RESOLUTION OF STRESSED ASSETS

📊 Historical Asset Classification Practices

Initially, banks classified loans and advances into four categories:

Category	Criteria
✅ **Good and Fully Secured**	Loans with adequate security
✅ **Good Secured by Guarantees**	Loans guaranteed by reliable guarantors
❗ **Doubtful**	Uncertain recoverability
❌ **Bad**	Clearly irrecoverable

📌 Introduction of IRAC Norms

The RBI introduced the **Income Recognition and Asset Classification (IRAC) norms** to establish consistent and prudent accounting practices across banks.

Principles of IRAC:

- Objective **income recognition based on actual recovery records.**
- Classification of assets using **uniform criteria.**
- **Provisioning** based on asset classification, duration of non-performance, and security realizable value.

Currently, all Indian banks follow uniform IRAC norms, monitored by **Bank Boards and regulators.**

🔍 Credit Monitoring

Banks carefully **appraise credit risks before lending to minimize future problems.** Credit monitoring is essential to manage loan portfolios effectively and ensure adherence to repayment schedules.

Fundamental Requirements for a Sustainable Credit Relationship:

Requirement	Importance

🎯 **Purposeful Credit Utilization**	Credit used as per sanctioned terms
📅 **Timely Interest and Principal Repayment**	Critical to avoid overdue accounts
📋 **Regular Information Sharing**	Essential for transparency
🤝 **Protecting Mutual Interest**	Maintains healthy banking relationship

Among these, **timely repayment (📅) is most crucial.** Non-adherence leads to accounts becoming overdue, **eventually classified as Non-performing Assets (NPAs).**

💻 Modern Credit Monitoring Methods

With advancements in IT systems, banks now:

- **Track transactions and account anomalies** in real-time.
- **Automatically halt** operations if limits expire without renewal.
- **Stop interest accruals** if payments are overdue.
- Generate **immediate reports on exceptions.**

🚨 Special Mention Accounts (SMAs)

- Accounts showing early **stress indicators are termed "Special Mention Accounts."**
- Monitoring these accounts **allows proactive intervention**, preventing further deterioration.

💡 Impact of Non-Performing Assets (NPAs)

NPAs negatively impact banks by:

- Not generating income.
- Consuming funds **through mandatory provisioning**.
- Incurring **additional carrying costs.**

📌 **Cost of Carrying NPAs**

Hidden Costs	Transparent Costs
Interest expenses on borrowed funds	Mandatory provisioning
Opportunity loss from idle funds	Reduction in reported profits

Transparent provisioning reflects accurate profitability, whereas hidden costs distort profit figures, causing volatility in financial results.

🕒 Management Attention to NPAs

Managing NPAs demands substantial managerial resources:

- **Frequent visits and negotiations**.
- Intensive **monitoring by senior** officials to encourage diligent recovery efforts by ground staff.

📋 Organizational Approach to Stressed Assets

Banks establish **specialized departments dedicated to stressed asset resolution:**

- Separate **performance metrics for recovery officers**.
- Regular **reporting and supervision** by senior management and the Board of Directors.

☑ Summary Table: Asset Classification and Actions Required

Asset Type	Description	Required Actions
✅ **Standard**	Performing regularly	Regular monitoring

⚠️ **Special Mention**	Early signs of irregularity	Increased monitoring
🟠 **Substandard**	NPA less than or equal to 12 months overdue	Provisioning, aggressive follow-up
🔴 **Doubtful**	NPA over 12 months overdue	Higher provisioning, intensive recovery
❌ **Loss**	Irrecoverable	Full provisioning, write-off actions

📉 Stressed Assets: Why and How 📈

Accounts become stressed due to internal or external factors:

🔍 Reasons for Stressed Assets

Factors	Description & Examples
📅 Business Cycle & Events	Seasonal fluctuations (e.g., woolen industry in summers, refrigerators in winters), unpredictable events like floods, famine, or global crises like the 2008 GFC impacting exports.

⚖️ Regulatory & Legal Events	Andhra Pradesh's ordinance affecting NBFC microfinance companies, leading banks to offer restructuring relief.
📈 Ambitious Cash Flow Projections	Over-optimistic cash flow estimates causing repayment difficulties. Banks must perform sensitivity analysis and benchmark sector practices.
💸 Diversion of Funds	Borrowers not routing transactions through sanctioned accounts or using business funds for personal use, violating RBI guidelines (e.g., RBI Circular dated April 19, 2022).
❌ Misuse of Funds	Using loan funds for purposes other than agreed (e.g., borrowing for a petrol pump but using funds for a retail shop).
⚠️ Over-dependence on Debt	Excessive leverage through borrowed equity causing repayment stress.
📉 Pledge of Owner's Shares	Owner's equity reduced by pledging shares, adversely affecting Debt-Equity Ratio and bank's security.

🌱 Expansion Issues	Unplanned business growth or diversification beyond core competencies leading to asset failures.
🚨 Wilful Default	Intentional default despite business profitability.
📢 Mis-selling of Loans	Selling inappropriate financial products, leading to borrower distress (e.g., derivatives, adjustable-rate mortgages).
📉 Inadequate Credit	Providing insufficient funding for projects, causing financial shortfalls and defaults.

🎯 Stressed Assets Resolution Policy

Banks require a Board-approved policy detailing the management of stressed assets:

(a) 📋 Monitoring and Supervision

- Intensive monitoring, especially for Special Mention Accounts (SMAs).
- Dedicated departments/verticals for managing and recovering stressed assets.

- Specialist staffing with legal and recovery expertise.

(b) 🔄 Follow-up and Restructuring

- Defined monitoring plans, negotiation parameters, and settlement guidelines (One-Time Settlements - OTS).
- Clear assignment of recovery targets for officers.
- Specific guidelines for write-offs, OTS approval, interest waivers, and security releases.

(c) 📊 MIS and Board Oversight

- Regular reporting to senior management and the Board on:
    - NPAs classified and upgraded.
    - Recoveries from cash accruals and asset sales.
    - Movement of SMAs.

