Report of the Expert Committee on Resolution Framework for Covid-19 related Stress

September 4, 2020

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Letter of Transmittal

Shri Shaktikanta Das
Governor
Reserve Bank of India
Mumbai – 400 001

Dear Sir,

We are pleased to submit the Report of the Expert Committee on Resolution Framework for Covid-19 related Stress. The Committee had the privilege of working on the topic of utmost importance. While working on the subject, we had the opportunity to interact with various stakeholders having expertise in the field. We would like to sincerely thank you for reposing confidence by entrusting this task to us. We hope the recommendations of the Expert Committee will be found acceptable and implementable and this will facilitate the resolution of Covid-19 hit accounts to the desired extent.

K V Kamath
Chairman

Diwakar Gupta	T N Manoharan	Ashvin Parekh
Member	Member	Member

Sunil Mehta
Member Secretary

Acknowledgements

The Expert Committee would like to gratefully acknowledge the valuable contributions from various stakeholders in compilation of this Report. The Committee would like to thank the representatives of Rating Agencies for their suggestions and perspectives on the subject.

The Expert Committee places on record its deep appreciation for the valuable inputs it received from the representatives of various Industry Associations.

The Expert Committee would like to place on record its commendation to Dr. P K Agrawal, Senior Advisor, IBA who participated in all the meetings of the Committee and contributed in the deliberations. The Committee also conveys its appreciation for the excellent support provided by the Committee's Secretariat at Indian Banks' Association and in responding to the complex information and analytical requirements and efficiently coordinating the meetings, besides contributing to the compilation of the Report. This greatly facilitated the work of the Committee.

Abbreviations

List of Abbreviations used in the Report

ATNW	Adjusted Tangible Net Worth
ADSR	Average Debt Service Coverage Ratio
Covid-19	Corona Virus Disease 2019
CR	Current Ratio
DCF	Discounted Cash Flow
DCCO	Date of Commencement of Commercial Operations
DSCR	Debt Service Coverage Ratio
EBITDA	Earnings before Interest, Taxes, Depreciation and Amortization
EC	Expert Committee
FITL	Funded Interest Term Loan
FB	Fund Based
IBA	Indian Banks' Association
ICA	Inter Creditor Agreement
ICR	Interest Coverage Ratio
ICE	Independent Credit Evaluation
IRAC	Income Recognition and Asset Classification
NCD	Non-Convertible Debentures
NFB	Non-Fund Based
NPA	Non-Performing Assets
RBI	Reserve Bank of India
RP	Resolution Plan
SMA	Special Mention Account
TEV	Techno-Economic Viability Report
TOL	Total Outside Liabilities
TNW	Tangible Net worth
WCC	Working Capital Cycle
WCDL	Working Capital Demand Loan
WCTL	Working Capital Term Loan

Chapter I
Introduction

1. Background

The Reserve Bank of India as part of its Statement on Developmental and Regulatory Policies released along with the Monetary Policy Statement on August 6, 2020, a ‘Resolution Framework for Covid-19 related Stress’, vide circular RBI/2020-21/16 DOR.No.BP.BC/3/21. 04.048/2020-21 dated August 6, 2020 as a special window under the Prudential Framework on Resolution of Stressed Assets issued on June 7, 2019.

The Committee recommendations are not applicable for accounts covered by Part A of the Annex to the above circular i.e., personal loans and the borrowers not covered by the circular, as listed in Paragraph 2 of the annex to the said circular.

The framework enables lending institutions including NBFCs, which are an essential part of the lenders’ pool under this Framework, to implement a Resolution Plan (RP) in respect of eligible corporate exposure even without change in ownership while classifying such exposure as Standard, subject to specified conditions.

The Resolution Framework inter alia envisages constitution of an Expert Committee (Committee) under the Chairmanship of Shri K V Kamath with following composition:

1)	Shri K V Kamath	Chairperson
2)	Shri Diwakar Gupta	Member (effective September 1, 2020)
3)	Shri T N Manoharan	Member (effective August 14, 2020)
4)	Shri Ashvin Parekh	Member
5)	Shri Sunil Mehta	Member Secretary

2. Terms of Reference of the Expert Committee

i) To identify suitable financial parameters that should be factored into the assumptions underlying RP finalised by the lending institutions under the Resolution Framework. The parameters shall cover aspects related to leverage, liquidity, debt serviceability, etc.

ii) To recommend sector-specific ranges for such financial parameters that will serve as boundary conditions for the RP.

iii) To make any other recommendations relating to financial or non-financial conditions to be considered for the RP, within the contours of the framework announced by the Reserve Bank of India.

iv) To undertake the process validations of RP submitted in respect of borrowers where the aggregate exposure of the lending institutions at the time of invocation of the resolution process is Rs. 1500 crore and above. The process validation shall entail verification of the RP in terms of their adherence to the conditions prescribed in the Resolution, without interfering with the commercial judgement exercised by the lenders.

