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Resolution Framework for COVID 19 Related Stress

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CONTENTS

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Editorial Team: Knowledge Management @ Acquisory

Key Highlights

- Pertinent to save the good borrowers who otherwise have good track record.
- Economic fallout due to Covid-19 pandemic has led to significant financial stress for borrowers across the board – can impact long term viability as their debt burden becoming disproportionate relative to their cash flow generation abilities.
- Current Guidelines of June 07, 2019 provides principle-based resolution framework for addressing borrower defaults under normal scenario – COVID is not only abnormal but akin to force majeure.
- Such widespread impact could impair the entire recovery process, posing significant financial stability risk. Defaults may have led to higher NCLT flow / loss of business ownership which are built with hard efforts and sweat – Discourages entrepreneurial spirit.
- Moratorium was provided in the interim till the impact subsides and corporate / banks are in a position to assess the impact and also expected cash flows to improve. However, there was a need to provide long term sustainable solution.
- In order to revive the sectors and mitigate the impact, RBI has decided to provide a window under the Prudential Framework to permit Resolution to eligible borrowers without change in Ownership and without classification of account as NPA.

Much Needed Relief now extended by RBI

- The Reserve Bank of India has notified the "Resolution Framework for COVID-19-Related Stress " vide their guidelines **RBI/2020-21/16(DOR.No.BP.BC/3/21.04.048/2020-21** dated August 6, 2020.
- RBI decided to provide a window under the prudential framework to enable the lenders to implement a resolution plan in respect of eligible corporate exposure without change in ownership, while classifying such exposures as standard, subject to specified conditions.
- The lending institutions shall ensure that the resolution under this facility is extended only to borrowers having stress on account of COVID 19.
- The lending institutions will be required to assess the viability of resolution plan, subject to the prudential boundaries laid out under this framework.
- Reserve Bank, based on recommendations of Shri K.V. Kamath Expert Committee, issued the framework to be followed mandatorily by all the lending institutions while finalizing the resolution plan in respect of eligible borrowers vide their circular **RBI/2020-21/34(DOR.No.BP.BC/13/21.04.048/2020-21** dated Sept 7, 2020.
- The resolution plan may *inter alia* include **sanctioning of additional credit facilities, extension of the residual tenor of the loan with or without payment moratorium by a period not more than two years and conversion of a portion of debt into equity or other marketable non-convertible debt securities,**

Eligibility and Exceptions

Applicable Lenders

- Commercial banks (including small finance banks, local area banks and regional rural banks)
- Primary (urban) cooperative banks / state co-operative banks/ district central co-operative banks
- All India term financial institutions (NABARD, NHB, EXIM Bank and SIDBI)
- All NBFCs including housing finance companies (HFCs)

Eligible Borrowers

Borrower having an exposure of > Rs. 25 crs and their account classified as standard but not in default for > 30 days with any lending institutions as on March 1, 2020

Lending institutions to ensure that resolution under this framework is extended only to borrowers having stress on account of COVID 19

The K.V. Kamath expert committee, after closely analyzing the Q1 2021 with Q1 2020 financials of companies across many sectors, has summarized that 72% of bank debt in these sectors are affected due to COVID 19 and only these sectors will be eligible for restructuring

Exceptions

- Borrowers with aggregate exposure of up to INR 25 crore as on 1 March 2020
- Exposure to financial service providers
- Exposure to HFCs where the account was rescheduled after 1 March 2020
- Exposure to state and central governments, farm credit & agricultural credit societies

Lending institutions shall frame Board approved policies pertaining to implementation of viable resolution plans for eligible borrowers under this framework

Implementation Guidelines

- Lending institutions to assess the viability of Resolution Plan subject to the prudential boundaries laid out in RBI guidelines with respect to Expert Committee recommendation identifying stressed sectors and Applicable Key Ratios to analyze the acceptability of any Plan.
- The concept behind the financial parameters laid down under this plan are.

  1. Leverage **2.** Liquidity **3.** Debt Serviceability

- Reference date for the outstanding amount of debt shall be considered for resolution as March 1, 2020

- Resolution under this framework may be invoked not later than Dec 31, 2020 and to be implemented within 180 days from date of invocation.

- Date of Invocation shall be the date on which both the borrowers and lending institutions have agreed to proceed with a resolution plan under this framework.

- In case of multiple lending institutions, the resolution process shall be treated as invoked in respect of borrowers if lending institutions representing 75% by value of the total outstanding credit facilities (Fund based as well as Non fund based) and not less than 60% of lending institutions by number agree to invoke the same.

- Once the resolution process is invoked and a resolution plan has to be implemented, Inter Creditor Agreement (ICA) shall be required to be signed by all lending institutions within 30 days form the date of invocation. In case, it is not signed, the invocation will be treated as lapsed and in such cases, the resolution process cannot be invoked again under this framework.