(d) ⚙️ Delegation of Authority

- Clearly defined authority levels for approvals of settlements and write-offs.
- Transparency balanced with safeguards against moral hazard and deliberate defaults.

26.3 📚 DEFINITIONS

📌 Non-performing Assets (NPA)

An asset ceasing to generate income is classified as a Non-performing Asset (NPA).

Facility Type	Parameters for Classification as NPA
📅 Term Loan	Interest/principal instalment overdue > 90 days
💳 Overdraft/Cash Credit	"Out of order" as defined below
💼 Bill Purchased/Discounted	Overdue > 90 days
🌾 Crop Loans (short duration)	Principal/interest overdue for 2 crop seasons
🌱 Crop Loans (long duration)	Principal/interest overdue for 1 crop season
🔄 Securitization Transactions	Outstanding liquidity facility overdue > 90 days
📈 Derivative Transactions	Receivables (mark-to-market positive value) overdue > 90 days

📋 'Out of Order' Status

- Outstanding balance exceeds sanctioned limit/drawing power continuously for 90 days, or

- No credits in the account continuously for 90 days, or credits insufficient to cover interest debited in the past 90 days.

🕒 'Overdue' Definition

Any credit facility amount not paid by the due date set by the bank. Such accounts are flagged as overdue during daily end-of-day processes.

26.4 🚦 SPECIAL MENTION ACCOUNTS (SMA)

Banks identify stressed accounts early by categorizing them as Special Mention Accounts (SMAs):

General Loans (Term Loans):

SMA Category	Days Overdue
⚠️ **SMA-0**	1-30 days
⚠️ **SMA-1**	31-60 days
⚠️ **SMA-2**	61-90 days

Revolving Credit Facilities (CC/OD):

SMA Category	Outstanding Exceeds Limit/Drawing Power for:

⚠️ **SMA-1**	31-60 days
⚠️ **SMA-2**	61-90 days

26.5 📊 CENTRAL REPOSITORY OF INFORMATION ON LARGE CREDIT (CRILC)

RBI established CRILC to maintain and disseminate credit data on large exposures (≥ ₹5 crore), including:

- Fund-based exposures
- Non-fund-based exposures
- Investments (bonds/debentures)

Reporting Frequency:

- **Monthly:** CRILC-Main Report
- **Weekly:** Defaults reported every Friday

INCOME RECOGNITION AND ASSET CLASSIFICATION

📌 Income Recognition Policy

- Income from NPAs recognized only on **actual cash recovery**.
- **Interest on advances against secured instruments** (Term Deposits, NSCs, IVPs, KVPs, Life Policies) recognized on accrual if **adequately margined**.

- Fees/commissions from debt renegotiations recognized on **accrual over the renegotiated period**.
- Interest on **government-guaranteed NPAs** recognized only on realization.
- **On turning NPA,** previously accrued but unpaid interest and fees reversed by debiting Profit & Loss account.
- Interest recovered from NPAs can be recognized as income only **if not funded from additional credit facilities**.
- **Unrealized finance charges on leased NPAs** reversed or provisioned.

Asset Classification

NPAs categorized based on non-performing duration and recoverability:

- **Sub-standard**
- **Doubtful** (often sub-categorized: Doubtful-1, Doubtful-2, Doubtful-3)
- **Loss Assets**

🔍 Guidelines for Classification of SMAs and NPAs

- Security/net worth generally not considered in classifying NPAs, except:
- **Doubtful:** Security erosion >50% of original assessed value.
- **Loss Asset:** Security realizable value <10% of outstanding.

Scenario	Classification Guideline
📌 **Ongoing Classification**	Daily, system-driven process
💼 **Temporary Irregularities**	Avoid premature NPA classification
🏭 **Operational but overdue (>90 days)**	Classify as NPA
📅 **Ad hoc Limits**	NPA if not regularized within 180 days
🔄 **Upgradation of NPAs**	Upon payment of arrears
🗂 **Borrower-wise Classification**	All borrower accounts NPA if one account turns NPA
📄 **Bills Discounted**	Classified as NPA if default occurs under LC
⚠️ **Potential Recovery Threats**	Immediate doubtful or loss classification
🌱 **Agricultural Advances**	Classified NPA based on crop seasons

Loans Secured by Liquid Instruments	Not NPA if sufficient margin exists
Central Government Guarantee	Classified NPA upon guarantee repudiation
State Government Guarantee	NPA classification after 90 days overdue
Derivative Contracts	NPA if positive MTM remains unpaid beyond 90 days

Consortium Arrangement

- Classification based on **individual member banks' recovery**.
- **Non-sharing of pooled remittances** treated as NPA by other banks.

Projects Under Implementation (Classification of NPA)

Project Loans

Project loans are term loans **granted for setting up economic ventures.**

Categories

- Infrastructure sector projects
- Non-infrastructure sector projects

26.6.5.2 Project Loans for Infrastructure Sector

Criteria	NPA Classification
Default >90 days before DCCO	Classified as NPA unless restructured appropriately
Failure to commence within 2 years of DCCO	Automatically classified as NPA
Extension due to court cases	Up to 4 years total allowed
Extension for other reasons	Up to 3 years total allowed
Moratorium on interest accrual	No income recognition beyond 2 years from original DCCO

Project Loans for Non-Infrastructure Sector (Including Commercial Real Estate)

Criteria	NPA Classification
Default >90 days before DCCO	Classified as NPA unless restructured appropriately
Failure to commence within 1 year of DCCO	Automatically classified as NPA
Extension due to genuine reasons	Fresh DCCO up to 2 years from original DCCO

For CRE projects	Extension permissible only with compliance to RERA 2016 and revised repayment ≤ extension of DCCO
Moratorium on interest accrual	No income recognition beyond 1 year from original DCCO

26.6.5.4 🔄 Change of Management and Extension of DCCO

- If **a stalled project** undergoes a change of ownership during permissible extension periods or before the original DCCO, banks may:
  - Allow an **additional extension of DCCO up to 2 years**.
  - Maintain **asset classification if conditions stipulated by RBI are met.**
  - **Adjust repayment schedules** accordingly, within permissible limits.

