ANNEX - VI

Prudential Guidelines on Restructuring of Advances by UCBs

1. General principles

The basic objective of restructuring is to preserve economic value of units, not evergreening of problem accounts. This can be achieved by banks and the borrowers only by careful assessment of the viability, quick detection of weaknesses in accounts and a time-bound implementation of restructuring packages. The following prudential guidelines will be applicable to all categories of debt restructuring other than those restructured on account of natural calamities, which will continue to be governed by the extant guidelines. The principles and prudential norms laid down are applicable to all advances including borrowers who are eligible for special regulatory treatment for asset classification as detailed in para 7. Key concepts used in these guidelines are defined in Annex-1.

2. Eligibility criteria for restructuring of advances

2.1 Banks may restructure the accounts classified under 'standard', 'sub-standard' and 'doubtful' categories.

2.2 Banks can not reschedule / restructure / renegotiate borrowal accounts with retrospective effect. While a restructuring proposal is under consideration, the usual asset classification norms would continue to apply. The process of re-classification of an asset should not stop merely because restructuring proposal is under consideration. The asset classification status as on the date of approval of the restructured package by the competent authority would be relevant to decide the asset classification status of the account after restructuring / rescheduling / renegotiation. In case there is undue delay in sanctioning a restructuring package and in the meantime the asset classification status of the account undergoes deterioration, it would be a matter of supervisory concern.

2.3 Normally, restructuring can not take place unless alteration / changes in the original loan agreement are made with the formal consent / application of the debtor. However, the process of restructuring can be initiated by the bank in deserving cases subject to customer agreeing to the terms and conditions.

2.4 No account will be taken up for restructuring by the banks unless the financial viability is established and there is a reasonable certainty of repayment from the borrower, as per the terms of restructuring package. The viability should be determined by the banks based on the acceptable viability benchmarks determined by them, which may be applied on a case-by-case basis, depending on merits of each case. Illustratively, the parameters may include the Return on Capital Employed, Debt Service Coverage Ratio, Gap between the Internal Rate of Return and Cost of Funds and the amount of provision required in lieu of the diminution in the fair value of the restructured advance. The accounts not considered viable should not be restructured and banks should accelerate the recovery measures in respect of such accounts. Any restructuring done without looking into cash flows of the borrower and assessing the viability of the projects / activity financed by banks would be treated as an attempt at ever greening a weak credit facility and would invite supervisory concerns / action.

2.5 The borrowers indulging in frauds and malfeasance will continue to remain ineligible for restructuring.

2.6 BIFR cases are not eligible for restructuring without their express approval. In the case of SME Debt Restructuring Mechanism and other cases, banks may consider the proposals for restructuring, after ensuring that all the formalities in seeking the approval from BIFR are completed before implementing the package.

3 Asset classification norms

3.1 Restructuring of advances could take place in the following stages :

(a) before commencement of commercial production / operation;

(b) after commencement of commercial production / operation but before the asset has been classified as 'sub-standard';

(c) after commencement of commercial production / operation and the asset has been classified as 'sub-standard' or 'doubtful'.

3.2 The accounts classified as 'standard assets' should be immediately re-classified as 'sub-standard assets' upon restructuring.

3.3 The non performing assets, upon restructuring, would slip into further lower asset classification category as per extant asset classification norms with reference to the pre-restructuring repayment schedule.

3.4 All restructured accounts which have been classified as non-performing assets upon restructuring, would be eligible for up-gradation to the 'standard' category after observation of 'satisfactory performance' during the 'specified period' (Annex-1).

3.5 In case, however, satisfactory performance after the specified period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the ***pre-restructuring payment schedule.***

3.6 Any additional finance may be treated as 'standard asset', up to a period of one year after the first interest / principal payment, whichever is earlier, falls due under the approved restructuring package. However, in the case of accounts where the prerestructuring facilities were classified as 'sub-standard' and 'doubtful', interest income on the additional finance should be recognised only on cash basis. If the restructured asset does not qualify for upgradation at the end of the above specified one year period, the additional finance shall be placed in the same asset classification category as the restructured debt.

3.7 In respect of loan accounts which enjoy special regulatory treatment as per para 7, upon restructuring, such non-performing assets would continue to have the same asset classification as prior to restructuring. In case satisfactory performance of the account is not evidenced during the ‘specified period’, it would slip into further lower asset classification categories as per extant asset classification norms with reference to the ***pre-restructuring repayment schedule***.

