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DBOD.BP.BC.No.98 / 21.04.132 / 2013-14 **February 26, 2014**

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

Dear Sir,

Framework for Revitalising Distressed Assets in the Economy - Refinancing of Project Loans, Sale of NPA and Other Regulatory Measures

Please refer to paragraphs 5 and 8 to 12 of the Framework for Revitalising Distressed Assets in the Economy, placed on our website on January 30, 2014. Accordingly, detailed guidelines on the subject of 'Refinancing of Project Loans', 'Sale of NPAs by Banks' and other regulatory measures are as under:

2. Refinancing of Project Loans

2.1 In terms of our circular DBOD.BP.BC.No.37/21.04.132/2008-09 dated August 27, 2008 on 'Prudential Guidelines on Restructuring of Advances by Banks', *a restructured account is 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 reasons other than competitive reasons)*. Thus, any change in repayment schedule of a loan will render it as restructured account.

बैंकिंग परिचालन और विकास विभाग, केन्द्रीय कार्यालय, 12वी मंजिल, केन्द्रीय कार्यालय भवन, शहीद भगतसिंह मार्ग, मुंबई-400001
फैक्स सं. / FAX NO.22705691 टेलीफोन सं ./ TELEPHONE No. 22661602
DEPARTMENT OF BANKING OPERATIONS & DEVELOPMENT, CENTRAL OFFICE, 12th Floor, Central Office Building, Shahid Bhagat Singh Marg, Mumbai-400 001 E-mail : cgmicdbodco@rbi.org.in
बैंक हिन्दी में भी पत्राचार का स्वागत करता है । हिन्दी आसान है, इसका प्रयोग बढ़ाइये ।

2.2 Further, in terms of DBOD.No.BP.BC.144/21.04.048-2000 dated February 29, 2000 on 'Income Recognition, Asset Classification, Provisioning and other related matters and Capital Adequacy Standards - Takeout Finance', banks can refinance their existing infrastructure project loans by entering into take-out financing agreements with any financial institution on a pre-determined basis. If there is no pre-determined agreement, a standard account in the books of a bank can still be taken over by other banks/FIs, subject to our guidelines on 'Transfer of Borrowal Accounts from one Bank to Another' issued vide circular DBOD.No.BP.BC-104/21.04.048/2011-12 dated May 10, 2012.

2.3 In partial modification to the above-mentioned circulars, banks are advised that if they refinance any existing infrastructure and other project loans by way of take-out financing, even without a pre-determined agreement with other banks / FIs, and fix a longer repayment period, the same would not be considered as restructuring if the following conditions are satisfied:

- Such loans should be 'standard' in the books of the existing banks, and should have not been restructured in the past.
- Such loans should be substantially taken over (more than 50% of the outstanding loan by value) from the existing financing banks/Financial institutions.
- The repayment period should be fixed by taking into account the life cycle of the project and cash flows from the project.

3. Sale of Financial Assets to Securitisation Company (SC)/Reconstruction Company (RC)

3.1 Securitisation Companies (SCs)/Reconstruction Companies (RCs) should be construed as a supportive system for stressed asset management with greater emphasis on asset reconstruction rather than asset stripping. Towards this end, sale of assets to SCs/RCs is encouraged at a stage when the assets have good chance of revival and fair amount of realizable value. In terms of circular DBOD.No.BP.BC.96/21.04.048/2002-03 dated April 23, 2003 on "Guidelines on Sale of Financial Assets to Securitisation Company (SC) /Reconstruction Company (RC) [Created under the Securitisation and Reconstruction of Financial Assets and

Enforcement of Security Interest Act, 2002] and Related Issues", a financial asset may be sold to the SC/RC by any bank/FI where the asset is:

i) *A NPA, including a non-performing bond/debenture, and*

ii) A Standard Asset where:

(a) the asset is under consortium/multiple banking arrangements,

(b) at least 75% by value of the asset is classified as non-performing asset in the books of other banks / FIs, and

(c) at least 75% (by value) of the banks/FIs who are under the consortium/ multiple banking arrangements agree to the sale of the asset to SC / RC.

