

# Restructuring, Refinancing & SDR

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# Flow of presentation

- ❑ NPA
- ❑ Early detection & Cure- JLF
- ❑ Options post NPA
- ❑ Restructuring
- ❑ Flexible structuring
- ❑ Refinancing
- ❑ Strategic Debt Restructuring (SDR)

# Why NPA

- Regulatory
- Legal
- Economic
- Political
- Financial
- Siphoning/Diversion of Fund
- Using short term fund for long term uses
- Using working capital for other purposes
- Aggressive projections
- Cost & Time Overrun
- Mis-management

# NPA Definition

- Term Loan - interest and/ or installment of principal remain overdue more than 90 days
- Overdraft/Cash Credit (OD/CC)- account remains 'out of order'\*
- Bills purchased and discounted - bill remains overdue for a period of more than 90 days
- Short duration crops- the installment/interest remains overdue remains overdue for two crop seasons
- Long duration crops- for one crop season
- Derivative transactions- positive mark-to-market value of a derivative contract, remain unpaid for a period of 90 days from the specified due date for payment.

\* Out of order - outstanding balance is less than the sanctioned limit/drawing power, but no credits continuously for 90 days or outstanding balance remains **continuously** in excess of the sanctioned limit/drawing power for 90 days

# Effect of NPA on Banks

- Negative impact on Return of Assets
- Reduction on Interest income
- Erosion of profits
- Effect on CAPITAL ADEQUACY RATIO
- Cost of capital goes up
- Economic value addition decreases

# Categories of NPA

Based on the period of non performing

- **Substandard Assets**- remained NPA for less than or equal to 12 months. Prov.- 15%
- **Doubtful Assets** - remained in the substandard category for a period of 12 months. Prov. – 25%, 40% & 100% depending on period.
- **Loss Assets** –identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. Prov. – 100% .

**Provisioning on standard assets** - Farm Credit to agricultural activities and Small and Micro Enterprises (SMEs) sectors 0.25% , CRE – 1%, CRE – RH- 0.75% , all other loans 0.40%.

# NPA classification applies across spectrum not facility wise

- Borrower has several facilities from a bank
- Borrower has issued certain securities too to the bank
- One facility or one investment in any security issued by borrower comes in problem

“All the facilities granted to the borrower and investment in all the securities issued by the borrower will have to be treated as NPA/NPI and not the particular facility/investment or part thereof which has become irregular”