📌 Other Issues Related to Project Loans

A change in **the repayment schedule of project loans due to an increased project scope and size** won't be considered restructuring if:

1. Scope increase occurs before commercial operations begin.

2. Cost increase (excluding overruns) **is ≥25% of the original project cost.**
3. **Project viability is reassessed** before scope enhancement and fresh DCCO approval.
4. **New credit rating** (if previously rated) does not fall by more than one notch.

Multiple DCCO revisions and subsequent repayment schedule adjustments within stipulated time limits are treated as one restructuring event, maintaining standard asset classification. Extensions beyond limits change asset classification to NPA.

📊 Income Recognition in Project Loans Under Implementation

- Recognize **income on accrual basis for standard accounts**; cash basis for sub-standard accounts.
- Reverse **incorrectly accrued interest** previously recognized.
- Make **full provisions for Funded Interest in NPA-classified project loans**.
- For restructured NPAs (without ownership change), **recognize income only on cash basis**.

- **Interest converted to equity or other instruments** requires full income provisioning unless equity is publicly traded (then at market value).

🏦 Take Out Finance (Income Recognition & Provisioning)

- Applicable in **long-term infrastructure financing** arrangements.
- Norms of income recognition and provisioning apply to the **lending bank until assets transfer**.
- Lending bank must **classify non-performing accounts, avoid accrual-based income recognition**, and provision accordingly.

📤 Post-shipment Supplier's Credit

- **Under EXIM Bank Guarantee-cum-refinance programme**, amounts received from EXIM Bank are excluded from NPA classification.
- EXIM Bank **guarantees repayment within 30 days post-invocation**.

🌐 Export Project Finance

- If political reasons delay remittance, asset classification occurs after 1 year from deposit date abroad.
- Requires documented proof of overseas payment completion before NPA classification.

Transfer of Loan Exposures

- If transferee (excluding ARCs) has **no prior exposure to the borrower,** the acquired stressed loan initially classified as **'Standard.' Subsequent** classification based on actual cash flow recovery.
- If **transferee has existing exposure**, the classification aligns with the existing status.
- For ARCs, classification and provisioning follow RBI Master Circular dated April 01, 2022.
- Assets classified as 'Loss' if NPA >36 months for ARCs.

Credit Card Accounts

- Classified as **NPA if minimum payment remains unpaid for 90 days post-statement.**
- **Statement intervals ≤ 1 month**.

PROVISIONING NORMS

Banks are required to **make provisioning based on asset classification norms**, addressing potential delays and security value erosion.

Provision for Standard Assets

Category	Sector/Type	Provision Requirement
Standard Assets	Agriculture, Micro and Small Enterprises	0.25% of funded outstanding
	Commercial Real Estate (CRE)	1.00% of funded outstanding
	Commercial Real Estate - Residential Housing Sector (CRE-RH)	0.75% of funded outstanding
	Housing Loans at teaser rates and restructured advances	2.00% during teaser rate period; 0.40% after 1 year

	Restructured Standard Accounts	5% during 'specified period' for advances up to ₹25 crore to MSME; 15% if default during 'specified period' for other advances
	Medium Enterprises	0.40% of funded outstanding
	All other advances	0.40% of funded outstanding

Provision for Non-Performing Assets (NPAs)

Category	Subcategory/Nature	Provision Requirement
Substandard Assets	Secured Exposure	15% outstanding (without ECGC/security adjustments)
	Unsecured Exposure[1]	Additional 10% (Total: 25%). For infrastructure loans with escrow mechanism:
Doubtful Assets	Unsecured Exposure[1]	100% irrespective of category
	Secured Portion[2] of DA:	
	- DA1	25%

	- DA2	40%
	- DA3	100%

📊 Provisioning Coverage Ratio (PCR)

PCR indicates the extent of provisions banks maintain against their Gross NPAs, with a mandated minimum of 70% (including floating provisions).

RBI Guidelines on PCR:

- Maintain PCR at 70% as per Gross NPAs as of September 30, 2010.
- Excess provisions beyond norms should be recorded as a "countercyclical provisioning buffer."
- Utilize this buffer with RBI approval during system-wide downturns.
- Disclose PCR details in Notes to Accounts of the Balance Sheet.

26.7.2 📌 Disclosure of Divergence in Asset Classification and Provisioning

Banks (excluding Regional Rural Banks) must disclose asset classification and provisioning divergences identified by RBI if:

- Additional provisioning exceeds 10% of reported profit before provisions.
- Additional Gross NPAs exceed 10% of incremental Gross NPAs reported.

For Urban Cooperative Banks (UCBs), incremental Gross NPA threshold begins at 15% and reduces progressively.

26.8 🔄 Options Available to Banks for Stressed Assets

Banks have three main resolution options for stressed assets:

1. Rectification
2. Restructuring
3. Recovery

26.8.1 ☑ Rectification

Rectification corrects account stress through borrower commitment for regularization supported by identifiable cash flows. Additional need-based financing may be provided without lender sacrifice. Timely identification and action are essential.

26.8.2 🔃 Restructuring

Restructuring involves modifying loan terms due to borrower financial difficulties, including:

- Reduced principal installments or maturity amount
- Lower interest rates than original terms
- Interest reduction or forgiveness
- Interest or principal deferral/extensions
- Extended maturity dates beyond market norms
- Extended DCCO beyond regulatory allowances

Formal agreement with new terms is required; otherwise, accounts are treated as impaired. Standard assets typically become substandard upon restructuring, unless exempted by RBI.

RESOLUTION OF STRESSED ASSETS

🚧 Holding on Operations (HOO)

If a default is temporary, banks may apply HOO:

- **Freeze exposure at sanctioned limit** or higher average outstanding.
- **Move irregular portion to separate WCTL account**, allowing operations within frozen limit.
- **Regulate account through cash budgets.**

⚖️ Banks' Right of Recompense

When extending reliefs/concessions:

- Clearly state banks' **recompense rights in sanction letters.**
- Require units to **disclose recompense as a contingent liability annually.**
- Regularly advise and document recompense amounts.
- Include **recompense losses in recovery** if the restructuring package fails.

