# Financing for Stressed Assets and Revival

**19th February 2021**

SBI
Capital
Markets
Limited

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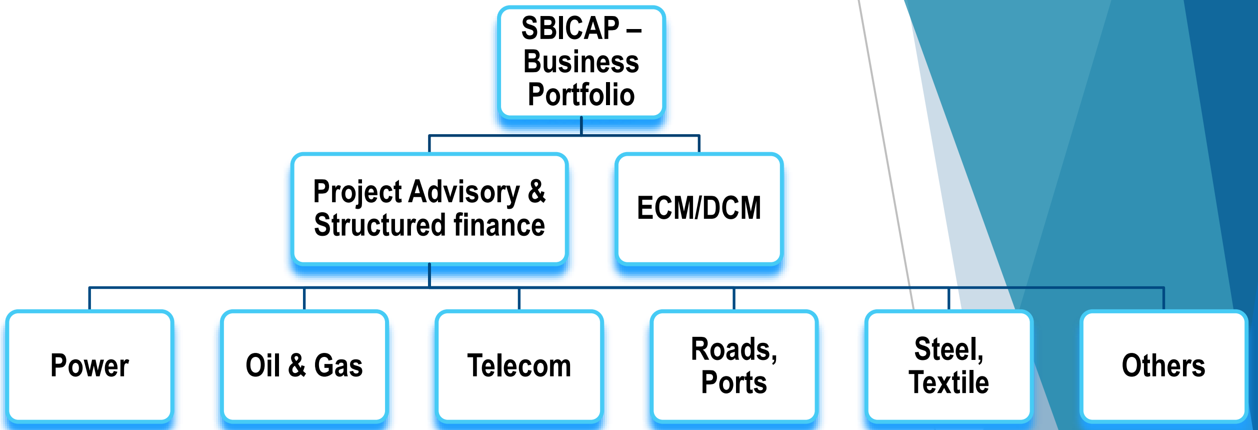
# About SBICAPS – India's Leading Investment Bank

SBI Capital Markets Limited

- Established in 1986., A wholly owned subsidiary (Investment Banking Arm) of Sate Bank of India.
- Leading Financial Advisor /fund mobiliser in the Country
    - Pan India coverage with 5 Offices in Delhi, Kolkata, Chennai, Mumbai and Ahmedabad
    - Global presence through foreign subsidiaries viz. SBICAPS Singapore
- Pioneer in Indian Project Finance Market
- Involved in several strategic sale & other advisory transactions, including:
    - Auction of Coal Mines
    - Auction of 6 Mineral blocks in India
    - Auction of RLNG for Stranded Gas Based Power Plants
    - Financial Structuring of State Distribution Utilities
- Dedicated team of over 225 professionals providing a variety of advisory services across industries to domestic and international clients.
- Worked on various aspects with Government of India (Ministry of Finance, CERC, Ministry of Power, Ministry of Coal & Mines.)




**Project Advisory & Structured Finance**

- **Financial Advisory Services**
- **Fund Mobilisation (Debt and Equity)**
- **Financial Appraisal, Bid Advisory, Tariff Advisory and Project Advisory**
- **Structured Finance for Acquisitions, Leverage & Mezzanine financing and convertibles**
- **Corporate Restructuring**
- **M&A Valuations Advisory**
- **Private Equity Advisory**

**ECM / DCM**

- **Equity & Debt Origination**
- **Private Placements**
- **International Offerings: GDRs, FCCBs etc.**
- **Open Offers, Buy-backs, De-listings**

***Diversified business portfolio across products and industry sectors***

# SBICAPS – Accolades & Awards

## Awards

| | |
|---|---|
| **2020** | The Asset Triple A Infrastructure Awards 2020 for – <br>• Project Finance House<br>• Petrochemical Deal of the Year – HPCL Rajasthan Refinery |
| **2019** | The Asset Triple A Country Awards 2019 for Best Loan Adviser |
| **2018** | Triple A Asia Infrastructure Awards - Project Finance Bank of the Year |
| | Triple A Asia Infrastructure Awards - Green Project of the Year - Adani Green Energy |
| | Triple A Asia Infrastructure Awards - Petrochemical Deal of the year - HPCL Mittal Energy |
| | Triple A Asia Infrastructure Awards - PPP deal of the year - Chhattisgarh East Railway Ltd. |

## Rankings for FY 2020

| |
|---|
| Ranked No.1-1H20 India - India Borrower Loans (Mandated Lead Arranger) with market share 27.050% (Volume 326,873 million) - Bloomberg-India Capital Markets-1H2020 |
| Ranked No.1 - H12020 - APAC Project Finance Loans (Mandated Lead Arranger) with market share 10.637% (Volume USD 2975 million) - Bloomberg-APAC Capital Market League Table |
| Ranked No.1 - H1 2020 - APAC Project Finance Loans (Mandated Lead Arranger) with market share 10.637% (Volume USD 2975 million) – Bloomberg Global Syndicated Loans |
| Ranked No.1 - H1 2020 - India Borrower Loans (Mandated Lead Arranger) with market share 27.050% (Volume INR 326873 million) – Bloomberg Global Syndicated Loans |
| Ranked No.1 -1H20 India Rupee Loans Mandated Arranger with market share 34.33% (Volume INR 185,586,066,667) - Refinitiv - APAC Loans League Tables |
| Ranked No 2 -1H20 India Non-Rupee Loans Mandated Arranger with market share 7.2% (Volume 758 million) - Refinitiv - APAC Loans League Tables |
| Ranked No 2 -1H20 South Asia Mandated Arranger with market share 7.1% (Voume USD 758 million) - Refinitiv - APAC Loans League Tables |
| Ranked No 2 - H1 2020 India Loans Volume by MLA with market share 13.6% (Volume USD 2,960 million) - Dealogic-Syndicated Loans H1 2020 |
| Ranked No 3 - 1H 2020 Global PFI/PPP Project Finance Loans Volume by MLA with market share 6.4% (Volume USD 528 million) - Dealogic-Project Finance Ranking 1H 2020 |
| Ranked No.1 Global Bookrunner (market share 5.6% with volume USD 7,712.2 Million) - Thomson Reuters |
| Ranked No.2 Global MLA Project Finance Loans (market share 4.5% /volume USD 10,388.1 Million) - Thomson Reuters |
| Retained both No. 1 Asia Pacific and Japan MLA Project Finance Loans and Bookrunner Project Finance Loans - Thomson Reuters |
| Ranked No.1- Local currency loans Mandated Lead Arrange - Bloomberg |

