Amendments to NBFC Regulations –
Exposure to infrastructure facility

Ref. DNBS. (PD). CC. No. 29 /02.01/2003-04

August 1, 2003

To
All Non-Banking Financial Companies
including Residuary Non-Banking Companies

Dear Sirs,

Amendments to NBFC Regulations –
<u>Exposure to infrastructure facility</u>

There have been certain developments in the recent past in the prudential standards for the banking system pertaining to the period for which a non-performing asset remains a sub-standard asset or period after which a sub-standard asset would become a doubtful asset. Reserve Bank of India has also issued guidelines for financing of infrastructure projects by scheduled commercial banks and All-India Financial Institutions.

2. In order to align the prudential norms applicable to NBFCs with those applicable to the banks and FIs, particularly in relation to exposure to infrastructure projects, it has been decided to amend the prudential norms for NBFCs. Accordingly, the following changes are effected:

(1) <u>Period of Non-Performing Assets (NPAs)</u>

An asset would be classified as sub-standard asset, if it remains non-performing for a period not exceeding 18 months, instead of the present norm of 24 months. Also, an asset would be classified as doubtful if it remains non- performing for a period exceeding 18 months instead of present norm of 24 months.

(2) <u>Infrastructure loans</u>

Accordingly, in supercession of the existing RBI norms, the following norms will be applicable to restructuring /rescheduling / renegotiation of the terms of agreement relating to infrastructure loans. These norms will apply to fully or partly secured standard and sub-standard assets. In case the asset is partly secured, a provision to the extent of shortfall in the security available, should be made while restructuring/rescheduling/ renegotiating the asset, apart from the provision required on present value basis and as per prudential norms. The revised norms would be applicable to the accounts which are subjected to restructuring, etc. of terms during the current financial year and thereafter.

(i) <u>Restructuring or reschedulement or renegotiation</u>

The NBFCs can restructure or reschedule or renegotiate the terms of infrastructure loan agreement as per broad policy framework laid down by their Board of Directors under the following stages:

(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 above three stages, the restructuring, etc. of principal and / or of interest could take place, with or without sacrifice, as part of the restructuring package evolved.

(ii) <u>Treatment of restructured standard accounts</u>

(a) A restructuring of the instalments of principal alone, at any of the aforesaid first two stages would not cause a standard asset to be re-classified in the sub-standard category, provided for restructuring, the project is re-examined and found to be viable either with the approval of the Board of Directors of the company or within the policy framework laid down by the Board by a functionary at least one step senior to the functionary who sanctioned initial loan for the project.

(b) A restructuring 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 interest foregone, if any, on account of adjustment in the element of interest as specified later, is either written off or 100 per cent provision is made thereagainst.

(iii) <u>Treatment of restructured sub-standard accounts</u>

(a) A sub-standard asset would continue to remain in the same category in case of restructuring of the instalments of principal.

(b) A restructuring of interest element would render a sub-standard asset eligible to be continued in the sub-standard category for the specified period of 12 months and will be subject to the condition that the amount of interest foregone, if any, on account of adjustment in the element of interest as specified later, is either written off or 100 per cent provision is made thereagainst. Even in cases where the adjustment is by way of write off of the past interest dues, the asset should continue to be treated as sub-standard.

(iv) <u>Interest adjustment</u>

Where restructuring involves a reduction in the rate of interest, the interest adjustment should be computed by taking the difference between the rate of interest as currently applicable to infrastructure loans (as adjusted for the risk rating applicable to the borrower) and the reduced rate and aggregating the present value (discounted at the rate currently applicable to infrastructure loans, adjusted for risk enhancement) of the future interest payable so stipulated in the restructuring proposal.

(v) <u>Funded interest</u>

On funding of interest in respect of NPAs, if interest funded is recognized as income, should be fully provided for.

(vi) <u>Income Recognition norms</u>

There will be no change in the existing instructions on income recognition. In other words, the NBFCs may recognise income on accrual basis in respect of the accounts which are classified as a standard asset, in terms of the provisions herein above. It is also clarified that if the restructured asset was a sub-standard asset, and it becomes a standard asset after satisfactory performance of 12 months, the interest can be recognized on accrual basis. However, interest income on sub-standard assets should be recognized on cash basis only.

