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Framework harmonized for resolution of stressed assets

By Sawant Singh and Aditya Bhargava, Phoenix Legal
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The Reserve Bank of India (RBI) offers an array of mechanisms for dealing with stressed assets. At last count, these included corporate debt restructuring, strategic debt restructuring, the scheme for sustainable structuring of stressed assets, and joint lenders forums with corrective action plans. Added to this are the various classifications of “special mention accounts” (SMAs) and the various stages of non-performing assets. The absence of a statute-driven insolvency apparatus justified the need for these mechanisms, but the enactment of the Insolvency and Bankruptcy Code (IBC) rendered their utility moot. Indeed, these mechanisms were unintendedly in conflict with the IBC.

On 12 February, the RBI moved decisively to resolve the inconsistency between the existing mechanisms and the IBC, by withdrawing the instructions for the mechanisms and replacing these with a harmonized instruction. This regulatory development, although not mentioned in the RBI’s statement on developmental and regulatory policies of 7 February, was clearly necessitated by the presence of the IBC (as recognized by the preamble of the RBI’s 12 February instruction).

The 12 February instruction requires borrowers to be classified as SMA-0 (if any principal or interest amount is up to 30 days overdue), SMA-2 (if any principal or interest amount is 31-60 days overdue), or SMA-3 (if any principal or interest amount is 61-90 days overdue). This is in line with the RBI’s previous instructions. However, unlike previous instructions, the 12 February instruction requires all lenders of a borrower to take immediate steps to cure a default (rather than wait for a prescribed time period to elapse).

A lender is required to have a board-approved policy for resolution of stressed assets. A resolution plan (RP) in respect of a borrower can involve restructuring or change in ownership or sale of the loan amounts to other persons. An RP will be considered as implemented only if the borrower is no longer is default to any lender, or, if the RP involves restructuring, when (i) all documentation and all creation and perfection of security is completed by all lenders, and (ii) any changes in capital structure or the terms of the loans are reflected in the books of the lenders and the borrower.

Where the aggregate exposure of lenders exceeds ₹1 billion (US$15.4 million) RPs will require an “independent credit evaluation” (ICE) by credit rating agencies authorized by the RBI for this purpose, and where the aggregate exposure of lenders exceeds ₹5 billion RPs will require an ICE by two such credit rating agencies. Only RPs that are graded as “RP4” or above (as per the scale set out in the 12 February instruction) will be eligible for implementation of the RP. Notably, the instruction provides that unlike usual practice where credit rating agencies are engaged by the borrower, for an ICE a credit rating agency will have to be engaged and paid for by the lenders.

In the case of borrowers where the exposure of the lenders exceeds ₹20 billion on or after 1 March 2018 (the reference date), an RP must be implemented within the following timelines: (a) if the borrower has defaulted on the reference date, within 180 days of the reference date; (b) if the default occurs after the reference date, within 180 days of the date of default. If the RP is not implemented within these timelines, the lenders are required to file an insolvency application under the IBC within 15 days of the expiry of the above-mentioned timelines.

The RBI will announce reference dates for implementing RPs in respect of accounts where the exposure of the lenders is below ₹20 billion but exceeds ₹1 billion.

In a signal to lenders that the RBI has taken cognizance of recent occurrences in the lending arena, the 12 February instruction clearly prescribes that any failure on the part of lenders in meeting the timelines prescribed under the instruction or any action taken by any lender with intent to conceal the status of a borrower would result in "stringent supervisory/enforcement actions" including higher provisioning and monetary penalties.

The 12 February instruction radically simplifies the relationship between the RBI's instructions to lenders for stressed assets and the IBC. By prescribing clear time-bound thresholds for reference of a borrower to the IBC, along with placing the onus on banks to take immediate steps to "cure" a borrower's default, the instruction also reconciles the impact of the IBC with the RBI's regulatory ecosystem. The clear regulatory roadmap provided by the 12 February instruction is a welcome development.

Sawant Singh and Aditya Bhargava are partners at the Mumbai office of Phoenix Legal.