# 1. Genesis: The causes of stress – India story so far

2016 – Demonetization shocked the economy

2017 – Half baked implementation of GST

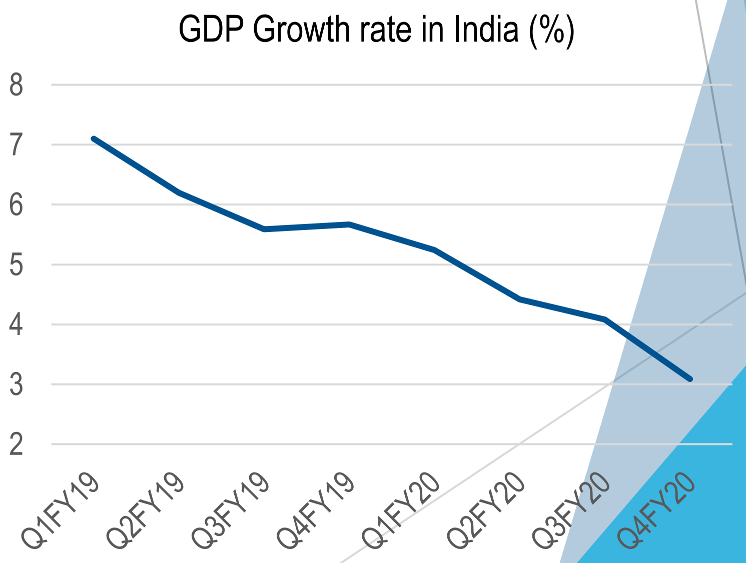
2018 – Liquidity crises flagged off by the fall of IL&FS followed by failure of YES bank & DHFL

2019 – Stress continued; the RBI cut interest rates five times in a row, from 6.50% in Jan’ 19 to 5.15% in Oct’ 19 (135 bps), giving renewed push to slowing economy.

2020 – The year of COVID-19, Nationwide lockdown imposed from 23-March 2020, RBI also reduced repo rate to 4% (reduction of 115 bps) to contain spiraling stress in the economy

**FY 2021: Current Scenario of PSB / NBFCs**

- Capital shortfalls for PSBs will remain despite a likely government equity infusion of Rs. 20,000 cr, leaving banks vulnerable to unexpected shocks and restricting credit growth
- High provisioning costs continuing to suppress PSBs profitability
- Asset quality of NBFCs is also expected to deteriorate due to disruption of business operations caused by the pandemic, especially in the industry sector.



# 1. Genesis: COVID-19 further aggravates the situation...

- The world comes under the grip of the COVID-19. Due to long periods of lockdown to contain the spread of the virus, the economic activity had come to a standstill and is now limping back to a 'new normal', albeit at snail's pace.
- The global economy is projected to contract sharply by 4.4% in 2020[1].
- Indian economy too is not an exception - in Q2 of FY 2019-20, Indian economy shrinks for 2 times in a row – Indian economy technically in 'recession'.
- India's economy is projected to contract by 10.3% by International Monetary Fund (IMF), 9% by Asian Development Bank and 9.6% by World Bank in 2020-21.
- The macro stress tests indicate that the Gross Non-Performing Asset ratio of all Scheduled Commercial Banks (SCBs) may increase from 8.5% in March 2020 (INR 8.9 Lakh Cr.) to 12.5% by March 2021 (**INR 13.3 Lakh Cr**.) under the baseline scenario and may escalate to 14.7% under the very severely stressed scenario.[2]
- At this rate, for SCBs 13.5% to 14.7% GNPA ratios would translate to **INR 15 lakh cr. to INR 16.5 lakh cr**. of stressed assets in the SCBs.
- GNPAs of NBFCs increased to 6.3% as of March 2020 from 5.3% as of March 2019, and likely to touch **Rs 1.5-1.8 lakh crore**, or 6-7.5% of their AUM by FY21. However, the one-time COVID-19 restructuring window, and MSME restructuring scheme of RBI may limit the reported GNPA

- **THUS, STRESS RESOLUTION REMAINS PARAMOUNT**

[1] International Monetary Fund (2020), World Economic Outlook, October 2020: A Long and Difficult Ascent
[2] The RBI's Financial Stability Report (FSR) released on January 11, 2021

# 2. Preamble: Financing for Stressed Borrowers / Assets

**Causes / Indicators of stress –**

- Delayed/ Stuck receivables
- Elongated WC cycles leading to requests for increase in WCDL/ WCTL limits
- Actual sales/profit falling short of projections
- Devolvement of LC/DPG or invocation of BGs
- Promoter pledging/selling shares
- Delay in submission of stock statement, credit monitoring or financial statements etc. or non-renewal of facilities
- Reduction of drawing power (DP) by 20% after a stock audit
- Request for extension of time for security perfection or for compliance with other T&C