3.2 In addition to the above and in order to ensure better chances of reconstruction of stressed assets, henceforth a financial asset may be sold to the SC/RC by any bank/FI where the asset is reported as a financial asset reported as SMA-2[1] by the bank/FI to Central Repository for Information on Large Credit (CRILC)[2].

3.3 Further, paragraph 5 (A) (a) of the above-mentioned circular dated April 23, 2003, inter-alia, states that:

(i) When a bank/FI sells its financial assets to SC/RC, on transfer the same will be removed from its books.

(ii) If the sale to SC / RC is at a price below the net book value (NBV) (i.e., book value less provisions held), the shortfall should be debited to the profit and loss account of that year.

(iii) If the sale is for a value higher than the NBV, the excess provision will not be reversed but will be utilized to meet the shortfall / loss on account of sale of other financial assets to SC / RC.

3.4 With a view to incentivising banks to recover appropriate value in respect of their NPAs promptly, henceforth, banks can reverse the excess provision on sale of NPA if the sale is for a value higher than the NBV to its P&L account in the year the

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[1] SMA 2 – Special Mentioned Account 2 as defined in our circular DBOD.BP.BC.No.97/21.04.132/2013-14 dated February 26, 2014 on 'Framework for Revitalising Distressed Assets in the Economy – Guidelines on Joint Lenders' Forum (JLF) and Corrective Action Plan (CAP)'

[2] CRILC as mentioned in DBS' circular DBS.No.OSMOS. 9862/33.01.018/2013-14 dated February 13, 2014 on 'Central Repository of Information on Large Credits (CRILC) – Revision in Reporting'

amounts are received. Further, as an incentive for early sale of NPAs, banks can spread over any shortfall, if the sale value is lower than the NBV, over a period of two years. This facility of spreading over the shortfall would however be available for NPAs sold up to March 31, 2015 and will be subject to necessary disclosures in the Notes to Account in Annual Financial Statements of the banks.

3.5 It has been brought to our notice that banks sometimes use the auction process for sale of NPAs as a price discovery mechanism for such assets, where they invite bids from SCs/RCs and do not accept any bid without assigning any reason. As quoting of bids involves costly and lengthy due-diligence by SCs/RCs, such practices by banks bring imperfection in the market by imposing disincentives on SCs/RCs to carry out proper due-diligence. Therefore, it is advised that banks using 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. If a bid received is above the Reserve Price and a minimum of 50 per cent of sale proceeds is in cash, and also fulfils the other conditions specified in the Offer Document, acceptance of that bid would be mandatory.

4. Purchase/Sale of Non-Performing Financial Assets to Other Banks

4.1 Our circular DBOD.No.BP.BC.16/21.04.048/2005-06 dated July 13, 2005 on 'Guidelines on Sale/Purchase of Non-Performing Financial Assets' as consolidated and updated in our Master Circular 'Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances', inter-alia, prescribes the following:

> *A non-performing asset in the books of a bank shall be eligible for sale to other banks only if it has remained a non-performing asset for at least two years in the books of the selling bank.*
>
> *A non-performing financial asset should be held by the purchasing bank in its books at least for a period of 15 months before it is sold to other banks*

4.2 In partial modification to the above, it is advised that banks will be permitted to sell their NPAs to other banks/FIs/NBFCs (excluding SCs/RCs) without any initial holding period. However, the non-performing financial asset should be held by the

purchasing bank in its books at least for a period of 12 months before it is sold to other banks/financial institutions/NBFCs (excluding SCs/RCs). The extant prudential norms on asset classification of such assets in the books of purchasing banks/FIs/NBFCs will remain unchanged.

