DEBT RESTRUCTURING MECHANISM & REHABILITATION POLICY FOR MICRO , SMALL AND MEDIUM ENTERPRISES (MSMEs) – REVIEW March'2013

Index of Contents

BANK OF INDIA
Board Meeting
17 APR 2013
BOARD SECRETARIAT
HEAD OFFICE

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1. **Preamble:**

Micro, Small and Medium enterprises are growth engine of Indian economy. Their contribution to GDP of India is approximately 8%. This sector is gradually acquiring pivotal position in Indian economy since it provides largest employment after Agriculture sector. Further, it provides depth to the Indian economy due to its presence even in remotest corner of India. However, the flip side is that this sector is vulnerable to economic downturn both global as well as domestic and very often requires urgent remedial steps to recover its lost ground. RBI has revised its existing guidelines for Rehabilitation of sick Micro and small Enterprises (MSE) (Ref. No. RPCD.CO.MSME & NFS.BC.40/06.02.31/2012-13 dated 1st November 2012) (**Annexure I**). These guidelines, inter alia, envisage the following:

(i) early identification of sickness of the unit;
(ii) extending handholding after detecting symptoms of sickness;
(iii) initiating timely corrective measures through restructuring exercise; and
(iv) proviso for the borrower to represent his case for restructuring to the higher authority in case the same is considered non-viable by the delegatee under whose power it otherwise falls.

Our Bank's policy on Debt Restructuring Mechanism & Rehabilitation policy for Small and Medium Enterprise was last reviewed in May 2008. In absence of any change, the guidelines were continued and last reported to Board while approving credit policy on MSME (BM/25.05.2011).

We propose to adopt the revised guidelines issued by RBI on restructuring of Micro and Small Enterprise also to Medium Enterprise which is part of the regulatory business.

The objective of the guidelines 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 MSMEs that are affected by certain internal and external factors and minimize the losses to the lenders (the Bank) and other stakeholders through an orderly, coordinated and pre-emptive restructuring program or rehabilitation package.

बैंक ऑफ इंडिया/BANK OF INDIA
बोर्ड बैठक
Board Meeting
17 APR 2013
बोर्ड सचिवालय
BOARD SECRETARIAT
प्र. का./HEAD OFFICE

2. Scope & Applicability

The Micro, Small & Medium Enterprises Development (MSMED) Act 2006 which came into effect from 2nd October 2006 classifies enterprises into three categories – Micro, Small and Medium based on investment in Plant & Machinery / Equipment 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 basically intends to cover Viable or Potentially Viable MSME units (both manufacturing and non-manufacturing) those 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 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" till decision is taken on the restructuring proposal as per the existing guidelines on holding on operations.

2.2 For units covered under CGTMSE and becoming sick due to factors beyond the control of borrower, assistance for rehabilitation extended by the lender could also be covered under the scheme provided the overall assistance is within the credit cap of Rs.100 lakh and with the concurrence of CGTMSE.

2.3 For eligible MSMEs 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.

बैंक ऑफ इंडिया/BANK OF INDIA
बोर्ड बैठक
Board Meeting
17 APR 2013
बोर्ड सचिवालय
BOARD SECRETARIAT
प्र. का. मुंबई/HEAD OFFICE

2.4 In case of multiple banking/ syndicated /consortium accounts where restructuring can be considered under Corporate Debt Restructuring Scheme (CDRS), we may make effective use of CDR mechanism.

2.5 BIFR cases are not eligible for restructuring without their express approval. Such proposals of restructuring may be considered after ensuring that all the formalities in seeking approval from BIFR are completed before implementing the package.

2.6 Suit filed cases are eligible if a minimum of 75% of the lenders (by value) in case of multiple banking/syndicate/consortium accounts consent for such restructuring.

2.7 Borrowers who have been identified as willful defaulters in terms of RBI directives (Annexure **II**), may generally not be considered for restructuring where the default is due to diversion of funds. Restructuring may however be 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. 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 stipulating additional margin / contribution, security etc. and placing suitable covenants to prevent recurrence of such diversion of funds in future keeping in mind safety of Bank's funds. Viability and the ability to service debt obligation after restructuring shall be the important criteria for determining eligible cases.

3. Eligibility Criteria:

The following entities would be eligible for restructuring:

i. All **non-corporate** MSMEs irrespective of the level of dues to the Bank.

ii. All **Corporate** MSMEs enjoying banking facilities **solely from our Bank**, irrespective of the level of dues to the Bank.

iii. All Corporate MSMEs, which have funded and non-funded outstanding less than Rs.10 Crores under multiple/consortium banking arrangement with our Bank and other banks. As per extant RBI guidelines on CDR mechanism, Corporates with aggregate outstanding exposure of Rs.10 crore and above are eligible for restructuring under CDR System.

iv. Accounts classified as Sub-Standard or Doubtful would also be eligible but accounts classified as "Loss Assets" will not be eligible for restructuring.