(vii) Provisioning

While the change in the norms on provisioning for NPAs in respect of loans to infrastructure projects will be prospective, the NBFCs which are already holding provisions against such accounts, which may now be classified as 'standard', shall continue to hold the provisions and shall not reverse the same till full recovery is made against the account.

(viii) Eligibility for upgradation of restructured sub-standard infrastructure loans

The sub-standard accounts subjected to restructuring, etc. whether in respect of principal instalment or interest amount, by whatever modality, would be eligible, subject to the satisfactory performance during the period, 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.

(ix) Conversion of debt into equity

If the amount of interest due, is converted into equity or any other instrument, and income is recognized in consequence, full provision should be made for the amount of income so recognized to offset the effect of such income recognition. However, provision would not be required, if the conversion of interest is into equity which is quoted. In such cases, interest income can be recognized at market value of equity, as on the date of conversion, not exceeding the amount of interest converted to equity.

(x) Conversion of debt into debentures

In case of conversion of principal and/or interest in respect of NPAs into debentures, such debentures should be treated as NPA, ab initio, in the same asset classification as was applicable to loan just before conversion and provision made as per norms.

(xi) Applicability of Restructuring, etc. norms to loans other than infrastructure loans

The present norm that any reschedulement or renegotiation or restructuring of a loan would make the asset a sub-standard asset and it can be upgraded only after 12 months of satisfactory performance would continue for loans other than infrastructure loans.

(xii) Increase in exposure limits for infrastructure related loans and investments

The NBFCs may exceed the concentration of credit/investment norms for single party and group by 5 and 10 per cent respectively if the additional exposure is on account of infrastructure related loans and investments. The present and revised norms are as under :

Subject	Single party	Group

	Present norms	Addl. Exposure for Infrastructure	Present norms	Addl. Exposure for Infrastructure
Credit Exposure	15%	5%	25%	10%
Investments	15%	5%	25%	10%
Credit and investment – combined	25%	5%	40%	10%

(xiii) <u>Asset – Liability management</u>

The long – term financing of infrastructure projects may lead to asset – liability mismatches, particularly when such financing is not in conformity with the maturity profile of the NBFCs' liabilities. The NBFCs would, therefore, need to exercise due vigil on their asset-liability position to ensure that they do not run into liquidity mismatches on account of lending to such projects.

(xiv) <u>Administrative arrangements</u>

Timely and adequate availability of credit is the pre-requisite for successful implementation of infrastructure projects. The NBFCs should, therefore, clearly delineate the procedure for approval of loan proposals and institute a suitable monitoring mechanism for reviewing applications pending beyond the specified period. Multiplicity of appraisals by every institution involved in financing, leading to delays, has to be avoided and the NBFCs should be prepared to broadly accept technical parameters laid down by leading public financial institutions. Also, setting up a mechanism for an ongoing monitoring of the project implementation will ensure that the credit disbursed is utilized for the purpose for which it was sanctioned.

(3) <u>Risk weights for investment in AAA rated securitized paper</u>

Investment in `AAA' rated securitized paper pertaining to the infrastructure facility would attract risk weight of 50 per cent for capital adequacy purposes subject to fulfilment of the following:

(a) The infrastructure facility should conform to the definition of lending given in the annexure.

(b) The infrastructure facility should be generating income / cash flows which would ensure servicing / repayment of the securitized paper.

(c) The securitized paper should be rated at least 'AAA' by the rating agencies and the rating should be current and valid. The rating relied upon will be deemed to be current and valid if the rating is not more than one month old on the date of opening of the issue, and the rating rationale from the rating agency is not more than one year old on the date of opening of the issue, and the rating letter and the rating rationale is a part of the offer document;

(d) In the case of secondary market acquisition, the 'AAA' rating of the issue should be in force and confirmed from the monthly bulletin published by the respective rating agency;

(e) The securitized paper should be a performing asset on the books of the investing / lending institution.

The above instructions are operative with immediate effect.

3. A copy each of the amending Notification No. 173 of date is enclosed. You are requested to ensure meticulous compliance with the regulatory framework.

4. Please acknowledge receipt of this letter to the General Manager/Deputy General Manager of the Regional Office of the Department of Non-Banking Supervision under whose jurisdiction the registered office of your company is located.