**Funding Instruments:**

- Priority Loan to ease liquidity / WC constraints
- Asset Backed financing – Additional Term Loan / STL / WC
- Loan against Pledge of Shares / Structured Finance
- Debt restructuring

**Funding for stressed Assets can be raised through:**

- Indian / Foreign Stressed Asset Funds
- Private Equity / Private Funding / acquisition by Strategic Investor
- Alternative Investment Funds (AIF)
- Assignment of debt to ARCs
- Restructuring of Debt

**Broadly Investments in the stressed assets are by way of :**

- Acquisition of the company / non-core assets of companies,
- Investments through interim / Priority debt financing,
- Investment in security receipts issued by Asset Reconstruction Companies, and Purchase of debt by ARC / AIF

# 2. Preamble: Framework for stress resolution

- Routes for Stress resolution
  - Out-of-NCLT
    - 1. RBI's prudential framework for resolution of stressed assets – ie. 7 June 2019 circular
    - 2. Resolution Framework for COVID-19-related Stress - ie. 6 August 2020 circular
  - NCLT - supervised
    - 3. Corporate Insolvency Resolution Process under IBC Code, 2016
    - 4. Scheme of Compromise/ Arrangement under the Companies Act, 2013 (SOA)
    - 5. Pre-packaged insolvency resolution process (Proposed)

# 3. Stressed borrowers: Financing & Restructuring

1. **What is restructuring?**
   - Restructuring is an act in which a lender, for economic or legal reasons relating to the borrower's financial difficulty, grants concessions to the borrower.
   - Restructuring generally involves
     - modification of terms of the loans / securities,
     - sanction of additional credit facility; or
     - compromise settlements (including haircut)

2. **What are the financing arrangements usually involved (Under RBI framework)?**
   1. Bifurcation of debt into sustainable and non-sustainable debt and conversion of non-sustainable debt into equity or quasi equity instruments
   2. Take over of financial debt by an investor with better credit rating or ARC.
   3. Additional credit backed by promoter’s personal guarantee/ pledge of shares
   4. Existing promoters bringing in capital by way of Inter-Corporate Deposits/ additional issue of equity
   5. Bring funds through Monetization of assets or simply extension of loan tenor by way of Interest and/or principal repayment moratorium.

# 3. Stressed borrowers: Financing & Restructuring

**2.1. Financing under 7th June 2019 - RBI Prudential Framework for Restructuring**

- Restructuring involves sustainable debt evolution (usually 60-70% depending on industry) based on cashflows ascertained by TEV while unsustainable part is converted into convertible / non-convertible Debentures or Pref Shares / quasi equity instruments
- Part of un-sustainable debt is also converted into Equity to lenders as part of Right to Recompense (RoR)
- The tenor of un-sustainable debt is longer and payable after majority of sustainable debt is paid
- Security structure is devised based on continuing security among inter-se lenders with possible security enhancements
- Priority debt / additional financing is considered to support operations in the interim period and avoid value erosion
- Also entails monetization of non-core assets or stuck receivables for repayment / prepayment of unsustainable part
- Negotiations on RoR for NPV loss to lenders (NPV loss in range of 25-30% is generally acceptable depending on industry / Borrower)
- Viability is based on DSCR > 1.2.

| | |
|---|---|
| Independent Credit Evaluation (ICE) | ▪ RP involving restructuring for aggregate exposure of >Rs. 100 Crore shall require ICE of RP4 or better by credit rating agencies |
| Prudential Norms – Asset classification | ▪ ‘Standard’ assets shall initially be downgraded to ‘sub-standard’ category of NPAs – to begin with.<br>▪ The NPAs, upon restructuring, would continue to have the same asset classification as prior to restructuring. |
| Prudential Norms - Conditions for Upgrade | ▪ Only when all the outstanding loan / facilities in the account demonstrate ‘satisfactory performance’ during monitoring period.<br>▪ Monitoring period = To – date by which at least 10% of the sum of outstanding principal debt as per the RP and interest capitalization sanctioned as part of the restructuring, if any, is repaid<br>▪ ‘Satisfactory performance’ of borrower entity ie. not in default at any point of time during the period concerned.<br>▪ For the accounts with aggregate exposure > 100 Cr., rating of investment grade (BBB- or better) from CRA. |

# 3. Stressed borrowers: Financing & Restructuring

## 2.2 Process of OTR under RBI's 6 August 2020 circular

Resolution Framework for COVID-19-related Stress) to enable the lenders to implement a resolution plan without change in ownership.

- Classification of the account being **'standard**' as on 1 March 2020, for the borrower to be eligible and OTR proposal to be invoked before 31 Dec' 2020.
- Majority lenders (75% by value and 60% by number) to sign **ICA within 30 days of invocation**
- Whether lenders' aggregate exposure > 100 Cr. the resolution plan shall require **credit rating of RP4** or better from one credit rating agency.
- The resolution plan shall have to comply with sector specific **benchmarks for financial ratios** specified by Expert committee

| Parameters | TOL/ATNW | Total Debt/EBIDTA | Current Ratio | Average DSCR | DSCR |
|---|---|---|---|---|---|
| Benchmark | <=3-6 (Range) | <=4-6 (Range) | >=1.00 | >=1.20 | >=1.00 |

- If lenders' aggregate exposure **> 1,500 Cr.,** such resolution plans to be vetted by this committee.
- Resolution plan must be **implemented within 180 days** from the date of invocation.

