companies, the acquiring lender on account of conversion of debt into equity under SDR has also been exempted from the obligation to make an open offer under regulation 3 and regulation 4 of the provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

Accordingly, it is clarified that the SDR framework will also be available to an ARC, which is a member of the JLF undertaking SDR of a borrower company.

13. We also invite attention to Paragraph 3.xiii of the circular ibid which prescribes that at the time of divestment of their holdings to a ‘new promoter’, banks may refinance the existing debt of the company considering the changed risk profile of the company without treating the exercise as ‘restructuring’ subject to banks making provision for any diminution in fair value of the existing debt on account of the refinance. In this regard, it is advised that banks should strictly adhere to the provisioning as prescribed under SDR framework while refinancing the existing debt of the company under the ‘new promoter’. It is clarified that if banks partially write off the existing loan which is being refinanced, the abovementioned provision for diminution in fair value will be net of the amount written off.

14. These revised guidelines will be applicable prospectively. However, it would be prudent if banks follow these guidelines even in cases where JLF has already decided to undertake SDR.

Part B - Framework to Revitalise the Distressed Assets in the Economy
Joint Lenders’ Forum Empowered Group (JLF – EG)

15. In terms of the extant guidelines, the decisions on the CAP must be approved by a minimum of 75% of creditors by value and 60% of creditors by number in the JLF. On a review, the proportion of lenders, by number, required for approving the CAP has been reduced to 50%.

16. In terms of paragraph 3.2 of the circular on revitalizing distressed assets dated September 24, 2015, *JLF will finalise the Corrective Action Plan (CAP) and the same will be placed before an Empowered Group (EG) of lenders, which will be tasked to approve the rectification/restructuring packages under CAPs*. In partial modification to this, it is advised that approval of JLF-EG is mandatory only in cases of rectification with additional finance and cases of restructuring under a CAP.

17. Paragraph 3.2 of the circular dated September 24, 2015 also prescribes the composition of JLF-EG. It has been decided to modify the composition of JLF-EG as under:

a. The top two banks in the system, in terms of advances, namely SBI and ICICI Bank, will continue to be permanent members of JLF EG, irrespective of whether or not they are lenders in the particular JLF.
b. If SBI and ICICI Bank are the lenders in a JLF, the JLF-EG would consist of these two banks, the three lenders (other than ICICI Bank and SBI) having largest exposures to the borrower and the two largest banks in terms of advances[1] which do not have any exposure to the borrower.
c. If either of SBI or ICICI bank is a lender, the JLF-EG would consist of these two banks, the four lenders (other than ICICI Bank and SBI) having largest exposures to the borrower and the next largest bank in terms of advances[2] which does not have any exposure to the borrower.
d. If neither SBI nor ICICI Bank are the lenders in a JLF, then the JLF-EG would consist of these two banks and the five lenders having largest exposures to the borrower.
e. All the JLF-EG members would have equal voting rights irrespective of size of exposure to the borrower.

18. In terms of the extant guidelines, the JLF is required to arrive at an agreement on the option to be adopted for Corrective Action Plan (CAP), i.e. either rectification, or restructuring or recovery, within 45 days from (i) the date of an account being reported as SMA-2 by one or more lenders, or (ii) receipt of request from the borrower to form a JLF, with substantiated grounds, if it senses imminent stress. The JLF should sign off the detailed final CAP within the next 30 days from the date of arriving at such an agreement. Further, in terms of the extant guidelines (para 5.2 of circular dated September 24, 2015), *banks were advised that dissenting lenders who do not want to participate in the rectification or restructuring of the account as CAP, which may or may not involve additional financing, will have an option to exit their exposure completely by selling their exposure to a new or existing lender(s) within the prescribed timeline for implementation of the agreed CAP. The* ***exiting lender will not have the option to continue with their existing exposure and***

[1] Advances of SCBs as per 'Table 2: Liabilities and Assets of Scheduled Commercial Banks' in the latest 'Statistical Tables Relating to Banks in India', available on the RBI website.
[2] Advances of SCBs as per 'Table 2: Liabilities and Assets of Scheduled Commercial Banks' in the latest 'Statistical Tables Relating to Banks in India', available on the RBI website.

