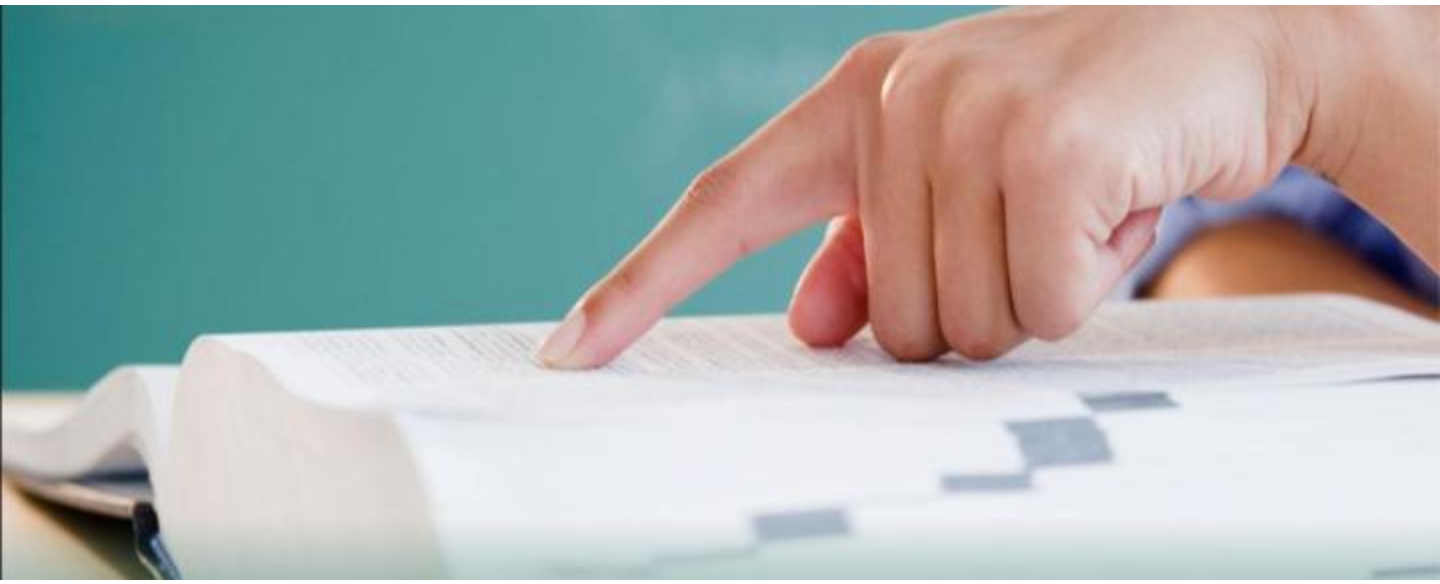
The RBI reviews guidelines on joint lenders' forum and corrective action plan

30 October 2014



First Notes on:
- **Financial Reporting**
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- Disclosures

Sector:
- All
- **Banking and Insurance**
- Information, Communication, Entertainment
- Consumer and Industrial Markets
- Infrastructure and Government

Relevant to:
- **All**
- Audit committee
- CFO
- Others

Transition:
- **Immediately**
- Within the next 3 months
- Post 3 months but within 6 months
- Post 6 months

The Reserve Bank of India (RBI) on 30 January 2014 had released a 'Framework for Revitalising Distressed Assets in the Economy' (the Framework) effective from 1 April 2014. The Framework lays down guidelines for early recognition of financial distress, taking prompt steps for resolution, and thereby attempting to ensure fair recovery for lending institutions. For operationalising the above Framework, the RBI has issued various notifications[1] that provide guidelines on refinancing of project loans, sale of non-performing assets (NPAs) by banks, guidelines on formation of joint lenders' forum (JLF), adoption of corrective action plan (CAP) and other regulatory measures.

The RBI has received representations from banks and the Indian Banks' Association stating that difficulties are being faced by them in effective implementation of the Framework. Therefore, on 21 October 2014, the RBI has introduced certain changes in the Framework and its guidelines[2].

This issue of First Notes provides an overview of these changes.

Accelerated provisioning: failure in convening JLF/agreeing upon a common CAP

Under the Framework, an account will be subjected to accelerated provisioning where:

- the account has been classified as a NPA, and
- the lenders have failed to convene the JLF/agree upon a common CAP within the stipulated time frame.

In this context, certain banks have represented to the RBI that in many cases lead bank of the consortium or the bank with the largest aggregate exposure under the multiple banking arrangements does not form the JLF, does not convene JLF or does not take initiatives in this context.

1. Notification-DBS.OSMOS.No.14703/33.01.001/2013-14 dated 22 May 2014
   Notification-DBOD.BP.BC.No.98/21.04.132/2013-14 dated 26 February 2014
   Notification-DBS.No.OSMOS.9862/33.01.018/2013-14 dated 13 February 2014
2. Notification-DBOD.BP.BC.No.97/21.04.132/2013-14 dated 26 February 2014

Now the RBI has decided that:

- where an account is reported by any of the lenders to the Central Repository of Information of Large Credits (CRILC) as Special Mention Accounts (SMA)–2, and
- JLF is not immediately formed or CAP is not decided within the prescribed time limit due to above reasons,

then accelerated provisioning requirement would apply only on the bank having responsibility to convene JLF and not on all the lenders in the consortium/multiple banking arrangement.