The Committee's term will be until June 30, 2021. IBA shall function as the Secretariat to the Committee. The Committee shall submit report within 30 days to RBI in terms of i, ii and iii above.

3. Key Highlights of Resolution Framework dated August 6, 2020

Eligibility:

- Resolution under this Framework extended only to borrowers having stress on account of Covid-19.
- Only those borrowers which were classified as standard and with arrears less than 30 days as at March 1, 2020 are eligible under the Framework.

Invocation Date and implementation:

- Resolution Framework may be invoked not later than December 31, 2020.
- RP needs to be implemented within 180 days from the date of invocation.

Signing of ICA and provision requirements:

- Resolution process shall be treated as invoked once lenders representing 75% by value and 60% by number (Majority Lenders) agree to invoke the same.
- ICA to be signed by all lenders within 30 days of invocation.
- Lenders who have signed ICA, to make provision, higher of 10% or IRAC norms.
- Lenders who have not signed ICA, to make a provision higher of 20% or as per IRAC norms, upon expiry of 30 days from invocation.

General Guidelines:

- The residual tenor of the loan may be extended by maximum 2 years with or without payment moratorium. The moratorium period, if granted, shall come into force immediately upon implementation of the RP.
- The asset classification may be maintained as standard or upgraded to standard subject to the RP being implemented as per the Framework.
- For aggregate exposures greater than Rs. 100 crore, an Independent Credit Evaluation (ICE) to be obtained from any one Credit Rating Agency authorised by RBI.

Conversion of Loans into Securities and Valuation:

- RP to include restructuring / regularization / change in ownership, if any, sanction of additional facilities.
- RP may provide for conversion of debt into equity or other marketable non-convertible debt securities provided amortization and coupon are similar to terms of debt.
- Equity to be valued as per lower of breakup value or DCF value (for unlisted companies) and market price (for listed companies).
- Any other instrument to be valued at Re.1.

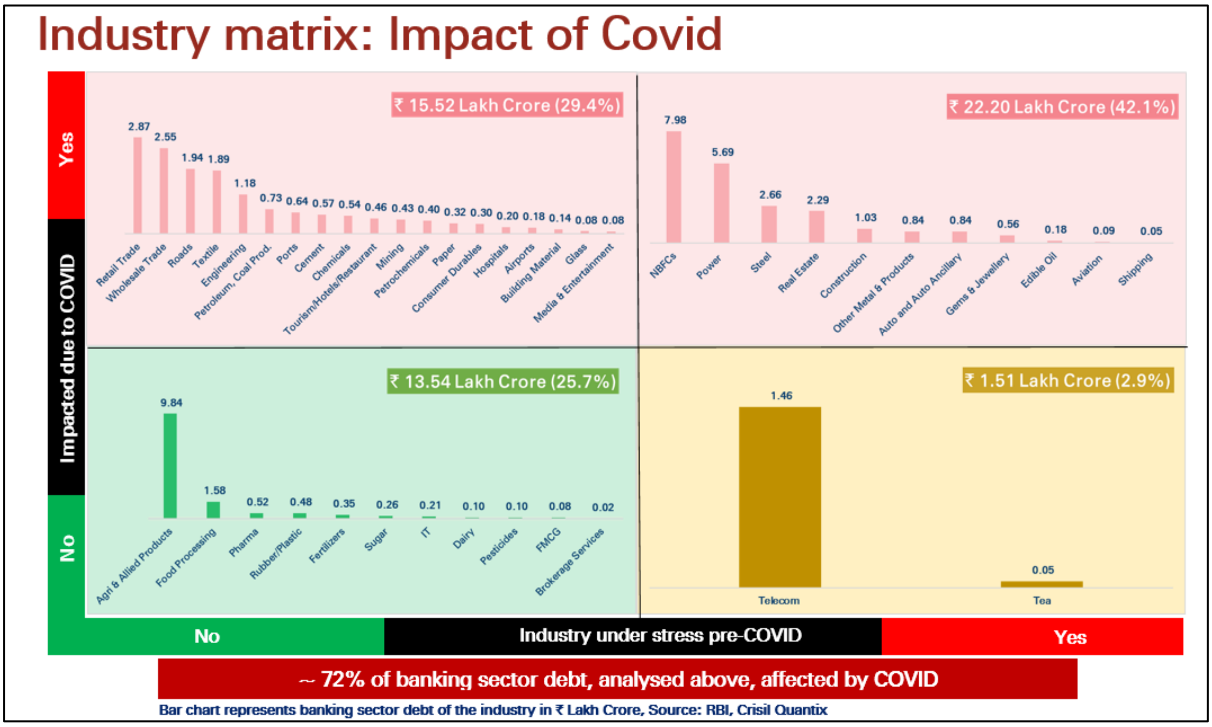
Post Implementation Performance:

