

**DEBT RESTRUCTURING MECHANISM & REHABILITATION POLICY FOR
SMALL AND MEDIUM ENTERPRISES (SMEs)**

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**DEBT RESTRUCTURING MECHANISM & REHABILITATION POLICY
FOR SMALL AND MEDIUM ENTERPRISES (SMEs)**

1. Objective:

This policy on Debt Restructuring & Rehabilitation for Small & Medium Enterprises (SMEs) has been framed taking into consideration the extant RBI guidelines on Restructuring/Rehabilitation and also the Bank's prevalent instructions on Restructuring.

The objective of this Policy is to ensure timely and transparent mechanism for restructuring the debts of viable SMEs facing problems, outside the purview of BIFR, DRT, CDR and other legal proceedings. In particular, the framework will aim at preserving viable SMEs that are affected by certain internal and external factors and minimize the losses to the creditors (the Bank) and other stakeholders through an orderly, coordinated and pre-emptive restructuring program or rehabilitation package.

2. Scope & Applicability

The Micro, Small & Medium Enterprises Development (MSMED) Act 2006 which has come into effect from 2nd October 2006 act classifies enterprises into three categories – Micro, Small and Medium based on investment levels as under:

Sr.	Description of Enterprises	Manufacturing Sector	Services Sector
		Investment(*) in Plant & Machinery	Investment(*) in Equipment
a.	Micro	Up to and including Rs.25 lacs	Up to and including Rs.10 lacs
b.	Small	Above Rs.25 lacs but upto and inclusive of Rs.5 crores	Above Rs.10 lacs but upto and inclusive of Rs.2 crores
c.	Medium	Above Rs.5 cr. but upto and inclusive of Rs.10 cr.	Above Rs.2 cr. but upto and inclusive of Rs.5 cr.

(*) excluding cost of pollution control, research and development, industrial safety devices and such other items as may be specified by notification.

2.1 This policy intends to cover basically Viable or Potentially Viable SME units (both manufacturing and non-manufacturing) that are facing problems which can be over come with timely remedial/corrective action. These problems may be due to cost/time overrun before commercial production, mismatch in cash flows resulting in temporary liquidity crunch, external factors etc. The guidelines enumerated below may generally be made applicable to accounts which are showing signs of slippage or have slipped to NPA category but have not become "unviable". In such accounts, timely decision on restructuring would be helpful. These accounts are more likely to be Standard and Sub

Standard accounts but instances of even doubtful accounts having potential viability cannot be ruled out. Restructuring may or may not involve additional funding. In such accounts, we may be required to permit “Holding on operations” in the account till decision is taken on the restructuring proposal as per the existing guidelines on holding on operations.

- 2.2 For eligible SMEs under Consortium/Multiple Banking Arrangement, the Bank with the maximum outstanding may work out the restructuring package along with the Bank having the second largest share
- 2.3 In case of multiple banking/syndicate/consortium accounts where restructuring can be considered under Corporate Debt Restructuring Scheme (CDRS), we may make effective use of CDR mechanism.
- 2.4 In case of accounts referred to BIFR and cases where Operating Agency has been appointed, restructuring may be considered on the basis of rehabilitation scheme worked out by the Operating Agency.
- 2.4 Borrowers who have been identified as willful defaulters in terms of RBI directives (Annexure I) , may generally not be considered for restructuring where the default is due to diversion of funds. Restructuring may be however considered when the funds diverted have been brought back and/or there is a change in management and/or where the diversion is intra Company. However, restructuring need not be withheld where even inter-Company diversion had taken place. However, in such instances, the restructuring would be subject to such diversion being brought back within a reasonable time and the same will be decided on a case to case basis. It shall also be our endeavor to address this issue by stipulation of additional margin/contribution, security etc. and placing suitable covenants to ensure non-recurrence in future keeping in mind safety of bank’s funds. Viability and the ability to service after restructuring shall be the important criteria for determining eligible cases.

3. Eligibility Criteria:

The following entities would be eligible for restructuring:

- All non-corporate SMEs irrespective of the level of dues to the Bank.
- All Corporate SMEs enjoying banking facilities solely from our bank, irrespective of the level of dues to the Bank.
- All Corporate SMEs, which have funded and non-funded outstanding up to Rs.10 Crores under multiple/consortium banking arrangement with our bank and other banks. (RBI has advised that a separate Restructuring mechanism would be announced for accounts with outstandings over Rs.10 Crores).

- Accounts classified as Sub-Standard or Doubtful would also be eligible but accounts classified as “**Loss Assets**” will be **ineligible** for restructuring.
- In respect of units where a mandatory reference had been made to BIFR, after completion of all the formalities in seeking approval of the BIFR before implementing the package.
- Cases where Operating Agency has been appointed, restructuring may be considered on the basis of the Rehabilitation Scheme worked out by the Operating Agency.
- Accounts involving wilful defaults, fraud, and malfeasance will not be eligible for restructuring under these guidelines. In respect of cases of default where a reporting has to be made to the RBI, classifying of the default as “wilful” shall be done at Head Office level as per extant procedure. In respect of other cases, the authority who had sanctioned the existing facilities to the defaulting unit shall classify the default as “wilful”. **(Definition of “wilful default” as stated by the RBI / as adopted by our Bank is given in Annexure I)**
- Where funds diverted earlier have been brought back into the business and/or there is change of management and/or where the diversion is intra company, restructuring may be undertaken on a case to case basis.
- However, restructuring/rehabilitation need not be withheld where intra company or even inter-company diversions have taken place, provided the amount diverted is brought back within a reasonable time. Such restructuring would be decided on a case to case basis, at the sole discretion of the Bank. But additional margin/contribution, security etc, and suitable covenants may be considered to ensure both safety of bank’s funds and non-recurrence in future.

