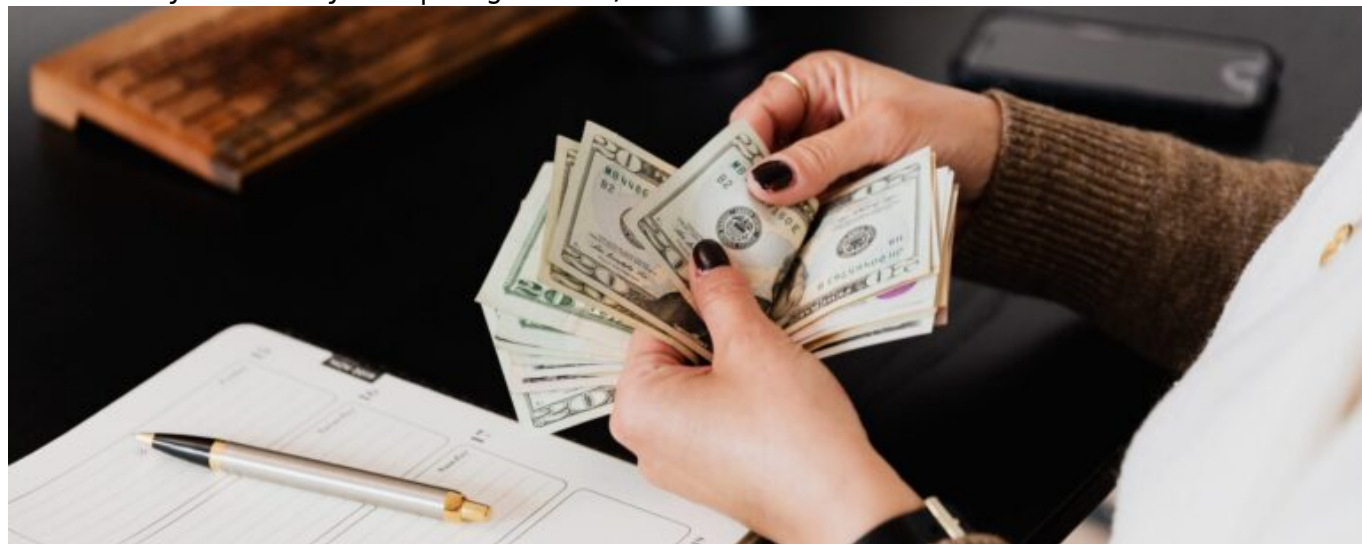


COVID-19 Resolution Framework: A Cushion To The Indebted Borrowers

written by Aishwarya S | August 20, 2020



COVID-19 Resolution Framework: Govt's Relief Strategy for Distressed Borrowers

A bank or financial institution that is lending financial assistance to a borrower faces the risk of being bankrupt on default of repayment by the borrower. Many laws were introduced by the legislature and various policies were also introduced by RBI to tackle such problems. As a result of which the borrower was not given any concession if the default on his part was due to reasons beyond his control.

Therefore, the Prudential Framework for resolution of Stressed Asset Direction 2019 was introduced by RBI vide its notification dated June 7, 2019[1]. The said direction provides concession to the borrower who is unable to repay debts due to financial problems by way of downgrading of the asset in the bank's automated system except when there is a change in ownership and in those cases the asset will be retained or upgraded to Standard, subject to prescribed conditions.

As we all know, the current situation has decreased the economic activity in certain sectors especially the manufacturing sector to a greater extent. As a result, it has lead to an increase in the financial difficulty of the borrower. To tackle this situation, the RBI has introduced a moratorium on loans. However, with the current situation, it seems that the moratorium will not be enough. The Reserve Bank of India, keeping in mind the same, has amended the existing framework and introduced a new framework known as the "Resolution Framework for Covid-19 related stress" vide its notification dated August 6, 2020[2].

However, it is to be noted that the said framework shall be applicable to eligible borrowers- corporate exposures subjected to prescribed conditions. The framework also specifies requirements to be fulfilled in case of resolution of personal loans, other eligible borrowers, and corporate exposures and specifies the requirements to be followed by the lending institutions.