Other key aspects of financing under this circular are as follows:

- **Sanctioning of additional credit facilities** to address the financial stress of the borrower on account of Covid19. As per Lenders internal policy, promoter's contribution of 10-15% of the additional finance sought is stipulated. Further as means of additional security, personal guarantee of promoters (for unlisted entities) and pledge of shares (for listed entities) may also be stipulated
- **Extension of residual tenor of the loan** with or without payment moratorium **by a period not more than two years.** Interest moratorium of up to 6 months may be considered.
- As per few of the lenders internal policy the interest rate on FITL created due to interest moratorium or additional finance availed in form of WCTL/WCDL should be higher by 1% over existing rates.
- **Conversion of unsustainable portion of debt** into equity or other marketable, non-convertible debt securities provided the amortisation schedule and the coupon carried by such debt securities are similar to the terms of the debt held on the books of the lending institutions, post implementation of the resolution plan.

# 3. Stressed borrowers: Financing & Restructuring

**2.3. Takeover of debt by ARCs/ Investors**

1. **ARCs**: ARCs usually takeover NPAs from the banks and issue security receipts (SR) as part of the consideration

2. **Private Equity/ Stress Asset Funds/ Special Situation Funds**: Such players have expertise in turnaround of stress assets by taking control of the operations and usually exiting in 5-7 years with high IRR expectations. They usually work in tandem with other private equity funds, industry professionals etc. through options such as:
   - As new investor with change in ownership under IBC/RBI June 7 circular
   - Participate in stake acquisition to work towards turnaround of business along with Promoters
   - As new promoter (along with Strategic industry Player) to invest money for OTS of debt of existing lenders
   - Funding for piecemeal asset acquisition / sale.

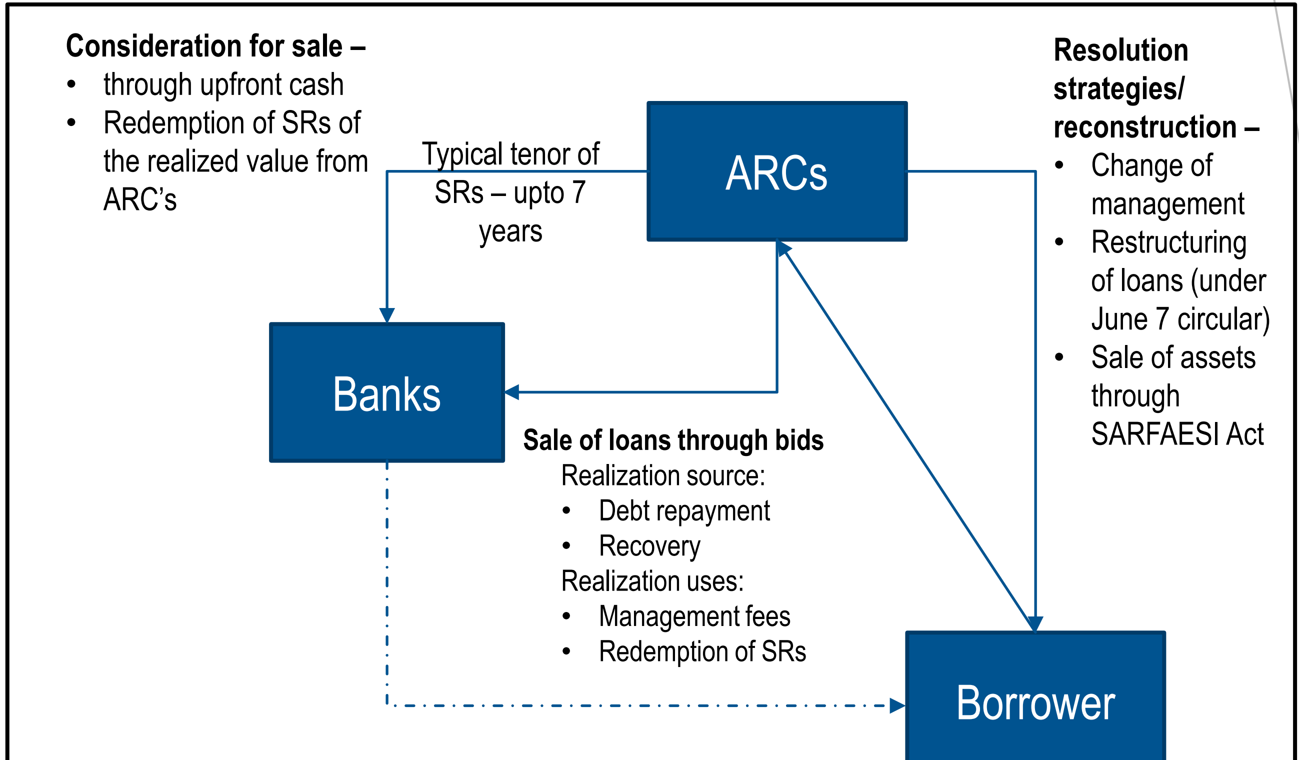
PE players are usually present in stress assets which are operational /has established business but undergoing liquidity issues

# 3. Stressed borrowers: Financing & Restructuring

**2.3.1 Assignment of Debt to ARC**

ARC's acquire loans at a discount from banks and specialize in monetizing these loans through various strategies.

- Banks sell stressed loans to ARCs on a 'without recourse' basis.
- Financially viable debt can be suitably restructured with ARC
- Existing management support will be required for effecting Change of management outside NCLT
- Majority Lenders are required to agree for sale of exposure to ARC




**Typical deal structure with ARC**

**Recent trends**

- With minimum required upfront cash component increased recently upto even 100% (from 15%), capital remains single biggest challenge for ARCs
- However, with FDI cap for ARCs raised to 74%, ARCs have now been inviting foreign PE/ AIF/ Special situation funds to invest in distressed asset market through equity participation (in ARC).