📚 Framework for Resolution of Stressed Assets

The Framework, initially introduced as the **Reserve Bank of India** (Prudential Framework for Resolution of Stressed Assets) Directions, 2019.

Now part of the Master Circular – Prudential norms on Income Recognition, Asset Classification, and Provisioning (October 2021), it has two components:

A) Framework for Resolution of Stressed Assets B) Prudential Norms for Restructuring

Applicability of the Framework

Applicable to:

- Scheduled commercial banks (excluding Regional Rural Banks)
- All India Term Financial Institutions (e.g., NABARD, NHB, EXIM Bank, SIDBI)
- Small finance banks
- Systemically important NBFCs (NBFC-ND-SI) and deposit-taking NBFCs (NBFC-D)

Exceptions:

- RBI-directed insolvency proceedings
- MSMEs with credit limits ≤ Rs. 25 crore (covered separately under RBI guidelines dated March 17, 2016)
- COVID-19 stress resolutions per specific RBI guidelines

🔍 Identification and Reporting of Stressed Accounts

Banks must immediately **classify defaults into SMA categories** and report to **CRILC for exposures of Rs. 5 crore and above**.

📝 Resolution Plan (RP)

A comprehensive document detailing resolution strategies for stressed accounts, addressing insolvency issues, and ensuring an assessment of resolvability.

📅 Review Period

Upon default, a 30-day period (Review Period) begins for lenders to evaluate resolution strategies or initiate legal actions for insolvency/recovery.

🤝 Inter-creditor Agreement (ICA)

Mandatory ICA among **multiple lenders** to finalize and implement Resolution Plans:

- Binding decisions require **approval from lenders holding ≥75% of outstanding credit value and ≥60% in number**.
- Model **ICA format provided by the Indian Banks' Association.**

⌛ Timeline for Plan Implementation

For corporate debtors with combined indebtedness ≥ Rs. 1500 crore, Resolution Plans must be documented and implemented **within 180 days after the Review Period**.

☑ CONDITIONS FOR PLAN IMPLEMENTATION

Independent Credit Evaluation (ICE)

- Required for restructured loans/change in ownership:
  - Exposure ≥ Rs. 100 crore: One ICE required
  - Exposure ≥ Rs. 500 crore: Two ICEs required

Continuing Credit Exposure

Nature of Plan	Conditions for Implementation
Plans without restructuring/ownership change	No default at 180 days post-Review Period (or 210 days from default date)

Restructuring/ownership change	Completion of documentation, security creation, updated capital structure in records, no defaults post-implementation
Assignment of exposure to third-party	Complete extinguishment of borrower exposure
Recovery actions	Complete extinguishment of borrower exposure

⚠ Additional Provisioning for Implementation Delays

Delay Duration	Additional Provisioning Required
>180 days from Review Period	Additional 20% of total outstanding debt
>365 days from Review Period	Additional 15% (total 35%) of outstanding debt

⚠ Additional Provisioning and Reversal

Additional provisioning is required from all lenders, capped at **100% of the total outstanding debt.** It applies in recovery proceedings until fully resolved.

Nature of Resolution Plan (RP)	Conditions for Reversal of Additional Provisions
Payment of overdue amounts only	No defaults for 6 months post-clearance of all overdue amounts
Restructuring/change in ownership (outside IBC)	Upon successful implementation of RP
Resolution pursued under IBC	Half reversed upon filing insolvency application; remainder upon admission
Assignment of debt/recovery proceedings	Upon completion of debt assignment/recovery

Prudential Norms for Restructuring

Meaning of Restructuring:

Restructuring involves **concessions by lenders due to borrower financial difficulties**, including modifications in terms (interest, repayment periods, additional credit, compromise settlements exceeding three months, etc.).

26.8.2.2.2 Asset Classification:

- Standard assets become sub-standard immediately upon restructuring.
- Existing **NPAs retain their classification post-restructuring.**

26.8.2.2.2.1 Conditions for Upgrading Assets:

Assets upgraded only after:

- **Demonstrating satisfactory performance** (no defaults) during the Monitoring Period.
- **Repayment of ≥10% principal and capitalized interest**.
- At least **one-year lapse from first repayment** after the longest moratorium.

ECR (External Credit Rating):

- ≥ Rs.100 crore: **One investment-grade rating** (BBB- or above).
- ≥ Rs.500 crore: **Two investment-grade ratings** required.

Failure of Satisfactory Performance:

Additional 15% provisioning required if borrower fails satisfactory performance during the Monitoring Period.

📌 Specified Period:

- **Defined from RP implementation** until ≥20% repayment (principal + interest capitalized).

⚠ Default During Specified Period:

- Any defaults **post-upgrade but within specified period** trigger fresh RP with additional 15% provisioning.

💰 Additional Finance:

- Treated as **'standard' during Monitoring** Period if performance is satisfactory.
- Otherwise, **classified similarly to restructured debt**.

🏦 Interim Finance:

- Finance provided **during insolvency under IBC remains 'standard' d**uring the resolution process.
- Post-resolution approval**, norms applicable to additional finance apply.**

💸 Income Recognition:

- **Accrual basis** for restructured 'standard' accounts.
- **Cash basis** for restructured NPAs.

- For additional finance, cash basis unless accompanied by ownership change.

📊 Conversion into Debt/Equity Instruments:

- Instruments created by conversion **remain in the same asset classification as restructured debt**.
- **Valuation governed by RBI Master Circular** on IRAC (April 1, 2022).

🔄 Change in Ownership:

Credit facilities may remain/upgrade to 'standard' post-change in ownership if:

- Acquirer is qualified (Section 29A, IBC).
- Acquirer not related to existing promoter group.
- Acquirer holds ≥26% equity and voting rights.
- Acquirer has ‘control’ as per applicable regulations.
- Conditions outlined in Master Circular are fulfilled.