Applicability Of COVID-19 Resolution Framework

In order to understand the framework, it is vital to know the applicability and non-applicability of the framework.

The resolution framework is applicable to all kinds of borrowers such as individual or corporate or otherwise except the following category of

borrowers [3]:

- MSME borrowers whose aggregate liability to lending institutions is ₹25 crore or less as of March 1, 2020
 - Farm credit is listed under the Master Direction FIDD.CO.Plan. 1/04.09.01/2016-17[i] dated July 7, 2016
 - Loans to Primary Agricultural Credit Societies (PACS), Farmers Service Societies(FSS), and Large-sized Adivasi Multi-Purpose Societies (LAMPS)
 - Financial service providers according to sub-section (17) of Section 3 of the Insolvency and Bankruptcy Act, 2016
 - Exposures of lending institutions to the Government (Central, State, Local Government Bodies) and body corporate established by an Act of Legislature
 - Housing finance companies where the account has been rescheduled in terms of The Housing Finance Companies (NHB) Directions, 2010 after March 1, 2020
- Conditions For COVID-19 Resolution Framework

The resolution framework provides relaxation for borrowers on fulfillment of certain conditions with respect to the following categories of exposure faced by lending institutions[4]:

- Resolution of stress in personal loans
- Resolution of other exposures
- Asset classification and provisioning
- Disclosures and credit reporting

Resolution Of Stress In Personal Loans

Personal loan in this context refers to the loan provided to individual borrowers by lending institutions[5]. However, it excludes the loan provided by such lending institutions to its own employees or staff members. The aspect under this resolution plan includes rescheduling of payments, conversion of any interest accrued, or to be accrued, into another credit facility, or, granting of a moratorium, based on an assessment of income streams of the borrower, subject to a maximum of two years.

A borrower falling under this category is eligible to avail relaxation for repayment under this framework provided the borrower account is classified as standard and has not defaulted in payment for more than 30 days as of March 1, 2020. The borrower will continue to be classified as standard till the date of invocation of resolution.

The said framework should be invoked before December 31, 2020, and implemented within 90 days of invocation. Further, it also provides for fulfillment of the following conditions to implement the resolution:

- All documentation, collaterals, and agreements executed between borrowers and lenders should be in accordance with the resolution plan provided in the new framework.
- Changes in terms and conditions of the loan should be reflected in the books of lending institutions.
- Borrowers must not fall in the category of defaulter as per the revised framework.

Resolution Of Other Exposures

This framework is applicable to the borrower who does not fall in the above-mentioned category, however, the eligibility criteria for availing of benefit under this framework is the same as above. The said framework should be invoked before December 31, 2020, and implemented within 180 days from the date of invocation.

The invocation of resolution will vary for a borrower availing financial

assistance from a single lending institution to multiple lending institutions. In the case of a borrower availing assistance from a single lending institution, the resolution should be invoked as per the policy approved by the board and should be within the limits of the framework. In the case of borrower availing finance from multiple lending institutions, then the resolution shall be treated as invoked if the lending institutions have outstanding from its borrower not less than 60% but up to 75% of its credit facilities(both fund and non-fund based).

On the invocation of the resolution framework by the borrower availing finance from multiple lending institutions, the lending institution should enter into Inter-Creditor Agreement (ICA) within 30 days from the date of invocation of resolution. If the agreement is not executed within the said period then the lending institutions should make provision for bad debt to the extent of 20% of the amount in its books of accounts.

Further, it also provides for the appointment of an expert committee to fix financial parameters and sector-specific benchmarks for the implementation of the resolution. The financial parameters fixed under this resolution framework refer to leverage, liquidity, debt serviceability, etc. The said committee also has the responsibility of vetting of resolution framework for the lending institutions having aggregate exposure of Rs 1500 and above.