4. Viability Criteria

4.1 Viability and the ability to service the debt after restructuring shall be the important criteria for determining eligible cases.

- a) A unit may be regarded as potentially viable if it would be in a position to continue to service its repayment obligations as agreed upon including those forming part of the package, after implementing a relief package spread over a period not exceeding 7 years from the commencement of the package from banks/ financial institutions/Government (Central/State) and other concerned agencies, as may be necessary, without the help of the concessions after the aforesaid period.

- b) The repayment period for restructured (past) debts should not exceed 10 years from the date of implementation of the package.
- c) In the case of Tiny/Decentralized sector units, the period of reliefs/concessions and repayment period of restructured debts should not exceed 5 and 7 years respectively.
- d) Average DSCR should be 1.25:1 over the restructuring period with annual DSCR not less than 1:1.

4.2 Based on the norms specified above, it is to be decided whether a unit is potentially viable or not.

- Viability of a unit should be decided quickly and made known to the unit and others concerned at the earliest.
- Restructuring may or may not involve additional funding. Where additional funding is not involved, holding-on operations may be allowed in such accounts enabling the units to draw funds to the extent of deposits made by them into their account.

5. Need For Restructuring/Rehabilitation

A need for restructuring of an asset could arise due to any one of the following internal/external problems faced by the unit resulting in the incipient sickness and borrower's inability to meet his financial commitments to the Bank.

5.1. Internal/External Problems:

- Technical problems in production/temporary break down of plant.
- Commercial compulsions caused by demand and supply position, pricing and market.
- Managerial inadequacies such as delay in appointing technical/professional staff.
- Economic factors – external in nature caused by changes in Government policies.
- Financial factors such as cost-overrun in project implementation resulting in liquidity crunch, unexpected payments, delay in release of Bank finance etc.
- Delay in commencement of commercial production.

5.2. Temporary cash flow aberration:

Temporary cash flow aberration may also arise due to any of the following aspects:

- Non-release of subsidies/grants by Government;
- Inadequacy of own funds/long term funds;
- Increase in credit on receivables;

- Decrease in trade credit;
- Spurt in prices of raw materials, other inputs;
- Decrease in selling price of finished goods;
- Disturbance in production due to strike;
- Power cuts, major repairs, etc.;
- Accumulation of inventories due to bulk purchases, temporary demand constraints, transport bottlenecks; etc.

Due to any of the above problems, the borrowers may not be in a position to service interest or installments or meet their commitments under Letters of Credit or Guarantees Issued.

6. Identification of Accounts for Debt Restructuring/Rehabilitation:

6.1 Sickness should be arrested at the incipient stage itself. Appropriate measures should be taken by the branches to ensure this. A close watch should be kept on the account operations. Borrowers should be advised about their primary responsibility to inform the Bank of any problems faced by them, which could result in the unit's sickness so as to restore the unit to normal health at the earliest. Early detection of sickness and prompt remedial action are very crucial. Effective monitoring of the operations of the unit as well as the borrowal account(s) with the Bank is essential to identify the units showing symptoms of sickness. As an integral part of the risk management process, our Bank already has a system that captures early warning signals in respect of accounts showing first signs of weakness. A note on this system is appended as **Annexure II**.

6.2 Deteriorating quality of an asset is detectable well in time through a proper system of asset classification. Slippage of a standard account into watch category or substandard asset or any of the early warning signals should immediately be followed up with the borrower/unit. Necessary corrective/remedial action should be initiated immediately. The action needs to be pre-emptive for an early and effective restoration of health to a unit turning sick or showing signs of incipient sickness.

6.3 Remedial Measures in respect of sickness may include timely need-based financial assistance and even advice of non-financial nature such as change in the management practices. Difficulties faced/envisaged by the unit/borrower or assistance required from outside agencies like Govt. Departments/undertakings, Electricity Boards, etc. may be sorted out by rendering timely help and advice. Wherever Term Lending Financial Institutions are involved, the position of the unit should immediately be informed to enable them also take necessary and timely remedial action.

6.4 An industrial unit is considered "Sick" if:

- a) any of the borrowal accounts of the unit remains Sub-Standard for more than six months i.e. principal or interest, in respect of any of its borrowal

accounts has remained overdue for a period exceeding one year. The requirement of overdue period exceeding one year will remain unchanged even if the present period for classification of an account as substandard, is reduced in due course;

OR

- b) there is erosion in the net-worth of the unit due to accumulated cash losses to the extent of 50% of its net-worth during the previous accounting year

AND

- c) the unit has been in commercial production for at least two years. ;

7. Restructuring/Rehabilitation Methods:

Restructuring may involve:

- Rephasement of recovery schedule in term loan accounts for both interest and installment(s).
- Waiver/concessions in interest charged with or without recompense.
- Funding the un-serviced interest/aberrations in the working capital facilities/term loan facilities. (WCTL/FITL)
- Reduction in margin for funded and non-funded limits.
- Realignment of limits from pre-sale to post- sale and vice versa or from funded to non-funded limits.
- Reassessment of the credit facilities including the working capital.