5. Use of Counter-cyclical/Floating Provision

5.1 In terms of our circulars DBOD.BP.BC.89/21.04.048/2005-06 dated June 22, 2006 and DBOD.BP.BC.68/21.04.048/2006-07 dated March 13, 2007 on 'Prudential Norms on Creation and Utilisation of Floating Provisions', floating provisions should not be used for making specific provisions in respect of non-performing assets or for making regulatory provisions for standard assets. The same can be used only for contingencies under extraordinary circumstances for making specific provisions in impaired accounts after obtaining board's approval and with prior permission of RBI.

5.2 Further, in terms of circular DBOD.BP.BC.87/21.04.048/2010-11 dated April 21, 2011, on 'Provisioning Coverage Ratio (PCR) for Advances', countercyclical provisioning buffer would be allowed to be used by banks for making specific provisions for non-performing assets, inter-alia, during periods of system wide downturn, with the prior approval of RBI. Accordingly, RBI vide circular DBOD.No.BP.95/21.04.048/2013-14 dated February 7, 2014 on 'Utilisation of Floating Provisions/Counter Cyclical Provisioning Buffer' has allowed banks, as a countercyclical measure, to utilise up to 33 per cent of countercyclical provisioning buffer/floating provisions held by them as on March 31, 2013, for making specific provisions for non-performing assets, as per the policy approved by their Board of Directors.

5.3 In addition to utilisation of countercyclical / floating provision up to 33 per cent of such provisions held by them as on March 31, 2013 as stated above, it has been decided that banks can use countercyclical/floating provisions for meeting any shortfall on sale of NPA i.e. when the sale is at a price below the net book value (NBV) [i.e., book value less provision held], which presently requires debit to the profit and loss account.

6. Bank Loans for Financing Promoters' Contribution

6.1 In terms of extant instructions on *Bank Loans for Financing Promoters Contribution* as consolidated in our Master Circular DBOD.No.Dir.BC.14 /13.03.00 /2013-14 dated July 1, 2013 on 'Loans and Advances – Statutory and Other Restrictions', the promoters' contribution towards the equity capital of a company should come from their own resources and banks should not normally grant advances to take up shares of other companies.

6.2 It has been decided that banks can extend finance to 'specialized' entities established for acquisition of troubled companies subject to the general guidelines applicable to advances against shares/debentures/bonds as contained in the above-mentioned Master Circular and other regulatory and statutory exposure limits. The lenders should, however, assess the risks associated with such financing and ensure that these entities are adequately capitalized, and debt equity ratio for such entity is not more than 3:1.

6.3 In this connection, a 'specialized' entity will be a body corporate exclusively set up for the purpose of taking over and turning around troubled companies and promoted by individuals or/and institutional promoters (including Government) having professional expertise in turning around 'troubled companies' and eligible to make investments in the industry/segment to which the target asset belonged.

7. Credit Risk Management

7.1 Banks are advised that they should strictly follow the credit risk management guidelines contained in our circular DBOD.No.BP.(SC).BC.98/21.04.103/99 dated October 7, 1999 on 'Risk Management Systems in Banks' and DBOD.No.BP.520/21.04.103/2002-03 dated October 12, 2002 on 'Guidance Notes on Management of Credit Risk and Market Risk'.

7.2 It is reiterated that lenders should carry out their independent and objective credit appraisal in all cases and must not depend on credit appraisal reports prepared by outside consultants, especially the in-house consultants of the borrowing entity.

7.3 Banks/lenders should carry out sensitivity tests/scenario analysis, especially for infrastructure projects, which should inter alia include project delays and cost overruns. This will aid in taking a view on viability of the project at the time of deciding Corrective Action Plan (CAP) as mentioned in paragraph 3 of our circular DBOD.BP.BC.No.97/21.04.132/2013-14 dated February 26, 2014 on 'Framework for Revitalising Distressed Assets in the Economy – Guidelines on Joint Lenders' Forum (JLF) and Corrective Action Plan (CAP)'.