# Early Detection & Cure - JLF

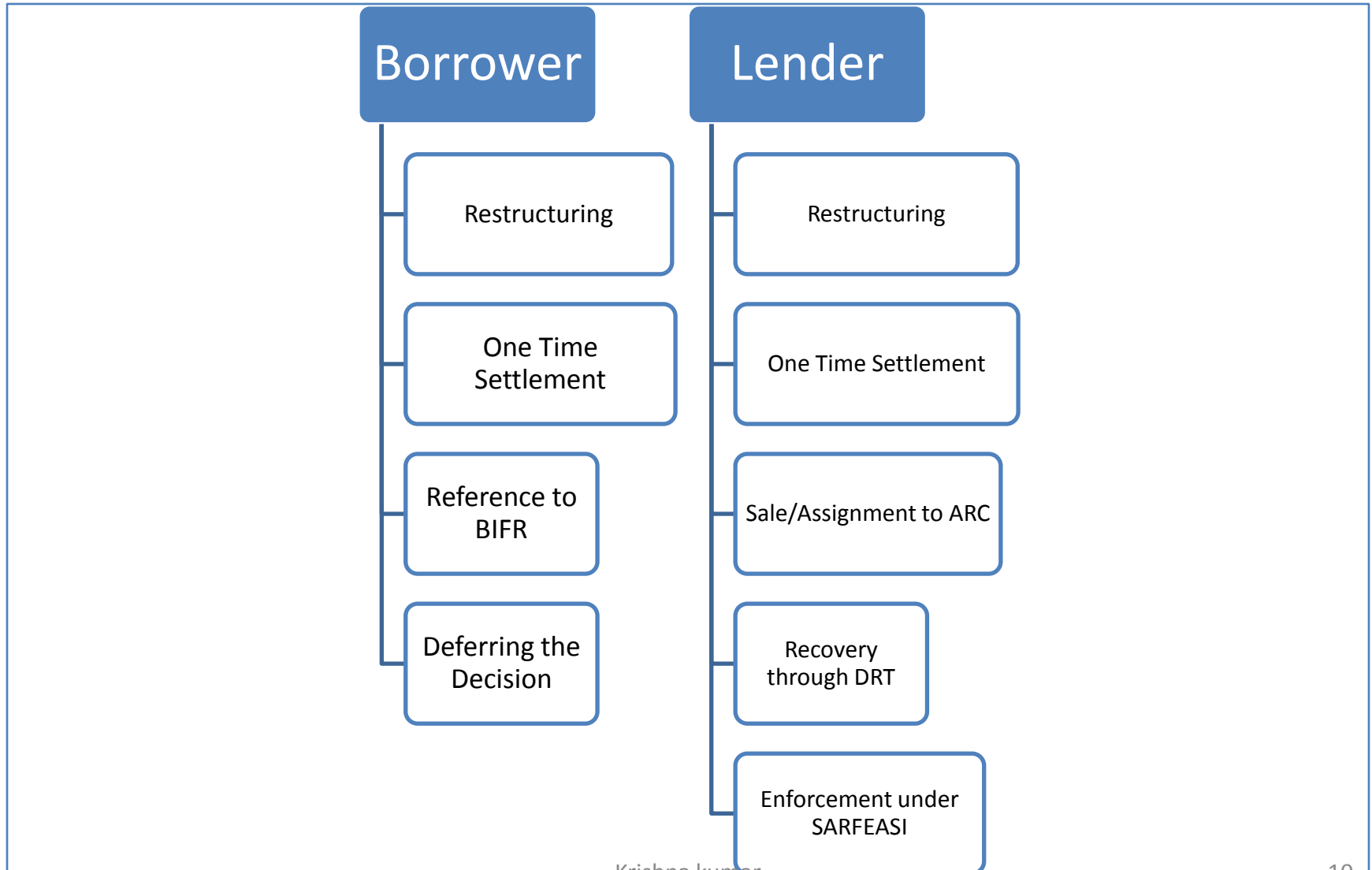
- Centralised reporting for large credit. RBI has set up Central Repository of Information on Large Credits (CRILC) for SMA reporting.
- Early formation of a lenders' committee to a plan for resolution.
- Incentives for lenders to agree collectively and quickly if a resolution plan is under way otherwise accelerated provisioning if no agreement can be reached.
- Formation of JLF – On report of account is by any lenders to CRILC as SMA-2 banks should mandatorily form a committee to be called Joint Lenders' Forum (JLF) if the aggregate exposure is Rs 100 cr and above. In case of less than 100 crore JLF formation is optional. JLF formation is optional in case aggregate exposure is less than Rs.100 crore of account is reported as SMA-0 or SMA-1.



# Early Detection & Cure – JLF (Contd.)

- Before account turns NPA, banks are required to identify incipient stress by creating 3 categories
- SMA-0 - Principal/interest payment not overdue for more than 30 days but account showing signs of incipient stress
- SMA – 1 – Principal/interest overdue between 31-60 days
- SMA- 2 – Principal/interest overdue between 61-90 days
- Reporting Compulsory for CC & OD A/C to CRILC as SMA 2 if outstanding balance remains continuously in excess of the sanctioned limit/drawing power for 60 days or in cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 60 days or credits are not enough to cover the interest debited during the same period. - Reporting every Friday by banks
- Consortium will serve as JLF with the Consortium Leader as convener, and in case of MBA arrangement lender with the highest exposure will convene JLF.

# Options available post NPA



# Restructuring – available means

Restructuring – “Novation” u/s 62 of the Indian Contract Act – New terms.

## Bilateral/JLF

- Borrower & Lender agree to certain terms
- New terms substitute old terms

## CDR

- A forum of lenders under aegis of RBI
- Highly effective
- Suitable where multiple lenders are involved

## BIFR

- Under provisions of SICA
- Order has binding powers

## National Company Law Tribunal

- U/s 230 of CA 2013-compromise and arrangement

Lenders must agree to the terms (each option)

# Restructuring – definition

- Restructured account is one where the bank, for economic or *legal reasons* relating to the borrower's financial difficulty, grants concessions that otherwise would not be considered. It involves modification of terms which would include , alteration of repayment period / repayable amount/ installments / rate of interest (*other than competitive reasons*).
- ***Roll-over of STL not treated as restructuring*** - Proper pre-sanction assessment , roll-over allowed based on the actual requirement of the borrower, no concession due to credit weakness, maximum roll over 2 times. Exception - properly assessed regular Working Capital Loans like revolving Cash Credit or Working Capital Demand Loans.
- Extension of Tenor of a floating rate loan on interest reset to keep the EMI unchanged (**provided applied to a class of accounts uniformly**) will not render the account to be classified as 'Restructured account'.

