



Workshop on Revitalising Distressed Assets

April 2014

The Reserve Bank of India has recently, come out with the final guidelines on the “Framework for Revitalising Distressed Assets in the Economy” and detailed guidelines on the subject of formation of Joint Lenders’ Forum (JLF) and adoption of Corrective Action Plan (CAP) for operationalisation of the framework, refinance of project loans, sale of NPAs by banks and other regulatory measures. The framework is developed outlining a corrective action plan that will incentivize early identification of problem account, timely restructuring of accounts which are considered to be viable, and taking prompt steps by lenders for recovery or sale of unviable accounts.

With an objective to understand and discuss the effective implementation of the said framework, CAFRAL organised a “Workshop on the Framework of Revitalising of Distressed Assets” on April 22, 2014 in its conference room, Mumbai. The workshop was attended by the senior officials from commercial banks, Non-banking FIs, ARCs, Rating Agencies, CDR Cell, legal and other experts as well as senior officers from RBI. The list of attendees is enclosed.

The summary of the discussions held is given below :-

Early recognition and centralised reporting

Quality of data getting reported to RBI by banks

- The present system of reporting to RBI is under off site return and u/s 27 (2) of the BR Act, 1949 and as per the provision, banks are required to report the data within 21 days from the close of the quarter.
- In many cases, the quality of reported data to RBI is observed to be not satisfactory and there are many instances of incorrect reporting.
- RBI has conducted a thematic study which examined the reason for such poor quality of data. The study indicates that many of the banks do not have the system in place to aggregate the exposure of the borrower across multiple types of facilities.
- Different systems are used in the banks to track the exposure of whole sale, retail, trade credit, off-balance sheet items, etc. and due to lack of co-ordination among the different segments in the banks, prior to reporting to RBI, instances of errors and omissions are observed by RBI repeatedly.

Use of software package provided by RBI

- In the software package which RBI has made available to the banks, there is a concept of maker-checker. It is observed that the banks are not adhering to this basic principle

while extracting data and finalising at their end before reporting to RBI. As a result consistency and accuracy is not being maintained by the banks.

- The RBI software package ensures automated data flow from the source file of the respective banks to the RBI without any manual intervention. However, banks are in different stages of implementation of this software. Central credit registry in RBI has started in the XBRL platform and as per the existing set up, banks should generate the “XML” file right from the source which enables them to upload it directly in the RBI site without any hassle. Since banks are not being fully equipped with the stated software, they are unable to generate the “XML” file for uploading in the RBI site resulting into the disruption of smooth flow of data from banks to RBI server.

Identification of various categories of accounts

Issues related to SMA 0 accounts

- In order to have proper system in place for recognition of SMA 0 accounts, banks could look at multiple factors which could be important signal so far as stress and early warning signal is concerned. A few macro factors viz. borrowers' industry segment – whether the industry is under volatile segment- external intelligence, promoters, directors of the firm - group companies rating – transmission of signal from the branches or zones to the HO etc. can be consolidated and such bank-wide data will be very useful for detecting SMA 0 status.
- Use of statistical models like Altman Model i.e predictive model can be explored for identification of SMA 0. A few compliance signals from the customer i.e delay in submission of stock statement etc. can be culled out from the system for better consolidation in arriving at SMA 0 status. Although the Annex of RBI circular contains a few such parameters for SMA 0, the above mentioned points can also be incorporated for better dissemination and awareness.

Issues related to SMA 2 accounts

- RBI has made reporting of SMA 2 live w.e.f from April 1 , 2014. In the present system of XBRL based software platform, once the data gets uploaded, It is difficult at the RBI end to change. Once an account is reported as SMA 2 in the CRICL, the system automatically search the other banks' exposure in that account and generates an automated email other banks as well. Hence, accuracy and integrity of data is of utmost

importance for the overall stability of the system and to implement the RBI guidelines in true spirit.