7.4 Lenders should ascertain the source and quality of equity capital brought in by the promoters /shareholders. Multiple leveraging, especially, in infrastructure projects, is a matter of concern as it effectively camouflages the financial ratios such as Debt/Equity ratio, leading to adverse selection of the borrowers. Therefore, lenders should ensure at the time of credit appraisal that debt of the parent company is not infused as equity capital of the subsidiary/SPV.

7.5 Ministry of Corporate Affairs had introduced the concept of a Director Identification Number (DIN) with the insertion of Sections 266A to 266G of Companies (Amendment) Act, 2006. Further, in terms of paragraph 5.4 of our Master Circular on Wilful Defaulters dated July 1, 2013, in order to ensure that directors are correctly identified and in no case, persons whose names appear to be similar to the names of directors appearing in the list of wilful defaulters, are wrongfully denied credit facilities on such grounds, banks/FIs have been advised to include the Director Identification Number (DIN) as one of the fields in the data submitted by them to Reserve Bank of India/Credit Information Companies.

7.6 It is reiterated that while carrying out the credit appraisal, banks should verify as to whether the names of any of the directors of the companies appear in the list of defaulters/ wilful defaulters by way of reference to DIN/PAN etc. Further, in case of any doubt arising on account of identical names, banks should use independent sources for confirmation of the identity of directors rather than seeking declaration from the borrowing company.

7.7 Paragraph 2.7 of our Master Circular on Wilful Defaulters states that, "*with a view to monitoring the end-use of funds, if the lenders desire a specific certification from*

the borrowers' auditors regarding diversion / siphoning of funds by the borrower, the lender should award a separate mandate to the auditors for the purpose. To facilitate such certification by the auditors the banks and FIs will also need to ensure that appropriate covenants in the loan agreements are incorporated to enable award of such a mandate by the lenders to the borrowers / auditors".

7.8 In addition to the above, banks are advised that with a view to ensuring proper end-use of funds and preventing diversion/siphoning of funds by the borrowers, lenders could consider engaging their own auditors for such specific certification purpose without relying on certification given by borrower's auditors. However, this cannot substitute bank's basic minimum own diligence in the matter.

8. Reinforcement of Regulatory Instructions

8.1 In terms of circular DBOD.No.CAS(COD)BC.142/WGCC-80 December 8, 1980 on 'Report of the Working Group to Review the System of Cash Credit – Implementation', banks were advised that before opening current accounts/sanctioning post sale limits, they should obtain the concurrence of the main bankers and/or the banks which have sanctioned inventory limits. Such accounts already opened may also be reviewed in the light of these instructions and appropriate action should be taken. Further, in terms of Master Circular DBOD.No.Dir.BC.12/13.03.00/2013-14 dated July 1, 2013 on 'Guarantees and Co-Acceptances', banks should refrain from issuing guarantees on behalf of customers who do not enjoy credit facilities with them.

8.2 RBI reiterates the above instructions regarding restrictions placed on banks on extending credit facilities including non-fund based limits, opening of current accounts, etc. to constituents who are not their regular borrowers. Banks must take necessary corrective action in case the above instructions have not been strictly followed. Further, RBI will ensure strict adherence by banks to these instructions. As non-compliance of RBI regulations in this regard is likely to vitiate credit discipline, RBI will consider penalising non-compliant banks.

8.3 Banks are custodians of public deposits and are therefore expected to make all efforts to protect the value of their assets. Banks are required to extinguish all

available means of recovery before writing off any account fully or partly. It is observed that some banks are resorting to technical write off of accounts, which reduces incentives to recover. Banks resorting to partial and technical write-offs should not show the remaining part of the loan as standard asset. With a view to bring in more transparency, henceforth banks should disclose full details of write offs, including separate details about technical write offs, in their annual financial statements as per the format prescribed in the Annex.

