

# Restructuring of Advances



Most of the Chartered Accountants are doing Bank Audits regularly, and restructuring of advances has become very usual these days. Encompassing this and other issues, Reserve Bank of India issues a Master Circular on Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances every year. In this article, the author goes through the basics of restructuring and the various conditions of special regulatory treatment for asset classification.



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## What is a Restructured Account?

**Restructured Account:** As per the Master Circular,

- An account where the bank, for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower concessions that the bank would not otherwise consider.
- Restructuring normally involves modification of terms of the advances/securities, which would generally include, among others, alteration of repayment period/repayable amount/the amount of instalments/rate of interest.
- Extension in repayment tenor of a floating rate loan on reset of interest rate, so as to keep the EMI unchanged, provided it is applied to a class of accounts uniformly, will not render the account to

be classified as “Restructured account”.

- It means, extension or deferment of EMIs to individual borrowers as against to an entire class, would render the accounts to be classified as “restructured accounts”.

The basic condition for an account to be called as a restructured account is that the borrower should be facing financial difficulty because of economic or legal reasons. Hence, if terms of the loan are changed because of competitive reasons, then such an alteration would not be tantamount to “restructuring”.

#### **Repeatedly Restructured Accounts:**

When a bank restructures an account second (or more) time(s), the account is to be considered as a 'repeatedly restructured account'.

However, if the second restructuring takes place after the period up to, which the concessions were extended under the terms of the first restructuring, that account shall not be reckoned as a 'repeatedly restructured account'.

#### **RBI Guidelines**

Banks may restructure the accounts classified under the following categories:

- Standard
- Sub-standard
- Doubtful

#### **Loss account cannot be restructured.**

- Banks cannot reschedule/restructure/renegeiate borrowal accounts with retrospective effect.
- The accounts classified as 'standard assets' should be immediately re-classified as 'sub-standard assets' upon restructuring.
- The non-performing assets, upon restructuring, would continue to have the same asset classification as prior to restructuring and slip into further lower asset classification categories as per extant asset classification norms with reference to the pre-restructuring repayment schedule.
- While a restructuring proposal is under consideration, the usual asset classification norms would continue to apply. The process of re-classification of an asset should not stop merely because restructuring proposal is under consideration.

*For example, ABC Limited applied for rescheduling of the repayment and has 70 days overdue in the loan account at the time of applying.*

*The account will slip to NPA on the 91st day even when the proposal for restructuring is under consideration.*

- The asset classification status as on the date of approval of the restructured package by the competent authority would be relevant to decide the asset classification status of the account after restructuring/rescheduling/renegeiation.
- Normally, restructuring cannot take place unless alteration/changes in the original loan agreement are made with the formal consent/application of the debtor. However, the process of restructuring can be initiated by the bank in deserving cases subject to customer agreeing to the terms and conditions.
- No account will be taken up for restructuring by the banks unless the financial viability is established and there is a reasonable certainty of repayment from the borrower, as per the terms of restructuring package. The accounts not considered viable should not be restructured. Any restructuring done without looking into cash flows of the borrower and assessing the viability of the projects/activity financed by banks would be treated as an attempt at ever greening a weak credit facility and would invite supervisory concerns/action. Also, in that case it would be treated as if no restructuring has been done in the account and the prudential norms will apply based on the existing repayment schedule and terms.
- All restructured accounts, which have been classified as non-performing assets upon restructuring, would be eligible for up-gradation to the 'standard' category after observation of 'satisfactory performance' during the 'specified period'.

#### **What is specified period?**

Specified Period means a period of one year from the date when the first payment of interest or installment of principal falls due under the terms of restructuring package.

**The basic condition for an account to be called as a restructured account is that the borrower should be facing financial difficulty because of economic or legal reasons. Hence, if terms of the loan are changed because of competitive reasons then such an alteration would not be tantamount to “restructuring”.**

### What is Satisfactory Performance?

Satisfactory performance during the specified period means adherence to the following conditions during that period.

