UPDATES

RBI's Resolution Framework for COVID-19 Related Stress

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This update covers:

1 Introduction

The Reserve Bank of India (**RBI**) has been considering various measures to provide a much needed breathing space to borrowers and lenders due to the prevailing COVID-19 related financial distress and has on 6 August 2020 issued the 'Resolution Framework for COVID-19 Related Stress' (**Special Framework**). The Special Framework provides a window under the existing RBI (Prudential Framework for Resolution of Stressed Assets) Directions, 2019 dated 7 June 2019 (**Prudential Framework**) enabling lending institutions (**Lenders**) to implement a resolution plan for personal loans and corporate exposures, without requiring a change in ownership while continuing to classify such exposures as standard assets. It has also broadened the ambit of Lenders to include all non-banking financial companies (**NBFCs**) and housing finance companies.

The Reserve Bank of India has issued a 'Resolution Framework for COVID-19 Related Stress'. It provides for a window to allow lending institutions to implement a resolution plan for accounts which would have had a good track record but for the COVID-19 pandemic, without requiring a change in ownership, while classifying such exposures as standard assets.

2 The Special Framework

2.1 Eligible Borrowers

The Special Framework broadly identifies the class of personal loans and other set of loans (**Other Loans**), which will have access to the relief measures as set out under the Special Framework. Personal loans (classified under RBI's Circular dated 4 January 2018 on XBRL Returns – Harmonization of Banking Statistics) are essentially loans to individual borrowers for consumer credit, education loans, housing loans and loans for investment in financial assets. All exposures that are covered under the Special Framework and some key exposures that are excluded are broadly described below:

Exposures covered	Borrowers who would have had a good track record but for the COVID-19 pandemic are covered. The reference date for examining the performance of a borrower is 1 March 2020, i.e. only those loan accounts which were classified as standard and had not been in default for more than 30 days as on 1 March 2020, are eligible to be resolved under the Special Framework.
Exposures excluded	▪ Loans to financial service providers. ▪ Loans to central and state governments, local government bodies and body corporates established under a legislation. ▪ Micro, small and medium enterprises (**MSME**) borrowers whose aggregate exposure to all its lending institutions collectively is INR 250 million or less as on 1 March 2020.

	▪ Loans provided by Lenders to their own personnel/staff. ▪ Loan accounts which are not classified as standard as on the date of invocation of the resolution process.

2.2 Resolution Process

Lenders are required to frame board approved policies detailing the manner in which the evaluation of a borrower's performance may be done and details of implementation of viable resolution plans for eligible borrowers.

Under the Special Framework, Lenders and their borrowers have been given time till 31 December 2020 to invoke the resolution process and reach an agreement to proceed with a resolution plan.

2.3 Key Features of Resolution plan - Personal Loans and Other Loans

The Special Framework provides for specific features applicable to resolution plans for personal loans and Other Loans.

2.3.1 Key Features - Personal Loans

a. The agreed resolution plan must be implemented within 90 days from the date of invocation of the resolution process.

b. In addition to the requirement of a borrower not being in default for more than 30 days as on 1 March 2020, the eligible borrower account should continue to be classified as standard till the date of invocation of the resolution process.

c. The resolution plan may provide for steps such as rescheduling of payments or granting of a moratorium subject to a maximum of 2 years.

d. For a resolution plan to be considered implemented:

   i. all related documentation must be completed,

   ii. changes in the terms and conditions of the loan have to be duly reflected in the books of the Lender, and

   iii. the borrower should not be in default under such revised terms.

2.3.2 Key Features - Other Loans

a. The agreed resolution plan will have to be implemented within 180 days from the date of invocation of the resolution process. The loan accounts are to be treated as standard till the date of invocation of the resolution process.

b. If there is only one lender, the decision by such lender may be taken as per its board approved policy framed under the Special Framework. In case of multiple lenders, the resolution process will be treated as invoked if the lenders representing at least 75% by value and 60% by number agree to invoke the resolution process. Once agreed, an intercreditor agreement (**ICA**) is required to be signed by all the Lenders within 30 days from the date of invocation.

c. A resolution plan may involve any action, including:

   i. sale of exposure to other entities;

ii. change in ownership and restructuring;

iii. extension of the residual tenor of the facility, with or without payment moratorium, by a period of not more than 2 years;

iv. conversion of a portion of the debt into equity or other marketable, non-convertible debt securities; and

v. sanctioning of additional loans to the borrower.