Such a restructuring may be:

- for a short or medium term;
- without additional term or working capital funding normally;
- with additional financing in genuine cases for Balancing Equipment, Modernisation, etc,. Working Capital may be required over short/medium/long term basis within the restructuring/rehabilitation frame work

8. Repeated Re-structuring:

The account is expected to revert to normal health during the stipulated time-frame when the Restructuring is done for the first time. However, further restructuring may be necessitated in some cases of genuine difficulties beyond the comprehension of the borrower like change in Govt. policies, shift in supply/demand, etc.

However, the special dispensation for asset classification enumerated hereinafterwards in paragraph (12) would be available **only when the restructuring is done for the first time.**

9. Holding On Operations:

While identifying and implementing the restructuring/rehabilitation package, "holding operation" may be considered for a period of 6 months. This will allow small-scale units to draw funds from the cash credit account at least to the extent of their deposit of sale proceeds during the period of such "holding operation" less pre-agreed cutbacks to reduce overdues.

- Holding on Operations essentially implies:
 - Continuous operations in the account, like opening fresh LCs to the extent of reduction in devolvement, even if devolvement is not fully cleared,
 - Roll over of LC opened by the Bank,
 - Allowing operations in the cash credit account despite interest/forced debits not being cleared,
 - Fall in drawing power etc.
- Such Holding on Operations may generally be permitted with a cutback of say at least 10-15% towards reduction in overdues.
- Further, operations are allowed within existing outstanding/exposure level.
- Holding on Operations within the overall Sanctioned Limits may be permitted by the level of Branch Manager as per extant guidelines subject to report to the next higher authority within 10 days.
- Grant of overlimits/ad-hoc limits may also be required as a part of Holding on Operation but should be dealt with as per delegation.

10. Delegation:

Restructuring/Rehabilitation may be considered by the delegatee under whose powers the limits fall for sanction as per the delegation of powers where there is no concession/sacrifice. In case of concession/sacrifice, the same may be considered by a delegatee one rank of above under whose powers the limits fall for sanction. A delegatee who has earlier sanctioned limit to the borrower immediately before its becoming sick should refer cases involving sacrifice to the next higher authority even if it is otherwise within his delegated power.

Approval for second and subsequent restructuring of advances (other than CDR accounts) has to be obtained from an authority who is one level higher than the authority who had sanctioned the advance.

11. Techno-Economic Viability Study

Technical/economic viability study may be carried out in house or through outside agencies whilst considering restructuring as may be determined by the sanctioning authority.

12. Prudential Norms for Restructured Manufacturing Accounts

In the context of restructuring of the accounts, the following stages at which the restructuring/rescheduling/renegotiation of the terms of loan agreement could take place, can be identified:

- a. Before commencement of commercial production
- b. After commencement of commercial production but before the asset has been classified as Sub Standard.
- c. After commencement of commercial production and after the asset has been classified as Sub Standard.

12.1. Standard Accounts:

12.1.1. Rescheduling of Principal:

- Mere rescheduling of Principal alone would not cause classification of a Standard account as Substandard a/c if borrower's out-standing is fully covered by tangible security.
- For SSI/Tiny Sector Units with loan limits up to Rs.5 Lakhs, the condition of tangible security would not be applicable (since collateral security requirements are dispensed with to such units).

12.1.2. Re-scheduling of the interest element:

A reschedulement of interest element at any of the accounts in first two categories (a) and (b) above would not cause an asset to be downgraded to Substandard category provided the amount of sacrifice, if any, measured in present value terms, is either written off or provision is made to the full extent of the sacrifice involved.

12.1.3. Upgradation of Restructured Accounts:

During the specified one year-period, the asset classification status of the rescheduled accounts will not deteriorate if satisfactory performance of the account is demonstrated during the period.

(Note: The asset classification of accounts under consortium/multiple banking arrangements would be bank-specific based on its own record of recovery, as per the existing prudential norms)

12.2. Substandard/Doubtful Accounts:

12.2.1. Rescheduling of Principal

Upon rescheduling of Principal alone a substandard or doubtful account would continue in the same Substandard or Doubtful category for the

specified period if the borrower's outstanding is fully covered by tangible security.

For SSI/Tiny Sector Units with loan limits up to Rs.5 Lakhs, condition of tangible security would not be made applicable (since collateral security requirements are dispensed with to such units).

12.2.2. Re-scheduling of the interest element:

A Substandard or Doubtful account would continue in the Substandard or Doubtful category for the specified period provided that the amount of sacrifice of the element of interest, if any, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved.

Even in such cases where the sacrifice is by way of write-off of the past interest dues, the asset should continue to be treated as substandard or doubtful.

12.2.3. Upgradation of Restructured Accounts:

Upgradation to Standard Category is possible only after the specified period i.e. a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms, subject to satisfactory performance during the period.

12.2.4. Additional finance:

Additional finance, if any, will be treated as Standard although the initial account may be classified as Substandard or Doubtful up to a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due under the approved restructuring package.

During the specified one year-period, the asset classification status of the rescheduled accounts will not deteriorate if satisfactory performance of the account is demonstrated during the period.

13. Prudential Norms for Restructured Non-Manufacturing Units

- a. Units other than manufacturing can also be restructured/rescheduled subject to their satisfying the basic test of viability.
- b. The above mentioned special dispensation of asset classification is not applicable for re-structured accounts of non-manufacturing borrowers.
- c. Such accounts would continue to age and migrate to next asset classification status in the normal course.