#### Non-Agricultural Cash Credit Accounts:

In the case of non-agricultural cash credit accounts, the account should not be out of order any time during the specified period, for a duration of more than 90 days. In addition, there should not be any overdues at the end of the specified period.

#### Non-Agricultural Term Loan Accounts:

In the case of non-agricultural term loan accounts, no payment should remain overdue for a period of more than 90 days. In addition, there should not be any overdues at the end of the specified period.

#### All Agricultural Accounts:

In the case of agricultural accounts, at the end of the specified period the account should be regular.

In case, however, satisfactory performance after the specified period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule.

*For example, an account was restructured on 24-08-2011 and the first interest as per the package falls due on 31-08-2011. As per the original repayment schedule, the outstanding balance in the account on 30-08-2012 and 30-09-2012 should have been ₹80 lakh and ₹70 lakh, respectively and as per the restructuring package the outstanding on the same dates should be ₹120 lakh and ₹110 lakh, respectively. However, the actual outstanding balance as on these dates was ₹122 lakh and ₹109 lakh. Since, the account balance as on 30-09-2012 is ₹89 lakh as against ₹90 lakh, the Bank upgraded the account to 'standard'.*

Now, let us examine the case as per the above-mentioned norms:

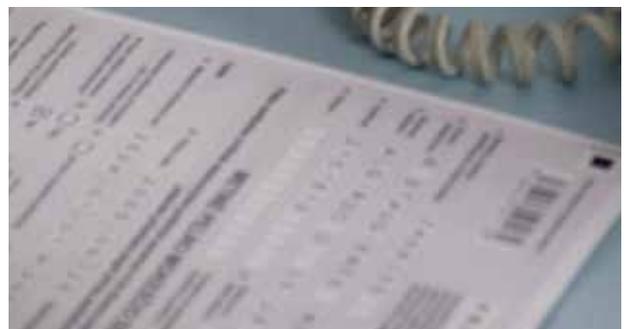
Specified Period	31-08-2011 to 30-08-2012
Satisfactory Performance	No, since as on 30-08-2012 there are overdues of ₹2 lakh. (122 – 120)

Since a satisfactory performance is not

*evidenced, the asset classification would now be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule. As per the pre-restructuring payment schedule, the balance as on 30-09-2012 should have been ₹70 lakh as against the actual outstanding of ₹109 lakh, the action of Bank to upgrade the account on 30-09-2012 is not correct.*

Any additional finance may be treated as 'standard asset', up to a period of one year after the first interest/principal payment, whichever is earlier, falls due under the approved restructuring package. However, in the case of accounts where the pre-restructuring facilities were classified as 'sub-standard' and 'doubtful', interest income on the additional finance should be recognised only on cash basis. If the restructured asset does not qualify for upgradation at the end of the above specified one year period, the additional finance shall be placed in the same asset classification category as the restructured debt.

In case a restructured asset, which is a standard asset on restructuring, is subjected to restructuring on a subsequent occasion, it should be classified as substandard. If the restructured asset is a sub-standard or a doubtful asset and is subjected to restructuring, on a subsequent occasion, its asset classification will be reckoned from the date when it became NPA on the first occasion. However, such advances restructured on second or more occasion may be allowed to be upgraded to standard category after one year from



**In the case of non-agricultural cash credit accounts, the account should not be out of order any time during the specified period, for a duration of more than 90 days. In addition, there should not be any overdues at the end of the specified period.**

the date of first payment of interest or repayment of principal whichever falls due earlier in terms of the current restructuring package subject to satisfactory performance.

### Special Regulatory Treatment for Asset Classification

The special regulatory treatment for asset classification will be available to the borrowers engaged in important business activities, subject to compliance with certain conditions as enumerated below. Such treatment is not extended to the following categories of advances:

- i. Consumer and personal advances;
- ii. Advances classified as Capital market exposures;
- iii. Advances classified as commercial real estate exposures.

The asset classification of these three categories accounts as well as that of other accounts, which do not comply with the conditions enumerated below, will be governed by the prudential norms in this regard described above.