- Resolution plans in which the aggregate exposure of lending institutions is > Rs. 100 crs will be required to have an Independent Credit Evaluation (ICE) by any one credit rating agency (CRA) authorized by Reserve Bank of India under the prudential framework.
- Resolution Plans for all accounts where the aggregate exposure is ≥ Rs. 1,500 crs will be vetted by the Expert committee before implementation under this window.

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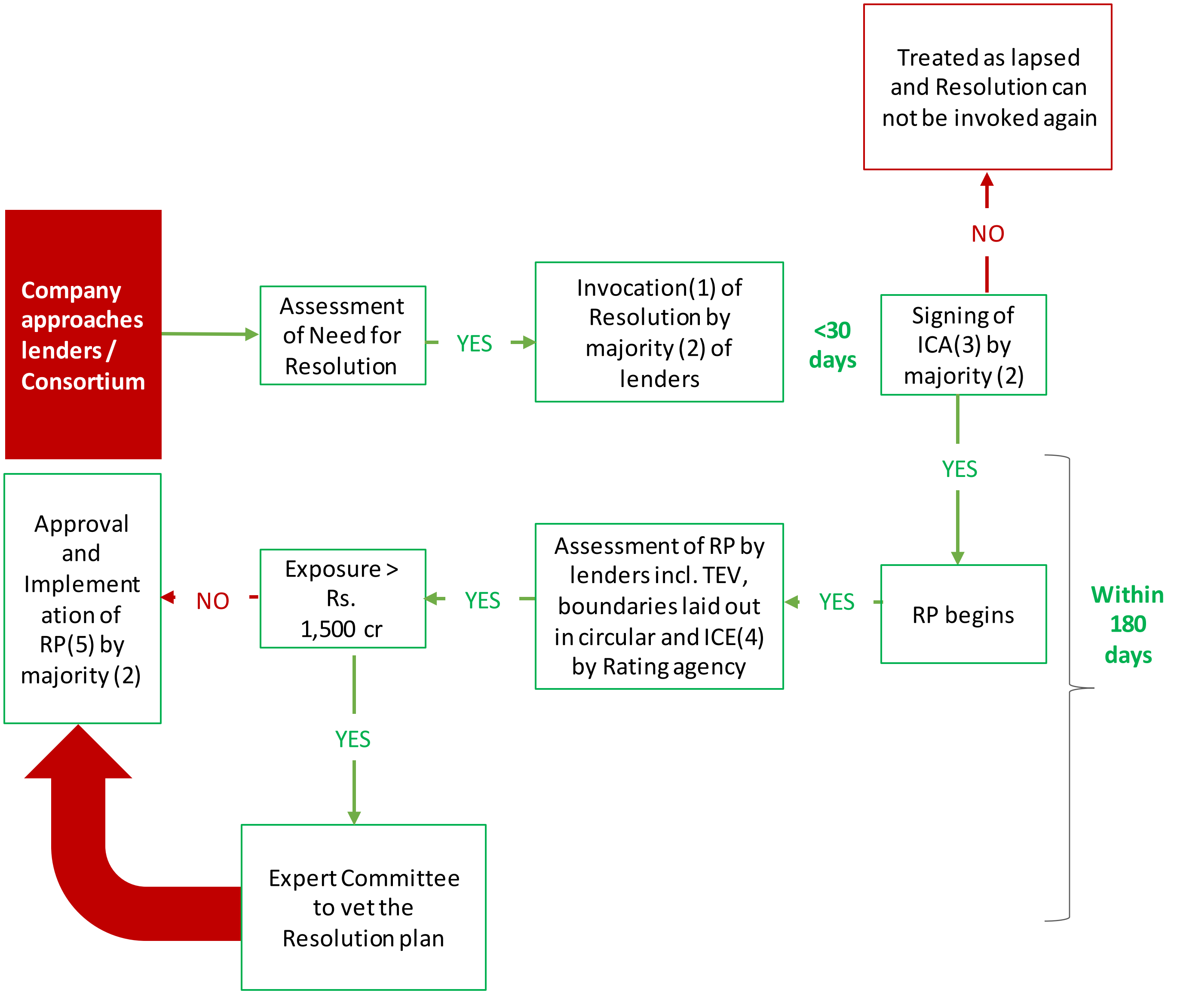
Resolution Process on or before 31st Dec 2020



1. **Invocation** - Date of invocation is the date on which both borrower & lending institution have agreed to proceed with a resolution plan
2. **Majority** - Resolution Process 75% by value of the total O/s Credit facilities (FB + NFB) and 60% by number
3. **ICA** – Inter Creditor Agreement
4. **ICE** - Independent Credit Evaluation
5. **RP** – Resolution Plan