***simultaneously not agreeing for rectification or restructuring as CAP**. The new lender to whom the exiting lender sells its stake may not be required to commit any additional finance, if the agreed CAP involves additional finance. In such cases, if the new lender chooses to not to participate in additional finance, the share of additional finance pertaining to the exiting lender will be met by the existing lenders on a pro-rata basis.*

It is therefore reiterated that if the dissenting lender is not able to exit by arranging a buyer within the above prescribed time, it has to necessarily adhere to the agreed CAP and provide additional finance, if the CAP so envisages.

Further, it has been observed that, in some cases, there are undue delays by banks in communicating their decision on CAP, which defeats the very purpose of this framework for initiating prompt corrective measures in cases of stressed accounts. It has, therefore, been decided to put in place an incentive structure for banks to communicate their decision on the agreed CAP in a time bound manner. Accordingly, asset classification and provisioning norms prescribed in the Appendix shall apply to different categories of lenders where the CAP has been agreed by majority members of JLF (i.e., lenders with 75 percent by value of debt and 50 per cent by number).

19. Furthermore, additional funding provided under restructuring/rectification as part of the CAP will have priority in repayment over repayment of existing debts. Therefore, instalments of the additional funding which fall due for repayment will have priority over the repayment obligations of the existing debt. Necessary conditions shall accordingly be incorporated in the JLF agreement.

Part C- Prudential Guidelines on Restructuring of Advances

20. We reiterate that the accounts classified as 'standard assets' should be immediately re-classified as 'sub-standard assets' upon restructuring as per the extant guidelines. Further, as per extant norms, any additional finance may be treated as 'standard asset' during the specified period under the approved restructuring package.

21. Paragraph 17.1.5 of Master Circular on IRAC Norms dated July 1, 2015, prescribe the following:

While the borrowers indulging in frauds and malfeasance will continue to remain ineligible for restructuring, banks may review the reasons for classification of the borrowers as wilful defaulters, specially in old cases where the manner of classification of a borrower as a wilful defaulter was not transparent, and satisfy itself that the borrower is in a position to rectify the wilful default. The restructuring of such cases may be done with Board's approval, while for such accounts the restructuring under the CDR Mechanism may be carried out with the approval of the Core Group only.

22. On a review, and with a view to preserve the economic value of viable accounts, it has been decided that in cases of fraud/malfeasance where the existing promoters are replaced by new promoters and the borrower company is totally delinked from such erstwhile promoters/management, banks and JLF may take a view on restructuring of such accounts based on their viability, without prejudice to the continuance of criminal action against the erstwhile promoters/management. Further, such accounts may also be eligible for asset classification benefits available on refinancing after change in ownership, if such change in ownership is carried out under guidelines contained in circular DBR.BP.BC.No.41/21.04.048/2015-16 dated September 24, 2015 on “Prudential Norms on Change in Ownership of Borrowing Entities (Outside Strategic Debt Restructuring Scheme)”. Each bank may formulate its policy and requirements as approved by the Board, on restructuring of such assets.

23. We also reiterate that restructured accounts classified as non-performing assets, when upgraded to standard category will attract a provision of 5 percent in the first year from the date of upgradation.

24. General Conditions

24.1 Instructions on ‘Special Regulatory Treatment for Asset Classification’ as contained in Part B of Master Circular DBR.No.BP.BC.2/21.04.048/2015-16 dated July 1, 2015 on “Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances’ stand withdrawn.

