भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA
www.rbi.org.in

RBI/2014-15/627
DBR.BP.BC.No.101/21.04.132/2014-15 June 8, 2015

All Scheduled Commercial Banks
(excluding RRBs)
All-India Term-lending and Refinancing Institutions
(Exim Bank, NABARD, NHB and SIDBI)

Dear Sir,

Strategic Debt Restructuring Scheme

Please refer to our circular DBOD.BP.BC.No.97/21.04.132/2013-14 dated February 26, 2014 on "Framework for Revitalising Distressed Assets in the Economy – Guidelines on Joint Lenders' Forum (JLF) and Corrective Action Plan (CAP)", wherein change of management was envisaged as a part of restructuring of stressed assets. Paragraph 5.3 of the circular states that *the general principle of restructuring should be that the shareholders bear the first loss rather than the debt holders. With this principle in view and also to ensure more 'skin in the game' of promoters, JLF/Corporate Debt Restructuring Cell (CDR) may consider the following options when a loan is restructured:*

- *Possibility of transferring equity of the company by promoters to the lenders to compensate for their sacrifices;*
- *Promoters infusing more equity into their companies;*
- *Transfer of the promoters' holdings to a security trustee or an escrow arrangement till turnaround of company. This will enable a change in management control, should lenders favour it.*

2. It has been observed that in many cases of restructuring of accounts, borrower companies are not able to come out of stress due to operational/ managerial inefficiencies despite substantial sacrifices made by the lending banks. In

such cases, change of ownership will be a preferred option. Henceforth, the Joint Lenders' Forum (JLF) should actively consider such change in ownership under the above Framework issued vide the circular dated February 26, 2014.

3. Further, paragraph 5.1 of the circular states that *both under JLF and CDR mechanism, the restructuring package should also stipulate the timeline during which certain viability milestones (e.g. improvement in certain financial ratios after a period of time, say, 6 months or 1 year and so on) would be achieved. The JLF must periodically review the account for achievement/non-achievement of milestones and should consider initiating suitable measures including recovery measures as deemed appropriate.* With a view to ensuring more stake of promoters in reviving stressed accounts and provide banks with enhanced capabilities to initiate change of ownership in accounts which fail to achieve the projected viability milestones, banks may, at their discretion, undertake a '**Strategic Debt Restructuring (SDR)**' by converting loan dues to equity shares, which will have the following features:

i. At the time of initial restructuring, the JLF must incorporate, in the terms and conditions attached to the restructured loan/s agreed with the borrower, an option to convert the entire loan (including unpaid interest), or part thereof, into shares in the company in the event the borrower is not able to achieve the viability milestones and/or adhere to 'critical conditions' as stipulated in the restructuring package. This should be supported by necessary approvals/authorisations (including special resolution by the shareholders) from the borrower company, as required under extant laws/regulations, to enable the lenders to exercise the said option effectively. Restructuring of loans without the said approvals/authorisations for SDR is not permitted. If the borrower is not able to achieve the viability milestones and/or adhere to the 'critical conditions' referred to above, the JLF must immediately review the account and examine whether the account will be viable by effecting a change in ownership. If found viable under such examination, the JLF may decide on whether to invoke the SDR, i.e. convert the whole or part of the loan and interest outstanding into equity shares in the borrower company, so as to acquire majority shareholding in the company;

ii. Provisions of the SDR would also be applicable to the accounts which have been restructured before the date of this circular provided that the necessary enabling clauses, as indicated in the above paragraph, are included in the agreement between the banks and borrower;

iii. The decision on invoking the SDR by converting the whole or part of the loan into equity shares should be taken by the JLF as early as possible but within 30 days from the above review of the account. Such decision should be well documented and approved by the majority of the JLF members (minimum of 75% of creditors by value and 60% of creditors by number);

iv. In order to achieve the change in ownership, the lenders under the JLF should collectively become the majority shareholder by conversion of their dues from the borrower into equity. However the conversion by JLF lenders of their outstanding debt (principal as well as unpaid interest) into equity instruments shall be subject to the member banks' respective total holdings in shares of the company conforming to the statutory limit in terms of Section 19(2) of Banking Regulation Act, 1949;

v. Post the conversion, all lenders under the JLF must collectively hold 51% or more of the equity shares issued by the company;

vi. The share price for such conversion of debt into equity will be determined as per the method given in paragraph 4 of this circular;

vii. Henceforth, banks should include necessary covenants in all loan agreements, including restructuring, supported by necessary approvals/authorisations (including special resolution by the shareholders) from the borrower company, as required under extant laws/regulations, to enable invocation of SDR in applicable cases;

viii. The JLF must approve the SDR conversion package within 90 days from the date of deciding to undertake SDR;

ix. The conversion of debt into equity as approved under the SDR should be completed within a period of 90 days from the date of approval of the SDR package by the JLF. For accounts which have been referred by the JLF to CDR Cell for restructuring in terms of paragraph 4.2 of circular DBOD.BP.BC.No.97/21.04.132/2013-14 dated February 26, 2014 cited above, JLF may decide to undertake the SDR either directly or under the CDR Cell;

x. The invocation of SDR will not be treated as restructuring for the purpose of asset classification and provisioning norms;

xi. On completion of conversion of debt to equity as approved under SDR, the existing asset classification of the account, as on the reference date indicated at para 4(ii) below, will continue for a period of 18 months from the reference date. Thereafter, the asset classification will be as per the extant IRAC norms, assuming the aforesaid 'stand-still' in asset classification had not been given. However, when banks' holding are divested to a new promoter, the asset classification will be as per the para 3(xiii) of this circular;