- In respect of exposures, any default by the borrower with any of the signatories to the ICA during the monitoring period shall trigger a Review Period of 30 days.
- If the borrower is in default with any of the signatories to the ICA at the end of the Review Period, the asset classification of the borrower with all lending institutions, including those who did not sign the ICA, shall be downgraded to NPA from the date of implementation of the RP or the date from which the borrower had been classified as NPA before implementation of the plan, whichever is earlier.
- In all cases, further upgradation shall be subject to implementation of a fresh restructuring under the Prudential Framework, or the relevant instructions as applicable to specific category of lending institutions where the Prudential Framework is not applicable.

Chapter II
Approach and Methodology Adopted

1. The first and foremost task before the Committee was to identify the sectors where the impact of Covid-19 was visible.

2. To have a better understanding of the above objective, the Expert Committee held several meetings with various stakeholders through the digital platform (details of the meetings are given in Annexure I). The Committee also studied the RBI's Financial Stability Report and other Publications and Research Reports. It also studied comparison of Q1 FY 2021 with Q1FY 2020 financials of companies across many sectors, which clearly indicated stress in several sectors as summarized below:



3. The Committee recognizes that:

- The Covid-19 pandemic has affected the best of companies.
- These businesses were otherwise viable under pre-Covid-19 scenario.
- Impact is pervasive across several sectors but with varying severity – mild, moderate and severe.

4. Based on past experience, it takes a few months to finalize a large restructuring proposal because of the host of compliances, as under:

Table

Compliance	Required Under	Rationale
Inter-Creditors Agreement (ICA)	RBI June 7, 2019 Circular	To bring consensus among lenders and provide moratorium /calm period for implementation of the RP. Execution of ICA should be fast tracked by regulatory prescription.
Forensic Audit @	RBI July 1, 2016 Master Direction on Frauds and borrowers who have committed fraud are not eligible for restructuring under RBI June 7, 2019 circular.	To establish whether there was diversion of funds / identify malfeasance.
Valuation Report from one / two Valuers	RBI June 7, 2019 Circular	For arriving at liquidation value for payout to dissenting creditors.
Rating from one / two External Credit Rating Agencies	RBI June 7, 2019 Circular	Independent Credit Evaluation (ICE).
Techno-Economic Viability Report (TEV Study upto EBITDA level)	Policy of respective lending institutions	Establish viability of the RP.
Stock and Receivables Audit	Policy of respective lending institutions	To validate the working capital irregularity and carving out Working Capital Term Loan (WCTL).
Financial Viability Study (Post EBITDA position)	Linked to TEV as TEV consultants give report only upto EBIDTA	To establish financial viability of the RP.
Legal Compliances	Legal requirement. RBI June 7, 2019 circular requires security perfection on implementation date.	Documentation and extension of security / fresh security creation. To create the agreement and perfection of security.

@ Forensic audit is mandated in all NPA accounts with aggregate exposure of Rs. 50 crore and above. It needs to be outlined that as the accounts, under RBI's August 6, 2020 Circular are standard on date of identification for restructuring, no Forensic audit will be required if the account happens to slip during the implementation period of 180 days.

5. As per RBI's August 6, 2020 circular, all the norms applicable to implementation of a RP, including mandatory requirements of ICA and specific implementation conditions, as laid out in June 7, 2019, circular are applicable to all lending institutions for the RP implemented under this circular (Item No. 6, Page 2).

6. Time is of essence at the present juncture. Considering the large volume and the fact that only Standard assets are eligible under the proposed scheme, a segmented approach of bucketing these accounts under mild, moderate and severe stress, may ensure quick turnaround. To complete this task simplified restructuring for mild and moderate stress may be prescribed. Severe stress cases would require comprehensive restructuring.

7. The task before the Committee was to select the set of financial parameters where the threshold has to be recommended for each identified sector. The financial parameters inter alia should include aspects related to leverage, liquidity, debt serviceability etc.