Practical difficulty expressed by the banks

- Some bankers expressed that Rs. 5 crore is too small an exposure to be aggregated for reporting to the Central Registry. Instead a higher exposure needs to be considered.
- As per extant RBI guidelines, all current account balance (Dr./Cr.) of Rs.1 crore and above needs to be reported to CRILC by the banks. Bankers expressed that for better tracking and monitoring of the accounts, , all the accounts should get reported to RBI, instead of Rs.1 crore and above. RBI clarified that due to operational inconvenience of maintaining such a huge database, RBI has taken a conscious decision of reporting of current account balance of Rs.1 crore and above.

Actions to be taken by the banks

- Bankers need to include in their Core Banking System (CBS), a few qualitative parameters, like projected sale, non-compliance of terms and condition etc. These qualitative parameters are not factored in most of the banks' CBS.
- RBI is in the process of introducing legal entity identifier, a part of Financial Stability Board (FSB) driven initiative post 2008 crisis. Initially a locally operated unit (LOU) is created i.e, CCIL which gives a 20 digit LEI number to all the OTC derivatives contract as well as the large borrowers (Rs. 5.00 crore and above exposure) . Banks need to incorporate this LEI number in their respective CBS platform.
- Credit summations need to be worked upon. Due to adoption of different stand-alone system, in many cases the credit summations derived from CBS does not reveal true status of the outstanding balance.
- Issues like instances of cheque returns, non-submission of stock statement or delayed submission etc. are not actually integrated and more importantly not tracked in case of multiple banking.
- In case of any borrower under RBI caution list, the banks need to be careful and should not extend any lending facility. Further, the banks should not allow opening current account of the non-borrowers.

- If any borrower submits interim order from court for continuation of credit facility, such information need to be immediately brought to the notice of RBI.

Joint Lenders' Forum (JLF) and Corrective Action Plans (CAP)

Issues related to Joint Lenders' Forum (JLF) and suggestions for better operationalization of the framework for better resolution

- Level of participation in JLF has to be at sufficiently senior level officer instead of the present system of representation of mid-level officers. This will ensure faster decision making.
- The decision making has to start at the identification of SMA 1 itself and banks need not wait for the stress signal for reporting as SMA 2. When an account is identified as SMA 1, the banks need to start working on the future course of action including restructuring, recovery etc. It will facilitate faster decision making once it is reported as SMA 2.
- In CDR mechanism there is a system of forwarding flash report of the related case to the members before the meeting for awareness and preparation prior to the meeting. To ensure faster resolution and effective solution, the same system is suggested to be introduced in case of JLF as well.
- In case of SMA 1 also, even though it is not mandatory, but if the bankers feel that JLF can be formed and the issue has to be discussed in detail , the banks should take up such issues even if the accounts are not SMA 2.
- Normally in all the PSBs the decision is approved at the Management Committee (MC) level which actually meets once in a month. If all the JLF members have to get the sanction of their respective MC, the broad purpose of faster resolution under JLF will be defeated. Instead, it is suggested that JLF proposals need to be sanctioned at a level below the MC. There should be some clause in the Inter Credit Agreement (ICA) that the JLF decision need not be vetted by the Board or MC instead a level below MC or Board may be factored
- For faster and effective decision making, the bank with the highest exposure and the next to highest exposure should discuss together and come out with the strategy even before the discussion under JLF. This can be done through the creation of JLF sub-committee in line with the CDR mechanism.

- Even though as per the RBI guidelines ICA has to be signed, there is a need for smooth operationalization of ICA among the members and sign off for better rationalisation and smoothening the process.

Issues for RBI clarifications

- Due to the special nature of agriculture loan and reckoning duration of the crop as the main factor for identifying stress, the issue on whether the reporting of SMA 2 by the bankers will include agriculture loan also, was discussed and suggested that RBI should clarify the issue.
- The issue of whether the existing CDR accounts are exempted from formation of JLF was discussed. Since RBI guidelines are silent on this issue, a separate clarification in this regard is sought for.
- In case of formation of JLF members, inclusion of category of banks, financial institutions, multilateral agency like ADB, IFC etc. needs to be clearly spelt out.
- The RBI guideline is silent on the issue of exit option. This needs to be clarified by RBI.
- If a CDR package fails, whether the same CDR has to discuss and come out with the new revival package? or, a JLF has to be formed and that JLF will have to actually come out with the solution?
- In the existing CDR mechanism there is a monitoring committee who can decide the next course of action. If a CDR package fails because of non-co-operation of the members or non-members of the CDR, there is a need for introduction of such monitoring committee at JLF also.
- At present the JLF is for banks and NBFCs who are regulated by RBI only. Private Equities, ARCs are not permitted to CDR. RBI is in discussion with FSDC as to whether insurance companies and other agencies can also be included under the framework.