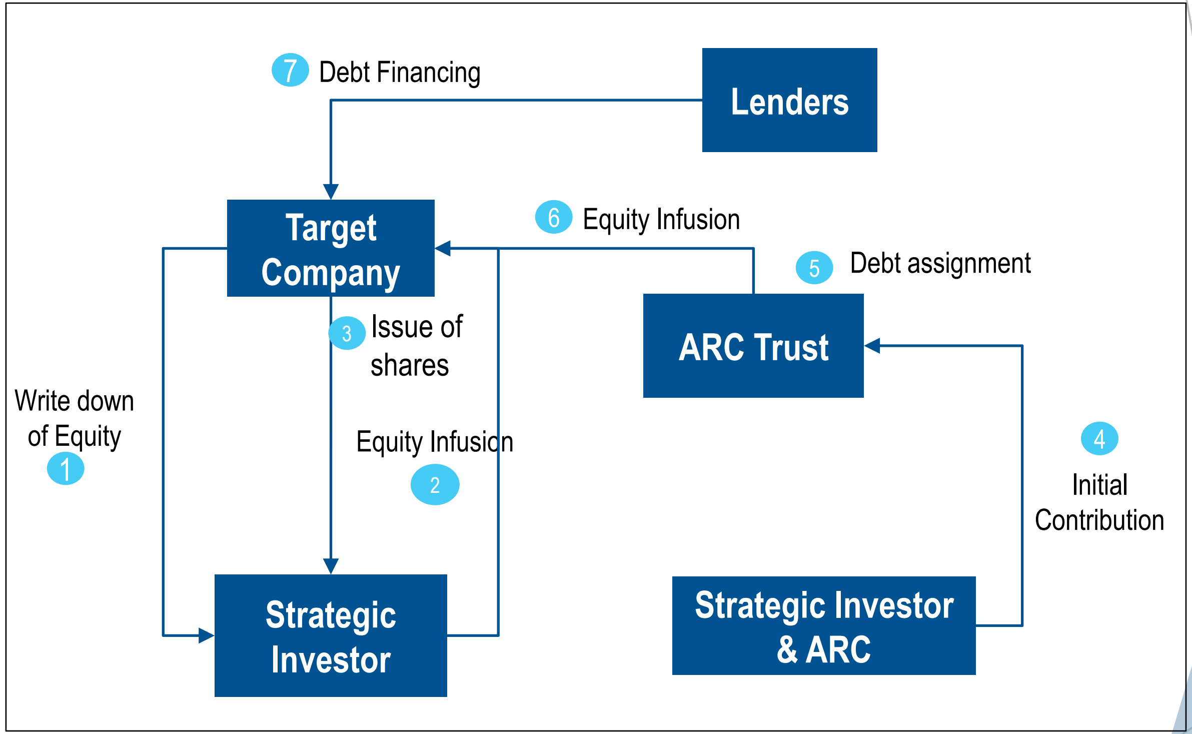
# 3. Stressed borrowers: Financing & Restructuring

**2.3.2 Acquisition / Takeover of debt by Investor /ARC (Funding Structure)**

- Strategic / financial investor brings their expertise to turnaround the business (expected approx. ROE of >18%):
- Can lead to change in ownership

- ❑ Investor can propose a buyout of the Company at Enterprise Value (EV) to be financed by raising term loan/NCD and working capital
- ❑ Also debt assignment can be done to ARC to manage tax outgo
- ❑ Typical transaction outlay would be as under:

| Application of Funds | | Sources of Funds | |
|---|---|---|---|
| **Repayment of Existing Lenders** | 2,000 | **NCD/ Equity** | 500 |
| **WC capital Requirement** | 1,000 | **Term Loan** | 1,500 |
| | | **WC Finance** | 1,000 |
| **Total** | 3,000 | **Total** | 3,000 |




- Process shall not take much time as compared to other options viz. Change of management under CIRP
- Existing promoter may not agree for Change of management (Mitigation –Existing promoters are likely to agree if existing Lenders agrees for releasing Personal Guarantee of Promoters)

# 3. Stressed borrowers: Financing & Restructuring

**2.3.3 Financing through NBFC's**

Funding by NBFC: NBFCs (prior to IL&FS crisis) used to fund high-risk borrowers to alleviate liquidity concerns. Some of the various products offered are:

- Loan against property
- Loan against shares
- Real Estate Funding – project funding, acquisition funding
- Structured financing

- NBFC are typically involved in asset based financing or short-term loan financing for meeting liquidity / WC related constraints to stressed borrowers
- However, considering the funding and policy support constraints, the funding by NBFCs is virtually dried down / minuscule.