Yours faithfully,

Sd/-

(O. P. Aggarwal)
Chief General Manager

Encls: 6 sheets

Reserve Bank of India
Department of Non-Banking Supervision
Central Office
Centre 1, World Trade Centre
Cuffe Parade, Colaba
Mumbai 400 005

NOTIFICATION NO.DNBS.173/CGM(OPA)-2003 dated August 1, 2003

The Reserve Bank of India, having considered it necessary in the public interest and being satisfied that for the purpose of enabling the Bank to regulate the credit system to the advantage of the country, it is necessary so to do, in exercise of powers conferred by Section 45JA of the Reserve Bank of India Act, 1934 (2 of 1934) and of all the powers enabling it in this behalf, hereby directs that the Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998 contained in Notification No.DFC.119/DG(SPT)-98 dated January 31, 1998 shall stand amended with immediate effect, as follows, namely:

1. In paragraph 1, the following sub-paragraph (4) shall be added, namely:

"(4) These Directions shall apply to infrastructure loan as defined in paragraph 2 (1) (viia) hereinafter, of these Directions, as provided in Paragraph 13C of these directions."

2. In sub-paragraph (1) of paragraph 2,

(1) for clause (iv), the following shall be substituted, namely:

"(iv) "doubtful asset" means –

(a) a term loan, or
(b) a lease asset, or
(c) a hire purchase asset, or

(d) any other asset,

which remains a sub-standard asset for a period exceeding 18 months."

(2) The following clause (viia) shall be inserted, namel:

"(viia) 'infrastructure loan' means a credit facility extended by NBFCs to a borrower, by way of term loan, project loan subscription to bonds/debentures/ preference shares / equity shares in a project company acquired as a part of the project finance package such that such subscription amount to be "in the nature of advance" or any other form of long term funded facility provided to a borrower company engaged in:

- Developing or
- Operating and maintaining, or
- Developing, operating and maintaining

any infrastructure facility that is a project in any of the following sectors:

(a) a road, including toll road, a bridge or a rail system;
(b) a highway project including other activities being an integral part of the highway project;
(c) a port, airport, inland waterway or inland port;
(d) a water supply project, irrigation project, water treatment system, sanitation and sewerage system or solid waste management system;
(e) telecommunication services whether basic or cellular, including radio paging, domestic satellite service (i.e., a satellite owned and operated by an Indian company for providing telecommunication service), network of trunking, broadband network and internet services;
(f) an industrial park or special economic zone;
(g) generation or generation and distribution of power;
(h) transmission or distribution of power by laying a network of new transmission or distribution lines;
(i) any other infrastructure facility of similar nature."

(3) For clause (xvi) the following shall be substituted, namely:

"(xvi) "sub-standard asset" means –

(a) an asset which has been classified as non-performing asset for a period not exceeding 18 months;

(b) an asset where the terms of the agreement regarding interest and / or principal have been renegotiated or rescheduled or restructured after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled terms:

Provided that the classification of infrastructure loan as a sub-standard asset shall be in accordance with the provisions of paragraph 13C of these directions."

3. After the existing paragraph 13B, the following paragraph 13C shall be inserted, namely:

"13C. Norms relating to Infrastructure loan:

(1) Applicability:

(i) These norms shall be applicable to restructuring and/or rescheduling and/or renegotiation of the terms of agreement relating to infrastructure loan, as defined in paragraph 2(1)(viia) of these directions which is fully or partly secured standard and sub-standard asset and to the loan, which is subjected to restructuring and/or rescheduling and/or renegotiation of terms with effect from the financial year 2003-2004.

(ii) Where the asset is partly secured, a provision to the extent of shortfall in the security available, shall be made while restructuring and/or rescheduling and/or renegotiation of the loans, apart from the provision required on present value basis and as per prudential norms.

