



Legislative Alert

RBI - Revised Framework for Resolution of Stressed Assets

Legislative Update
February 14, 2018

ANALYSIS ON THE RBI CIRCULAR ON THE REVISED STRESSED ASSET FRAMEWORK

In an effort to harmonise the stressed asset framework of Reserve Bank of India (“RBI”) with the current Insolvency and Bankruptcy Code, 2016 (“IBC”) regime, the RBI on February 12, 2018 came out with the revised framework for stressed assets vide circular RBI/2017-18/131 DBR.No.BP.BC.101/21.04.048/2017-18 (“Circular”).

The Circular replaces all the existing guidelines on stressed assets issued by RBI including but not limited to the Strategic Debt Restructuring (SDR) scheme, the Scheme for Sustainable Structuring of Stressed Assets (S4A), and the Corporate Debt Restructuring (CDR) scheme (“Existing Guidelines”, as more specifically detailed in Annexure-3 of the Circular).

In conformity with the time bound mechanism for resolution as envisaged in IBC, the Circular also stipulates a strict timeline for resolution of stressed assets failing which the stressed accounts must be referred to IBC. However, at this stage the Circular poses several questions and issues which may be required to be considered.

Certain salient features are as follows:

1. The Circular is applicable to lenders as has been specified in the Circular “to generally include all scheduled commercial banks (excluding RRBS) and all India Financial Institutions”. Considering it is a circular issued by RBI it would ideally be applicable to entities over whom RBI has supervision. However, it is important to note that the inclusive nature of the definition may allow an interpretation that other lenders (like bond holders, ECB lenders) may be covered.
 - (i) For every borrower having aggregate exposure above INR 50 million, the reportage of special mention account (SMA) classification must be carried out by the lenders on a monthly basis. For every borrower in default such reportage will have to be on a weekly basis starting from February 23, 2018.
 - (ii) For all defaulting entities, lenders have to agree on a resolution plan and implement the same in a time bound manner. Lenders can singly or jointly initiate steps to cure the default. However, the resolution plan is required to be clearly documented by all lenders.
 - (iii) Timelines:
 - For entities having aggregate exposure above INR 20 billion and presently in default, the resolution plan shall be implemented within 180 days of March 1, 2018 (“Reference Date”).
 - For entities having aggregate exposure above INR 20 billion and where the default is after the Reference Date, the resolution plan shall be implemented within 180 days from the date of such default.
 - For entities having aggregate exposure below INR 20 billion and above INR 1 billion, the RBI intends to announce over a 2-year period for implementation of the resolution plan.
 - (iv) In case, resolution plan is not implemented within the above-mentioned timelines, the Circular mandates the lenders to singly or jointly file an insolvency application under IBC within 15 days from expiry of the relevant timeline.
 - (v) For any account where resolution plan has been implemented, the account should not be in default for the ‘Specified Period’. The Circular defines Specified Period to be the date by which at least 20% of the outstanding principal and the interest capitalisation is repaid, which cannot be before 1 year from the commencement of the first payment on interest or principal, whichever is later.
 - (vi) For all accounts (having aggregate exposure of INR 1 billion or above) where resolution plan involves restructuring or change of ownership, an independent credit evaluation (“ICE”) would be required. For all accounts having aggregate exposure of INR 5 billion or above two such ICEs would be required.

Keeping in mind the above salient features, the following are our observations:

1. Definition of 'Default'.

The Circular allows all lenders to singly or jointly take steps for curing a default. As provided under IBC, the Circular does not stipulate any threshold amount for triggering such action. Further, the definition of default merely mentions non-payment on the due date and does not stipulate that the existing lender would be required to call an event of default. In order to avoid frivolous triggers, it would be essential to rationalise the definition of default with certain thresholds.

2. Automatic Cross default

The Circular in effect seems to have provided the lenders with a right of calling a cross default by allowing all lenders to initiate action in case of a default against any lender. This effectively substantiates the cross default rights, which are obtained by the lenders under the loan agreements.

3. Single or Joint Actions

Although the Circular stipulates that on the occurrence of default, any lender of such borrower may initiate steps to cure the default, it also stipulates that the resolution plan shall be documented by all lenders. It would be important to understand what is meant by such documentation. Whether, minutes of meetings or inter-creditor agreements would be adequate or whether IBA would be providing specific drafts for documenting such arrangements would have to be seen.

4. Decision making

The Circular does not stipulate any threshold for decision making by all lenders for implementing a resolution plan, unlike in the Existing Guidelines (60% by value and 50% by number). Additionally, in the erstwhile process, the lead bank was provided with the responsibility to initiate and drive the process. One of the main reasons for this was the inability to procure unanimous approval or even an approval of a higher threshold. It would be crucial to understand whether RBI intends to completely do away with decision making thresholds and allow the lenders to come up with their own resolution mechanism, failing which the consequence will be referral to IBC.

The Circular mentions that for successful implementation of a resolution plan, all the relevant documents should be entered into and the changes should be duly recognised in the books of all lenders. This would indicate that RBI intends to have all lenders on-board for successful implementation of the resolution plan. The market has experienced this to be the biggest challenge.

5. Stricter reporting and compliance

The Circular provides for stricter reporting requirements along with increased frequency of reporting. Such additional compliances and reporting would help in increasing the level of transparency and bringing more discipline to the business of lending. Additionally, it can form an effective monitoring tool for RBI.

6. Resolution Plan involving restructuring/change in ownership

In case a change of ownership is implemented pursuant to this Circular, then for the account to be classified as 'standard', *inter alia* the acquirer has to be a person who is not disqualified under Section 29A of IBC. Although, this brings about parity with the requirements of IBC, it does reduce the list of prospective acquirers. Considering, the number of stressed assets and on the back of the market's experience under the SDR regime, it would be important to broaden the number of interested bidders.

7. Concept of restructuring

The Circular mentions restructuring to be an act by which lenders provide concessions to a borrower who is in 'financial difficulty'. The non-exhaustive list explaining 'financial difficulty' provided in the appendix of the Circular is itself a very wide and subjective illustration. In light of the same, it would be important for every lender to analyse the implications at the time of any refinancing so as to ensure that it is not considered as restructuring.

Conclusion – Is IBC really the end solution?

Considering the apparent intent of the regulators and the legislators, it is important for the market to analyse whether the mechanism under IBC is the clear solution for all stressed cases. In light of the requirement of provisioning by the lenders, the uncertainty of information with the insolvency professionals and the requirement for acquirers to undertake indefinite liability, it is important to thoroughly test the IBC mechanism before pushing additional cases under the regime.

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