3.8 In case a restructured asset, which is a standard asset on restructuring, is subjected to restructuring on a subsequent occasion, it should be classified as substandard. If the restructured asset is a sub-standard or a doubtful asset and is subjected to restructuring, on a subsequent occasion, its asset classification will be reckoned from the date when it became NPA on the first occasion. However, such advances restructured on second or more occasion may be allowed to be upgraded to standard category after one year from the date of first payment of interest or repayment of principal whichever falls due earlier in terms of the current restructuring package subject to satisfactory performance.

4. Income recognition norms

Subject to provisions of paragraphs 3.6 and 6.2, interest income in respect of restructured accounts classified as 'standard assets' will be recognized on accrual basis and that in respect of the account classified as 'non performing assets' will be recognized on cash basis.

5. Provisioning norms

5.1 <u>Normal provisions</u>
Banks will hold provision against the restructured advances as per the existing provisioning norms.

5.2 <u>Provision for diminution in the fair value of restructured advances</u>
"The erosion in the fair value of the advance should be computed as the difference between the fair value of the loan ***before*** and ***after*** restructuring. *Fair value of the loan before restructuring* will be computed as the present value of cash flows representing the interest at the <u>existing rate charged on the advance before restructuring</u> and the principal, discounted at a rate equal to the bank's BPLR as on the date of restructuring plus the appropriate term premium and credit risk premium for the borrower category on the date of restructuring". *Fair value of the loan after restructuring* will be computed as the present value of cash flows representing the interest at the <u>rate charged on the advance on restructuring</u> and the principal, discounted at a rate equal to the bank's BPLR as on the date of restructuring plus the appropriate term premium and credit risk premium for the borrower category on the date of restructuring".

3. It may please be noted that the above formula moderates the swing in the diminution of present value of loans with the interest rate cycle and will have to be followed consistently in future. No request for changing the same, particularly for reversion to the present formula, will be entertained in future.

4. Further, it is reiterated that the provisions required as above arise due to the action of the banks resulting in change in contractual terms of the loan upon restructuring which are in the nature of financial concessions. These provisions are distinct from the provisions which are linked to the asset classification of the account classified as NPA and reflect the impairment due to deterioration in the credit quality of the loan. Thus, the two types of the provisions are not substitute for each other.

5. It is also re-emphasised that the modifications effected to the guidelines on restructuring of advances by RBI are aimed at providing an opportunity to banks and borrowers to preserve the economic value of the units and should not be looked at as a means to evergreen the advances.

6. In their published annual Balance Sheets for the year ending March 2009, in addition to the disclosures regarding restructured loans required in terms of paragraph 9 of the guidelines enclosed to circular dated March 6, 2009 referred to above, banks should also disclose the amount and number of accounts in respect of which applications for restructuring are under process, but the restructuring packages have not yet been approved.

(ii) In the case of working capital facilities, the diminution in the fair value of the cash credit / overdraft component may be computed as indicated in para (i) above, reckoning the higher of the outstanding amount or the limit sanctioned as the principal amount and taking the tenor of the advance as one year. The term premium in the discount factor would be as applicable for one year. The fair value of the term loan components (Working Capital Term Loan and Funded Interest Term Loan) would be computed as per actual cash flows and taking the term premium in the discount factor as applicable for the maturity of the respective term loan components.

(iii) In the event any security is taken in lieu of the diminution in the fair value of the advance, it should be valued at Re.1/- till maturity of the security. This will ensure that the effect of charging off the economic sacrifice to the Profit & Loss account is not negated.

(iv) The diminution in the fair value may be re-computed on each balance sheet date till satisfactory completion of all repayment obligations and full repayment of the outstanding in the account, so as to capture the changes in the fair value on account of changes in BPLR, term premium and the credit category of the borrower. Consequently, banks may provide for the shortfall in provision or reverse the amount of excess provision held in the distinct account.

(v) If due to lack of expertise / appropriate infrastructure, a bank finds it difficult to ensure computation of diminution in the fair value of advances extended by small branches, as an alternative to the methodology prescribed above for computing the amount of diminution in the fair value, banks will have the option of notionally computing the amount of diminution in the fair value and providing therefor, at five percent of the total exposure, in respect of all restructured accounts where the total dues to bank(s) are less than rupees one crore till the financial year ending March 2011. The position would be reviewed thereafter.