The requirement of entering into an ICA for loans involving multiple lenders may prove to be cumbersome given the sheer number of borrowers that may undergo resolution under this Special Framework. From previous experience where ICAs were mandated, there have been delays from lenders with the borrower not having any ability to influence timelines. An alternate approach where the implementation of a resolution plan is linked to a borrower entering into a resolution plan (together with execution of the relevant documents) independently with its respective lenders rather than an ICA jointly with all lenders could be considered.

2.4 Expert Committee

The RBI has set up an expert committee to recommend a list of financial parameters to be factored into a resolution plan including any sector specific benchmark ranges for such parameters. The expert committee will also be responsible for reviewing resolution plans to be implemented under the Special Framework in respect of all accounts where the aggregate exposure of Lenders is INR 1.5 billion and above. However, this role will be limited to checking and verifying compliance of the due processes without interfering with the commercial decisions taken by the Lenders.

2.5 Asset Classification and Provisioning

2.5.1 Asset Classification

The RBI has also prescribed asset classification norms and provisioning requirements to be followed by Lenders for loan accounts being resolved under the Special Framework.

a. The asset classification of loan accounts classified as standard may be retained upon implementation of the resolution plan.

b. For accounts which may have become non-performing asset (**NPA**) between the period of invocation of the resolution plan and its implementation, such accounts may be upgraded as standard on the date of implementation of the resolution plan.

c. If an interim additional loan is granted to a borrower before implementation of a resolution plan, the interim loan may be classified as standard till the implementation of the resolution plan, regardless of the performance of the borrower with respect to such loan.

2.5.2 Provisioning

a. The Special Framework stipulates that post implementation of a resolution plan, both in case of personal loans and Other Loans, Lenders must from the date of such implementation keep a minimum of 10% of their re-negotiated debt exposure. However, a Lender which is not a party to the ICA will be required to keep provisions of at least 20% of the carrying debt on its books in case of Other Loans. This higher provisioning requirement for non-ICA Lenders appears to have been stipulated to encourage all Lenders with an exposure to an eligible borrower to become a signatory to the ICA.

b. With regard to rolling back of provisions made, it has been specified that half of the provisions may be written back upon the borrower paying at least 20% of the residual debt without slipping into NPA. The remaining half may be written back upon the borrower paying another 10% of the residual debt without slipping into NPA subsequently.

2.6 Credit Evaluation and Lender Disclosures

In case of resolution plans where the aggregate exposure of Lenders at the time of invocation of the resolution process is INR 1 billion and above, an independent credit evaluation of such resolution plans will have to be conducted by any one credit rating agency authorized by the RBI. Lenders are also required to make necessary disclosures in their quarterly/ half-yearly/ annual financial statements as per the prescribed formats in respect of accounts where a resolution plan is implemented.

3 Conclusion

While the moratorium reliefs granted by the RBI post the nationwide lockdown was meant to provide interim relief to a largely cash strapped borrowing class, the measures under the Special Framework reflect the acknowledgement of the RBI of the long term impact of COVID-19 pandemic and the requirement to provide a more sustainable solution. However, extending relief to only performing assets may not have the desired impact for all class of borrowers. Many of the previously restructured loans (under the Prudential Framework) which were performing in accordance with the restructured terms but for COVID-19 may not be able to avail benefits under the Special Framework since borrowers who have restructured their loans previously could not have upgraded their asset classification to 'standard' under the Prudential Framework.

Considering the impact of the financial distress, as the moratorium window is coming to an end, it is clear that a substantial number of borrowers would be keen to avail the benefits under the Special Framework. Further, with the Insolvency and the Bankruptcy Code (Amendment) Ordinance, 2020, suspending the initiation of any corporate insolvency for defaults that occur on or after 25 March 2020 for a period of six months (extendable for a maximum period of another six months), Lenders may be obliged to initiate discussions with eligible borrowers for resolution under the Special Framework. Apart from the cost and time expended in running the resolution process, we may need to watch this space to understand the impact of these measures on the liquidity of the Lenders as well.