New guidelines: Getting a grip on restructured loans

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By restructuring distressed accounts instead of classifying them as non-performing assets (NPAs), banks skirt around the requirement to provide for NPAs by setting aside a specific portion of their capital to make up for losses that could arise from a potential default. However, the rules of the game changed significantly with the issuance by the Reserve Bank of India (RBI) of a circular dated 30 May, which introduced several changes to the prudential guidelines on restructuring of advances by banks and other financial institutions.

The revisions in the circular were based on recommendations by a working group headed by B Mahapatra, an executive director of the RBI, which had been tasked with reviewing the restructuring framework. The updated Master Circular on Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances, issued on 1 July, includes the recommendations of the working group that have been accepted by the RBI.

Classification as NPAs

Pursuant to the circular of 30 May, with certain exceptions, all loans that are restructured after 1 April 2015 are to be classified as substandard accounts or NPAs. One such exception is for loans to infrastructure and non-infrastructure projects, where a change in the date of commencement of commercial operations will not result in the loans being classified as restructured accounts if the revised commencement date is within two years of the original commencement date for infrastructure projects, and within one year of the original commencement date for non-infrastructure projects.

Additionally, loans to commercial real estate projects will not be classified as restructured accounts if the revised commencement date is within one year of the original commencement date and the only other changes to the loan are in relation to the repayment schedule and loan servicing requirements.

Similarly, loans to private-public partnership (PPP) accounts will not be reckoned as restructured loans if the commencement date is extended as a result of a shift in the "appointed date", as provided in the concession agreement. However, this is subject to the conditions that: (a) the project is an infrastructure project under the PPP model awarded by a public authority; (b) the loan disbursement is yet to begin; (c) the revised commencement date is documented through a supplementary agreement between the borrower and the lender; and (d) the project viability has been reassessed and sanction has been obtained from the appropriate authority.

Provisioning rates

From 1 June 2013, banks will have to provide for new standard restructured advances by setting aside 5% (instead of 2.75% earlier). However, for standard accounts that have already been restructured as of 31 March 2013, this increase may be brought about in a phased manner: to 3.5% (with effect from 31 March 2014 spread over the four quarters of 2013-14); to 4.25% (with effect from 31 March 2015 spread over the four quarters of 2014-15); and to 5% (with effect from 31 March 2016 spread over the four quarters of 2015-16).

Tough rules for promoters

The 30 May circular requires promoters to furnish personal guarantees in respect of restructured accounts. Such guarantees can be dispensed with only where promoters are bodies corporate rather than individuals, or where individual promoters cannot be clearly identified. This move is intended to ensure that the promoters have "skin in the game" and commit to the restructuring package.

The working group had also recommended that promoters contribute up to 15% of the diminution in fair value of the advance, or 2% of the total restructured debt, whichever is greater. The circular has instead prescribed a higher standard by stipulating a minimum promoters' contribution of the greater of 20% of the diminution in fair value of the advance or 2% of the total restructured debt, and also requires the promoters' contribution to be paid upfront.

The circular also states that the above is the minimum contribution required from promoters in cases of restructuring, and banks are at liberty to require a higher contribution depending on the risk associated with the project and the ability of the promoters to pay.

To prevent the misuse of the restructuring mechanism, a stringent regime on restructuring of loans is the need of the hour. Given that many companies in India are promoter driven, the increase in the promoters' contribution in the case of restructuring, while a steep prescription, is expected to have a cascading effect in arresting the debt spree of Indian companies.

While the revised restructuring guidelines may seem unreasonable at a time when the economy is ailing, it should be noted that these guidelines have been prescribed with the ultimate aim of strengthening the Indian banking sector and improving the debt situation in the country.

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