5.3. The total provisions required against an account (normal provisions plus provisions in lieu of diminution in the fair value of the advance) are capped at 100% of the outstanding debt amount.

6. Prudential Norms for Conversion of Unpaid Interest into 'Funded Interest Term Loan' (FITL)

6.1 <u>Asset classification norms</u>

The FITL created by conversion of unpaid interest will be classified in the same asset classification category in which the restructured advance has been classified. Further movement in the asset classification of FITL would also be determined based on the subsequent asset classification of the restructured advance.

6.2 Income recognition norms

6.2.1 The income, if any, generated may be recognised on accrual basis, if FITL is classified as 'standard', and on cash basis in the cases where the same has been classified as a non-performing asset.

6.2.2 The unrealised income represented by FITL should have a corresponding credit in an account styled as "Sundry Liabilities Account (Interest Capitalization)".

6.2.3 Only on repayment in case of FITL, the amount received will be recognized in the P&L Account, while simultaneously reducing the balance in the "Sundry Liabilities Account (Interest Capitalisation)".

7. Special Regulatory Treatment for Asset Classification

7.1.1 The special regulatory treatment for asset classification, in modification to the provisions in this regard stipulated in para 3, will be available to the borrowers engaged in important business activities, subject to compliance with certain conditions as enumerated in para 7. 2 below. Such treatment is not extended to the following categories of advances :

(i) Consumer and personal advances including advances to individuals against the securities of shares/bonds/debentures etc

(ii) Advances to traders

7.1.2 The asset classification of the above two categories of accounts as well as that of other accounts which do not comply with the conditions enumerated in para 7.2, will be governed by the prudential norms in this regard described in para 3 above.

7.1.3 As real estate sector is facing difficulties, it has been decided to extend special regulatory treatment to commercial real estate exposures, which are restructured up to June 30, 2009. Further, housing loans granted by banks would also be eligible for special regulatory treatment, if restructured.

7.2 Elements of special regulatory framework

7.2.1 The special regulatory treatment has the following three components :

(i) Incentive for quick implementation of the restructuring package.

(ii) Retention of the asset classification of the restructured account in the pre restructuring asset classification category

7.2.2 Incentive for quick implementation of the restructuring package

As stated in para 2.2, during the pendency of the application for restructuring of the advance with the bank, the usual asset classification norms would continue to apply. The process of reclassification of an asset should not stop merely because the application is under consideration. However, as an incentive for quick implementation of the package, if the approved package is implemented by the bank within 120 days from the date of receipt of application by the bank, the asset classification status may be restored to the position which existed when the restructuring application was received by the bank: Further, all accounts which were standard accounts as on September 1, 2008 would be treated as standard accounts on restructuring provided the restructuring package is put in place within 120 days from the date of taking up the restructuring package. The 120 days norm for quick implementation of the restructuring package would stand reduced to 90 days in respect of all restructuring packages implemented after June 30, 2009.

7.2.3 Asset classification benefits

Subject to the compliance with the undernoted conditions in addition to the adherence to the prudential framework laid down in para 3:

(i) In modification to para 3.2, an existing 'standard asset' will not be downgraded to the sub-standard category upon restructuring.

(ii) In modification to para 3.3 during the specified period, the asset classification of the sub-standard / doubtful accounts will not deteriorate upon restructuring, if satisfactory performance is demonstrated during the specified period.

However, these benefits will be available subject to compliance with the following conditions:

i) The dues to the bank are 'fully secured' as defined in Annex 1. The condition of being fully secured by tangible security will not be applicable in the following cases:

(a) SSI borrowers, where the outstanding is up to Rs.25 lakh.

(b) infrastructure projects, provided the cash flows generated from these projects are adequate for repayment of the advance, the financing bank(s) have in place an appropriate mechanism to escrow the cash flows, and also have a clear and legal first claim on these cash flows.