xii. Banks should ensure compliance with the provisions of Section 6 of Banking Regulation Act and JLF should closely monitor the performance of the company and consider appointing suitable professional management to run the affairs of the company;

xiii. JLF and lenders should divest their holdings in the equity of the company as soon as possible. On divestment of banks' holding in favour of a 'new promoter', the asset classification of the account may be upgraded to 'Standard'. However, the quantum of provision held by the bank against the said account as on the date of divestment, which shall not be less than what was held as at the 'reference date', shall not be reversed. At the time of divestment of their holdings to a 'new promoter', banks may refinance the existing debt of the company considering the changed risk profile of the company without treating the exercise as 'restructuring' subject to banks making provision for any diminution in fair value of the existing debt on account of the refinance. Banks may reverse the provision held against the said account only when all the outstanding loan/facilities in the account perform satisfactorily during the 'specified period' (as defined in the extant norms on restructuring of advances), i.e. principal and interest on all facilities in the account are serviced as per terms of payment during that period. In case, however, satisfactory performance during the specified period is not evidenced, the asset classification of the restructured account would be governed by the the extant IRAC norms as per the repayment schedule that existed as on the reference date indicated at para 4 (ii) below, assuming that 'stand-still' / above upgrade in asset classification had not been given. However, in cases where the bank exits the account completely, i.e. no longer has any exposure to the borrower, the provision may be reversed/absorbed as on the date of exit;

xiv. The asset classification benefit provided at the above paragraph is subject to the following conditions:

a. The 'new promoter' should not be a person/entity/subsidiary/associate etc. (domestic as well as overseas), from the existing promoter/promoter group. Banks should clearly establish that the acquirer does not belong to the existing promoter group; and

b. The new promoters should have acquired at least 51 per cent of the paid up equity capital of the borrower company. If the new promoter is a non-resident, and in sectors where the ceiling on foreign investment is less than 51 per cent, the new promoter should own at least 26 per cent of the paid up equity capital or up to applicable foreign investment limit, whichever is higher, provided banks are satisfied that with this equity stake the new non-resident promoter controls the management of the company.

4. The conversion price of the equity shall be determined as per the guidelines given below:

(i) Conversion of outstanding debt (principal as well as unpaid interest) into equity instruments should be at a 'Fair Value' which will not exceed the lowest of the following, subject to the floor of 'Face Value' (restriction under section 53 of the Companies Act, 2013):

a) Market value (for listed companies): Average of the closing prices of the instrument on a recognized stock exchange during the ten trading days preceding the 'reference date' indicated at (ii) below;

b) Break-up value: Book value per share to be calculated from the company's latest audited balance sheet (without considering 'revaluation reserves', if any) adjusted for cash flows and financials post the earlier restructuring; the balance sheet should not be more than a year old. In case the latest balance sheet is not available this break-up value shall be Re.1.

(ii) The above Fair Value will be decided at a 'reference date' which is the date of JLF's decision to undertake SDR.

5. The above pricing formula under Strategic Debt Restructuring Scheme has been exempted from the Securities and Exchange Board of India (SEBI) (Issue of Capital and Disclosure Requirements) Regulations, 2009 subject to certain conditions, in terms of SEBI (Issue of Capital and Disclosure Requirements) (Second Amendment) Regulations, 2015 notified vide the Gazette of India Extraordinary Part–III–Section 4, published on May 5, 2015. Further, in the case of listed companies, the acquiring lender on account of conversion of debt into equity under SDR will also be exempted from the obligation to make an open offer under regulation 3 and regulation 4 of the provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 in terms of SEBI (Substantial Acquisition of Shares and Takeovers) (Second Amendment) Regulations, 2015. This has been notified vide the Gazette of India Extraordinary Part–III–Section 4 published on May 05, 2015. Banks should adhere to all the prescribed conditions by SEBI in this regard.

6. In addition to conversion of debt into equity under SDR, banks may also convert their debt into equity at the time of restructuring of credit facilities under the extant restructuring guidelines. However, exemption from regulations of SEBI, as detailed in paragraph 5 above, shall be subject to adhering to the guidelines stipulated in the above paragraphs.

7. Acquisition of shares due to such conversion will be exempted from regulatory ceilings/restrictions on Capital Market Exposures, investment in Para-Banking activities and intra-group exposure. However, this will require reporting to RBI

(reporting to DBS, CO every month along with the regular DSB Return on Asset Quality) and disclosure by banks in the Notes to Accounts in Annual Financial Statements. Equity shares of entities acquired by the banks under SDR shall be assigned a 150% risk weight for a period of 18 months from the 'reference date' indicated in paragraph 4(ii). After 18 months from the 'reference date', these shares shall be assigned risk weights as per the extant capital adequacy regulations.

8. Equity shares acquired and held by banks under the scheme shall be exempt from the requirement of periodic mark-to-market (stipulated vide Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by Banks) for the 18 month period indicated at para 3(xi).

9. Conversion of debt into equity in an enterprise by a bank may result in the bank holding more than 20% of voting power, which will normally result in an investor-associate relationship under applicable accounting standards. However, as the lender acquires such voting power in the borrower entity in satisfaction of its advances under the SDR, and the rights exercised by the lenders are more protective in nature and not participative, such investment may not be treated as investment in associate in terms of paragraph 10.2.3 of Annexure to circular DBOD.No.BP.BC.89/21.04.018/2002-03 dated March 29, 2003 on 'Guidelines on Compliance with Accounting Standards (AS) by Banks'.

Yours faithfully,

(Sudarshan Sen)
Chief General Manager-in-Charge