RBI modifies guidelines on schemes related to stressed assets

23 November 2016

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Transition

Immediately

Within the next 3 months

Post 3 months but within 6 months

Post 6 months

Background

The Reserve Bank of India (RBI), issued various notifications in the past, aimed at strengthening the ability of lenders in India to deal with stressed assets. Some of these include notifications which provide guidelines for a scheme of:

- Strategic Debt Restructuring (SDR) (DBR.BP.BC.No.101/21.04.132/2014-15 dated 8 June 2015), and
- Sustainable Structuring of Stressed Assets (DBR.No.BP.BC.103/21.04.132/ 2015-16 dated 13 June 2016).

These schemes provided an avenue to rework the financial structure of entities facing genuine difficulties and to require coordinated deep financial restructuring.

New development

On 10 November 2016, RBI through its notifications DBR.No.BP.BC.33/21.04.132/2016-17 and DBR.No.BP.BC.34/21.04.132/2016-17, made certain revisions to the guidelines referred above.

These changes are aimed at achieving the following:

i. Harmonisation of 'stand-still' clause as applicable in case of SDR scheme with other guidelines

ii. Provides clarification on the deemed Date of Commencement of Commercial Operations (DCCO), and

iii. Partial modification of certain guidelines based on the experience gained in using these tools in resolving the stressed assets as well as feedback received from stakeholders, and taking into consideration the requirements of the construction sector.

This issue of First Notes provides a synopsis of the significant modifications made by RBI to the following topics relating to stressed assets:

1. Scheme for Sustainable Structuring of Stressed Assets
2. SDR Scheme
3. Prudential norms on change in ownership of borrowing entities (outside SDR scheme)
4. Norms on income recognition, asset classification and provisioning pertaining to advances – projects under implementation
5. Flexible structuring of existing long term project loans to infrastructure and core industries.

Summary of the modifications made to schemes related to stressed assets

1. Revisions to Sustainable Structuring of Stressed Assets (the scheme) – New guidance in relation to situations where there is 'no change of promoters'

The RBI recently notified the following revisions to paragraphs 9(B) (i) to (iv) of the asset classification norms for loans under the scheme in cases where there is no change of promoters.

Additional period

The asset classification as on the date of lenders' decision to resolve the account under the scheme (the reference date) to continue for a period of 180 days as compared to 90 days under the original guidelines. Additional period for this 'stand-still clause' is intended to provide banks some flexibility on time lines for formulation and implementation of the resolution plan.

If the resolution plan is not implemented within 180 days, the asset classification would be as per the extant asset classification norms assuming there was no 'stand-still'. Further, this notification clarifies that the 'stand-still' clause only applies to asset classification and no income should be accrued by banks if the interest is not serviced within 90 days from due date.

Standard accounts

For accounts classified as 'standard' on the reference date, the scheme guidelines permit the entire outstanding (both Part A – serviceable debt and Part B – the remaining debt) to be treated as 'standard' subject to upfront provisions being made at the higher of 40 per cent of the amount held in Part B or 20 per cent of the aggregate outstanding.

The notification also permits the provisions to be reversed one year after the date of implementing the resolution plan or one year after completion of the longest pre-existing moratorium, whichever is later, subject to satisfactory performance of Part A and B during this period.

Non-Performing Asset (NPA) accounts

For accounts classified as an NPA as on the reference date, Part B instruments shall continue to be classified as a non-performing investment and provided for as an NPA as per extant prudential norms, as long as such instruments remain in Part B.

The notification also permits that the sustainable portion (Part A) may be optionally treated as 'standard' upon implementation of the resolution plan by all banks, subject to provisions made upfront by the lenders being the higher of 50 per cent of the amount held in part B or 25 per cent of the aggregate outstanding amount.

Part B may be upgraded to 'standard' category and enhanced provisions may be reversed after one year of satisfactory performance of Part A loans or after one year of completion of the longest pre-existing moratorium, whichever is later, subject to satisfactory performance of Part A during this period. However, the required MTM provisions on Part B instruments must be maintained at all times. The transition benefit available can be availed.

Additionally, banks are required to make disclosures in their annual financial statements on application of the scheme, as per the specified format.

2. Revisions to the SDR schemes

New guidance

In order to avail asset classification benefits under the SDR scheme (on divestment of banks' holding in favour of a new promoter), the recent RBI notification requires new promoter to acquire at least 26 per cent of the paid up equity capital of the borrower company and should be the single largest shareholder of the borrower company. Previously, the new promoter was required to acquire at least 51 per cent of the paid up equity capital.

In addition, the notification now requires the new promoter to be in 'control' of the borrower company as per the definition of 'control' provided in the Companies Act, 2013/regulations issued by the Securities and Exchange Board of India/any other applicable regulations/accounting standards as the case may be.

The 'stand-still' clause would be applied to asset classification only and banks should not recognise income on an accrual basis if the interest is not serviced within 90 days from the due date. Further, banks are required to make disclosures on invocation of SDR in annual financial statements as per the prescribed format.