# 3. Stressed borrowers: Financing & Restructuring

**2.3.4 Financing through PE Funds / AIFs / Distressed Funds**

- Many global private equity funds have begun investing in India's stressed assets space often in partnership with Indian firms after the IBC became law in May 2016.
- In distressed private equity, firms invest in troubled companies' Debt or Equity to take control of the companies during bankruptcy or restructuring processes, turn the companies around, and eventually sell them or take them public.
- Distressed funds might use any of the following strategies to invest in the stressed borrowers:
    - **Debt Non-control**: funds buy debt trading at huge discounts to gain influence in the restructuring or bankruptcy process; negotiate favorable terms in order to increase market value of their debt
    - **Debt Control**: funds buys the "fulcrum security" that will end up being converted into Equity and having a controlling stake in the company post-restructuring. The firm then operates the company, makes improvements, and sells it or takes it public
    - **Turnaround**: funds acquire Equity in the company rather than Debt, usually **before a bankruptcy process** begins, and then attempts to restructure the company and get it out of distress
    - **Special Situations**: this is a broad strategy around a special situation/event like bankruptcy, that could include any of the ones above, but which could also refer to investments in spin-offs, asset sales, recapitalizations, acquisitions, or capital raises.
- All the above could be done under the aegis of IBC/RBI June 7 circular

# 3. Stressed borrowers: Financing & Restructuring

**2.3.4 Financing through PE Funds / AIFs / Distressed Funds (Continued)**

- AIFs are pooling vehicles (such as trusts, limited liability partnerships, companies and other body corporates) that can pool monies from both Indian resident and offshore investors for deployment in Indian and, to a limited extent, in foreign companies.
- Funds for distressed assets are **category II** Alternative Investment Funds (AIFs), which invest in stressed assets of various companies, with the investment philosophy that not all NPAs are bad assets and a turnaround in these will provide a good return.
- Distressed asset funds usually raise commitments from big institutional players such as banks, large pension funds and insurers, which include global entities.
- **Key players in market**: Edelweiss, Kotak AMC, Piramal Group and Eight Finance Private Limited are among the renowned players in distressed assets fund space.
- **Advantage over other financial institutions**: Distressed asset funds are emerging as new source of credit for corporates, a space that has largely been occupied by banks, NBFCs and mutual funds.
  - better placed than other financial institutions to handle credit events because of their close-ended and private placement nature
  - No capital adequacy norms unlike banks and NBFCs

**Some prominent PE/Stress asset funds active in Indian stressed asset market–**

- **Oaktree and Edelweiss ARC partnering to acquire GTL Infrastructure**
- **AION Capital Partners and JSW Steel winning the bid for Monnet Ispat & Energy under IBC**
- **India Resurgence Fund – JV between Piramal Enterprises Limited and Bain Capital Credit**
- **Deutsche Bank/BoAmerica/GS, etc**
- **Carval acquired Uttam Galva**
- **KKR**
- **ADIA**
- **SSG Capital**
- **Cerberus Capital**

# 3. Stressed borrowers: Financing & Restructuring

***In the event all of the above financing options are explored and no resolution is achieved then lenders opt for – OTS***

**2.4. One-Time Settlement with haircut**

- Structured finance through combination of debt from new lenders &/or equity infusion / allocation to new investor
- Sale of majority stake to Strategic / Financial Investors
- Involves monetization of non-core assets / realization of inflows from stuck receivables etc.
- Extensive negotiations on release of PG of existing Promoters in case of OTS backed by new investor
- OTS installment Repayments are envisaged in time bound manner (preferred approx. 6-9 months)
- Swiss Challenge may be opted by lenders for price discovery

# 3. Stressed borrowers: Financing & Restructuring

## 3. Financing under Corporate Insolvency Resolution Process (CIRP) under the IBC

**3.1.** Resolution Applicants (RA or Investors) submits their resolution plans – that involves change of ownership

- Financing typically involves combination of
  - upfront payment,
  - elongated debt / quasi equity instruments,
  - write down of equity/ further infusion of new equity,
  - ARC debt assignment etc.
- The COC approves best resolution plan with 66% majority and submit it to the NCLT for approval.

## 3.2. The journey so far[1]..

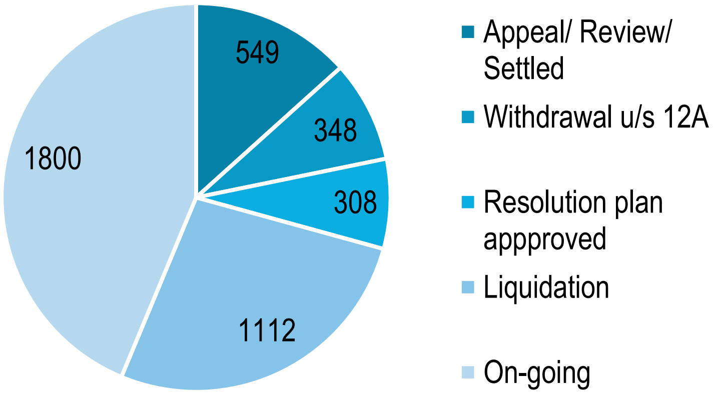
- Since enactment, IBC remains dominant channel of recovery of bad loans

| Recovery channels | FY2018 | FY2019 | FY2020 |
|---|---|---|---|
| Lok Adalats | 4.00% | 5.10% | 6.20% |
| DRTs | 5.40% | 3.90% | 4.10% |
| SARFAESI | 32.20% | 15.00% | 26.70% |
| IBC | 49.60% | 45.70% | 45.50% |
| Total recovery | 14.90% | 16.30% | 23.20% |

[1]*Source: Economic Survey of India 2021-22, Chapter 4*

- In case of 308 resolution plans that were approved by the NCLT,
  - Debt claims were 4.99 lakh cr., while recovery was 1.99 lakh cr.
  - Average time taken for CIRP – 441 days, as against 270 days

