Resolution Plan by RBI for Covid-19 Stressed Assets

Why in News

The **Reserve Bank of India** (RBI) has specified **five financial ratios and sector-specific thresholds** for resolution of **Covid-19** related **stressed assets in 26 sectors.**

Key Points

- **Recommended by:** This resolution plan is based on the recommendations of the **K.V. Kamath committee.**
- **Financial Ratios:** The key financial ratios to be considered in the restructuring of loans impacted by the Covid-19 pandemic are:
  - **Total Outside Liability to Adjusted Tangible Net Worth Ratio :** This ratio is arrived at by addition of long-term debt, short term debt, current liabilities and provisions and deferred tax liability divided by tangible net worth net of the investments and loans. **It indicates a company's financial leverage over the total net worth of the company.**
  - **Total debt to EBIDTA ratio:** It is total debt divided by Earnings Before Interest, Depreciation, Taxes and Amortisation (EBIDTA). This ratio indicates **the cash position of a company to pay back its debt.** Higher ratio means the company has more leverage.
  - **Current ratio:** Current assets divided by current liabilities. Current ratio indicates the **company's ability to pay short term debt and other liabilities** which are due within a year's time.
  - **Debt Service Coverage Ratio:** It is the **available cash to pay current debt.**
  - **Average Debt Service Coverage Ratio.**
- **Sectors:** The 26 sectors specified by the RBI include automobiles, power, tourism, cement, chemicals, gems and jewellery, logistics, mining, manufacturing, real estate, and shipping among others.

- **Eligibility:** The resolution under this framework is applicable only to those borrowers **who have been impacted on account of Covid.**
    - Only those borrowers which were classified as **standard and with arrears less than 30 days as at March 1, 2020** are eligible under the Framework.
    - The res o lu tion plans shall take into ac count **the pre-Covid-19 op er at ing and fi nan cial per for mance** of the bor rower **and im pact of Covid-19** on its op er at ing and fi nan cial per for mance.
- **Graded Approach:** The lend ing in sti tu tions may, at their dis cre tion, adopt a **graded ap proach de pend ing on the sever ity of the im pact on bor row - ers** while im ple ment ing the res o lu tion plan.
    - The banks can classify the accounts into **mild, moderate and severe** as recommended by the committee.
    - Simplified restructuring may be done for mild and moderate stress. Severe stress cases would require comprehensive restructuring.
- **Background:**
    - The RBI took a number of steps to give relief to companies affected by Covid-19 in its **Monetary Policy Report.**

        It permitted lenders a one-time restructuring of loans without classifying these as **Non-Performing Assets.**
    - It allowed lenders to grant a **loan moratorium** for three months on Equated Monthly instalments (EMIs) falling due between March 1 and May 31, 2020. Later, it **extended this for another three months** until August 31.
- According to a report by **India Ratings and Research,** a high proportion of debt from the real estate, airlines, hotels, and other sectors had been restructured, the **largest contribution had been from infrastructure, power, and construction.**
    - Banks are likely to restructure up to Rs. 8.4 lakh crore of loans, or 7.7% of the overall system's credit.
    - The restructuring quantum from the corporate sector in FY21 could range between **3% and 5.8% of the banking credit,** amounting to Rs 3.3-6.3 lakh Crores.
    - At least **Rs. 210,000 crore (1.9% of banking credit) of non-corporate loans** is likely to undergo restructuring after the announcement, which would have otherwise slipped into the **Non-Performing Asset** category.
    - India Ratings and Research is a credit rating agency that provides credit opinions regarding India's credit markets.

Way Forward

The loan restructuring must be a temporary step as continuing it for long may lead to an **inflation surge, currency crisis, and financial instability** due to **accumulation of bad loans.** It is important that post-Covid-19, regulatory measures are rolled out in a very careful and orderly manner and the financial sector returns to normal functioning **without relying on the regulatory relaxations as the new norm.**