(c) The value of security is relevant to determine the likely losses which a bank might suffer on the exposure should the default take place. This aspect assumes greater importance in the case of restructured loans. However, owing to the current downturn, the full security cover for the WCTL created by conversion of the irregular portion of principal dues over the drawing power, may not be available due to fall in the prices of security such as inventories. In view of the extraordinary situation, this special regulatory treatment is available to '**standard**' and '**sub standard accounts**' even where full security cover for WCTL is not available, subject to the condition that provisions are made against the **unsecured portion of the WCTL**, as under:

- Standard Assets : 20%
- Substandard Assets: 20% during the first year and to be increased by 20% every year thereafter until the specified period (one year after the first payment is due under the terms of restructuring)
- If the account is not eligible for upgradation after the specified period, the unsecured portion will attract provision of 100%

ii) The unit becomes viable in 10 years, if it is engaged in infrastructure activities, and in 7 years in the case of other units.

iii) The repayment period of the restructured advance including the moratorium, if any, does not exceed 15 years in the case of infrastructure advances and 10 years in the case of other advances. However the ceiling of 10 years would not apply in case of housing loans and the Board of Directors of the banks should prescribe the maximum period not exceeding 15 years for restructured advances keeping in view the safety and soundness of advances.

(iv) The restructured housing loans would be assigned additional risk weight of 25 percentage points over the prescribed risk weights.

iv) Promoters' sacrifice and additional funds brought by them should be a minimum of 15% of banks' sacrifice.

v) Personal guarantee is offered by the promoter except when the unit is affected by external factors pertaining to the economy and industry.

vi) The restructuring under consideration is not a 'repeated restructuring' as defined in para (iv) of Annex 1. However, as a one time measure, second restructuring carried out by banks of exposures (other than commercial real estate, capital market exposures, personal/consumer loans and loans to traders) upto June 30, 2009 will also be eligible for special regulatory treatment.

8. Procedure

8.1 (i) Based on these guidelines, banks registered under the State Acts may formulate, with the approval of the concerned Registrar of the Cooperative Societies, a debt restructuring scheme for SMEs and other borrowers. However in the case of Multi State Cooperative banks, the above guidelines may be formulated with the approval of the Board of Directors.

(ii) The restructuring would follow a receipt of a request to that effect from the borrowing units

(iii) In case of eligible SMEs which are under consortium / multiple banking arrangements, the bank with the maimum outstanding may work out the restructuring package, along with the bank having the second largest share.

(iv) In cases where the UCBs, if any, participating in the debt restructuring of other industrial units coming under consortium / multiple banking / syndication arrangements and also under Corporate Debt Restructuring (CDR) Mechanism, the banks may be guided by the guidelines issued by our Department of Banking Operations and Development (DBOD) from time to time.

8.2 Banks may consider incorporating in the approved restructuring packages creditor's rights to accelerate repayment and the borrower's right to pre-pay. The right of recompense should be based on certain performance criteria to be decided by the banks.

9. Disclosures

Banks should also disclose in their published annual Balance Sheets, under "Notes on Accounts", information relating to number and amount of advances restructured, and the amount of diminution in the fair value of the restructured advances in Annex-2. The information would be required for advances restructured under SME Debt Restructuring Mechanism and other categories separately.

10. Illustrations

A few illustrations on the asset classification of restructured accounts are given in Annex-3.

Key Concepts

(i) Advances

The term 'Advances' will mean all kinds of credit facilities including cash credit, overdrafts, term loans, bills discounted / purchased, receivables, etc. and investments other than that in the nature of equity.

(ii) Fully Secured

When the amounts due to a bank (present value of principal and interest receivable as per restructured loan terms) are fully covered by the value of security, duly charged in its favour in respect of those dues, the bank's dues are considered to be fully secured. While assessing the realisable value of security, primary as well as collateral securities would be reckoned, provided such securities are tangible securities and are not in intangible form like guarantee etc., of the promoter / others. However, for this purpose the bank guarantees, State Government Guarantees and Central Government Guarantees will be treated on par with tangible security.

(iii) Restructured Accounts

A restructured account is one where the bank, for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower concessions that the bank would not otherwise consider. Restructuring would normally involve modification of terms of the advances / securities, which would generally include, among others, alteration of repayment period / repayable amount/ the amount of instalments / rate of interest (due to reasons other than competitive reasons).

(iv) Repeatedly Restructured Accounts

When a bank restructures an account a second (or more) time(s), the account will be considered as a 'repeatedly restructured account'. However, if the second restructuring takes place after the period up to which the concessions were extended under the terms of the first restructuring, that account shall not be reckoned as a 'repeatedly restructured account'.

(v) SMEs

Small and Medium Enterprises is an undertaking defined in circular UBD.PCB.Cir.No. 35 / 09.09.001 / 06-07 dated April 18, 2007.