**Cases admitted into CIRP (Till Dec' 20)**




[1]*Source: Economic Survey of India 2021-22, Chapter 4*

# 3. Stress Resolution Routes – Comparison (1/2)

| Feature | 1. RBI's Prudential Framework (June 7, 2019 Circular) | 2. RBI's (August 6, 2020 Circular - COVID-19 stress) | 3. CIRP under IBC, 2016 | 4. SOA under the Companies Act, 2013 |
|---|---|---|---|---|
| Available for | All entities with debt from RBI regulated lenders | All entities classified as standard, but not in default for more than 30 days with lenders as on March 1, 2020 | Companies, LLPs, and entities with limited liability | Companies |
| Stress covered | Pre and Post default | Stress should be on account of COVID-19 only | Default above Rs.1 crore (other than COVID-19 defaults) | Pre and post default, including stress in group companies |
| Initiation by | RBI regulated lenders | Debtor or a creditor; May be invoked by Dec 31, 2020 only | Debtor or a creditor | Company, a member, a creditor, or the liquidator |
| Scope of resolution plan | Wide –<br>1. Sale of assets and/or business,<br>2. Change in ownership/management<br>3. Change in any terms of the debt including OTS, moratorium, rescheduling of repayments, haircut, conversion into other instruments, etc. | Narrow –<br>1. Repayment extension of existing Financial liabilities may not be more than 2 years<br>2. Interest + Instalments moratorium allowed<br>3. Conversion of debt into equity allowed | Widest – Since the resolution plan is approved by NCLT, almost anything is possible. | Wide |

# 3. Stress Resolution Routes – Comparison (1/2)

| Feature | 1. RBI's Prudential Framework (June 7, 2019 Circular) | 2. RBI's (August 6, 2020 Circular - COVID-19 stress) | 3. CIRP under IBC, 2016 | 4. SOA under the Companies Act, 2013 |
|---|---|---|---|---|
| Protection of OCs and dissenting FCs | No | No | Yes | No |
| Approval by stakeholders | 75% of RBI-regulated FCs (and other voluntary signatories to the ICA) by value and 60% by number | | 66% FCs by value | 75% creditors by value |
| Regulatory benefits | No | No | More | Less |
| Debtor-in-possession | Yes | Yes | No | Yes |
| Moratorium | No | No | Yes | No |
| Liability of CD in respect of past offences | Continues | Continues | Ceases (Section 32A of the Code) | Continues |
| Time Limit | 180 days (without additional provisions) for large accounts | 180 days from the date of invocation | 180 days + 90 days | No |
| Consequence of failure | CIRP under IBC or liquidation | Resolution under June 7 circular | Liquidation | Not specified |
| Pros | • Less time consuming<br>• Least business disruptions | • Least time consuming<br>• Lower compliances | • Widest scope<br>• Highest regulatory benefits | • Wide scope<br>• No time limit |
| Cons | • Less regulatory benefits | • Narrow scope | • Time consuming<br>• High business disruptions | • No moratorium over the resolution period |

# 4. Recent Developments

- In response to COVID-19 related stress, RBI & GOI have taken a plethora of measures like –
  - Suspension of fresh IBC proceedings for a year till 24 March 2021.
  - On 3 September 2020, the SC ordered all banks to not classify Covid-19 related defaults as NPAs until further notice
  - RBI has allowed interest and instalment repayment moratorium from 1 March 2020 to 31 August 2020
  - Emergency Credit Line Guarantee Scheme - ECLGS 1.0 & ECLGS 2.0 having total corpus of Rs 3tn
  - Targeted Long Term Repo Operations (TLTRO) scheme
  - Partial Guarantee Scheme expanded to cover NBFC, HFC & MFIs
- On account of these measures, although asset quality has improved in Q2 & Q3 of FY21, it is only expected to worsen once the effects of these COVID-19 reliefs get over.
- **Thus, alternative stress resolution options are the need of the hour.**
- In the current regime, CIRP under IBC is not only too heavy on over-burdened NCLTs and hence, time consuming, but also causes often irreversible reputational damage to business when the existing promoter loses control of the company.
- On the other hand, out of court settlements have been failing since negotiation among diverse set of stakeholders – FCs, OCs, management, shareholders, employees requires some regulatory intervention
- Thus, there is a need of a semi-formal option to resolve stress, and the post pandemic era is just about the right time for it. One such option is introduction of a pre-packaged insolvency resolution process. A sub-committee of Insolvency Law Committee (ILC) headed by Dr. M. S. Sahoo, was constituted to prepare a detailed scheme for implementing pre-pack and prearranged insolvency resolution process.

# 4. Recent Developments: Proposed ‘Bad Bank’

- Further, In the Union Budget 2021-2022, the Financial Minister has proposed to set up a **bad bank** under the ARC (asset reconstruction company), AMC (asset management company) and AIF (alternative investment funds) model to aggregate and dispose existing stressed assets in the banking system.
- This process will enable aggregation of bad loans from several banks to single entity which is a market making mechanism to deal with NPA issue and help banks to focus on credit.
- Modalities of resolution via ARC-AMC model:
  - Banks will transfer these assets to the ARCs at net book value. Net book value is the value of the asset minus provisioning already done. Banks will be paid 15 per cent cash and 85 per cent by way of securitised receipts
  - The asset then goes to the AMCs where dedicated professionals will resolve the asset. They will operate the asset for some time or find a suitable investor or an AIF
- However, clarifications on contours of the operating and regulatory framework for such an ARC/ AMC are still awaited.
- As per reports, ARC is expected to buy large stressed assets of at least Rs 1.40-1.50 lakh crore from banks and may require around Rs 10,500 crore of capital.