# General Principles for Restructured Advances

- Restructuring of accounts of any category viz. 'standard', 'sub-standard' or 'doubtful'.
- Restructuring can't be done from retrospective effect.
- Usual asset classification norms would continue to apply while restructuring under process.
- Asset classification status as on the date of approval of the restructured package would be relevant to decide the asset classification status of the account .

# Restructuring - prerequisite

- Formal consent / application by the borrower. Bank can also initiate restructuring process in deserving cases subject to customer agreeing to the terms and conditions.
- Financial viability – **Role of CA**
- Reasonable certainty of repayment as per package .
- Restructuring without looking cash flows & assessing viability would be treated as ever greening attempt & would invite supervisory concerns / action. Recovery action to be initiated.
- Alteration / changes in the original loan agreement with the formal consent / application of borrower.
- Restructuring of willful defaulter- Non CDR cases with Board's approval & with the approval of the Core Group in CDR cases
- BIFR cases- Specific approval from CDR Core Group , lead bank in the case of SME Debt Restructuring Mechanism , Individual banks . However all the formalities for approval from BIFR to complete before package implementation.

# Financial Viability Parameters

- **Return on capital employed**- At least equivalent to 5 year GSEC yield+ 2% .
- **DSCR** – 5 years- 1.25 >, 10 years - 1.33 > , year to year basis the ratio should be 1 >.
- **IRR > Cost of Capital** at least by 1 per cent.
- **Operating & Cash BEP** - comparable with the industry norms.
- **Future projections** - To be comparable with the industry.
- **Loan life ratio (LLR)** - should be 1.4

PV of ACF during loan life period (incl. int. & prin.)

LLR= -----

Maximum amount of loan

- \* Above viability parameters are for CDR cases and banks may suitably adopt them with appropriate adjustments, if any, for specific sectors while restructuring of accounts in non-CDR cases.

# Stages of Restructuring

- before commencement of commercial production
- after commencement of commercial production / but before asset classified as 'sub-standard';
- after commencement of commercial production and the asset has been classified as 'sub-standard' or 'doubtful'.
- Standard assets to be re- classified as 'sub-standard assets' immediately upon restructuring. **As per earlier RBI provisions it was treated as restructured standard asset and no NPA provisioning was required.**
- NPA assets, upon restructuring, would continue to have the same asset classification as prior to restructuring.



# Restructuring before implementation of project

- **Projects under implementation (DCCO)** - clearly documented.
- **Deferment of DCCO & consequential shift in repayment schedule .**
- **Revision of DCCO beyond above time limits** - standard if the fresh DCCO within another 2 years (total 4 years) in case of infrastructure project involving court cases and up to another 1 year (total 3 years) in case of infrastructure project in case the reason for extension of DCCO is beyond promoters control provided the account continues to be serviced as per the restructuring terms.
- **Change of ownership-** Additional 2 years or 1 year in case of Infra or Non Infra project.

# Projects under Implementation – Change in Ownership

- If ownership change takes place any time during (1 or 2 years in case of Non Infra or Infra project) from original DCCO, banks may permit extension of the DCCO up to two years additionally. Banks may also consequentially shift/extend repayment schedule, if required, by an equal or shorter duration.
- Additional period of 1/1/2 years with restructuring.

# Upgradation of Account post Restructuring

- Standard accounts classified as NPA and NPA accounts retained in the same category on restructuring by the bank should be upgraded only when **all** the outstanding loan/facilities in the account perform satisfactorily during the 'specified period', i.e. principal and interest on all facilities in the account are serviced as per terms of payment during that period.
- Specified Period - a period of one year from the commencement of the first payment of interest or principal, **whichever is later**, on the credit facility with **longest moratorium**.

# Flexible Structuring of Long Term Project Loans to Infrastructure and Core Industries

- Object – To avoid banks asset liability matching & project cash flow mismatch
- Longer tenor upto 25 years with periodic refinancing
- Core Industries - coal, crude oil, natural gas, petroleum refinery products, fertilizers, steel , cement & electricity.
- 15% tail period should be left (amortization within 85% of the project life)
- Loan Must be standard as on change of Amortisation Schedule
- No change in Net present value
- Applicable to loan sanctioned after July 15, 2014

## Flexible Structuring ( Loan sanctioned before July 15, 2014)

- Qualification – Only term loans to projects aggregate exposure > Rs.500 crore in infrastructure sector & core industries
- once during the life time of project after DCCO
- standard loan as on date of change of loan amortization schedule
- No change in NPV
- Fresh amortization Schedule within 85% of life
- Viability to be reassessed by the bank & vetted by the Independent Evaluation Committee(**IEC**).
- If restructured standard fixing fresh loan amortisation schedule not treated as repeated restructuring & can be upgraded as per normal rules.
- Further refinancing should stop if loan becomes NPA at any stage & provisioning applicable.