🔄 **Principles for Classification of Sale and Leaseback Transactions as Restructuring**

A sale and leaseback or similar transaction shall be classified as restructuring if the following conditions are satisfied:

a. The asset seller faces financial difficulty.
b. **Over 50% of the buyer's revenue** from the specific asset depends on the seller's cash flows.
c. At **least 25% of the buyer's loans for asset purchase** come from lenders already having credit exposure to the seller.

📊 Prudential Norms for Refinancing Borrower Exposures

Refinancing or borrowing for repayment of existing loans, either from Indian banking system lenders or with guarantees/support from Indian banks (e.g., Guarantees, Standby Letters of Credit, Letters of Comfort), will be **treated as restructuring if the borrower is under financial stress.**

🛡️ Regulatory Exemptions for Debt-to-Equity Conversion and Non-SLR Securities

▧ Exemptions from RBI Regulations:

- Debt-to-equity conversion exempted from RBI's prudential limits on **unlisted Non-SLR securities**.

- Shares acquired via debt-equity conversion during restructuring exempted from limits on capital market exposure, para-banking activities, and intra-group exposure.
- **Reporting to RBI and annual financial statement disclosures** required. Must comply with Section 19(2) of the BR Act.

26.8.2.2.10.2 ▨ Exemptions from SEBI Regulations:

- Exempt from SEBI's Issue of Capital and Disclosure Requirements (ICDR) Regulations, 2018, **if restructuring complies with RBI regulations.**

26.8.2.2.11 🚩 **Frauds/Wilful Defaulters**

Borrowers involved in fraud, malfeasance, or wilful default are not eligible for restructuring unless:

- New promoters replace old ones.
- Complete dissociation from previous management/promoters.

Restructuring decision based on business viability without affecting criminal actions against previous promoters/management.

🛠️ **Framework for Revival and Rehabilitation of Stressed MSME Advances up to ₹25 crore**

- The Framework for Revival and Rehabilitation of MSMEs (**notified by RBI on March 17, 2016**) offers a streamlined approach for **addressing MSME stress and promoting MSME development.**
- It applies specifically to MSMEs with loan limits up to ₹25 crore, **including those under Consortium or Multiple Banking Arrangements (MBA).**
- Before an MSME loan account turns NPA, banks must proactively identify stress by categorizing them **under Special Mention Accounts (SMAs).**

🧑‍💼 **Committee for Corrective Action Plan (CAP)**

Banks must establish **Committees at District, Regional, or Zonal levels to address stressed MSME accounts**.

Committee Composition:

- Regional/Zonal head of the convener bank (Chairperson)
- Officer-in-charge, MSME Credit Department of the convener bank (Member & Convener)
- One independent external MSME expert
- One representative from the State Government (or a retired bank executive if unavailable)
- Senior representatives of all lenders involved in consortium/MBA cases

CAP Referral:

- **Accounts above ₹10 lakh identified** as SMA-2 must be mandatorily referred to the Committee within 5 days.
- **Accounts ≤ ₹10 lakh identified as SMA**-2 to be examined directly by branch manager/designated official without Committee referral.

In **consortium/MBA cases,** the **lead bank refers stressed accounts to the Committee**, which coordinates between lenders.

Application Process for CAP

Any **lender identifying MSME accounts as SMA-**2, or upon application from the stressed enterprise, forwards accounts **above ₹10 lakh to the Committee**.

Application must include:

- Latest audited financials (including net worth)
- Details of all liabilities (government and unsecured creditors included)
- Nature and extent of stress
- Proposed remedial actions

Separate simplified formats provided by the Indian Banks' Association (IBA) apply for accounts up to ₹10 lakh.

Committee Procedure

Upon receiving an application:

- Notify the MSME within 5 days.
- MSME to respond within 15 days (liabilities and representations).
- Statutory creditors may be notified and allowed 15 days to make representations.

- Committee decides on the CAP within 30 days of the initial meeting and **informs the MSME within 5 days of the decision.**

📌 CAP Options and Timelines

- **Rectification:** Implemented within 30 days.
- **Restructuring:** Conduct a Techno-Economic Viability (TEV) study (within 20 working days for exposures up to ₹10 crore, 30 working days for exposures ₹10 crore-₹25 crore), finalize restructuring within 90 days.
- **Recovery:** Initiate recovery promptly as per the bank's policy and regulations.

📌 **Corrective Action Plan (CAP) by the Committee**

The Committee explores options to address stressed MSME accounts. For exposures ≥ ₹10 crore, a detailed Techno-Economic Viability study is mandatory.

During CAP, the MSME **can access secured/unsecured credit under defined conditions.**

📍 CAP Options:

a. ☑ Rectification:

- Commitment from borrower specifying concrete actions and timelines.
- Backed by identifiable cash flows, no lender sacrifice.
- Additional finance provided only exceptionally and temporarily (max. 6 months); **repeated rectifications within one year treated as restructuring.**
- No additional finance if fraud reported.

b. 🔄 Restructuring:

- For viable enterprises **without wilful default/fraud**.
- Promoter commitment with personal guarantees, net worth, and non-alienation of assets.
- Inter-Creditor Agreement (ICA) and Debtor-Creditor Agreement required.
- Stand-still arrangements to aid restructuring without stopping borrower repayments.

Eligibility:

- Standard, SMA, or Sub-Standard accounts.

- Doubtful accounts eligible if majority lenders classify as Standard/Sub-Standard.
- Wilful defaulters generally excluded unless rectification possible (requires bank board approval).

Conditions for Restructuring:

- Clearly defined timelines and milestones for viability improvements.
- Regular Committee reviews; recovery initiated if milestones missed.
- Restructuring within prescribed timelines.
- Enterprise stakeholders to bear initial losses; lenders protected.

Restructuring Approaches:

- Transfer promoter equity to lenders for sacrifices.
- Promoters infuse additional equity.
- Temporary transfer of promoter equity to a trustee or escrow.
- Sale of non-core assets in diversified groups.