- d. To provide fully for or write off an amount equal to interest sacrifice measured in present value terms.
- e. These restructured/rescheduled accounts whether in respect of principal/interest amount by whatever modality would be eligible to be upgraded to the Standard Category only after a period of one year subject to satisfactory performance during that period

14. Treatment of Provision

- Provision for interest sacrifice should be debited to P & L Account and held in a distinct account. For this purpose, the future interest due as per the current BPLR in respect of an account should be discounted to the present value at a rate appropriate to the risk category of the borrower (i.e. current PLR + the appropriate term premium and credit risk premium for the borrower category) and compared with the present value of the dues expected to be received under the restructuring package, discounted on the same basis;
- Sacrifice may be recomputed on every balance sheet date till satisfactory completion of all repayment obligations and full repayment of the outstanding in the account, so as to capture the changes in the fair value on account of changes in the BPLR, term premium and borrower's credit category. Difference arising in the provision amount may either be provided additionally or reversed as the case may be;
- The amount of provision made for NPA may be reversed as and when the account gets reclassified as a Standard account.

15. Procedure & Time Frame for restructuring:

15.1 The SME Borrower must submit specific requests for restructuring.

15.2 The Debt Restructuring-SME Cell would scrutinize, undertake viability study and submit proposals for sanctions to the appropriate authority for all SME advances solely held with our Bank.

15.3 The **cut off date** for restructuring of SME Accounts would be the **date of classifying** the account as NPA or **Date of request of the unit** for restructuring whichever is earlier.

15.4 In the case of Multiple Lending Scenario

A Debtor-Creditor Agreement and an Inter-Creditor Agreement shall provide the legal basis to SME Debt Restructuring.

All the participants in the Debt Restructuring of an SME unit, shall have to enter into a legally binding agreement, with

necessary enforcement and penal clauses, to operate the system through laid down policies and guidelines.

One of the most important elements of Debtor-Creditor Agreement would be 'Stand-Still Clause' binding for 60 days, by both sides. Under this clause, both the debtor and the creditor(s) shall agree to a legally binding 'stand-still' whereby both the parties commit themselves for not taking recourse to any other legal action during the 'stand-still' period. This is necessary for enabling the Bank to undertake the necessary debt restructuring exercise without any outside intervention, judicial or otherwise. However, this will not be a bar for executing the documents, Acknowledgement Of Debt etc., by the borrower in favour of the Bank so as to keep the limitation alive.

The Inter-Creditors Agreement would be a legally binding agreement **amongst the secured creditors**, with necessary enforcement and penal clauses, wherein the creditors would commit themselves to abide by the various elements of SME Debt Restructuring Mechanism. Further, the creditors shall agree that if **75% of secured creditors by value**, agree to a Debt Restructuring package, the same would be binding on the remaining secured creditors.

- 15.5 Time frame for restructuring would be Maximum 60 days from the date of receipt of the borrower's request for restructuring, complete in all respects.

16. Reliefs/Concessions To Be Extended and Sacrifice:

Norms for grant of Reliefs/Concessions are furnished in Annexure III and are common for SMEs under Restructuring as well as Rehabilitation. For the sake of clarity we state here that the term Restructuring refers to the borrowal facilities (Fund Based as well as Non-Fund based) of the unit with us/other financial institutions whereas the term Rehabilitation refers to the progress of the unit on its way to recovery through restructuring of its liabilities/repayment obligations. Rehabilitation should result in the unit becoming viable again so as to meet such liabilities/repayment obligations.

The viability and the rehabilitation of a unit would depend primarily on the unit's ability to continue to service its repayment obligations including the past restructured debts. It is, therefore, essential to ensure that ordinarily there is no write-off or scaling down of debt such as by reduction in rate of interest with retrospective effect except to the extent indicated in the guidelines. Interest concessions granted, if any, may be subject to annual review depending on the performance of the units.

The reliefs and concessions specified are not to be given in a routine manner and have to be decided based on the commercial judgement and merits of each case. Reliefs and concessions may be extended beyond the parameters in deserving cases. Only in exceptional cases, concessions/reliefs beyond the parameters would be considered. In fact, the viability study itself should contain a sensitivity analysis in respect of the risks involved that in turn will enable firming up of the corrective action matrix.

17. Appointment of Special Monitor

Bank has been appointing nominee directors to the Board of Companies in which we have substantial exposure and which are showing signs of incipient sickness or have become NPA and where such appointment is deemed necessary to safeguard Bank's interest. Banks' derive the power to appoint one or more nominee directors on the Board of a borrower Company vide Sec 16 A(10) of the Bank Nationalization Act, 1970. As a requirement of this provision, Bank obtains a stamped undertaking to the effect that the Bank has the right to appoint and remove a director to the Board of Directors of assisted companies in case of Limited Company borrowers enjoying fund based limits of Rs.50 lakhs and above. The functions of a nominee director and RBI guidelines in this regard are given in Annexure IV. We may appoint consultants, Chartered Accountants and/or Cost Accountants to carry out specific assignments – such as concurrent audit/cost audit etc, to safeguard Bank's interest where appointment of nominee director is not found to be adequate/necessary. It is now proposed to include Ex-Officers of Bank of India also for such assignments.

Whilst considering restructuring proposals in accounts with funded limits of Rs.5 crs. and above (both fund based and non- fund based) the need to appoint nominee director/monitor may be examined and a view would be taken by the sanctioning authority but not lower than the level of Zonal Manager. It is also proposed to include Ex-officers of Bank of India also for such assignment as monitors. The functions of the monitor would be similar to that of the nominee director and are as broadly described in Annexure IV.