Issues related to Independent Evaluation Committee (IEC)

- For formation of Independent Evaluation Committee (IEC), a structure will be created by RBI over a period of time based on the experience in the new framework. It was suggested that Industry specific consultants can be engaged to make IEC more effective.

- It is strongly recommended that none of the lenders should be a member of the IEC. IEC should not do the whole process of evaluation and instead they should validate and suggest their expert comments for better resolution. Inclusion of professional bodies like IACI can be explored.
- RBI needs to evaluate the system of IEC after a period of six months. This will ensure plugging the loopholes in the system and will bring new ideas for faster resolution.

Wilful defaulters, Accountability of Promoters / Directors / Auditors

Encouraging response

- Banks feel more empowered in terms of recovery effort, after the present guidelines is issued.
- Along with the RBI, Government also has to come forward and assure every step for strengthening and easing the recovery process.

Need for proper legal framework

- If the banks resort to implementation of “change of management” of the defaulting unit, there should be proper legal system in place which can support this effort. At present the legal system to support this effort is not adequate and there is a need to bring in proper legal mechanism for faster resolution.

Action points for the banks

- In a few cases it has been observed that the defaulting borrowers approached court for continuation of lending facility by the borrower and court has directed the banks not to stop lending facilities. In such a scenario the appropriate course of action need to be worked out in consultation with the RBI.
- A few banks suggested higher interest rate for the wilful defaulters. However, charging higher rate of interest to the wilful defaulters is not the desirable solution to tackle the problem of wilful defaulters. This actually does not work as it will add to the overall cost on the part of the bank only and ultimately if the borrower doesn't pay, the bank has to write it off with more outstanding balance.
- In tackling the issue of wilful defaulters, there is a need for the united effort by the bankers to put ban on any further sanctions to such borrowers.

- Apart from the regular course of due diligence, bankers need to make soft enquiry on the promoters, partners which will help in identifying the weakness of the unit in advance.
- In the guidelines there are provisions of transferring of promoters' holding to a security trustee. Such provisions should not be used as a threat to the promoter, but should be used only as a business advantage.

Clarifications sought from RBI

- Guidelines of wilful defaulters and non-co-operative borrowers are so far not extended to ARCs. This need to be looked into.
- There should be a provision for declaring "Non co-operative borrower"/ "wilful defaulter" by at least 3 to 4 large lenders. Otherwise the small banks may take the advantage of declaring a borrower as "non-co-operative" or "wilful" and the whole process will get delayed. As per RBI guidelines, wilful defaulters are not to be permitted under CDR framework. Similarly these set of borrowers will be a problem under JLF framework also unless the issue of declaring such borrowers as non-co-operative or wilful becomes mandatory by 3 to 4 large lenders instead of any lender of such borrowing unit.

As an alternative to the solution of the above mentioned issue, the JLF should be sufficiently empowered to overrule the decision of declaring a borrower as "non-co-operative" or "wilful" by any bank or group of banks.

Sale of Assets

Practical difficulties in the operationalization of sale of assets to ARCs by Banks

- When the assets are transferred to ARCs - number of accounts are bunched by the banks and very less time is given to ARCs for due diligence at their end which is a deterrent to the ARC for coming out with viable resolution plan for offering. Instead individual accounts or one or two accounts at a time if it is transferred to ARCs, they will have sufficient time for due diligence.
- Banks invite bids from the ARCs for sale of assets. Banks provide only basic information about the accounts. For submission of bids short time is given. During this period at

times it does not become possible for the ARCs to make a meaningful assessment of the value of the assets based on independent enquiries/evaluation. Moreover, most of the banks offer assets for sale towards the close of the financial year or half year. This bunching can be avoided if the banks spread out their sales though out the year.