- Listed companies compensate lenders upfront with equity or implement recompense clauses.
- Clearly defined priority among secured, partially secured, and unsecured creditors via ICA.

c. ⚖️ Recovery:

- If rectification/restructuring infeasible, initiate legal recovery.
- Decisions by creditors (≥75% by value and ≥50% by number) binding on all under ICA.
- Legal minimum criteria apply for recovery actions.

Timelines 🕒

- The Committee must decide on the Corrective Action Plan (CAP) and **restructuring package within the stipulated timelines.**
- If there's a delay due to **unavailability of statutory dues information,** an additional period of **30 days** may be availed.
- However, beyond this, the Committee must proceed with the CAP.

Additional Finance 💰

- Additional finance under restructuring/rectification will have **repayment priority** over existing debts.
- Instalments of **additional funding must be repaid before any existing dues.**
- If promoters **can't bring in funds, the enterprise may raise secured/unsecured loans**—with Committee consent.
- If the enterprise fails under rectification or restructuring terms, the **recovery process** must be initiated.

Viability 📊

Viability assessment by the Committee is based on key financial indicators:

Financial Metric	Benchmark/Consideration
Debt-Equity Ratio	Should be within acceptable limit
DSCR	Must indicate debt servicing capability
Current Ratio	Must show sufficient liquidity

26.8.2.3.8 Prudential Norms 🧾

- All **restructuring cases under the Framework** will follow existing **asset classification and provisioning norms** as prescribed by RBI.

26.8.2.3.9 Review 🔍

- If recovery is suggested by the Committee, the borrower may file for **review within 10 working days** of receiving the decision.
- Review allowed only if:
  - There's an **apparent mistake** in the record.
  - **New evidence** or information is discovered.
- Committee will decide within **30 days**, and may implement a new CAP if warranted.

26.8.3 Recovery 💼

Banks have **four major methods** for recovering loans:

Method	Description
Exit 🚪	Borrower is pushed to repay or shift to another bank

Compromise 🤝	Settlement involving partial waiver and mutual agreement
Legal Action ⚖️	Suit filed under Civil or DRT process for legal recovery
Sale of Asset 🏦	Sale to ARC, NBFCs, or other banks for recovery

(a) Exit 🚪

Early Warning Signals for Exit:

- Performance deterioration 📉
- Breach of financial covenants ⚠️
- Negative audit/market reports 🧾
- Sectoral risks or group entity stress

Measures for Exit:

- Freeze limits, increase margin 🧊
- Withdraw concessions 🚫
- Enforce penal interest 🏦
- Nominate directors 🧑‍⚖️
- Consider forensic audit 🕵️‍♀️

(b) Compromise 🤝

- Negotiated settlement involving **sacrifice** by bank and **partial payment** by borrower.
- Compromise amount must be **more beneficial than selling security**.

Key Points:

- Initial deposit as sign of intent 💵
- Prefer lump sum payments 💰
- Installment-based payments to be short-term 📅
- Consent Decree in court suits ⚖️
- Lok Adalat as alternative legal resolution 🏛️

RBI Framework (2023):

- All REs must have Board-approved policy 📋
- Define sacrifice thresholds, accountability, valuation methodology 📉

(c) Filing of Suits ⚖️

Categories:

- **Civil suits**: For dues < ₹20 lakh 🏛️

- **DRT suits**: For dues ≥ ₹20 lakh 🧑‍⚖️

Key Stages:

1. **Pre-filing**:
    - Document verification 📂
    - Security inspection 🏠
    - Jurisdiction & parties' clarification 📍
    - Recall notice 📬
    - Suit preparation 📝
2. **Filing Stage**:
    - Selection of suit type 🏛️
    - Authorised signatory confirmation ✍️
    - Follow-up with advocate 📞
3. **Post-filing**:
    - Application for interim receiver 🧾
    - Injunction or attachment of properties 🔒
    - Interim sale of movable goods 🛒
    - Adducing evidence and court procedures ⚖️

26.8.2.3.10 Types of Decrees

- **(a) Money Decree:** A decree passed in a money suit, enforceable by attachment and sale of movable and immovable properties of the borrower and guarantors.
- **(b) Preliminary Decree:** Passed in mortgage suits granting 6 months to the defendants for redemption. If redemption fails, the court proceeds to pass a final decree.
- **(c) Final Decree after Time for Redemption:** To be applied for within 3 years from the expiry of the redemption period mentioned in the preliminary decree.
- **(d) Decree for Repayment by Instalments:** Decreed amount payable in instalments. If the defendant fails to comply, enforcement of securities begins.

- **(e) Decree by Mutual Consent / Compromise:** Granted when disputes are lawfully compromised and signed by both parties. Advocates usually receive half the remuneration in such cases.
- **(f) Ex-parte Decree:** When the defendant fails to appear or file written statements. Can be set aside later if sufficient cause is shown.

RESOLUTION OF STRESSED ASSETS

Application for Final Decree

Wherever a preliminary decree is obtained, a final decree application must be filed within time.

- **Appeal:** Appeals against **unsatisfactory decrees must be evaluated and filed** within the limitation period in consultation with Legal Department.

◆ **Execution Proceedings (EP):** Filed to execute the decree. Limitation: **12 years from the date of the decree**.

⚙ Modes of Execution of Decree

- Delivery of property specifically decreed
- Attachment and sale (or sale without attachment)
- Arrest and detention in prison
- Appointment of a receiver

🏠 Procedure for Sale of Property

1. Attached/mortgaged property is auctioned.
2. Sale proclamation is published (tom-tom, pamphlets, newspaper, etc.).
3. Sale stopped if debt and costs are paid to court/officer.
4. Decree holder can bid with court's permission.

📌 **Sale may be set aside if:**

- Judgment Debtor (JD) deposits purchase price + costs
- Irregularity or fraud in the sale process
- Judgment Debtor has no saleable interest.