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WILLFUL DEFAULTERS

(Para.2.1 of the Policy)

Commercial Banks are required to report all instances of Willful Default to RBI periodically. RBI shall publish the same in their web site.

1. As per RBI guidelines vide DBOD No.DL(W)BC:110:20.16.003(1):2001-02 dated 30.5.2002, Willful Default is defined as follows :-

"A Willful Default would be deemed to have occurred if any of the following events is noted :-

- The unit has defaulted in meeting its payment / repayment obligations to the lender even when it has the capacity to honour the said obligations.
- The unit has defaulted in meeting its payment / repayment obligations to the lender and has not utilised the finance from the lender for the specific purposes for which finance was availed of but has diverted the funds for other purposes.
- The unit has defaulted in meeting its payment/repayment obligations to the lender and has siphoned off the funds so that the funds have not been utilised for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets."

2. The terms "**diversion of funds**" and "**siphoning of funds**" are construed to include any one of the undernoted occurrences:

- utilisation of short-term working capital funds for long-term purposes not in conformity with the terms of sanction;
- deploying borrowed funds for purposes / activities or creation of assets other than those for which the loan was sanctioned;
- transferring funds to the subsidiaries / Group companies or other corporates by whatever modalities;
- routing of funds through any bank other than the lender bank or members of consortium without prior permission of the lender;
- investment in other companies by way of acquiring equities / debt instruments without approval of lenders;
- shortfall in deployment of funds vis-à-vis the amounts disbursed / drawn and the difference not being accounted for.

3. **Siphoning of funds**, referred to above, should be construed to occur if any funds borrowed from banks / FIs are utilized for purposes un-related to the

operations of the borrower, to the detriment of the financial health of the entity or of the lender. The decision as to whether a particular instance amounts to siphoning of funds would have to be a judgment of the lenders based on objective facts and circumstances of the case.

4. While the penal measures indicated below would normally be attracted by all the borrowers identified as willful defaulters or the promoters involved in diversion / siphoning of funds, keeping in view the present limit of Rs. 25 lakh fixed by the Central Vigilance Commission for reporting of cases of willful default by the banks/FIs to RBI, any willful defaulter with an outstanding balance of Rs. 25 lakh or more, as on the date of this circular, would attract the penal measures stipulated below. This **limit of Rs. 25 lakh** may also be applied for the purpose of taking cognizance of the instances of '**siphoning**' / '**diversion**' of funds.

5. While dealing with willful default of a single borrowing company in a Group, the banks / FIs should consider the **track record** of the individual company, with reference to its repayment performance to its lenders. However, in cases where a letter of comfort and / or the guarantees furnished by the companies within the Group on behalf of the willfully defaulting units are not honored when invoked by the banks / FIs, such Group companies should also be reckoned as willful defaulters. Bank will have to **furnish RBI the list of identified “willful defaulters” on a quarterly basis**. Based on the information so collected, Reserve Bank of India will be publishing every year in a booklet / CD form the list of suit filed accounts and also an update of the list on a quarterly basis, containing the lists of 'added' and 'deleted' accounts during the quarter.

6. Besides, Bank is also required to initiate following **penal measures** against willful defaulters :

- a) **No additional facilities** should be granted by banks / FIs.
- b) Entrepreneurs / promoters of companies, where diversion of funds, siphoning of funds, misrepresentation, falsification of accounts and fraudulent transactions have been identified by banks / FIs, should be **debarred from institutional finance** from banks / FIs, Government owned NBFCs, investment institutions, etc. for floating new ventures **for a period of 5 years** from the date the name of willful defaulter is disseminated in the list of willful defaulters by RBI.
- c) Initiate **legal proceedings** and foreclosure for recovery of dues expeditiously, wherever warranted, against the borrowers / guarantors.
- d) Initiate **criminal proceedings** against willful defaulters wherever necessary.
- e) Banks/FIs should adopt a proactive approach for a **change of management** of the willfully defaulting borrower unit, wherever possible.
- f) Incorporate a covenant in the loan agreement with the borrowing companies stipulating that they should not induct a person who is a

director on the Board of a company which has been identified as a willful defaulter and that in case, such a person is found to be on the Board of the borrower company, it would take expeditious and effective steps for **removal of the person from its Board.**

It should also be ensured that the penal provisions are used effectively and determinedly but after careful consideration and due caution. Towards this end, banks / FIs are advised to put in place a transparent mechanism, with the approval of their Board, for initiating criminal proceedings based on the facts of individual case. If necessary, criminal proceedings may also be initiated based on facts of each case.

7. Procedure:

The Zonal Offices shall identify and report (format given in Annexure) to Head Office, ARD on quarterly basis new accounts to be reported as 'willful defaulters'. The Branch / Zone shall submit conclusive documentary evidence leading to willful nature of the default. The reports / recommendations shall be signed by the Zonal Manager. The reports shall be processed by HO, ARD and eligible cases will be submitted to an '**Identification Committee**' headed by the Executive Director (consisting of 2 General Managers). After the account is identified by the said Committee for reporting purpose, the Zonal Manager will be advised about this decision. The Zonal Managers shall write to the borrower company / directors giving them an opportunity to represent their case to "**Grievances Committee**" formed at Head Office with the Chairman & Managing Director as the head and 2 General Managers as members. Zonal Managers shall advise the borrower company to avail this facility of **appealing to Grievance Committee** within 15 days. If there is any representation from the company within the stipulated period, they will be given an opportunity to **present their case to the Grievance Committee** and the decision to report the account to RBI will be reviewed or confirmed by this Committee and reporting will be done if necessary. If no representation is received within stipulated time, Head Office, ARD shall report the account to RBI in the prescribed format after getting concurrence from Grievance Committee based on Zonal Manager's reports about representations received (or not received) from the aggrieved parties.

