RBI’s New Framework for Resolving NPAs - II

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What is the need for new reform?

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- Following the RBI’s first asset quality review (AQR) in 2016, state-owned banks had reported sharp slippages.
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- In the same year a whopping Rs.2.7 lakh-odd crore of bad loans were added to the system.
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- Nearly Rs.1.7 lakh crore NPAs were added in just the first nine months of the current fiscal.
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- A significant portion of NPAs had been swept under by banks under the appearance of various restructuring schemes.
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- For this reason RBI has withdrawn the CDR, JLF, SDR, S4A or 5/25, and placed them under the new framework.
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How will the new framework work?

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- Banks will now have to begin the resolution process on an account as soon as it is classified as a Separately Managed Account (SMA-0), where payments are overdue by 1-30 days by any one bank within a consortium.
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- This will tighten the norms for reporting default to the central repository.
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- At least 20 per cent of the outstanding principal and capitalised interest will have to be repaid by the defaulters for the account to be upgraded back to ‘standard’ from default.

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- In respect of accounts with aggregate exposure of Rs.2,000 crore and above, lenders will have to draw up a resolution plan within 180 days from March 1, 2018 (or default date as the case may be).
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- The resolution plans proposed by the banks need the approval of credit rating agencies and will have to deliver results.
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- Failing which banks will have to refer the case for insolvency under the IBC.
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What are few practical constrains with RBI's framework?

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- Banks will have to make higher provisioning 15% when an asset's restructured and 50 per cent if referred to the IBC.
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- With around Rs.2 lakh crore of loans likely to come under the revised framework, capital issues could annoy PSBs yet again.
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- The requirement of all lenders agreeing to the resolution plan could also prove challenging.
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- Whether the existing infrastructure under the IBC set up will be able to deal with the expected deluge of insolvency filings is another issue.
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- Above all, the new framework still deals with the stock of the NPA problem and not the flow.
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Source: Business Line

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Quick Fact

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The following schemes of RBI has been abolished

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CDR

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- Corporate debt restructuring is the reorganization of a company's outstanding obligations.
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- It is often achieved by reducing the burden of the debts on the company by decreasing the rates paid and increasing the time the company has to pay the obligation back.
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SDR

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- Strategic Debt Restructuring was introduced by RBI to help banks recover their loans by taking control of the distressed listed companies.
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- The Scheme has been enacted with a view to revive stressed companies and provide lending institutions with a way to initiate change of management in companies which fail to achieve the milestones under Corporate Debt Restructuring ("CDR").
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S4A

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- Scheme for Sustainable Structuring of Stressed Assets was introduced by RBI as an optional framework.
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- The S4A envisages determination of the sustainable debt level for a stressed borrower, and bifurcation of the outstanding debt into sustainable debt and equity/quasi-equity instruments.
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- This is expected to provide upside to the lenders when the borrower turns around.
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5/25 rule

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- In Infra projects the project’s economic life is 20-25 years and its cash flows are beyond that, but the repayment was restricted to 10 or 15 years.
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- The 5:25 scheme allows banks to extend long-term loans of 20-25 years to match the cash flow of projects, while refinancing them every 5 or 7 years.
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- This expected to match the cash flows according to the repayment schedule and making long-term infrastructure projects viable.
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