3. Revisions to the prudential norms on change in ownership of borrowing entities (outside SDR scheme)

The notification modifies the guidelines pertaining to restructuring under the 'outside SDR scheme' and introduces a 'stand-still' clause on asset classification and provisioning requirements on the lines of the SDR scheme. The significant changes to the guidelines are as follows:

- The decision on invoking the change in ownership by any of the prescribed methods should be well documented and approved by majority of Joint Lenders' Forum (JLF) members (minimum of 75 per cent of creditors by value and 50 per cent of creditors by number). The date on which banks resolve to effect a change in ownership will be called as 'reference date'.
- Where banks decide to change ownership through conversion of debt into equity/invocation of pledge of shares, the existing asset classification of the account as on

the reference date would continue for a period of 18 months from the reference date to enable banks to complete the process of change in ownership. Banks should approve the debt to equity conversion package within 90 days from the 'reference date' and the conversion of debt into equity should be completed within a period of 90 days from the date of such approval by the consortium/JLF.

- In case of invocation of pledge of equity shares, the same should be completed within 180 days from the reference date.
- If the targeted conversion of debt into equity shares/transfer of pledged equity shares does not take place within 180 days from the reference date, the 'stand-still' benefit would cease to exist and loans would then be classified as per the extant income recognition, asset classification and provisioning norms, as if no 'stand still' on asset classification was provided.
- In case of change of ownership effected by issue of new shares by the borrower company or sale of shares by the existing promoter of the company to an acquirer, the asset classification as on the date of binding agreement between the borrower company/existing promoter and the new promoter should continue for a period of 12 months to enable issue of new shares/transfer of shares from existing promoter to new promoter.
- If the ownership has not been transferred in favour of new promoters on expiry of stand-still (18 or 12 months, as the case may be), the asset classification would be as per the extant asset classification norms, assuming that the 'stand-still' in asset classification had not been given.
- It has been clarified that 'stand-still' clause would apply only to asset classification and banks should not recognise income on accrual basis if the interest is not serviced within 90 days from the due date.
- All other instructions as applicable to SDR would also apply to cases where banks decide to change ownership of borrowing entities (outside SDR scheme).
- Banks should circumspect and consider change in ownership (including under SDR) only in cases where change in ownership is likely to improve the economic value of the asset and the prospects of recovery of their dues.
- Additionally, banks are required to make disclosures on accounts where change in ownership is being effected outside SDR scheme in the prescribed format.

4. Revision of norms pertaining to amounts due to projects under implementations

Current guidance

As per the guidelines issued earlier by the RBI, for all projects financed by the financial institutions/banks , the 'date of completion' and the DCCO of the project should be clearly defined at the time of financial closure of the project and the same should be formally documented.

These guidelines also permit deferment of DCCO and consequential shift in repayment schedule for an equal or shorter duration (including the start date and end date of revised repayment schedule) without downgrading the asset classification subject to certain conditions.

New guidance

The recent notification refers to 'Guidance Note on Treatment of Expenditure during Construction Period' and Accounting Standard (AS) 16, *Borrowing Costs* and provides that a project with multiple independent units may be deemed to have commenced commercial operations from the date when the independent units representing 50 per cent (or higher) of the originally envisaged capacity have commenced commercial operations subject to the following conditions:

a) The units representing the remaining 50 per cent (or lower) of the originally envisaged capacity should commence commercial operations within a maximum period of one year from the deemed DCCO

b) Commercial viability of the project is reassessed beyond doubt, and

c) Capitalisation of interest obligation in respect of project debt component attributable to the units of the plant which have commenced commercial operations have ceased and the revenue expenditure has been booked under revenue account.

In the above cases, banks may, at their discretion, also effect a consequential shift in the repayment schedule of the debt attributable to units which have not commenced commercial operations for equal or shorter duration (including the start date and end date of revised repayment schedule) i.e., one year, subject to adhering to other applicable guidelines.

If the remaining units do not commence commercial operations within the stipulated time, classification norms applicable to projects under implementation would apply and accordingly would be treated as an NPA upon expiry of the one year period.

Additionally, guidelines relating to project loans which are applicable after DCCO of a project, including flexible structuring of project loans would not be applicable to project loans attributable to units which have not commenced commercial operations.

5. Revision of guidelines on flexible structuring of long-term project loans to infrastructure and core industries

Current guidance

The RBI through its circular DBOD.No.BP.BC.24/ 21.04.132/2014-15 dated 15 July 2014 prescribed guidelines for flexible structuring of long-term project loans to infrastructure and core industries subject to prescribed conditions. Further, banks were allowed to flexibly structure such existing loans through RBI's circular DBR.No.BP.BC.53/ 21.04.132/2014-15 dated 15 December 2014.

New guidance

The recent RBI notification now permits banks to apply flexible structuring to the following types of loans subject to the terms and conditions stipulated in the respective guidelines:

a) New project loans in all sectors, and

b) Existing project loans, in which the aggregate exposure of all institutional lenders exceeds INR250 crore, in all sectors.

Banks should also establish a detailed policy on flexible structuring of loans to various sectors containing the norms on determining useful economic life, the tenor of loans based on economic life of the assets, management of refinance and asset liability management risk, etc.