The special regulatory treatment has the following two components:

- i. Incentive for quick implementation of the restructuring package.
- ii. Retention of the asset classification of the restructured account in the pre-restructuring asset classification category.

#### ***Incentive for quick implementation of the restructuring package:***

As mentioned above, during the pendency of the application for restructuring of the advance with the bank, the usual asset classification norms would continue to apply. The process of reclassification of an asset should not stop merely because the application is under consideration. However, as an incentive for quick implementation of the package, if the approved package is implemented by the bank as per the following time schedule, the asset classification status may be restored to the position which existed when the reference was made to the CDR Cell in respect of cases covered under the CDR Mechanism or when the restructuring application was received by the bank in non-CDR cases:

- i. Within 120 days from the date of approval under the CDR Mechanism.
- ii. Within 90 days from the date of receipt of application by the bank in cases other than those restructured under the CDR Mechanism.

**The special regulatory treatment for asset classification will be available to the borrowers engaged in important business activities, subject to compliance with certain conditions as enumerated below. Such treatment is not extended to the categories of advances like 'Consumer and personal advances,' 'Advances classified as Capital market exposures,' 'Advances classified as commercial real estate exposures'.**



*For example, ABC Limited applied for rescheduling of payments on 24-08-2012 to Bank. The account was standard at the time of application but slipped into NPA on 30-09-2012 because of arrears in the account. Now, if the Bank restructures the account before 90 days from the date of application (i.e. 22-11-2012), the asset classification will be restored to standard. However, if the account is restructured after 90 days, then the condition of satisfactory performance during the specified period will have to be complied with for upgrading the account.*

### Asset Classification Benefits

Subject to the compliance with the undernoted conditions in addition to the adherence to the prudential framework laid down above:

- i. An existing 'standard asset' will not be downgraded to the sub-standard category upon restructuring.
- ii. During the specified period, the asset classification of the sub-standard/doubtful accounts will not deteriorate upon restructuring, if satisfactory performance is demonstrated during the specified period.

However, these benefits will be available subject to compliance with the following conditions:

- i. The dues to the bank are 'fully secured'. The

**During the pendency of the application for restructuring of the advance with the bank, the usual asset classification norms would continue to apply. The process of reclassification of an asset should not stop merely because the application is under consideration.**

condition of being fully secured by tangible security will not be applicable in the following cases:

- a. SSI borrowers, where the outstanding is up to ₹25 lakh.
  - b. Infrastructure projects, provided the cash flows generated from these projects are adequate for repayment of the advance, the financing bank(s) have in place an appropriate mechanism to escrow the cash flows, and also have a clear and legal first claim on these cash flows.
  - c. Dues of Micro Finance Institutions (MFIs) restructured up to 31<sup>st</sup> March, 2011
  - ii. The unit becomes viable in 10 years, if it is engaged in infrastructure activities, and in 7 years in the case of other units.
  - iii. The repayment period of the restructured advance including the moratorium, if any, does not exceed 15 years in the case of infrastructure advances and 10 years in the case of other advances. The aforesaid ceiling of 10 years would not be applicable for restructured home loans; in these cases, the Board of Director of the banks should prescribe the maximum period for restructured advance, keeping in view the safety and soundness of the advances. Lending to individuals meant for acquiring residential property which are fully secured by mortgages on residential property that is or will be occupied by the borrower or that is rented are risk weighted as under the new capital adequacy framework, provided the LTV is not more than 75% , based on board approved valuation policy.
- However, the restructured housing loans should be risk weighted with an additional risk weight of 25 percentage points to the risk weight prescribed already.
- iv. Promoters' sacrifice and additional funds brought by them should be a minimum of 15% of banks' sacrifice. The term 'bank's sacrifice' means the amount of "erosion in the fair value of the advance", to be computed as per the methodology enumerated above.
  - v. However, based on the representations received from Banks and Indian Banks' Association that corporate under stress find it difficult to bring in the promoter's share of sacrifice and additional funds upfront on some occasions, it was decided that:
  - vi. The promoter's sacrifice and additional funds required to be brought in by the promoters should generally be brought in upfront. However, if banks are convinced that the promoters face genuine difficulty in bringing their share of the sacrifice immediately and need some extension of time to fulfill their commitments, the promoters could be allowed to bring in 50% of their sacrifice, i.e. 50% of 15%, upfront and the balance within a period of one year.
  - vii. However, in case the promoters fail to bring in their balance share of sacrifice within the extended time limit of one year, the asset classification benefits derived by banks will cease to accrue and the banks will have to revert to classifying such accounts as per the asset classification norms specified above.
  - viii. Promoter's contribution need not necessarily be brought in cash and can be brought in the form of de-rating of equity, conversion of unsecured loan brought by the promoter into equity and interest free loans.
  - ix. Personal guarantee is offered by the promoter except when the unit is affected by external factors pertaining to the economy and industry.
  - x. The restructuring under consideration is not a 'repeated restructuring'