8. This procedure for identifying and **reporting of willful default by Head Office to RBI is applicable only for A/cs with outstanding dues of Rs. 25 lakh and above.** However, Zonal offices as well as branches are also required to examine each account turning to NPA (with outstanding dues below Rs. 25 lakhs) to the extent of ascertaining whether any act of willful default is discernable from the part of the borrowers. Even though these Accounts with outstanding dues below Rs. 25 lakh, need not be reported to Head Office/ RBI, it is advised that the branch / Zone should take adequate penal measures against such borrowers as mentioned in para 5.5 above.

EARLY WARNING SIGNALS

(Para 6.1 of the Policy)

Our Bank already has a system that captures early warning signals in respect of accounts showing first signs of weakness. This system is an integral part of the risk management process of the bank.

2. For internal monitoring purposes under the system, a time limit for overdue accounts is designated to determine the threshold for a proactive intervention – well before the accounts become NPA. This is to enable the Bank to assess whether the default is due to some inherent weakness or due to a temporary liquidity / cash flow problem. For example, where there is a default in an account for 30 days, it shall be shifted to a special category, classified as Asset Code 12. All accounts displaying unsatisfactory features/early warning signals should be put under watch list for follow up and time bound action to prevent slippages, even though such accounts could be regular at present. An illustrative list of unsatisfactory features that should put a lender on guard is given below :

2.1 SIGNALS WHICH COULD BE NOTICED WITHIN THE BANK:

- i. Non-compliance with the terms of sanction regarding documentation / security.
- ii. Unplanned borrowing for margin contribution.
- iii. Delay in payment of interest beyond **15 days**.
- iv. More than one installment overdue and beyond 30 days.
- v. Return of cheques for financial reasons.
- vi. Reduction in credit summations - not routing entire (or prorata) transactions through the Bank (opening of collection accounts with another bank) without prior approval of appropriate authority.
- vii. Longer outstanding in the bill purchased accounts.
- viii. Longer period of credit allowed on sale documents negotiated through the Bank and frequent returns by buyers of the same - Late or non realisation of receivables.
- ix. Constant utilisation of working capital limits to the hilt.
- x. Unexplained delay or failure to submit periodic statements such as stock/book debt statements, MSOD, CMA, balance sheets etc./other papers needed for review of account.

- xi. Frequent requests for overlimit/additional limit or for extension of time for repayment of interest / installments.
- xii. Adhoc/overlimit/Bill Purchase overdue, LC/guarantee devolvments.
- xiii. Lack of transparency in borrowers dealings with the Bank/avoiding to meet bank officials.
- xiv. Constant failure or unwillingness to mention unpaid stock in stock statements or age of book debts in book debt statement.

2.2 BENCH MARKS that have been fixed for various Early Warning Signals are reproduced here below:

- i. A/c is overdrawn for more than 30 days .
- ii. Interest overdue more than 15 days.
- iii. Variation in estimates/projection of sales > 25% during the last quarter.
- iv. Delay in submission/non submission of QIS I & II > 30 days.
- v. Non submission/delay in submission of MSOD statement > 1 month.
- vi. Delay/Non submission of monthly stock/book debts statements > 1 month.
- vii. Return of cheques on financial grounds > 2 occasions in a month.
- viii. Invocation of guarantees/devolvement of L/Cs > 1 occasions in a month.
- ix. Devolvement of L/Cs/Invocation of guarantees and non regularization of the account within 30 days from date of invocation/devolvement.
- x. No credit in the operative account for consecutive 30 days.
- xi. Delay in servicing of term loan installment >30 days
- xii. Return of Bills purchased > 2 Bills in a month.
- xiii. Past Due Bills >30 days
- xiv. Over Due EPC beyond 30 days
- xv. Less than 50% marks scored out of applicable first 80 marks of our credit rating evaluation module.

2.3 **SIGNALS WHICH COULD BE NOTICED BY VISITING THE UNIT/TALKING TO BORROWERS OR THEIR EMPLOYEES OR FROM MARKET ENQUIRIES :**

- i. Undue and unreported delay in project implementation.
- ii. Installation of sub standard machinery or machinery not as per the project report/approved quotations.
- iii. Frequent breakdown in plant/machinery.
- iv. Production noticeably below projected level of capacity utilisation.
- v. Labour problem and frequent interruptions in manufacturing.
- vi. Non-availability of vital spare parts.
- vii. Production of unplanned items without reporting to the Bank.
- viii. Disposal/replacement of vital plant and machinery without Bank's knowledge.
- ix. Downward trend in sales.
- x. Higher rate of rejection at process stage/final stage/after sales.
- xi. Delay in or failure to pay statutory dues.
- xii. Diversion of working capital to capital expenditure or for other use.
- xiii. Abnormal increase in debtors and creditors.
- xiv. Increase in inventory which may include large quantity of slow and non-moving items.
- xv. General decline in the particular industry combined with many failures.
- xvi. Rapid turnover of key personnel.
- xvii. Filing of law suits against the company by its customers, creditors, employees etc.
- xviii. Unjustified rapid expansion within a short time without appropriate financial tie up.
- xix. Sudden / frequent changes in Management / infighting within the management.
- xx. Reduction in profit/unit starting incurring losses.
- xxi. Dependence on single or few buyers / no alternate market for product.