- If a resolution plan is implemented in adherence to the provisions of this facility, the asset classification of borrowers' accounts classified as Standard may be retained as such upon implementation, whereas the borrowers' accounts which may have slipped into NPA between invocation and implementation may be upgraded as Standard, as on the date of implementation of the plan

Financial Parameters - Resolution Framework For COVID 19 Related Stress

- All lending institutions shall mandatorily consider the following key ratios while finalizing the resolution plan in respect of eligible borrowers(annexed). The key ratios under financial parameters laid down by the committee based on leverage, liquidity and Debt serviceability etc. are indicated below
  - **Total Outstanding Liability (TOL) / Adjusted Tangible Net Worth (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 / EBITDA** : 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 / 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
- Based on the outstanding and the severity impact, the sector specific threshold for each of the above key ratios to be considered by the lending institutions in the resolution assumptions for 26 selected sectors are annexed.
- In respect of those sectors where the sector specific thresholds parameters have not been specified, lending institutions shall make their own internal assessment regarding TOL/ATNW and Total Debt / EBITDA. However, the current ratio and DSCR in all cases shall be ≥1.0X and ADSCR shall be ≥1.2X.
- Lending institutions are free to consider other financial parameters as well while finalizing the resolution assumptions in respect of eligible borrowers apart from the above mandatory key ratios and the sector specific thresholds that has been prescribed.
- The ratios prescribed above are intended as Floors or Ceilings as the case may be, but the resolution plans shall take into account the pre COVID 19 operating and financial performance of the borrower and impact of COVID 19 on its operating and financial performance at the time of finalizing the resolution plan to assess the cash flows in subsequent years while stipulating appropriate ratios in each case.
- Given the differential impact of the pandemic on various sectors / entities, the lending institutions at their discretion adopt a graded approach depending on the severity of the impact on the borrower, while preparing or implementing the resolution plan.
- Such graded approach may also entail classification of the impact on the borrowers into mild, moderate and severe.
- Lending institutions are expected to ensure compliance to TOL/ATNW agreed as per the resolution plan at the time of implementation itself. Nevertheless, in all cases this ratios shall have to be maintained as per the resolution plan by March 31, 2022 and on an ongoing basis thereafter. However, wherever the resolution plan envisage equity infusion, the same may be suitably phased-in over this period. All other key ratios shall have to be maintained as per the resolution plan by March 31, 2022 and on an ongoing basis thereafter.
- The various requirement of the resolution framework, especially the mandatory requirement of ICA where ever applicable and maintenance of an Escrow account after implementation of a resolution plan shall be applicable at the borrower/account level i.e. the legal entities to which the lending institutions have exposure to, which could include a special purpose vehicle having a legal entity status set up for a project.

How Acquisory Can Assist in Debt Restructuring

Conversion of Irregular Portion into WCTL

Funding of Unpaid Interest into FITL

Moratorium and Extended Repayment period

Additional Financing

Processes

1 Understanding the Business and Modelling the Scenarios

2 Assessment of Cashflow Mismatches

3 Required solutions within the Ambit of Restructuring Plan related to COVID 19 stress

Acquisory will prepare a Debt Restructuring Plan and Related Documents including Financial Model with Detailed Financial Projections and Scenarios, Modified Repayment Schedule, Information Memorandum and Pitching to the Lenders to Support the Restructuring Proposition in view of COVID related stress

Annexure – 26 Sectors And Its Key Financial Parameters

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

CONTACT US

OUR OFFICES

Delhi NCR

1116, 11th Floor, WTT, C-1, Sector 16,

DND Flyway, Noida – 201301
T: +91 120 614 300
Fax: +91 120 6143033

Mumbai

1st Floor, Unit No. 108, Inspire, BKC, Bandra Kurla Complex, Bandra Ease, Mumbai City, Maharashtra, 400051
T: +91 22 68648100
Fax: +91 22 68648132

Bengaluru

BHIVE WORKSPACE- 7th Floor, Mahalakshmi Chambers, 29, MG Road, Yellappa Garden, Yellappa Chetty Layout, Ashok Nagar, Bengaluru, Karnataka 560001

info@acquisory.com

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- RERA Compliance
- Secretarial

IT Risk, Forensics

- Information Security Management Services
- Forensics
- Technology Risk Solution
- Security Risk Management
- Creative Training Solution

Krishan Goyal	Rajarshi Datta	Divya Vij	Dinesh Pillai
krishan.goyal@acquisory.com	rajarshi.datta@acquisory.com	divya.vij@acquisory.com	dinesh.pillai@acquisory.com