# Thank You

# Annexures

# 1. Prudential Framework for Resolution of Stressed Assets – RBI's June 7, 2019 Circular

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| Eligibility & Timelines | ▪ An event of default is the trigger for commencement of 'review period' as per the circular.<br>▪ Timelines to implement the Resolution Plan (RP) shall be 180 days from the end of a 30-day review period. |
| Inter creditor Agreement | ▪ Majority lenders (75% by value and 60% by number) to sign an Inter-Creditor Agreement (ICA) before the end of review period<br>▪ ICA to specify rights and duties of majority lenders, duties and protection of rights of dissenting lenders, treatment of lenders with priority in cash flows/differential security interest, etc. |
| Resolution Plan | The RP may involve any action / plan / reorganization including, but not limited to –<br>• regularization of the account by payment of all over dues by the borrower entity,<br>• sale of the exposures to other entities / investors,<br>• change in ownership, and<br>• Restructuring |
| Asset classification & provisioning | ▪ Where a viable RP in respect of a borrower is not implemented within the timelines given below, all lenders shall make additional provisions as under: |

| Timeline for implementation of viable RP | Additional provisions to be made as a % of total outstanding, if RP not implemented within the timeline |
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| 180 days from the end of Review Period | 20% |
| 365 days from the commencement of Review Period | 15% (i.e., total additional provisioning of 35%) |

# 1. Prudential Framework for Resolution of Stressed Assets – RBI's June 7, 2019 Circular…Contd

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| Independent Credit Evaluation (ICE) | ▪ In cases with RP involving restructuring for aggregate exposure of Rs. 100 Crore and above shall require ICE of residual debt by credit rating agencies specifically authorized by the RBI and only the RPs receiving rating of RP4 or better shall be considered for implementation. |
| Prudential Norms – Asset classification | ▪ 'Standard' assets shall initially be downgraded to 'sub-standard' category of NPAs – to begin with.<br>▪ The NPAs, upon restructuring, would continue to have the same asset classification as prior to restructuring. |
| Prudential Norms - Conditions for Upgrade | ▪ Only when all the outstanding loan / facilities in the account demonstrate 'satisfactory performance' during monitoring period.<br>▪ Monitoring period =<br>• FROM – from the date of implementation of RP<br>• To – date by which at least 10% of the sum of outstanding principal debt as per the RP and interest capitalization sanctioned as part of the restructuring, if any, is repaid<br>▪ 'Satisfactory performance' means that the borrower entity is not in default at any point of time during the period concerned.<br>▪ For the accounts with aggregate exposure > 100 Cr., rating of investment grade (BBB- or better) must be received from credit rating agencies in addition to satisfactory performance. |

# 2. Resolution Framework for COVID-19-related Stress – 6 August 2020 circular

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| Eligibility & Timelines | ▪ Corporate persons or otherwise having stress on account of COVID-19 only<br>▪ Account must be classified as standard, but not in default for more than 30 days with lenders as on March 1, 2020<br>▪ Accounts should continue to be classified as Standard till the date of invocation of resolution |
| Inter creditor Agreement and Implementation | ▪ Reference date shall be March 1, 2020.<br>▪ Resolution under this framework may be invoked not later than December 31, 2020 and must be implemented within 180 days from the date of invocation<br>▪ Lenders who do not sign the ICA within 30 days of invocation shall, immediately upon the expiry of 30 days, keep provisions of 20 per cent of the debt on their books as on this date |
| Lender's Role | ▪ To assess the viability of the resolution plan,<br>▪ To formulate a Board approved policy detailing the manner in which such evaluation may be done<br>▪ Approval to be provided by lenders amounting to not less than 75 % by value (FB+NFB), and not less than 60% by number. |
| Asset classification & provisioning | ▪ If a RP is implemented in adherence to the provisions of this facility, the asset classification of borrowers' accounts classified as Standard may be retained<br>▪ The lending institutions on implementation of RP shall keep provision higher of the provision as per IRAC norms or 10% of the total debt<br>▪ Half of the above provisions may be reversed upon payment of at least 20% of residual debt without slippage into NPA post implementation of RP. The other half may be reversed upon repayment of another 10% of the carrying debt, subject to maintaining IRAC provisions |

# 2. Resolution Framework for COVID-19-related Stress – 6 August 2020 circular…Contd

<table>
<tr><td>Resolution Plan (RP)</td><td colspan="6"><ul><li>May also include sanctioning of additional credit facilities to address the financial stress of the borrower on account of Covid19 even if there is no renegotiation of existing debt</li><li>May allow extension of the residual tenor of the loan, with or without payment moratorium, by a period not more than two years. The moratorium period, if granted, shall come into force immediately upon implementation of the resolution plan</li><li>May provide for conversion of a portion of debt into equity or other marketable, non convertible debt securities issued by the borrower. Valuation as per RBI norms</li></ul></td></tr>
<tr><td rowspan="4">Expert Committee (EC)</td><td colspan="6">Expert Committee has recommended following financial parameters for Textile Industry to be complied</td></tr>
<tr><td>Parameters</td><td>TOL/ATNW</td><td>Total Debt/EBIDTA</td><td>Current Ratio</td><td>Average DSCR</td><td>DSCR</td></tr>
<tr><td>Benchmark</td><td><=3.50</td><td><=5.50</td><td>>=1.00</td><td>>=1.20</td><td>>=1.00</td></tr>
<tr><td colspan="6">The key ratios shall have to be maintained as per the RP by March 31, 2022 and on an ongoing basis thereafter</td></tr>
<tr><td>Others</td><td colspan="6"><ul><li>RP in respect of accounts where the aggregate exposure of the lending institutions at the time of invocation is Rs.100 crore and above, shall require an independent credit evaluation (ICE) by any one credit rating agency (CRA) authorized by the RBI under the Prudential Framework</li><li>All disbursements made by lenders and payments made by borrowers to lenders shall be routed through escrow account maintained with one of the lenders</li><li>Any default by the borrower with any signatory to the ICA during the monitoring period shall trigger a Review Period of 30 days</li></ul></td></tr>
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