8. On the evaluation and analysis, the following parameters were selected based on their relevance while considering the RP:

- Total Outside Liability / Adjusted Tangible Net Worth (TOL / Adjusted TNW)
- Total Debt / EBIDTA
- Current Ratio
- Debt Service Coverage Ratio (DSCR)
- Average Debt Service Coverage Ratio (ADSCR)

Definitions of Key Ratios

Key Ratio	Definition
TOL / Adjusted TNW	Addition of long-term debt, short term debt, current liabilities and provisions along with deferred tax liability divided by tangible net worth net of the investments and loans in the group and outside entities.
Total Debt / EBIDTA	Addition of short term and long-term debt divided by addition of profit before tax, interest and finance charges along with depreciation and amortisation.
Current Ratio	Current assets divided by current liabilities.
Debt Service Coverage Ratio (DSCR)	For the relevant year addition of net cash accruals along with interest and finance charges divided by addition of current portion of long term debt with interest and finance charges.
Average Debt Service Coverage Ratio (ADSCR)	Over the period of the loan addition of net cash accruals along with interest and finance charges divided by addition of current portion of long term debt with interest and finance charges.

8. These ratios would provide the requisite assessment framework for the RP.

9. The Committee decided to source sector specific reports / company data from various sources to have a better sectoral outlook and to obtain industry benchmarks to formulate the financial parameters in a rational manner.

10. Based on the outstanding and the severity impact, the Committee selected the following sectors for the purpose of recommending financial parameters to be factored in the RP:

Table

Sr. No.	Sector
1	Power
2	Construction
3	Iron & Steel Manufacturing
4	Roads
5	Real Estate
6	Trading-Wholesale
7	Textiles
8	Chemicals
9	Consumer Durables/FMCG
10	Non-ferrous Metals
11	Pharmaceuticals Manufacturing
12	Logistics
13	Gems & Jewellery
14	Cement
15	Auto Components
16	Hotel, Restaurants, Tourism
17	Mining
18	Plastic Products Manufacturing
19	Automobile Manufacturing
20	Auto Dealership
21	Aviation
22	Sugar
23	Port & Port services
24	Shipping
25	Building Materials
26	Corporate Retail Outlets

The Committee deliberated on the financial parameters applicable to the above 26 sectors, which are discussed in **Chapter III.**

Chapter III
Recommendations on Sector Specific Parameters

1. The following table gives the summary of sector specific threshold parameters recommended by the Committee. These parameters were selected by the Committee based on its discussions with the Rating Agencies and lending institutions. For this purpose, sector reports were obtained from rating agencies and lending institutions as also experience of the banking sector in their own credit appraisal and polices. Certain outliers found by the Committee are explained later.

2. The sector specific parameters may be considered as guidance for preparation of RP for a borrower in the specified sector. The RP may be prepared based on the pre-Covid-19 operating and financial performance of the borrower and impact of Covid-19 on its operating and financial performance in Q1 and Q2FY21, to assess the cash-flows for FY21 / FY22 and subsequent years. In these financial projections, the threshold TOL/Adjusted TNW and Debt/ EBIDTA ratios should be met by FY23. The other three threshold ratios should be met for each year of the projections starting from FY22. The base case financial projections need to be prepared as part of RP.

3. In respect of those sectors where the threshold parameters have not been specified by the Committee, lenders can make their own internal assessments for the solvency ratios i.e. TOL/Adj TNW and Total Debt/EBIDTA. However, the current ratio and DSCR shall be 1.0 and above, and ADSCR shall be 1.2 and above.

4. The Committee has uniformly proposed thresholds for current ratio, DSCR and ADSCR as in the table below in most of the sectors (exceptions flagged in the table). The borrowers eligible under the current Framework are Standard Accounts and as such, they may require some time to restore their position to pre-Covid-19 levels.