The following are the features of this resolution framework[6]:

- The resolution plan will be as per the provisions relating to the existing framework except in case of a compromise settlement.
- It also grants additional facilities to the borrower on account of Covid-19.
- The lending institutions under this framework may extend the residual tenor of the loan, a maximum of 2 years, irrespective of the fact whether the loan moratorium is given to the borrower.
- A portion of debt securities issued by the borrower whether non-convertible or convertible can be converted into equity by the lending institutions provided the coupons issued for payment of interest for such instruments are similar to the terms of debt held by the lending institution
- In the case where aggregate exposure to the lending institutions of the borrower is Rs. 100 crore or more, then a separate evaluation shall be conducted by anyone credit rating agency authorized by RBI.
- A significant feature of this resolution framework is that an escrow account will be maintained with the lending institutions which would be consisting of all the receipts, repayments, and disbursements by the borrower to the institution. This feature is applicable to the accounts which involve consortium or multiple banking arrangements after the plan has been implemented.
- To assure effortless functioning, there will be an escrow manager who will enter into an agreement with the lending institutions. The agreement so entered will contain details regarding the duties and responsibilities of the escrow manager and the lending institutions, and an enforcement mechanism that will be contractually available to the escrow manager to ensure that lending institutions service their disbursement obligations in a timely basis.

Asset Classification And Provisioning

The said resolution framework provides for additional finance to the borrower to whom the resolution plan has been invoked. However, the asset of the borrower can be classified as a standard asset till the implementation of the

plan irrespective of the actual performance of the borrower. If the plan is implemented by lending institutions within the stipulated time then asset classification will be based on the actual performance of the borrower for the additional credit facilities or the rest of the credit facilities whichever is worse.

If a resolution plan is implemented according to the Resolution Framework, then upon implementation, the asset of the borrower will be retained as a "standard asset". In the case of borrowers, accounts that may have glided into non-performing assets("NPAs"), during the time period between the date of invocation and the date of implementation of the resolution plan can be updated as 'standard'.

If the resolution plan is implemented for personal loans, the lending institutions should make provisions for bad debts from the date of implementation of the resolution framework as per existing IRAC norms immediately before implementation, or 10 % of renegotiated exposure of lender institution post-implementation, whichever is higher.

Any additional provisions maintained by the lending institutions in accordance with the RBI's circular on 'Covid-19 regulatory package' dated April 17, 2020[7], can be used for meeting provisional requirements under the Resolution Framework. Further, additional provisions maintained in accordance with the Prudential Framework can be reversed at the time of invocation.

However, if the framework is not implemented within 180 days from the date of invocation, the provisions as per the Prudential Framework will be applicable and the framework so adapted by lending institution will be considered as not being invoked.

The above provisions for debts will be reversed and be written off in the following events[8]:

- If the borrower pays 20% of residual debt without being glided into non-performing assets(NPA).
- If the borrower pays subsequently 10% of residual debt without being glided into non-performing assets(NPA).

Disclosures And Credit Reporting

Lending institutions shall make disclosure in the form of statement for the quarter ending March 31, 2021, June 30, 2021 and September 30, 2021. Further, it is also required to make disclosure on a half yearly basis on September 30 and March 31.

The reporting made above should reflect the "restructured status" of the account of the borrower[9].

Conclusion

The framework for RBI indeed serves as a cushion for the borrower facing financial difficulties in this time of the pandemic. Moreover, with the decrease in economic activity in certain sectors, there has been a decrease in cash flow by entities. However, when we analyse the provision as a whole it will serve as a temporary solution to the existing financial difficulties of the borrower. In the long term, it may also lead to the downfall of lending institutions since it will increase lending exposure. The benefit of this framework can be derived only when there is a resumption of normal day to day economic activities

[1] <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11941&Mode=0>

[2] <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=11941&Mode=0>

[3] <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=11941&Mode=0>

[4] Lending institutions in this context refers to commercial banks(including small finance banks, regional rural banks and local area banks),Primary Urban Co-operative banks/ State Co-operative banks/District Central Co-operative Banks, All India Financial Institution and Non-banking Financial Institutions

[5] <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=11941&Mode=0>

[6] <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11872&Mode=0>

[7] <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=11941&Mode=0>

[8]<https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=11941&Mode=0>

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