Framework strives to give new life to distressed assets

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As part of its policy to tackle the growing incidence of non-performing assets (NPAs) in the Indian financial system, the Reserve Bank of India (RBI) issued a discussion paper on 17 December 2013 which aimed at putting in place a framework that includes incentives for the early recognition of "problem cases" and restructuring of viable accounts.

Based on the discussion paper, on 30 January 2014, the RBI issued the Framework for Revitalising Distressed Assets in the Economy. The framework is applicable from 1 April 2014. The measures prescribed by the framework include establishing a database on borrowers called the Central Repository of Information on Large Credits (CRILC), continuous monitoring and classification of accounts at various levels of "stress", and the formation of a joint lenders' forum (JLF) for early resolution of a stressed account before it turns into an NPA.

Identification and reporting

Banks will now have to identify accounts that show "incipient stress" as special mention accounts (SMAs), and also classify such accounts as: SMA-0, principal or interest payment not overdue for more than 30 days; SMA-1, principal or interest payment overdue between 31 and 60 days; or SMA-2, principal or interest overdue between 61 and 90 days.

Simultaneously, with the establishment of the CRILC, banks are also now required to provide credit information to the CRILC on all borrowers with facilities exceeding (in aggregate) ₹50 million (US839,000) and customers whose current account balances exceed ₹10 million (whether or not such customers have obtained any financial assistance). Further, all borrowers classified as SMA-2 will need to be reported to the CRILC on the 61st day of any principal or interest being overdue.

Joint lenders' forum

As soon as a borrower's account is classified as SMA-2, its lenders will need to come together to form a JLF if the aggregate exposure to the borrower exceeds ₹1 billion. Banks would even have the option of forming a JLF when the aggregate exposure is below ₹1 billion and the account is not reported as SMA-2. Borrowers can also request that lenders form a JLF on the grounds of "imminent stress". To operationalize the JLF arrangement banks would need to execute a master JLF agreement, the format of which would be provided by the Indian Banks' Association.

Corrective action plan

The aim of constituting a JLF is to explore various options to resolve a stressed account and to formulate a corrective action plan (CAP). The resolution options for a CAP formulated by a JLF include: (a) obtaining specific commitments from the borrower to regularize its account so that it does not become an NPA; (b) restructuring the borrower's account; and (c) initiating recovery proceedings against the borrower.

In the case of restructuring, all decisions taken by 75% of the creditors by number and 60% of the creditors by value would be binding on all other creditors. In the case of initiation of recovery proceedings by the JLF, decisions taken by creditors representing the minimum thresholds prescribed by law would bind other creditors.

A JLF is required to agree on a mode of resolution within 30 days of an account being reported as SMA-2 or within 30 days of receipt of a request from a borrower for the formation of a JLF. Further, within 30 days of the above, the JLF would be required to put in place a final CAP.

Sale of NPAs

Pursuant to the framework, the RBI has also issued instructions withdrawing the requirement for banks to hold an NPA for two years in its books before selling it to another bank. Banks will now be allowed to sell an NPA to any bank, financial institution or a non-banking financial company (other than a securitization company or a reconstruction company) without any initial holding period.

Conclusion

In addition to early reporting and the formation of a JLF, the framework also prescribes measures such as incentives to banks for early recognition of problem assets and accelerated provisioning for failure to report. The framework also proposes to allow private equity firms with "proven expertise" to participate in the resolution/recovery process. However, these measures address the symptoms and not the disease itself. The prevalence of NPAs can be attributed to systemic shortcomings such as loose credit appraisal practices and infrastructure defects that force projects to become unviable. Until these are resolved, the NPA issue will continue to plague the Indian financial system.

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