(vi) Specified Period

Specified Period means a period of one year from the date when the first payment of interest or installment of principal falls due under the terms of restructuring package.

(vii) Satisfactory Performance

Satisfactory performance during the specified period means adherence to the following conditions during that period.

Non-Agricultural Cash Credit Accounts: In the case of non-agricultural cash credit accounts, the account should not be out of order any time during the specified period, for duration of more than 90 days / 180 days as applicable to Tier I and Tier II UCBs respectively. In addition, there should not be any overdues at the end of the specified period.

Non-Agricultural Term Loan Accounts: In the case of non-agricultural term loan accounts, no payment should remain overdue for a period of more than 90 days. In addition there should not be any overdues at the end of the specified period.

All Agricultural Accounts: In the case of agricultural accounts, at the end of the specified period the account should be regular.

Particulars of Accounts Restructured

(Rs. in lakh)

		Housing Loans	**SME Debt Restructuring**	**Others**
Standard advances restructured	No. of Borrowers			
	Amount outstanding			
	Sacrifice (diminution in the fair value)			
Sub standard advances restructured	No. of Borrowers			
	Amount outstanding			
	Sacrifice (diminution in the fair value)			
Doubtful advances restructured	No. of Borrowers			
	Amount outstanding			
	Sacrifice (diminution in the fair value)			
TOTAL	No. of Borrowers			
	Amount outstanding			
	Sacrifice (diminution in the fair value)			

Asset Classification of Restructured Accounts under the Guidelines

	Particulars	Case 1	Case 2	Case 3	Case 4
I	Assumed due date of payment	31.01.2007	31.01.2007		
	Assumed date of restructuring	31.03.2007	31.03.2007	31.03.2007	31.03.2007
	Period of delinquency as on the date of restructuring	2 months	2 months	18 months	18 months
	Asset Classification (AC) before restructuring	'Standard'	'Standard'	'Doubtful - less than one year'	'Doubtful - less than one year'
	Date of NPA	NA	NA	31.12.05 (Assumed)	31.12.05 (Assumed)
II	**Asset classification (AC) on restructuring**				
	Assumed status of the borrower	Eligible for special regulatory treatment	Not eligible for special regulatory treatment	Eligible for special regulatory treatment	Not eligible for special regulatory treatment
	AC after restructuring	'Standard'	Downgraded to 'Substandard' w.e.f 31.03.07 (i.e., on the date of restructuring)	'Doubtful - less than one year'	'Doubtful - less than one year'
	Assumed first payment due under the revised terms	31.12.07	31.12.07	31.12.07	31.12.07
III	**Asset classification after restructuring**				
	A The account performs satisfactorily as per restructured terms				
	(a) AC during the specified one year period (i.e., from 31.12.07 to 31.12.08)	No change (i.e., remains 'Standard')	'Doubtful - less than one year' w.e.f. 31.03.08 (i.e. one year after classification as	No change (i.e., remains 'Doubtful - less than one year')	'Doubtful - one to three years' w.e.f. 31.12.07 (i.e., one year after classification as 'Doubtful less

					'Substandard')		than one year')
		(b)	AC after the specified one year period	Continues in 'Standard' category	Upgraded to 'Standard' category	Upgraded to 'Standard' category	Upgraded to 'Standard' category
	B	If performance not satisfactory vis-a-vis restructured terms					
		(a)	AC during the specified one year period (in case the unsatisfactory performance is established before completion of one year period)	Treated as substandard w.e.f 30.4.2007 and downgraded to 'Doubtful less than one year' with effect from 30.04.08.	'Doubtful - less than one year' w.e.f. 31.03.08 (i.e. one year after classification	'Doubtful one to three years' w.e.f. 31.12.07	'Doubtful - one to three years' w.e.f. 31.12.07 (i.e., one year after classification as 'Doubtful less than one year' (on 31.12.06)
		(b)	AC after the specified one year period, if the unsatisfactory performance continues	Will migrate to 'Doubtful - one to three years' w.e.f. 30.04.09 and 'Doubtful more than three years' w.e.f. 30.04.2011.	Will migrate to 'Doubtful - one to three years' w.e.f. 31.03.09 and 'Doubtful more than three years' w.e.f. 31.03.2011.	Will migrate to 'Doubtful - more than three years' w.e.f. 31.12.09	Will migrate further to 'Doubtful more than three years' w.e.f. 31.12.09