(2) Restructuring, reschedulement or renegotation terms of infrastructure loan

The NBFCs may, not more than once, restructure or reschedule or renegotiate the terms of infrastructure loan agreement as per the policy framework laid down by the Board of Directors of the company under the following stages:

(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:

Provided that in each of the above three stages, the restructuring and/or rescheduling and/or renegotiation of principal and / or of interest may take place, with or without sacrifice, as part of the restructuring or rescheduling or renegotiating package evolved;

(3) Treatment of restructured standard loan

The rescheduling or restructuring or renegotiation of the instalments of principal alone, at any of the aforesaid first two stages shall not cause a standard asset to be re-classified in the sub-standard category, if the project is re-examined and found to be viable by the Board of Directors of the company or by a functionary at least one step senior to the functionary who sanctioned the initial loan for the project, within the policy framework laid down by the Board:

Provided that rescheduling or renegotiation restructuring or of interest element at any of the foregoing first two stages shall not cause an asset to be downgraded to sub-standard category subject to the condition that the amount of interest foregone, if any, on account of adjustment in the element of interest as specified later, is either written off or 100 per cent provision is made thereagainst.

(4) Treatment of restructured sub-standard asset :

A sub-standard asset shall continue to remain in the same category in case of restructuring or rescheduling or renegotiation of the instalments of principal until the expiry of one year and the amount of interest foregone, if any, on account of adjustment, including adjustment by way of write off of the past interest dues, in the element of interest as specified later, shall be written off or 100 per cent provision made thereagainst.

(5) Adjustment of interest :

Where rescheduling or renegotiation or restructuring involves a reduction in the rate of interest, the interest adjustment shall be computed by taking the difference between the rate of interest as currently applicable to infrastructure loan (as adjusted for the risk rating applicable to the borrower) and the reduced rate and aggregating the present value (discounted at the rate currently applicable to infrastructure loan, adjusted for risk enhancement) of the future interest payable so stipulated in the restructuring rescheduling or renegotiation proposal.

(6) Funded Interest :

In the case of funding of interest in respect of NPAs, where the interest funded is recognized as income, the interest funded shall be fully provided for.

(7) Income Recognition norms:

The income recognition in respect of infrastructure loan shall be governed by the provisions of paragraph 3 of these directions;

(8) Treatment of Provisions held :

The provisions held by the NBFCs against non-performing infrastructure loan, which may be classified as 'standard' after the coming into effect of these norms, shall continue to be held and shall not be reversed until full recovery of the loan is made.

(9) Eligibility for upgradation of restructured sub-standard infrastructure loan :

The sub-standard asset subjected to rescheduling and/or renegotiation and/or restructuring, whether in respect of instalments of principal amount, or interest amount, by whatever modality, shall not be upgraded to the standard category until expiry of one year of satisfactory performance under the restructuring and/or rescheduling and/or renegotiation terms.

(10) <u>Conversion of debt into equity</u> :

Where the amount due as interest, is converted into equity or any other instrument, and income is recognized in consequence, full provision shall be made for the amount of income so recognized to offset the effect of such income recognition:

Provided that no provision is required to be made, if the conversion of interest is into equity which is quoted;

Provided further that in such cases, interest income may be recognized at market value of equity, as on the date of conversion, not exceeding the amount of interest converted to equity.

(11) <u>Conversion of debt into debentures</u> :

Where principal amount and/or interest amount in respect of NPAs is converted into debentures, such debentures shall be treated as NPA, ab initio, in the same asset classification as was applicable to the loan just before conversion and provision shall be made as per norms.

(12) <u>Increase in exposure limits for Infrastructure related loan and investment</u> :

The NBFCs may exceed the concentration of credit/investment norms, as provided in paragraph 12 of these directions, by 5 per cent for any single party and by 10 per cent for a single group of parties, if the additional exposure is on account of infrastructure loan and/ or investment.

(13) <u>Risk weight for investment in AAA rated securitized paper</u>:

The investment in "AAA" rated securitized paper pertaining to the infrastructure facility shall attract risk weight of 50 per cent for capital adequacy purposes subject to the fulfilment of the following conditions:

(i) The infrastructure facility generates income / cash flows, which ensures servicing / repayment of the securitized paper.

(ii) The rating by one of the approved credit rating agencies is current and valid.

Explanation:

The rating relied upon shall be deemed to be current and valid, if the rating is not more than one month old on the date of opening of the issue, and the rating rationale from the rating agency is not more than one year old on the date of opening of the issue, and the rating letter and the rating rationale form part of the offer document.

(iii) In the case of secondary market acquisition, the 'AAA' rating of the issue is in force and confirmed from the monthly bulletin published by the respective rating agency;

(iv) The securitized paper is a performing asset."

Sd/-
(O. P. Aggarwal)
Chief General Manager-in-Charge