# Refinancing of Project Loans

- Standard & should have not been restructured in the past.
- Repayment period based on project life cycle & cash flow.
- Minimum exposure 1000 crore
- After achieving DCCO
- Viability to be established
- Total repayment period should not exceed 85% of the initial economic life of the project.
- In case of partial take-out minimum 25% of the outstanding loan by value) should be taken over by a new set of lenders
- DE Ratio & DSCR to be acceptable to banks (promoter to bring addl. Equity if needed)
- only once during the life of the existing project

# Strategic Debt Restructuring (SDR)

*JLF/CDR Cell may consider the following options when a loan is restructured:*

- *Transfer equity by promoters to the lenders to compensate for their sacrifices*
- *Promoters infusing more equity in company*
- *Transfer promoters' holdings to security trustee till turnaround of company which will enable change in management control.*
- With a view to ensuring more stake of promoters in reviving stressed accounts & with a view to have option by bank to initiate change of ownership, banks may, at their discretion, undertake a **'Strategic Debt Restructuring (SDR)'** by **converting loan dues to equity shares.**

# Steps of SDR

- Formation of joint Lenders' Forum (“**JLF**”)
- If viability milestones or critical conditions under Loan Agreement not achieved by borrower, review of account by JLF and examination of viability by exercising the right of Debt Conversion and change in ownership.
- Accounts must restructured before SDR Circular date & enabling clauses for Debt Conversion exists in documents



# SDR Features

- Conversion option to be incorporated in initial restructuring package if borrower not able to achieve viability milestones or adhere to 'critical conditions' as stipulated in the restructuring package to be supported by necessary resolutions/ approvals from the borrower company.
- Restructuring without SDR provisions not permitted after 8 June, 2015. Loan documents to be amended to include SDR provisions.
- Banks should consider using SDR *only in cases where change in ownership is likely to improve the economic value of the loan asset and the prospects of recovery of their dues. SDR Trigger must be non-achievement of viability milestones and /or non-adherence to 'critical conditions' linked to the option of invoking SDR, as stipulated in restructuring agreement, and SDR cannot be triggered for any other reason.*
- JLF must immediately on review the account and examine whether the account will be viable by effecting a change in ownership.
- If found viable, JLF may decide to invoke the SDR so as to acquire majority stake in the company;
- Decision on invoking the SDR should be taken by the JLF as early as possible but within 30 days from the review of the account. Approval by 75% lenders by value and 60% by number is necessary.

# SDR Features (contd.)

- Post the conversion, all lenders under the JLF must collectively hold 51% or more of the equity shares issued by the company
- Timeline – 210 days from Review by JLF
- The ‘new promoter’ should not be from the existing promoter group.
- Maintenance of panel of management firms/individuals having expertise in running firms/companies by banks till ownership is transferred to the new promoters.
- Current management can’t continue to run the company without banks representatives.
- Minimum Divestment - 26% to new promoters within 18 months.

# SDR Features(contd.)

- Lenders have option to exit their remaining holdings gradually, with upside as the company turns around. Right of First Refusal for balance shareholding to new promoters.
- Stand-still benefit will apply from the reference date provided conversion of debt into equity to complete within 210 days from the review of account, otherwise the benefit will cease to exist and Account will turn to NPA.
- Provision of dimension in value of equity shares.
- *On divestment of banks' holding in favour of a 'new promoter', the asset classification of the account may be upgraded to 'Standard'.*
- 15% provision in the residual loan required to be made in equal installments over the four quarters.

# SDR Timeline

- within 30 (thirty) days from the review of the account
- Formulation of SDR package by JLF Pursuant to the decision on invocation of SDR
- Approval of SDR package within 90 days from the date of Debt Conversion decision
- Necessary Board and shareholder resolution by Borrower for issue of shares
- Amendment to MOA & AOA for increase in authorized capital.
- Issue of conversion notice by individual lender.
- Signing of Shareholding Agreement
- Borrower to issue shares to Lenders and update Register of Members Register to reflect the allotment of equity shares to the Lenders.

According to RBI estimates, the top 30 loan defaulters currently account for one-third of the total gross NPAs of PSBs



<http://indianexpress.com/article/business/business-others/the-npa-roll-call-too-big-to-name/>

# Thank You

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