- xxii. Threat of action against the borrower from statutory bodies e.g. pollution control, Labour Welfare Dept., Income Tax/Sales Tax/Octroi/Excise/Customs Dept. etc.
- xxiii. Poor or dubious record maintenance.
- xxiv. Loss of key product lines, franchises, distribution rights or sources of supply.
- xxv. Speculative inventory acquisition not in line with normal purchasing practices.
- xxvi. Poor maintenance of plant / machinery.
- xxvii. Lack of planning / poor planning.
- xxviii. Apathy of promoters / owners in running the business.
- xxix. Adverse market reports on the borrower / concern.
- xxx. Loss of crucial customers.

2.4 **Noticing of the early warning signals through constant vigil** and initiating timely action for safeguarding the health of an account is of paramount importance. Even though the basic responsibility for the same lies with the Branch Manager / Credit In-charge of the branch, looking to the enormity of the job, such work has to be **shared by all other staff of the branch**, not only the officers who are not directly associated with the credit functions of the branch but also the other categories of staff such as clerical staff. Similarly, in controlling offices also, wherever available, the help of officers from other departments / clerical staff should be taken

2.5 Needless to add, the **inspectors / concurrent auditors who are expected to deal with large exposure accounts in any branch, should supplement branch efforts** for the purpose of credit monitoring. They will also be responsible for detection of early warning signals in an account and caution the branch well in time for initiating corrective measures.

X-X-X-X-X

**Reliefs and concessions which can be extended by
Banks/Financial Institutions (FIs) to
POTENTIALLY VIABLE SICK SME UNITS
under rehabilitation based on
RBI guidelines presently in vogue**

(Para.1 of Chapter16 of the Policy)

The viability and the rehabilitation of a sick SSI unit would depend primarily on the **unit's ability to continue to service its repayment obligations including the past restructured debts**. It is, therefore, essential to ensure that ordinarily there is no write-off or scaling down of debt such as by reduction in rate of interest with retrospective effect except to the extent indicated in the guidelines. The guidelines on various parameters on reliefs and concessions are given below:

i) **Interest Dues on Cash Credit and Term Loan**

If **penal rates of interest or damages** have been charged, such charges **should be waived** from the accounting year of the unit in which it started incurring cash losses continuously.

After this is done, the **unpaid interest** on term loans and cash credit during this period should be **segregated** from the total liability **and funded**.

No interest may be charged on funded interest and repayment of such funded interest should be made within a period not exceeding 3 years from the date of commencement of implementation of the rehabilitation programme.

ii) **Unadjusted Interest Dues**

Unadjusted interest dues such as interest charged between the date up to which rehabilitation package was prepared and the date from which actually implemented, may also **be funded** on the same terms as at (i) above.

iii) **Term Loans**

The rate of **interest on term loans may be reduced**, where considered necessary, by not more than 3% in the case of tiny/decentralised sector units and by not more than 2% for other SSI units, below the document rate.

iv) **Working Capital Term Loan (WCTL)**

After the unadjusted interest portion of the cash credit account is segregated as indicated at (i) and (ii) above, the balance representing principal dues may be **treated as irregular to the extent it exceeds drawing power**. This amount may be **funded as WCTL** with a repayment schedule not exceeding 5 years. The rate of interest applicable may be 1.5% to 3% points below the prevailing fixed rate/prime lending rate **or contracted rate of interest**,

whichever is less, wherever applicable, to all sick SSI units including tiny and decentralized units.

v) **Cash Losses**

Cash losses are likely to be incurred in the initial stages of the rehabilitation programme till the unit reaches the break-even level. Such cash losses excluding interest as may be incurred during the nursing programme may also be financed by the bank or the financial institution, if only one of them is the financier. But if both are involved in the rehabilitation package, the financial institution concerned should **finance such cash losses**. Interest may be charged on the funded amount at the rates prescribed by SIDBI under its scheme for rehabilitation assistance.

Future cash losses in this context will refer to losses from the time of implementation of the package up to the point of cash break-even as projected. Future cash losses as above, should be worked out before interest (i.e., after excluding interest) on working capital etc., due to the banks and should be financed by the financial institutions if it is one of the financiers of the unit. In other words, the financial institutions should not be asked to provide for interest due to the banks in the computation of **future cash losses** and this **should be taken care of by future cash accruals**.

The **interest due to the bank should be funded by it separately**. Where, however, a commercial bank alone is the financier, the future cash losses including interest will be financed by it.

The interest on the funded amounts of cash losses/interest will be at the rates prescribed by Small Industries Development Bank of India under its scheme for rehabilitation assistance.

vi) **Working Capital**

Interest on working capital may be charged at 1.5% below the prevailing fixed/prime lending rate **or contracted rate of interest, whichever is less**, wherever applicable. Additional working capital limits may be extended at a rate not exceeding the PLR.

vii) **Contingency Loan Assistance**

For meeting escalations in capital expenditure to be incurred under the rehabilitation programme, banks/FIs may provide, where considered necessary, appropriate additional financial assistance upto 15% of the estimated cost of rehabilitation by way of **contingency loan assistance**. Interest on this contingency assistance may be charged at the **concessional rate** allowed for working capital assistance.

viii) **Funds for Start-up Expenses and Margin for Working Capital**

There will be need to provide the unit under rehabilitation with funds for start-up expenses (including payment of pressing creditors) or margin money for working capital in the form of long-term loans. Where a financial institution is not involved, banks may provide the loan for start-up expenses, while margin money assistance may either come from SIDBI under its Refinance Scheme for Rehabilitation or should be provided by State Government where it is operating a Margin Money Scheme. Interest on fresh rehabilitation term loan may be charged at a rate 1.5% below the prevailing fixed/prime lending rate **or contracted rate of interest, whichever is less.** wherever applicable or as prescribed by SIDBI/NABARD where refinance is obtained from it for the purpose.

