

Restructuring To Resurrect- Crucial Framework Created By RBI

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Archit Gupta

CA



Divya Tanwar

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COVID-19 pandemic has created a sense of uncertainty in the world. The pandemic has impacted the businesses and economies adversely around the globe. Every economy has taken considerable steps to minimize the losses suffered due to this crisis. Certain economies like Australia has provided same harbor for insolvent trading, extension of deadlines for initiating insolvency/liquidation proceeding against a business whereas some economies are providing tax incentives and exemptions in order to ensure that the businesses stay afloat during this rocky phase. Many economies have taken a bold step by suspending insolvency laws for a limited period of time; to ensure that the viable businesses would not suffer from insolvency and bite this bullet under this pandemic.

Indian economy has taken a mix bag approach, where series of measures have been taken by the legislature along with the association of various sector regulators in order to ensure the Indian market and financial ecosystem remain less impacted from this pandemic. Some of the measures includes the reduced tax outflows, extension of time limit for necessary compliances, special relief packages for Small and Micro Industry, in order to ensure that the small businesses do not suffer the plight of closing down due to the lockdown and the restrictions imposed by the governments to control the spread of disease. The Reserve Bank of India (RBI) has taken different approaches to deal with the stress caused.

Initially, RBI provided a blanket moratorium on loan repayment and downgrading of the stressed assets as NPA for a period of three months i.e. from 01st March, 2020 to 31st May, 2020, which was further extended to 31st August, 2020. However, it was a short-term measure taken by RBI to ensure that there is no unanticipated rise in bad loans in the banking sector due to uncontrolled situation. Recently, RBI has come up with a detailed mechanism through its circular dated 06th August, 2020 which allows banks, financial institutions, NBFCs and other market players with a window of one-time restructuring for stressed assets without downgrading the asset quality from standard to sub-standard.

Salient Features

1. Provision of one-time restructuring window to individuals and companies which are highly impacted by the COVID-19 without necessitating a change of ownership or/and asset classification being downgraded.
2. Following borrowers are eligible for restructuring under the circular which are as follows:
 - a. Classified as **standard**, but not defaulted more than 30 days with any lending institution as on March 01, 2020, and
 - b. Having stressed account due to COVID-19.
3. In case of multiple lending arrangement/consortium arrangement, the agreement among the lenders being 75% (value) and 60 % (number) are required to utilize this special window.
4. This window can be exercised before **31st December, 2020** and subsequent plan shall be made within 90 days from the date of invocation¹ of the mechanism.
5. Under this Framework, the resolution plans may follow any of the mechanisms prescribed in the Prudential Framework (June 7, 2019), such as sale of exposure, or restructuring or rescheduling of debt etc. The lenders may also extend the tenor of the existing facilities up to two years. The plan may also include the sanctioning of additional facilities.
6. Implementation of plan must be completed within 180 days from the date of invocation.
7. For existing credit facilities, if the implementation of resolution plan becomes successful, the asset shall be considered as '**standard**'. If no resolution plan takes place, then, no relief will be granted to the lenders as per prudential norms with respect to NPA classification.
8. From the date of invocation until the implementation of resolution plan, the classification of the additional facility shall be considered as 'standard'.
9. RBI will set up an Expert Committee (EC) under the chairmanship of Mr. K. V. Kamath which shall make recommendations on the required parameters and sector specific benchmarks which are to be factored in a resolution plan.
10. The EC will also validate plans with an aggregate debt account of more than Rs. 1,500 crores. The resolution plans for debt accounts where the aggregate exposure at the time of invocation is more than Rs. 100 crores will require an independent credit evaluation from a credit rating agency recognized by the RBI;
11. Accounts involving consortium / multiple banking arrangements, all receipts, repayments and disbursements are to be routed through an escrow account.

Earlier, it was experienced that the banks especially the State-Owned Banks were not willing to restructure the loans because any

change in the lending terms in favor of the borrower resulted in downgrading of assets as sub-standard; which subsequently put more burden of provisioning in their balance Sheet. This circular has comforted the banks to worry less about the downgrading of the assets and make an independent call on restructuring the loan account as per requirements of the business.

Due to the suspension of initiation of CIRP under section 10A of the Insolvency Bankruptcy Code, 2016; any default which takes place from 25th March, 2020 to 24th September, 2020 shall not be included in the definition of default as per Section 3(12) of IBC, which can be extended up to 24th March, 2021. It becomes pertinent for lenders to restructure their current lending terms for ongoing default in the said period. This will give some breather to business facing stress. In addition to this, it will give an opportunity to lenders to initiate the CIRP proceedings in case there is a continuous default incurred by the business.

However, there exists certain shortcomings which includes provision of a limited window under this circular. It will become difficult for certain industries to exercise this window with such a limited period or to arrive at a resolution plan especially where lenders are in huge numbers. Under the prudential norms of restructuring (June 7, 2019), the time period for getting any resolution plan to be completed is 180 days, which seems reasonable. Again, the circular has put significant emphasis on the Inter-Creditor Agreement. It was earlier experienced by the market that the signing of an intercreditor agreement (ICA) with a majority consent is a difficult and humongous task for any borrower. This is one of the major reasons why a resolution under the June-7 circular is one of the slower process. The circular framed by the RBI does not bind many real players such as Mutual Funds and Insurance companies which are not regulated by it; consequently, making it difficult for the borrower to get its account restructured.

The circular put forth certain restrictions on restructuring process which includes a maximum period of two years with extension in existing facilities. Such restrictions are harmful for the businesses which ultimately makes its business model unviable due to uncertain future. For example, the businesses of multiplexes and amusement parks are still in question, as current scenario does not show any sign of their early revival. It will become difficult for these entities to avail the benefits of this circular. Further, constituting a committee specially for loans above ₹ 1500 crores to overview the process and procedures is against in the interest of the basic principle of market forces. Also, the committee will make the process more stringent for banks to operate and the banks especially the public sector banks might feel pressurized while taking any decisions which could be creative and non-conventional in nature.

From the past experiences, the Indian banking industry always shied away from taking the haircuts or converting unviable portion of their loans into equity shares, in case a business has lost its value. There is also a question, will the Indian banking industries will forgo unviable portion of its advances? This question becomes more relevant as such resistance from the banking industry will make the business survival difficult for the companies which has already lost its value due to COVID-19. The hospitality or airline industry are the current examples for the same.

The recent experience of the Indian economy with relation to the restructuring done by PSBs has not shown any significant and efficient results so far; since the regulators has observed only radical rise in evergreening bad loans. Therefore, this circular provides various safeguards under this one-time special framework, to ensure the window shall not be abused by the different market players by providing certain penal provisioning in order to ensure that the circular is used in the best interest of the lenders and the borrowers.

Even with the persisting shortcomings, this one-time restructuring window is a welcoming step for the lending institutions in order to make a virtue of necessity to resolve the stress in the Indian debt market which is currently in a flutter.

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1. Invocation is the date on which borrower and lender (by applicable majority) have agreed to proceed with a resolution plan. If there are multiple lending institutions with exposure to the borrower, the invocation must be with agreement of lenders being 75 % (value) and 60 % (number).