💰 Recovery of Balance Amount after Sale

- File Execution Petition for attachment of other immovable property
- File Execution Petition for attachment of movables
- File Execution Petition for attachment of salary
- File **Execution Petition** for arrest of judgment debtor

💸 Distribution of Sale Proceeds

1. Sale expenses
2. Decree amount
3. Other encumbrances (if any)

🏢 **Enforcement of Securities in Company Liquidation / Insolvency**

📘 **As per Sec. 325 of ICA 2013:**

➡️ Applies similar insolvency rules to companies under liquidation:

- Proving debts
- Valuing contingent liabilities

- Secured creditor rights

⚖️ Suits Instituted Prior to Winding-Up

- Court's leave required to continue suit
- No sale/attachment of assets without court's approval after winding-up

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🧾 ROC Filing (Receiver Appointment)

- Bank must file details with ROC **within 30 days of appointing receiver (court-appointed or otherwise).**
- **Limitation for suit continues**; suit against guarantors to be filed within the limitation period.

🚫 Operations in Account During Winding-Up

- Operations to be stopped on **notice of winding-up**
- Company must obtain **court permission for further payments**

📅 **Limitation for EP (Execution Proceedings):** 12 years from date of final decree.

🔹 (i) Lok Adalats (People's Court) –

📌 Purpose:

As per the **Supreme Court of India** and **RBI guidelines**, banks have been advised to use **Lok Adalats** for:

- ✅ Recovering loans (filed & pre-litigation)
- ✅ Reducing court case pendency

🔧 Use Case:

Banks can approach Lok Adalats for:

🔍 Case Type	📝 Description
Suit-filed accounts	Already filed in court
Pre-litigation accounts	Not yet filed but likely to be litigated

🏛 Organizing Bodies:

Lok Adalats are organized by:

⚙ Authority Type	🏢 Examples
State Legal Services Authority	State level Lok Adalat
District Legal Services Authority	District-level sessions

Supreme/High Court Legal Services Committee	Apex level committees
Taluk Legal Services Committee	Sub-district level

🧾 Jurisdiction & Powers:

- Consent-based jurisdiction
- Parties or court may initiate the referral
- Can handle disputes or potential disputes
- Guided by principles of **justice, equity, and fair play**
- 💼 **Award** is final & binding. **No appeal** allowed 🚫

💰 Monetary Limit:

Lok Adalat Type	Monetary Limit
Civil Court-organized	Up to ₹20 lakh ✅
DRT/DRAT-organized	No monetary cap 🚫

🔹 (ii) Debt Recovery Tribunals (DRTs) 🏛️ 💼

🧾 Purpose:

Established under the **Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI)**, now known as the **Recovery of Debts and Bankruptcy Act, 1993 (RD&B Act)**, to enable:

- ⚡ Speedy adjudication
- 🏦 Recovery of dues by banks and FIs

🏢 Structure:

🧑‍⚖️ DRT Component	📄 Details
Established by	Central Government under the Act of Parliament
Location	Set up in major cities 📍
Volume-based setup	More cases = More DRTs
Presiding Officer	Rank of District & Sessions Judge
Supporting Staff	Includes Recovery Officers, Commissioners, etc.

🔁 **Recovery Officer's orders** are appealable before the Presiding Officer.

⚙️ Tribunal Powers:

✅ Powers like Civil Courts under Summary Procedure (Rule

✅ Can:

- Hear **cross suits**, **counterclaims**, **set-offs**
- Appoint **Receivers**, issue **ex-parte**, **interim**, **review orders**

❌ Cannot:

- Hear claims for **damages**, **service deficiency**, **contract breach**, or **criminal negligence.**

🧾 **Evidence Procedure:**

📑 Type	🔍 Explanation
Evidence Format	By affidavit only 📄
Cross-examination	Only on request & if deemed essential by DRT
Frivolous Requests	May be denied 🚫

🧑‍⚖️ Filing & Process Flow:

📝 Step	🕒 Description

Filing of OA (Original Application)	Bank files claim with DRT within jurisdiction
Joinder of Banks	Other banks/FIs can join existing OA for same borrower
Summons & Response	DRT issues summons; Defendant must reply within 30 days 📅
Written Statement	Must be filed by first hearing (or within extended time allowed)
Interim Injunctions	DRT may restrain defendant from dealing with assets
Final Order & Recovery	After hearing both sides, DRT passes order and issues **Recovery Certificate**

🧑‍⚖️ Appeal Process

⚖️ Appeal Element	📝 Details
Forum	DRAT (Debt Recovery Appellate Tribunal)
Headed by	Chairperson 🧑‍⚖️
Timeline to File	Within **45 days** of receiving DRT order
Deposit Requirement	Up to **50% of due amount**, may be waived with written justification

Consent Orders	No appeal allowed if DRT order was by mutual consent

⏱️ Appeals must be disposed of **within 6 months.**

📆 Limitation Period:

- As per **Limitation Act**
- OA must be filed **within 3 years** from the date of cause of action

📊 Summary Table 📝

🆚 Feature	🔸 Lok Adalat	🔸 DRT/DRAT
Purpose	Settlement through compromise 🤝	Legal recovery of debt 💼
Jurisdiction	Voluntary, based on consent 📜	Statutory, under RD&B Act 🏛️
Monetary Limit	Upto ₹20 lakh (civil courts only) 💰	Minimum ₹20 lakh ✅
Authority	Legal Services Authorities 🏢	Presiding Officer (District Judge level)

Appeal Provision	❌ Not allowed	✅ DRAT → High Court (Writ) 🧑‍⚖️
Settlement Type	Compromise-based only 🤝	Legal adjudication 🧾
Evidence Procedure	Oral/summary	Affidavits + limited cross-examination
Timeframe	Fast-track, one-day forums ⏳	Faster than civil courts ⏱️
Legal Backing	Legal Services Authorities Act, 1987 📘	Recovery of Debts and Bankruptcy Act 📘

🔷 **SARFAESI Act, 2002 – A Powerful Recovery Tool** 📜 💼

The **Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI)** Act, 2002 empowers **banks and financial institutions** (FIs) to recover defaulted loans by enforcing security interests **without court**

intervention. It was introduced to align India's banking framework with international standards and reduce mounting NPAs 📉.