■ Some practical issues with respect to asset classification in respect of restructuring:

	Particulars	Case 1	Case 2	Case 3	Case 4
I	Assumed due date of payment	31-01-2010	31-01-2010		
	Assumed date of restructuring	31-03-2010	31-03-2010	31-03-2010	31-03-2010
	Period of delinquency as on the date of restructuring	2 months	2 months	18 months	18 months
	Asset classification (AC) before restructuring	Standard	Standard	Doubtful – less than one year	Doubtful – less than one year
	Date of NPA	NA	NA	31-12-2008	31-12-2008

Particulars		Case 1	Case 2	Case 3	Case 4
<b>II AC on restructuring</b>					
Assumed status of the borrower		Eligible for special regulatory treatment	Not eligible for special regulatory treatment	Eligible for special regulatory treatment	Not eligible for special regulatory treatment
AC after restructuring		Standard	Downgraded to substandard w.e.f. 31-03-2010 (i.e. from the date of restructuring)	Doubtful – less than one year	Doubtful – less than one year
Assumed first payment due under the revised terms		31-12-2010	31-12-2010	31-12-2010	31-12-2010
<b>III AC after restructuring</b>					
<b>A The <i>account performs satisfactorily</i> as per restructured terms</b>					
(a)	AC during the specified one year period (i.e. from 31-12-2010 to 31-12-2011)	No change (i.e. remains standard)	Doubtful - less than one year w.e.f. 31-03-2011 (i.e. one year after classification as Substandard)	No change (i.e., remains Doubtful – less than one year)	Doubtful - one to three years w.e.f. 31-12-2010 (i.e., one year after classification as Doubtful less than one year)
(b)	AC after the specified one year period	Continues in standard category	Upgraded to standard category	Upgraded to standard category	Upgraded to standard category
<b>B If <i>performance not satisfactory vis-à-vis</i> restructured terms</b>					
(a)	AC during the specified one year period (in case the unsatisfactory performance is established before completion of one year period)	Treated as substandard w.e.f. 30-04-2010 and downgraded to Doubtful less than one year with effect from 30-04-2011	Doubtful – less than one year w.e.f. 31-03-2011 (i.e. one year after classification)	Doubtful one to three years w.e.f. 31-12-2010	Doubtful - one to three years w.e.f. 31-12-2010 (i.e., one year after classification as Doubtful less than one year (on 31-12-2009))
(b)	AC after the specified one year period, if the unsatisfactory performance continues	Will migrate to Doubtful – one to three years w.e.f. 30-04-2012 and Doubtful more than three years w.e.f. 30-04-2014	Will migrate to Doubtful – one to three years w.e.f. 31-03-2012 and Doubtful more than three years w.e.f. 31-03-2014	Will migrate to Doubtful – more than three years w.e.f. 31-12-2012	Will migrate further to Doubtful more than three years w.e.f. 31-12-2012

Reference:

Master Circular– Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances dated 2nd July, 2012 issued by the Reserve Bank of India. ■