- In most of the deals only 5-15% sales consideration is offered by ARCs in cash and the remaining in the form of security receipts. In absence of the market for the security receipts these are invariably subscribed by the selling bank. The deals are structured in such a manner that ARCs do not have to bear any down side and the selling bank takes the hit if the SRs are not realised to full extent. Normally, ARCs take 2% management fees every year on the assessed value of the asset and are invariably able to recover their investment in a few years irrespective of the realisation from the asset. Keeping in view the sharp deterioration in the value of SRs in the past there is a need to relook the structure of the deals. Regulatory intervention by way of a model deal structure will be useful.
- Banks give very less time to ARCs for offer price and as a result, carrying out due diligence by the ARCs has become difficult.
- ARCs find it difficult to propose a viable resolution plan at the time of bidding because the present auction process prohibits ARCs to visit plants, sites, machinery to talk to borrowers. Resolution plan like restructuring etc. can only be worked out by ARCs if they are permitted to discuss the issues with the borrower in advance. Hence, the ARCs must endeavour to do so after the purchase of the asset and enhance the ultimate recovery from the asset so that the realisation on SRs is also higher for the buyer.

Clarifications sought from RBI

- Going forward the ARCs should also form consortium approach for buying assets from banks. RBI may consider issuing such guidelines.
- ARC may also be allowed to become member of JLF and CDR

Clarifications sought from IBA

- ARC should also be considered as a member of IBA. This will bring out better exchange of views to sort out specific problem.

Need for better co-ordination between Banks and ARCs.

- There has to be much more co-ordination and transparency and this will definitely be gainful for both ARCs and the banks. Early sale by banks to ARCs will definitely facilitate better recovery by the ARCs.
- Sale of assets between banks and the ARCs will pick up if the banks are able to offer full information about the asset to the ARCs while inviting bids.
- Banks and ARCs themselves have to mutually decide the sale price. RBI's Latest guidelines provides for announcement of the reserve price which is a very welcome step.
- In case of consortium accounts, selling to ARC should be a consortium approach rather than individual bank selling the asset to ARC.

List of participants

First name	Last Name	Designation	Organisation
A K	Verma	GM	Punjab National Bank
Aloke	Chatterjee	GM	RBI
Anil	Bhatia	MD & CEO	J M Financial ARC P Ltd
Ashok	Garg	CGM	CAFRAL
Birendra	Kumar	MD & CEO	International ARC
C V	Balaji	CGM (Stressed Asset Management)	SBI
Diwakar	Gupta	Former MD & CFO	SBI
G	Gopalakrishna	Director	CAFRAL
G K	Sharma	CEO	Invent Assets Securitisation & Reconstruction P Ltd
K K	Arora	GM	Bank of India
Lalit	Chawla	President (Corporate Cr)	Axis Bank
Malini	Bansal	CGM	CDR Cell
Manish	Jaiswal	Sr. Director	CRISIL
Manoj	Poddar	AGM	RBI
Mayank	Agarwal	GM	ICICI Bank
Mohan	Kumar	AGM	Federal Bank
N K	Jha	GM	Canara Bank
P	Rudran	MD & CEO	ARCIL
P H	Ravikumar	MD & CEO	NCDEX
Pothukuchi	Sitaram	CFO	IDBI Bank
Prabhat	Gupta	GM (Regulatory Affairs)	L&T Finance Holdings
Pradyamna	Bapat	Financial Advisor	Adharaya Financial Advisors P Ltd.
Prakash	Baliga	GM	RBI
R K	Bansal	ED	IDBI Bank
R K	Arora	GM (Recovery)	Bank of Baroda
S K	Amarnath	Sr. Vice President	ARCIL
S S	Rao	DGM (Risk Management)	SBI
Sangeet	Shukla	Sr. Advisor	IBA
Satish	Arora	President & COO	International ARC
Sharad	Bhatia	President (Stressed Assets)	Axis Bank
Shashikant	Shah	GM	Bank of India
Shashikant	Bhojani	Partner	Amarchand & Mangaldas
Smita	Aggarwal	CGM	CAFRAL
Somasekhar	Vemuri	Sr. Director	CRISIL
Sudhir	Dayal	DGM	SBI
Udaya	Kumar	GM	Vijaya Bank
Usha	Thorat	Former Director	CAFRAL