Banks could apply flexible structuring of funded exposures to construction companies, identifiable against the specific projects being executed by such companies, which may include funded exposure due to invocation/ devolvement of guarantees by project developers. The revised amortisation schedule of such funded exposure shall be restricted up to DCCO of the underlying projects.

Where flexible structuring is applied to such existing exposures, the aggregate exposure of all institutional lenders should exceed INR250 crore.

Additionally, banks should make annual disclosures as per the specified format in their financial statements on application of flexible structuring to existing loans.

Our comments

- These revisions are based on stakeholder feedback and past experience gained in resolving stressed assets. Accordingly, these are expected to assist lenders in implementing the restructuring schemes while providing some flexibility and additional relief in terms of asset classification and provisioning when restructuring is in process.
- A significant change is with respect to revision in the amount of the paid-up equity capital (from 51 per cent to 26 per cent now) to be held by a new promoter under the SDR scheme. While this is a significant relief provided under the revised guidelines, there may be some challenges in determining whether the new promoter has 'control' over the borrower company. The notification links the existence of 'control' with the guidance in the Companies Act, 2013 as well as applicable accounting standards, which may require detailed analysis. While the minimum shareholding has been revised to 26 per cent, there may be instances where this does not result in the new promoter obtaining 'control' over the borrower company. Lenders should therefore consider the shareholding terms at the time of formulating a resolution plan under the scheme.

The bottom line

Revision in the guidelines reflect that RBI continues to consider the practical challenges faced by the banks while restructuring their stressed assets and has tried to ease out implementation of the related schemes.

KPMG in India

Ahmedabad
Commerce House V, 9th Floor
902 & 903, Near Vodafone House
Corporate Road, Prahaladnagar
Ahmedabad 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bengaluru 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Gurgaon
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604, 6th Floor,
Tower - 1, Godrej Waterside,
Sector – V,
Salt Lake, Kolkata - 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3058 5764/65
Fax: +91 20 3058 5775

Vadodara
iPlex India Private Limited,
1st floor office space, No. 1004,
Vadodara Hyper, Dr. V S Marg
Bund Garden
Vadodara 390 007
Tel: +91 0265 235 1085/232 2607/
232 2672

KPMG in India's IFRS institute

KPMG in India is pleased to re-launch its IFRS institute - a web-based platform, which seeks to act as a wide-ranging site for information and updates on IFRS implementation in India.

The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework..

IFRS Notes

ICAI issues FAQs on elaboration of terms used in Ind AS 109 and presentation of dividend distribution tax

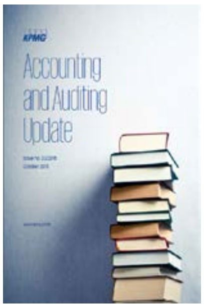
10 November 2016

Considering the practical difficulties being faced by companies while implementing Ind AS, the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI), on 3 November 2016 issued certain clarifications in the form of Frequently Asked Questions (FAQs) on the following topics:

1. Elaboration of terms 'infrequent number of sales' or insignificant in value' used in Ind AS 109
2. Presentation of dividend and Dividend Distribution Tax (DDT) under Ind AS.

Our issue of IFRS Notes provide an overview of these FAQs.

Missed an issue of Accounting and Auditing Update or First Notes?



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This month the Accounting and Auditing Update highlights new and emerging concepts in the field of accounting and auditing. In continuation with our Data and Analytics (D&A) series, this edition carries an article on D&A in audit. Ind AS 109, *Financial Instruments* brings various new concepts and financial instruments accounting can be complex under new framework. Companies in India have investments in mutual funds and application of Ind AS 109 on classification requirements of mutual fund investments is likely to have an impact on their accounting treatment in the financial statements. Additionally, effective interest rate method is a new concept under Ind AS 109. In this edition we have discussed these issues with the help of illustrative examples and detailed flowcharts. We have analysed annual reports of companies that are part of the Nifty 50 index with regard to Internal Financial Controls (IFC) reporting on both directors' responsibility statement and auditor's report. We also highlight new developments in financial reporting and its likely impact on future focus of IFC. With respect to revenue, which is an important performance metric for companies and Ind AS 18, *Revenue* introduces new concepts. Our article focusses on the impact areas due to implementation of Ind AS 18 on food, drink and consumer goods sector. We also cast our lens on recent development in the Emerging forms of External Reporting (EER).

Our publication also carries a regular synopsis of regulatory updates.

RBI issues NBFCs Auditor's Report Directions, 2016

12 October 2016

On 29 September 2016, RBI issued NBFCs Auditor's Report Directions, 2016 (Auditor's Report Directions, 2016) to every auditor of an NBFC for submission of an additional report to the Board of Directors (Board). These directions replace the previous circular and shall come into force with immediate effect.

This issue of First Notes provides a summary of the Auditor's report directions, 2016.

KPMG in India is pleased to present Voices on Reporting – a monthly series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

Special session on revised Income Computation and Disclosure Standards (ICDS)

During our recent call, on 7 October 2016, we provided an overview of the key changes to the ICDS and their likely impact on companies in India.

Feedback/queries can be sent to aaupdate@kpmg.com

Previous editions are available to download from: www.kpmg.com/in