ICRA

Indian Banking Sector

Revised framework for resolution of stressed assets

June 2019

RBI's approach towards dealing with stressed assets remain strong; lenders to be pushed to undertake resolution in a time bound manner

Credit provisioning can increase as banks will need to provide on standard stressed accounts

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Anil Gupta
+91 124 4545314
anilg@icraindia.com

Aashay Choksey
+91 22 6114 3430
aashay.choksey@icraindia.com

HIGHLIGHTS

Highlights of the RBI's revised Framework for resolution of Stressed Assets

- Unlike the earlier framework that covered banks and All India Term Financial Institutions (AIFI's), the scope and reach under the new framework has been extended to include Non Banking Financial Companies (NFBC's) and Small Finance Banks (SFB's)
- The framework requires lenders to put in place a board approved policy for resolution of stressed assets including measures that address various signs of financial difficulty, which will also be subject to supervisory oversight by RBI
- Lenders will continue to identify incipient stress in loans, immediately on default by classifying them under SMA-0, SMA-1 and SMA-2[1]; frequency of reporting stressed loans for exposures above Rs.5 crore to CRILC remains un-changed
- Key departure from the erstwhile framework is the granting of a 30 day "Review Period" (unlike the earlier framework that offered no grace period) from the date of default, during which, the lender (excluding NBFC's) may formulate or decide the resolution strategy
- During the review period, creditors shall enter into an Inter Creditor Agreement (ICA), that will formulate the ground rules for implementation of the RP. Furthermore, decision agreed by creditors under the ICA that represent 75% of the creditor by value and 60% by number shall be binding upon all the lenders as against 100% mandated earlier
- The RP requires to be implemented within 180 days of the end of the "Review Period"; the implementation of the revised framework comes into immediate effect for exposures above Rs.2000 crore, and for exposures between Rs.1500-2000 crore from January 1,2020. Further, for exposures below Rs.1500 crore, the reference date will be announced in due course of time
- Failure to formulate a RP within the stipulated timeline of 180 days will entail lenders making additional provision of 20% which would step-up to 35% if the matter remains un-resolved upto 365 days; under the erstwhile dispensation, the matter was compulsorily referred for resolution under Insolvency and Bankruptcy Code, 2016 (IBC) on expiry of 15 days post the resolution period of 180 days
- The revised dispensation incentivizes lenders to reverse half of such additional provisions upon reference under IBC; despite this relaxation, lenders may adopt a case specific approach, especially if they expect the haircuts upon resolution under IBC to be higher than provisions
- As was also the case under the February 12 circular, all the legacy restructuring schemes (S4A, SDR,5/25 etc) stand withdrawn
- Restructured accounts can be upgraded on repayment of atleast 10% of the outstanding principal, which has been relaxed from 20% earlier, subject to an investment grade rating from external rating agency
- As per ICRA's estimates, this will not lead to an increase in the non-performing assets at the system level, however it may force banks to make higher credit provisions on large accounts if they were to delay the implementation of resolution plans currently having SMA 1/SMA2 status or even on those accounts which are recognized as non-performing. Further, delayed resolution on large-ticket NPA accounts may entail accelerated provisioning as compared to regulatory minimum requirements

[1] If Principal or interest payment is partly or fully overdue for a) 0-30 days = SMA 0, b) 31-60 days = SMA 1, c) 61-90 days = SMA 2.

Overall approach of RBI to deal with stressed assets remains strong: Following the Hon'ble Supreme Court's ruling vide its order dated April 2, 2019, wherein the earlier framework on Resolution of Stressed Assets dated February 12, 2018 was quashed, the RBI has formulated a revised framework that replaces the earlier one. The revised framework incentivizes lenders to be more pro-active in pursuing resolution of stressed accounts in a timebound manner, failing which the they run the risk of accelerated credit provisions on large sized borrowers, which will be higher than regulatory minimum requirements. *We believe the revised framework will continue to push lenders for active resolution and the overall approach of RBI for dealing with stressed assets remains strong.*

Provisioning even on standard SMA 1 and SMA 2 accounts, if resolution delayed: The earlier circular proposed a compulsory reference of stressed assets for resolution under IBC upon the expiry of 6 months from the date of account turning SMA. In the revised circular, once the accounts get classified as SMA1, a resolution plan needs to be implemented in a time bound manner to correct the SMA status of the borrower. In case of failure to implement a resolution plan (i.e. to correct the SMA status of the borrower), the bank will need to make provisioning of 20% even if the account remains standard and further increase provisioning to 35% in case implementation of resolution plan is delayed by a year. Effectively, the provisioning on the stressed accounts will become a norm, even if the account remains in SMA1 or SMA2 category unlike the existing regulatory requirement of standard asset provisioning.

Provisioning on NPA accounts will get accelerated, if resolution delayed: The accounts which turns NPAs currently require a provision of 15% in the first year and 25% in second year and 40% in third and finally to be fully provided for. However, as per revised framework, for large sized borrowers, if the resolution plan is not implemented in a time-bound manner, the provisioning on such accounts can increase up-to 50% in a period of 4-5 quarters from the account turning SMA. This will prompt the banks to accelerate the resolution process in our view.