24.2 Henceforth, the following General Conditions would be applicable in all cases of restructuring in addition to General Conditions already mentioned in paragraph 21 (Miscellaneous) of the Master Circular ibid:

i. All restructuring packages will be required to be implemented in a time bound manner. All restructuring packages under CDR/JLF/Consortium/MBA arrangement should be implemented within 90 days from the date of approval. Other restructuring packages should be implemented within 120 days from the date of receipt of application by the bank.

ii. Promoters must bring additional funds in all cases of restructuring. Additional funds brought by promoters should be a minimum of 20 per cent of banks' sacrifice or 2 per cent of the restructured debt, whichever is higher. The promoters' contribution should invariably be brought upfront while extending the restructuring benefits to the borrowers. Promoter's contribution need not necessarily be brought in cash and can be brought in the form of conversion of unsecured loan from the promoters into equity;

iii. Banks should determine a reasonable time period during which the account is likely to become viable, based on the cash flow and the Techno Economic Viability (TEV) study;

iv. Banks should be satisfied that the post restructuring repayment period is reasonable, and commensurate with the estimated cash flows and required DSCR in the account as per their own Board approved policy.

v. Each bank should clearly document its own due diligence done in assessing the TEV and the viability of the assumptions underlying the restructured repayment terms.

24.3. All other instructions under Part B of Master Circular DBR.No.BP.BC.2/21.04.048/2015-16 dated July 1, 2015 on "Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances" shall remain unchanged.

Part D - Flexible Structuring of Project Loans

25. We have been receiving queries from banks as to whether banks can flexibly structure project loans availed in foreign currency. In this connection, it is clarified that guidelines contained in DBOD.No.BP.BC.24/ 21.04.132/2014-15 dated July 15, 2014 and DBR.No.BP.BC.53/21.04.132/2014-15 dated December 15, 2014 on

'Flexible Structuring of Long Term Project Loans to Infrastructure and Core Industries' are also applicable to external commercial borrowings (ECBs) availed for funding projects in infrastructure and core industries sectors, subject to regulations issued under the Foreign Exchange Management Act, 1999.

Part E- Sale of financial assets to securitisation company (RC)/ reconstruction company (RC)

26. Reserve Price – In terms of extant instructions contained in paragraph 3.5 of circular DBOD.BP.BC.No.98/21.04.132/2013-14 dated February 26, 2014 banks were advised that the auction process for sale of NPAs to SCs/RCs should be more transparent, including disclosure of the Reserve Price, specifying clauses for non-acceptance of bids, etc. In this connection, it is clarified that banks shall disclose the Reserve Price at the time of inviting bids/expression of interest from the SCs/RCs.

27. Due Diligence – Banks shall provide adequate time and due facilitation to SCs/RCs to conduct due diligence on financial assets offered for sale. Banks shall provide not less than 2 weeks for submission of bids from the time of inviting bids/expression of interest from SCs/RCs.

28. Treatment of security receipts/pass through certificates post realisation period – In terms of extant instructions, if redemption of any of the instruments issued by SC/RC (and invested by banks) is limited to the actual realisation of the financial assets assigned to the instruments in the concerned scheme, the bank/ FI shall reckon the Net Asset Value (NAV), obtained from SC/RC from time to time, for valuation of such investments. In this connection, it has been decided that security receipts/pass through certificates which are not redeemed as at the end of the resolution period (i.e., five years or eight years as the case may be) will be treated as loss asset in the books of the banks.

Appendix

Lender Category	Description	Asset Classification	Provisioning
A	Agreed to CAP in the JLF meetings and also conveyed final approval to the CAP within the stipulated period	As per the extant asset classification norms	As per the extant provisioning norms
B	Agreed to CAP, as approved, in the JLF meeting but conveyed final approval and signed off the detailed final CAP after the stipulated period but within prescribed implementation period.	Lowest asset classification of the borrower among all the JLF lenders	A penal provisioning of 10 per cent in addition to provisioning applicable as per Lowest asset classification of the borrower with any JLF lender, for one year from the date of sign off of CAP.
C	Agreed to CAP, as approved, in the JLF meeting but failed to convey final approval and sign off the detailed final CAP within prescribed implementation period.	Lowest asset classification of the borrower among all the JLF lenders	A penal provisioning of 15 per cent in addition to provisioning applicable as per Lowest asset classification of the borrower with any JLF lender, for one year from the date of sign off of CAP. As the prescribed implementation period is over, the lender has to compulsorily abide by the terms of the approved CAP.