In other cases, accelerated provisioning will be applicable on all banks in the consortium/multiple banking arrangement.

The RBI has also advised banks that in case the lead bank of the consortium or the bank with the largest aggregate exposure under the multiple banking arrangement fails to convene JLF within 15 days of reporting SMA–2 status, then the bank with the second largest aggregate exposure shall convene the JLF within the next 15 days. Such a bank will have the same responsibilities and disincentives as applicable to the lead bank/bank with the largest aggregate exposure.

Accelerated provisioning: repayment proceeds not appropriated to lenders as per agreed terms

As per the present requirement, if an escrow maintaining bank under JLF/Corporate Debt Restructuring (CDR) mechanism does not appropriate proceeds of repayment by the borrower among the lenders as per agreed terms, then following would be the implications:

- down-gradation of asset classification of the account in the book of other lenders
- it would attract lowest asset classification among the lending member banks
- accelerated provisioning requirement.

The RBI has decided that in the above cases, the account status in the books of the escrow maintaining bank would have following implications:

- it would attract the asset classification which is lowest among the lending member banks
- it would be subject to accelerated provisioning instead of normal provisioning, and such accelerated provisioning will be applicable for a period of one year from the effective date of provisioning or till rectification of the error, whichever is later.

Reporting of cash credit and overdraft accounts

The RBI has clarified that banks must report cash credit and overdraft accounts, including overdraft arising out of devolved letter of credits/invoked guarantees to CRILC as SMA–2 when these are ‘out of order’ for more than 60 days.

Similarly, bills purchased or discounted (other than those backed by letter of credits issued by banks) and derivative exposures with receivables representing positive mark to market value remaining overdue for more than 60 days should be reported to CRILC as SMA–2.

Formation of JLF not mandatory in certain cases

Banks should continue to report the credit information and SMA status to CRILC on loans including loans extended by their overseas branches. However, formation of JLF will not be mandatory in cases of offshore borrowers which do not have any presence in India, either by way of a subsidiary, parent or a group entity. Further, the inclusion of offshore lenders as part of JLF shall not be mandatory.

Under CRILC-Main (quarterly submission) return, banks are required to report their total investment exposure to the borrower being reported. On this requirement, the RBI has clarified that formation of JLF will not be mandatory for reporting of investment portfolio as SMA, except in cases of bonds / debentures acquired on private placement basis or due to conversion of debt under restructuring of advances.

Exit option from additional finance

Currently, as per the RBI Master Circular – Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances, a creditor (outside the minimum 75 per cent by value and 60 per cent by number), who for any internal reason does not wish to commit additional finance will have an exit option. At the same time, in order to avoid the ‘free rider’ problem, it is necessary to provide some disincentive to the creditor who wishes to exercise this option. Such creditors can either:

- arrange for its share of additional finance to be provided by a new or existing creditor, or
- agree to the deferment of the first year's interest due after the CDR package becomes effective.

The above Master Circular also provided an exit option to all lenders within the minimum 75 per cent by value and 60 per cent by number provided the purchaser agrees to abide by the restructuring package approved by the Empowered Group. The Master Circular further states that exiting lenders may be allowed to continue with their existing level of exposure to the borrower, provided they tie up with either the existing lenders or fresh lenders taking up their share of additional finance.

Now, the RBI has decided that banks, irrespective of whether they are within or outside the minimum 75 per cent by value and 60 per cent by number can, henceforth, exercise the exit option for providing additional finance only by arranging their share of additional finance to be provided by a new or existing creditor. The provision for exit from the package by selling their existing share to either the existing lenders or to fresh lenders will continue to remain in force.

Sale of financial assets to Securitisation Company (SC)/Reconstruction Company (RC)

Currently, under the RBI circular 'Framework for Revitalising Distressed Assets in the Economy - Refinancing of Project Loans, Sale of NPA and Other Regulatory Measures' a financial asset may be sold to the SC/RC by any bank/financial institution where the asset is reported as SMA–2 by the bank/financial institution to CRILC.

The RBI had received representations that sale of accounts to SCs/RCs after deciding the CAP under the JLF disrupts the implementation of the CAP, especially in cases where lenders are required to provide additional finance under restructuring.

Now, the RBI has decided that if restructuring has been decided as the CAP, then banks will not be permitted to sell such assets to SCs/RCs, without arranging their share of additional finance to be provided by a new or existing creditor.

Reporting of SMA–2 and JLF formations

Under the Framework, banks are required to report any account having principal or interest overdue for more than 60 days as SMA–2 on the sixty-first day.

Further, the RBI previously adviced that whenever a large borrower's account becomes overdue for 61 days, that account is required to be reported to CRILC as SMA–2.

Now after reviewing the above requirements, the RBI has permitted banks to report SMA–2 accounts and JLF formations on a weekly basis at the close of business on every Friday or on the preceding working day of the week, if Friday happens to be a holiday.