External ratings retained for implementation of resolution plan: The framework continues to require independent credit evaluation (ICE) from credit rating agencies (CRAs) subject to a minimum credit opinion of "RP4" on scale of "RP1" to "RP7". In absence of the minimum requisite level of credit opinion, the resolution plan will not be deemed to be implemented. The resolution plans of large borrowers with Rs 100 crore and above of exposure from banks will need ICE from a single CRA while borrowers with Rs.500 crore and above exposure will necessitate ICE from two CRA's.

Provisioning on standard stressed accounts to drive resolution: With heavy provisioning requirement of up to 35% on stressed standard accounts, banks will be forced to put up a resolution plan. *Furthermore, no special concession has been extended to any sector under the revised framework. Lenders will have to endure higher provisions on failing to implement the RP irrespective of the sectoral exposure of the assets.* The lenders under the revised framework, will be bound to enter into an Inter Creditor Agreement, in case it is decided to implement a resolution plan. The ICA will be binding on all the creditors party to the ICA if it is approved by 75% of the creditors in terms of outstanding value and 60% of the number of creditors. *In ICRA's opinion, lowering the requisite creditor approval limits is expected to expedite the overall resolution process by avoiding possible impasse under multi creditor arrangements.*

Provisioning reversal may incentivize reference to IBC: The effectiveness of the new framework to ensure timely resolution has been enhanced by extending relaxations to the lender by allowing reversal of 50% of additional provisions (of additional 35% made in addition to IRAC norms) for cases that are referred for resolution under IBC. This is unlike the earlier framework that made referral to IBC compulsory without any concessions, in case the resolution plan was to fail. *ICRA believes, that lenders are more likely to approach referral to IBC on a case specific basis as viability under the IBC route will depend on the extent of haircut the bank may take. The volume of such stressed cases, particularly with respect to exposures more than Rs.2,000 crore was estimated by us at ~ Rs.3.8 lakh crore of exposure across 72 large borrowers as of September 2018.*

Given the stringency of the earlier framework, a large volume of stressed assets is already under various stages of resolution. Moreover, banks and AIFI's have under-taken accelerated provisioning on several of these assets over FY2019 on the back of capital support from the GoI. *In ICRA's view, incremental stressed assets identified and pursued under the new framework* *is likely to be lower in comparison to the earlier framework in the immediate near term. Going forward, speedy resolution of stressed assets will be key in shoring up profitability by freeing up provisions, which in-turn will be subject to the extent of hair-cut already taken by the lender. Large scale recoveries can aid in the prospects of these banks to raise capital in FY2020 and FY2021 as well.*

Upgradation criterion relaxed, subject to investment grade ratings: Under the revised framework, RBI has relaxed the criterion for up-gradation of NPA accounts or accounts that get classified as NPAs upon restructuring under the resolution plan. The accounts can be upgraded if the borrower has demonstrated meaningful track record of timely debt repayments and has paid at-least 10% of the principal outstanding at time of resolution plan, as against the earlier dispensation that required at least 20% repayment. Despite this relaxation, the upgrade of restructured accounts continues to remain subject to a minimum investment grade credit rating from a CRA. *In our view, entities having sustainable financial and operational risk profiles are more likely to be upgraded by CRAs and this will ensure that only viable accounts get upgraded at later stages, irrespective of debt amortization at time of upgrade.*

ICRA
A MOODY'S INVESTORS SERVICE COMPANY

ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

Alliance with Moody's Investors Service

The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

The ICRA Factor

Our services are designed to

- Provide information and guidance to institutional and individual investors/creditors;
- Enhance the ability of borrowers/issuers to access the money market and the capital market for tapping a larger volume of resources from a wider range of the investing public;
- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

ICRA
A MOODY'S INVESTORS SERVICE COMPANY

Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
Tel: +91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: jayantac@icraindia.com
Tel: +91 80 4332 6401/ +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: communications@icraindia.com
Tel: +91 124 4545 860

Registered Office:

1105, Kailash Building, 11th Floor,
26, Kasturba Gandhi Marg,
New Delhi - 110 001
Tel: + 91 11 2335 7940-45

Corporate Office:

Building No.8, 2nd Floor,
Tower A, DLF Cyber City Phase II,
Gurgaon- 122 002
Tel: +91 124 4545300

Ahmedabad

907 & 908, Sakar – II,
Ellisbridge, Opp. Town Hall,
Ahmedabad - 380 006
Tel: +91 79 4027 1500/01

Bengaluru 1

'The Millenia', Tower- B, Unit No. 1004,
10th Floor,1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber,
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5th Floor, Karumuttu Centre,
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

No. 7-1-58, 301, 3rd Floor, 'CONCOURSE',
Above SBI-HPS Branch, Ameerpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Hyderabad 2

4A, 4th Floor, SHOBHAN,
6-3-927, A&B Somajiguda,
Raj Bhavan Road,
Hyderabad – 500082
Tel: +91 40 40676500

Kolkata

A-10 & 11, 3rd Floor,
FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata -700 020
Tel: +91 33 7150 1100/01

Mumbai

3rd Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5th Floor, Symphony,
S. No. 210 CTS 3202 Range Hills Road,
Shivajinagar,Pune - 411 020
Tel: +91 20 2556 0194, 020 6606 9999

Email: info@icraindia.com
Helpdesk: 124 3341580
Website: www.icra.in/ www.icraresearch.in