🚨 Why SARFAESI Was Needed?

⚠️ Issue	🔎 Explanation
Rising NPAs in the late 1990s	Banks faced difficulties in recovering defaulted loans
Slow legal processes	Civil courts were inefficient and time-consuming
Reform recommendations	Suggested by Narasimham II & Andhyarujina Committees
Global alignment	Aimed to match global financial recovery standards

🔑 Key Provisions of the Act

SARFAESI revolutionized recovery by introducing:

🔸 Provision	📌 Purpose

Securitisation of assets	Convert illiquid assets to tradable securities
Reconstruction of financial assets	Rehabilitate bad assets via restructuring
Recognition of 'security interest'	Even when asset not in possession
Direct enforcement rights	Recover dues without courts ⚖️
Central Registry (CERSAI)	Record creation of security interests 🔐

📦 What is a 'Financial Asset' under SARFAESI?

💼 **Type of Financial Asset**

✅ Secured or unsecured debt/receivables

✅ Mortgaged immovable property

✅ Hypothecation or pledge of movable assets

✅ Beneficial interest in movable/immovable properties (current or future)

🛠️ Powers of Banks/FIs:

✅ Enforce security without approaching court or DRT

✅ Override other laws (legal supremacy)

✅ Choose between DRT, SARFAESI or civil court

❌ However, SARFAESI applies **only to secured assets** and **not personal belongings.**

⚙️ 🔒 Enforcement Conditions – When Can SARFAESI Be Used?

✅ **Condition**

- Account must be classified as **NPA** per RBI norms
- Dues (with interest) must be **≥ ₹1 lakh**
- Outstanding must exceed **20%** of principal + interest
- Not time-barred under **Limitation Act**
- Charge must be **registered with CERSAI**

❌ **Exclusions – Where SARFAESI Doesn't Apply**

🚫 Not Covered by SARFAESI

Lien under Indian Contract Act or Sale of Goods Act
Pledge under Section 172 of Indian Contract Act
Security in aircraft or ships 🚢 ✈️
Agricultural land 🚜
Right of unpaid sellers
Properties protected under CPC Section 60

📩 SARFAESI Notice Procedure

1. 🔔 **60-Day Notice** served to borrower after NPA declaration
2. 📄 Notice includes:
   - Due amount
   - Details of security
   - Loan defaults and overdue period
3. 🔄 If borrower responds, reply must be evaluated within **15 days**

💼 If Borrower Doesn't Pay...

Bank can:

- 🏠 Take possession of asset

- 🧑‍💼 Appoint manager
- 🏢 Take over business
- 💰 Recover secured dues via asset sale

👮 Magistrate's Role

Bank may request:

- Chief Metropolitan Magistrate (CMM) or
- Chief Judicial Magistrate (CJM)

➡️ To help take **possession/control** of the secured asset 🏛️

They then **handover possession** to the bank 🔐

📣 Borrower's Right to Appeal

🧑‍⚖️ Forum	⏱️ Timeline	💸 Deposit Requirement
DRT	Within 45 days	None
DRAT (Appeal)	Within 30 days	50% (can be reduced to 25%)

✅ Compensation to borrower if possession wrongly taken

⚖️ RD&B Act vs SARFAESI Act

🔍 Feature	RD&B Act, 1993	SARFAESI Act, 2002
Who adjudicates?	DRT	Bank/FI (no court)
Appeal by borrower	After DRT order	After bank's action under SARFAESI
Scope	Borrower, guarantor & securities	Secured asset only
Minimum due	₹20 lakh	₹1 lakh & 20% of principal + interest
Asset type	All types of security	Only secured assets

🔄 Sale of Loan Assets – Recovery via ARCs/SCs 💼 📦

SARFAESI enables **Securitisation Companies (SCs)** and **Asset Reconstruction Companies (ARCs)** to buy NPAs from banks and recover them using SARFAESI powers.

🔍 Who can invest?	💼 Qualified Institutional Buyers (QIBs)
🔐 **Instrument used**	🔸 Security Receipts
🏦 **Role of ARC**	Aggregator & recovery agent for bank NPAs

🔁 Methods Used by ARCs:

🔧 Reconstruction Action	🔎 Purpose
Change/Takeover of management	Improve recovery
Sale/Lease of borrower's business	Liquidation or monetization
Rescheduling of debt	To ease cash flows
Asset possession & enforcement	To realize security interest
Settlement of dues	One-time settlement options 💰

🔄 RBI Guidelines for SMA-2/NPAs

Banks/NBFCs/FIs can now:

- Buy/sell **SMA-2**, **NPAs**, and **Non-Performing Investments**
- Improve balance sheet by **asset quality clean-up**
- Reduce cost of legal recovery via **sale to ARCs**

🗑️ Write-Off – When Recovery Seems Impossible ❌ 💰

When recovery efforts fail, banks may write off the asset.

🧾 Types of Write-Off:

✏️ Type	📌 Description

🔹 **Technical Write-Off**	Debt adjusted against provision, but recovery efforts continue (contra entry)
🔹 **Actual Write-Off**	Final removal, used in **compromise settlements** or full loss cases

📊 Summary Table – SARFAESI Act & Related Recovery Tools

🆚 Feature	🧾 SARFAESI Act	🏛 RD&B Act (DRT)	💼 ARC/SC Recovery
Judicial intervention needed?	❌ No	✅ Yes	❌ No
Applicable debt threshold	₹1 lakh & 20% of loan	₹20 lakh	NPA or SMA-2 asset
Asset Type	Secured assets only	All borrower-related assets	Acquired NPAs
Enforcement method	Possession, Sale, Management Takeover	Court order via DRT	ARC-led recovery via multiple tools
Appeals Available	✅ DRT → DRAT	✅ DRAT → HC	❌ Not generally