Exemption to report certain exposures to CRILC

Under the Framework, banks are required to report credit information, including classification of an account as SMA to CRILC for all their borrowers having aggregate fund-based and non-fund based exposure of INR50 million and above.

Now after reviewing the above requirement, the RBI has decided as follows:

- crop loans would be exempted from reporting to CRILC. However, banks should continue to report other agriculture loans
- interbank exposures, including exposures to National Bank for Agriculture and Rural Development, Small Industries Development Bank of India, Export Import Bank of India and National Housing Bank would not be required to be reported to CRILC.

Adoption of CAP by JLF

Currently, the guidelines require that JLF should arrive at an agreement on the option to be adopted for CAP within 30 days from:

- the date of an account being reported as SMA–2 by one or more lender, or
- on receipt of request from the borrower to form a JLF, with substantiated grounds, if it senses imminent stress.

Now after reviewing the above requirement, the RBI has increased the above time limit from 30 days to 45 days.

Evaluation by Independent Evaluation Committee (IEC)

Currently, the guidelines require that the IEC should look into the viability aspects for accounts with aggregate exposure of INR5,000 million, after ensuring that the terms of restructuring are fair to the lenders. The IEC is required to provide their recommendation in these aspects to the CDR cell/JLF within a period of 30 days.

Now after reviewing the above requirement, the RBI has increased the above time limit from 30 days to 45 days.

Our comments

The RBI has provided some additional guidance and clarifications on its SMA–2/JLF and CAP requirements. These measures should help banks apply these guidelines in a more consistent manner and also address some of the practical challenges faced by some banks due to the inaction of lead banks in certain cases.

The bottom line

The changes to the Framework and its guidelines are a reflection of the fact that the RBI continues to consider the practical challenges faced by the banks in the implementation of the Framework. It has responded with amendments to make the Framework easier to apply in practice but yet achieve its stated objectives.

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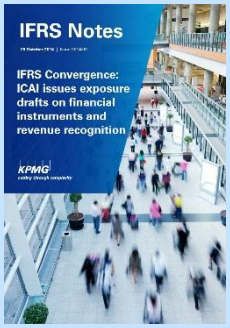
Introducing IFRS Notes



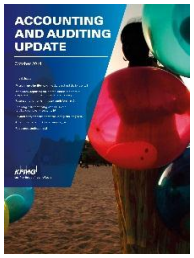
IFRS Convergence: ICAI issues exposure drafts on financial instruments and revenue recognition

As part of the initiatives towards India's convergence with IFRS from 2016-17, the Accounting Standards Board of the Institute of Chartered Accountants of India has recently issued exposure drafts on Ind AS 109, Financial Instruments (ED on financial instruments) and Ind AS 115, Revenue from Contracts with Customers (ED on revenue).

These exposure drafts are in line with the requirements of the corresponding International Financial Reporting Standards (IFRS) (IFRS 9, Financial Instruments and IFRS 15, Revenue from Contracts with Customers), the International Accounting Standards Board has recently issued.

In this issue of IFRS Notes, we have provided an overview of these exposure drafts along with key impact areas.

Missed an issue of Accounting and Auditing Update or First Notes?



October 2014

The October 2014 edition of the Accounting and Auditing Update provides insights into the microfinance sector in India and its distinct story of turnaround, continuing challenges and opportunities. We cover an article on the Companies Act, 2013 – reporting on internal financial controls and highlight some of the critical aspects of these requirements.

This month we have covered some additional perspectives on related party transactions. This issue also covers recent changes to the tax audit report and key accounting and reporting issues associated with the foreign direct investment in the retail cash and carry sector.

The MCA rationalises norms relating to consolidated financial statements and internal financial controls system

The Companies Act, 2013 was largely operationalised from 1 April 2014. The Ministry of Corporate Affairs (MCA) vide notifications dated 14 October 2014 has amended/clarified provisions relating to:

- the preparation of consolidated financial statements (CFS) by an intermediate wholly-owned subsidiary – amended to provide an exemption
- the preparation of CFS by companies having just an associate or a joint venture – amended to grant a transition period
- reporting on the internal financial control systems by auditors, mandatory for financial years commencing on or after 1 April 2015 – amended to grant a transition period
- the Schedule III-related disclosures made in stand-alone financial statements which are not to be repeated in CFS.

Our First Notes provides an overview of these amendments.

KPMG in India is pleased to present Voices on Reporting – a monthly series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

On September 24, 2014 we covered two topics:

Amendments relating to tax audit reports in India: There are a number of significant amendments to the Form No. 3CD. Due to the amendments made in the Form No. 3CD, the reporting responsibilities of the assessee and the auditor have increased considerably.

Recent amendments to the clause 49 of the Equity Listing Agreement: To address the concerns industry associations, companies and other market participants and to help the listed companies to ensure compliance with the provisions of the revised clause 49, the Securities and Exchange Board of India (SEBI) vide circular dated 15 September 2014 has amended some of the requirements of the revised clause 49.

In our call, we discussed these amendments and developments.

Feedback/Queries can be sent to aaupdate@kpmg.com

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