All interest rate concessions would be subject to annual review depending on the performance of the units.

ix) **Promoters' Contribution**

As per the extant RBI guidelines, promoter's contribution towards the rehabilitation package is fixed at a **minimum of 10% of the additional long-term requirements** under the rehabilitation package in the case of tiny sector units and at 20% of such requirements for other units. In the case of units in the decentralized sector, promoters' contribution may not be insisted upon. A need is felt for increasing the promoters' contribution towards rehabilitation from the present limits. It is, therefore, **desirable to stipulate a higher promoters' contribution** where warranted. At least **50%** of the above promoters' contribution should be brought in **immediately** and the **balance within 6 months**. For arriving at promoters' contribution, the **monetary value of the sacrifices** from banks, FIs and Government may be taken into account, in addition to the long-term requirement of funds under the rehabilitation package. While evolving packages, it should be made a precondition that the promoters should bring in their contribution within the stipulated time frame. Further, in regard to concessions and relief made available to sick units, banks should incorporate a **'Right of Recompense' clause** in the sanction letter and other documents to the effect that when such units turn the corner and rehabilitation is successfully completed, the sacrifices undertaken by the FIs and banks should be recouped from the units out of their future profits/cash accruals.

Norms for selection of Nominee Directors
Role and Functions of Nominee Directors

I) SELECTION OF DIRECTORS:

1) Criterion -

- i) The rights of banks to nominate directors flows from the contractual obligations between the assisted companies and institutions, as also the relevant provision in the status of the latter. Considering the dual role required to be played by the directors i.e that of a company representative as also the guardian of public funds, factors such as size of the project, total financial assistance granted to them, composition of the Board, professional skills already available and the complexity of the problems in the unit, shall be reckoned irrespective of an account being NPA/standard.
- ii) The nominee director so selected is required to have conceptual clarity on the areas related to the credit policy/ philosophy of the Bank framed from time to time. He is also required to have handled adequate areas in credit, with courage of conviction and articulate in expression. He should be a man who not only considers the interests of the company but also protects the interests of the Bank in his capacity as Nominee Director.

2) The nominee directors on the Boards of companies assisted by the Bank therefore are suggested to be senior officers of the rank of Asst.Gen.Manager and above in the Bank, who have considerable exposures in handling credit portfolio of the Bank.

3) Norms for inducting Directors -

At the moment, the Bank, as a rule, appoints nominee directors on the Boards of sick assisted companies. We consider it would be prudent to appoint directors –

- a. in all companies where the Bank's stake is Rs.10 crores or more (sick or healthy).
- b. where consortium lending is in vogue such appointment may be decided in consultation with consortium members, if we are not the leaders.
- c. where credit rating is below A, for total exposures of Rs.10 crores and above, the consortium leader may appoint a nominee director.
- d. where hi-tech/high-risk projects are financed a nominee director should be appointed for all exposures above Rs.10 crores.
- e. where Bank considers it necessary to appoint Nominee Directors.

A suitable trigger clause may be incorporated in our sanctioned terms to enforce this right.

II) ROLE OF NOMINEE DIRECTORS:

- a. The Nominee Directors (ND) on Board of assisted companies are intended not only to safeguard the interests of the institutions but also to serve the interests of sound public policy/commercial principles.
- b. He should be vigilant and if any undesirable practice including abuse by the promoter group of its powers and privileges comes to his notice, he should promptly bring this to the attention of the Board/his nominating institution.
- c. He should provide adequate feedback to the institutions on the affairs/operations of the company on which he is represented.
- d. The NDs should have a high degree of probity of independent approach. They should make suggestions conducive to better management practices, effective functioning of the Board, improvement in productive efficiency and continued growth of the assisted company.
- e. The ND should see that the company develops a proper MIS to provide regular feedback of the company's affairs and all important matters having a bearing on the company's performance should be brought to the notice of the Board.
- f. ND should insist on timely submission of agenda papers atleast one week in advance of the Board Meetings and discourage piecemeal/ supplementary items.

III) CONTROL MECHANISM :

- 1) The Nominee Director will directly advise the Head Office functional department the deliberations in the meeting and the salient adverse or favourable features of the company's position where Bank has to pay special attention. The appointment of Nominee Directors will act as controlling factor in the monitoring aspect of audit discipline.
- 2) The Nominee Director will ensure that meetings are held as per requirements of the company and arrange to obtain agenda in advance from the company. Any deviation in this regard should be reported to H.O. functional department who shall quickly take up the matter with the company.
- 3) The Nominee Director should attend meetings without exception and absence of leave should be permitted with prior approval of Gen. Manager , Head Office, of the functional department.
- 4) H.O. should inform the salient financial features of company and areas where special attention is required by the Board for deliberations.
- 5) The functional, department at H.O. shall monitor that meetings are held periodically in all eligible cases and any irregularity is taken up with the company directly to be dealt with for consideration and review of facilities. A list of companies where meetings are not held continuously for 3 consecutive periods and attended by Nominee Director shall be brought before GM, functional department to deal with it appropriately.