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RBI releases Report of the Working Group to review the existing prudential guidelines on restructuring of advances by banks/financial institutions

The Reserve Bank of India (RBI) today placed on its website the [Report of the Working Group \(WG\) to review the existing prudential guidelines on restructuring of advances by banks/financial institutions](#) (Chairperson: Shri B. Mahapatra). Comments on the Report may please be [emailed](#) or forwarded by August 21, 2012 to the Chief General Manager-in-Charge, Department of Banking Operations and Development, Reserve Bank of India, Central Office, Mumbai-400 001.

The WG approached the mandate given to it from the perspective that restructuring of advances serves a useful social purpose as it protects the productive assets of the economy. It also approached the issue from the perspective that internationally restructuring of an account is considered as an event of impairment irrespective of whether an account's asset classification status is downgraded or not. The WG has, however, suggested a gradual and calibrated approach.

The key recommendations of the WG are:

- The RBI may do away with the regulatory forbearance regarding asset classification, provisioning and capital adequacy on restructuring of loan and advances in line with the international prudential measures. However, in view of the current domestic macroeconomic situation as also global situation, this measure could be considered say, after a period of two years. (Para 6.9)
- In the interregnum, in order to prudently recognise the inherent risks in existing assets classified as standard on restructuring (stock), the provision requirement on such accounts should be increased from the present 2% to 5% in a phased manner over a two-year period, i.e. 3.5% in the first year and 5% in the second year. However, in cases of new restructuring of standard asset (flow), provision of 5% should be made with immediate effect.(Para 6.10)
- Notwithstanding the recommendation for progressively doing away with the asset classification benefit on restructuring, the WG felt that extant asset classification benefits in cases of change of date of commencement of commercial operation (DCCO) of infrastructure project loans may be allowed to continue for some more time in view of the uncertainties involved in obtaining clearances from various authorities and importance of the sector in national growth and development. (Para 6.11)

- Accounts classified as NPAs upon restructuring are presently eligible for upgradation to the 'standard' category after observation of 'satisfactory performance' during the 'specified period'. The specified period has been defined as a period of one year from the date when the first payment of interest or instalment of principal falls due under the terms of restructuring package. The WG has recommended that the 'specified period' should be redefined in cases of restructuring with multiple credit facilities as 'one year from the commencement of the first payment of interest or principal, whichever is later, on the credit facility with longest period of moratorium. (Para 6.19)
- Conversion of debt into preference shares should be done only as a last resort. Also, conversion of debt into equity/preference shares should be restricted to a cap (say 10% of the restructured debt). Further, conversion of debt into equity should be done only in the case of listed companies. (Para 6.52 & 6.53)
- A higher amount of promoters' sacrifice in cases of restructuring of large exposures under CDR mechanism needs to be considered. Further, the promoters' contribution should be prescribed at a minimum of 15% of the diminution in fair value of the restructured account or 2% of the restructured debt, whichever is higher. (Para 6.50)
- As stipulating personal guarantee will ensure promoters' "skin in the game" or commitment to the restructuring package, obtaining the personal guarantee of promoters be made a mandatory requirement in all cases of restructuring, i.e., even if the restructuring is necessitated on account of external factors pertaining to the economy and industry. Further, corporate guarantee should not be considered as a substitute for the promoters' personal guarantee. (Para 6.66 & 6.67)
- RBI may prescribe the broad benchmarks for the viability parameters based on those used by CDR Cell; and banks may suitably adopt them with appropriate adjustments, if any, for specific sectors. The WG also felt that the prescribed time span of seven years for non-infrastructure borrowal accounts and ten years for infrastructure accounts for becoming viable on restructuring was too long and banks should take it as an outer limit. The WG, therefore, recommended that, in times when there is no general downturn in the economy, the viability time span should not be more than five years in non-infrastructure cases and not more than eight years in infrastructure cases. (Para 6.24 & 6.25)
- In terms of present guidelines, banks are required to disclose annually all accounts restructured in their books on a cumulative basis even though many of them would have subsequently shown satisfactory performance over a sufficiently long period. The WG has, therefore, recommended that once the higher provisions and risk weights (if applicable) on restructured advances (classified as standard either *ab initio* or on upgradation from NPA category) revert back to the normal level on account of satisfactory performance during the prescribed period, such advances should no longer be required to be disclosed by banks as restructured accounts in the "Notes on Accounts" in their Annual Balance Sheets. (Para 6.28)

- The WG observed that there were cases which were found to be viable before restructuring but the assumptions leading to viability did not materialise in due course of time. There were also cases where the approved restructuring package could not be implemented satisfactorily due to external reasons or due to promoters' non-adherence to the terms and conditions. The WG recommended that in such cases, banks should be advised to assess the situation early and use the exit options with a view to minimise the losses. The WG also recommended that the terms and conditions of restructuring should inherently contain the principle of 'carrot and stick', i.e. while restructuring being an incentive for viable accounts, it should also have disincentives for non-adherence to the terms of restructuring and under-performance. (Para 6.59)
- Due to the current guidelines issued by CDR Cell that recompense be calculated on compounding basis and that 100% of recompense so calculated is payable, exit of companies from CDR system was not happening. Therefore, the WG recommended that CDR Standing Forum/Core Group may take a view as to whether their clause on 'recompense' may be made somewhat flexible in order to facilitate the exit of the borrowers from CDR Cell. However, it also recommended that in any case 75% of the amount of recompense calculated should be recovered from the borrowers and in cases of restructuring where a facility has been granted below base rate, 100% of the recompense amount should be recovered. The WG also recommended that the present recommendatory nature of 'recompense' clause should be made mandatory even in cases of non-CDR restructurings. (Para 6.63 & 6.64)

Background

It may be recalled that in the Second Quarter Review of Monetary Policy 2011-12 announced on October 25, 2011, it was proposed to constitute a WG to review the existing prudential guidelines on restructuring of advances by banks/financial institutions and suggest revisions taking into account the best international practices and accounting standards. Accordingly, a WG was constituted on January 31, 2012 under the Chairmanship of Shri B. Mahapatra, Executive Director, RBI. The WG had members representing RBI, select commercial banks, IBA, CDR Cell and a rating agency. The WG was required to submit its Report by July 31, 2012.

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