9. Registration of Transactions with CERSAI

Currently security registration, especially registration of mortgages, is done at district level and Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) is generally used to register equitable mortgages. The Government mandate to register all types of mortgages with CERSAI will have to be strictly followed by banks. In this connection, instructions contained in our circular DBOD.Leg.No.BC.86/09.08.011/2010-11 dated April 21, 2011 on 'Setting up of Central Electronic Registry under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002' is reiterated, i.e. transactions relating to securitization and reconstruction of financial assets and those relating to mortgage by deposit of title deeds to secure any loan or advances granted by banks and financial institutions, as defined under the SARFAESI Act, are to be registered in the Central Registry.

10. Board Oversight

10.1 The Board of Directors of banks should take all necessary steps to arrest the deteriorating asset quality in their books and should focus on improving the credit risk management system. Early recognition of problems in asset quality and resolution envisaged in these guidelines requires the lenders to be proactive and make use of CRILC as soon as it becomes functional.

10.2 Boards of banks should put in place a policy for timely submission of credit information to CRILC and accessing information therefrom, prompt formation of Joint

Lenders' Forums (JLFs)[3], monitoring the progress of JLFs and adoption of Corrective Action Plans (CAPs)[4], etc. There should be a periodical review, say on a half yearly basis, of the above policy.

10.3 The boards of banks should put in place a system for proper and timely classification of borrowers as wilful defaulters or/and non-cooperative borrowers[5]. Further, Boards of banks should periodically review the accounts classified as such, say on a half yearly basis.

Yours faithfully,

(Rajesh Verma)
Chief General Manager

[3, 4 and 5] JLF, CAP & Non-Cooperative Borrowers - as detailed in our circular DBOD.BP.BC.No.97/21.04.132/2013-14 dated February 26, 2014 on 'Framework for Revitalising Distressed Assets in the Economy – Guidelines on Joint Lenders' Forum (JLF) and Corrective Action Plan (CAP).

Annex

Disclosure of Write-Offs & Technical Write-Offs

Instructions contained in our circular DBOD.BP.BC.No. 79 /21.04.018/2009-10 dated March 15, 2010 on '*Additional Disclosures by banks in Notes to Accounts'* specifically require banks to disclose the amounts written off during the year while giving details of movement in non-performing assets (NPAs). The format specified in the said circular stands modified as under.

(Amount in Rs. crore)

Particulars	Current year	Previous year
Gross NPAs[6] as on 1st April of particular year (Opening Balance)		
Additions (Fresh NPAs) during the year		
Sub-total (A)		
Less:-		
(i) Upgradations		
(ii) Recoveries (excluding recoveries made from upgraded accounts)		
(iii) Technical/ Prudential[7] Write-offs		
(iv) Write-offs other than those under (iii) above		
Sub-total (B)		
Gross NPAs as on 31st March of following year (closing balance) (A-B)		

Further banks should disclose the stock of technical write-offs and the recoveries made thereon as per the format below:

(Amount in Rs. crore)

Particulars	Current year	Previous year
Opening balance of Technical/ Prudential written-off accounts as at April 1		
Add: Technical/ Prudential write-offs during the year		
Sub-total (A)		
Less: Recoveries made from previously technical/ prudential written-off accounts during the year (B)		
Closing balance as at March 31 (A-B)		

[6] *Gross NPAs as per item 2 of Annex to DBOD Circular DBOD.BP.BC.No. 46/21.04.048/2009-10 dated September 24, 2009 which specified a uniform method to compute Gross Advances, Net Advances, Gross NPAs and Net NPAs.

[7] Technical or prudential write-off is the amount of non-performing loans which are outstanding in the books of the branches, but have been written-off (fully or partially) at Head Office level. Amount of Technical write-off should be certified by statutory auditors. (Defined in our circular reference DBOD.No.BP.BC. 64 /21.04.048/2009-10 dated December 1, 2009 on Provisioning Coverage for Advances)