Table

Sectors	TOL / ATNW	Total Debt/ EBITDA	Current Ratio	Average DSCR	DSCR
Auto Components	<= 4.50	<= 4.50	>= 1.00	>= 1.20	>= 1.00
Auto Dealership	<=4.00	<=5.00	>=1.00	>=1.20	>=1.00
Automobile Manufacturing*	<= 4.00	<= 4.00	--	>= 1.20	>= 1.00
Aviation**	<= 6.00	<= 5.50	>= 0.40	--	--
Building Materials - Tiles	<=4.00	<=4.00	>=1.00	>=1.20	>=1.00
Cement	<=3.00	<=4.00	>=1.00	>=1.20	>=1.00
Chemicals	<=3.00	<=4.00	>=1.00	>=1.20	>=1.00
Construction	<=4.00	<=4.75	>=1.00	>=1.20	>=1.00
Consumer Durables / FMCG	<=3.00	<=4.00	>=1.00	>=1.20	>=1.00
Corporate Retails Outlets	<=4.50	<=5.00	>=1.00	>=1.20	>=1.00
Gems & Jewellery	<=3.50	<=5.00	>=1.00	>=1.20	>=1.00
Hotel, Restaurants, Tourism	<=4.00	<=5.00	>= 1.00	>=1.20	>=1.00
Iron & Steel Manufacturing	<=3.00	<=5.30	>=1.00	>=1.20	>=1.00
Logistics	<=3.00	<=5.00	>=1.00	>=1.20	>=1.00
Mining	<=3.00	<=4.50	>=1.00	>=1.20	>=1.00
Non Ferrous Metals	<=3.00	<=4.50	>=1.00	>=1.20	>=1.00
Pharmaceuticals Manufacturing	<=3.50	<=4.00	>=1.00	>=1.20	>=1.00
Plastic Products Manufacturing	<=3.00	<=4.00	>=1.00	>=1.20	>=1.00
Port & Port Services	<=3.00	<=5.00	>=1.00	>=1.20	>=1.00
Power					
- Generation	<=4.00	<=6.00	>=1.00	>=1.20	>=1.00
- Transmission	<=4.00	<=6.00	>=1.00	>=1.20	>=1.00
- Distribution	<=3.00	<=6.00	>=1.00	>=1.20	>=1.00
Real Estate***					
- Residential	<=7.00	<=9.00	>=1.00	>=1.20	>=1.00
- Commercial	<=10.00	<=12.00	>=1.00	>=1.20	>=1.00
Roads****	--	--	--	>=1.10	>=1.00
Shipping	<=3.00	<=5.50	>=1.00	>=1.20	>=1.00
Sugar	<=3.75	<=4.50	>=1.00	>=1.20	>=1.00
Textiles	<=3.50	<=5.50	>=1.00	>=1.20	>=1.00
Trading – Wholesale*****	<=4.00	<=6.00	>=1.00	Instead Interest Coverage Ratio > = 1.70	
Others not specified above	To be decided by lenders			>=1.20	>=1.00

***Automobile Manufacturing:**

We are not prescribing any threshold for Current Ratio due to the "just in time inventory" business model for raw materials and parts, and finished goods inventory is funded by channel financing available from the dealers.

*****Aviation:**

1. *Targeted Current Ratio for Airline Industry is kept at 0.40 and above because of following key reasons:*

   - *Cash and carry model for revenue purpose, thereby creating almost nil debtors and higher current liabilities in form of advance received from customers. These advances are approximately 2 months of yearly sales of the airline industries.*
   - *The airline enjoys credit of typically 6-9 months from vendors (including fuel payment).*

2. *DSCR is not ascertainable for airline industry since most of the airline companies work on refinancing of debt as a financing strategy. As a consequence, Avg. DSCR is not ascertainable for airline industry.*

*****Real Estate:**

Considering the typical nature of Real Estate projects, the parameters to be considered at project level rather than at entity level.

*******Roads:**

In the roads sector, the financing is cash flow based and at SPV level where the level of debt is decided at the time of initial project appraisal. It may also be noted that the working capital cycle in this sector is negative. Accordingly, ratios like TOL / ATNW, Debt/EBITDA and Current ratio may not be relevant at the time of restructuring in this sector. Since cash flows of several projects are by way of annuity payments, the threshold ADSCR has been kept at 1.10.

*******Trading - Wholesale**:*

DSCR/ Avg. DSCR is not ascertainable for trading business as most of the companies do not use long term debt for funding their operations and are unlisted.

Annexure I

Details of the Meetings held by the Expert Committee

Sr. No.	Meeting Date	Description
1	August 11, 2020	Internal deliberations
2	August 18, 2020	Internal deliberations
3	August 21, 2020	Internal deliberations and Presentation by CRISIL Limited
4	August 24, 2020	Internal deliberations
5	August 26, 2020	Internal deliberations and Presentation by ICRA, CARE, Association of Power Producers, National Highways Builders Federation (NHBF) and CREDAI National
6	August 28, 2020	Internal deliberations
7	August 30, 2020	Internal deliberations
8	August 31, 2020	Internal deliberations
9	September 1, 2020	Internal deliberations
10	September 2, 2020	Internal deliberations
11	September 3, 2020	Internal deliberations
12	September 4, 2020	Internal deliberations