बैंक ऑफ इंडिया/BANK OF INDIA
बोर्ड बैठक
Board Meeting
17 APR 2013
बोर्ड सचिवालय
BOARD SECRETARIAT
प्र. का./HEAD OFFICE

v. 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 but before implementing the package.

vi. Cases where Operating Agency has been appointed, restructuring may be considered on the basis of the Rehabilitation Scheme worked out by the Operating Agency.

vii. 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 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 II**).

viii. Where funds diverted earlier have been brought back into the business and/or there is change in 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. Need For Restructuring/Rehabilitation

A need for restructuring / rehabilitating 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.

4.1 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.

बैंक ऑफ इंडिया/BANK OF INDIA
बोर्ड बैठक
Board Meeting
17 APR 2013
बोर्ड सचिवालय
BOARD SECRETARIAT
प्र. का. मुंबई/HEAD OFFICE

4

4.2. 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.

5. Identification of Accounts for Debt Restructuring/Rehabilitation:

5.1 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 operations in the account. 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 III.**

5.2 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.

5.3 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.

RBI in their recent guidelines has crystallized the steps to be initiated sequentially by the lender which is as under:

6. Handholding Stage

An intermediary stage is introduced i.e "Handholding Stage" prior to the account falling in "SICK" category so that timely and adequate assistance to MSMEs can be extended and rehabilitated quickly back to health. Effort should begin on a proactive basis when early signs of sickness are detected and the account saved from further deterioration. An account may be treated to have reached the "Handholding stage"; if any of the following events are triggered:

a. There is delay in commencement of commercial production by more than six months for reasons beyond the control of the promoters;

b. The company incurs losses for two years or cash loss for one year, beyond the accepted time frame;

c. The capacity utilization is less than 50% of the projected level in terms of quantity or the sales are less than 50% of the projected level in terms of value during a year.

After identifying the account as having reached the handholding stage, branch should take timely remedial action which includes a meeting with the borrower for diagnostic analysis, enquiry into the operations of the unit and proper scrutiny of accounts, providing guidance / counseling services to the borrower unit, timely financial assistance as per borrower's need and also helping the unit in sorting out the difficulties which are non-financial in nature or requiring assistance from other agencies. The handholding support to such units should be extended **within a maximum period of two months of identification of such units.**

The units which could not be revived after extending handholding support need to be classified as 'sick' subject to complying with any one of the two conditions as laid down below and based on a viability study the units be provided necessary rehabilitation packages.

बैंक ऑफ इंडिया/BANK OF INDIA
बोर्ड बैठक
Board Meeting
6
17 APR 2013
बोर्ड सचिवालय
BOARD SECRETARIAT
प्र. का. मुंबई/HEAD OFFICE

7. **Definition of sickness**

A Micro, Small and Medium Enterprise (MSME) is said to have become sick, if any of the

Borrowal account of the enterprise remains NPA for three months or more;

OR

There is erosion in the net-worth of the unit due to accumulated losses to the extent of 50% of its net-worth during the previous accounting year.

7.1 **Sickness on account of willful mis-management;**

Units becoming sick on account of willful mis-management, willful default, unauthorized diversion of funds, disputes among partners / promoters, etc. should not be classified as sick units and would not be eligible for any relief and concessions. In such cases recovery procedures to be stepped up and extant RBI guidelines in this regard should be followed.

8. **Viability criteria**:

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 generate adequate profit from its core business operations in a period not exceeding 5 years (which may be stretched to maximum 7 years in deserving cases) so that it would be in position to meet its future financial obligations as agreed upon including those forming part of the restructuring package. Besides, it would be in position to withstand its business operation 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) As per broad benchmark with regard to DSCR suggested by RBI it should be greater than 1.25 within the 5 years period in which the unit should become viable and on year to year basis the ratio should be above 1. The normal DSCR for 10 years repayment period should be around 1.33. However, as per our internal credit policy DSCR 1.1(average) for all cases is permitted as maximum relaxation after reckoning entire repayment period of loan. We may accept the same in deserving cases.

d) Other financial viability Parameters Bench mark levels provided as per **Annexure IV**

बैंक ऑफ इंडिया/BANK OF INDIA
बोर्ड बैठक
Board Meeting
17 APR 2013
बोर्ड सचिवालय
BOARD SECRETARIAT
प्र. का. मुंबई/HEAD OFFICE

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.

8.1 Decision on viability of the Unit

As directed by RBI, rehabilitation of the unit may be under taken only if the related unit is declared viable and/or potentially viable. **The decision on viability of the unit should be taken at the earliest but not later than 3 months of becoming sick under any circumstances.**

The following procedure should be adopted before declaring any unit as unviable;

a. A unit should be declared unviable only if the viability status is evidenced by a viability study.

b. Branch Manager should conduct viability study of the unit as per exposure limit given in the table below and record the same along with proper justification. The viability study should be carried out as per format attached with this policy document (Annexure IX). If exposure limit of the account is beyond the purview of the respective branch incumbent then viability of the unit would be examined by next higher authority i.e. ZLCC. However, where the aggregate limit is Rs.10.00 cr. and above guidelines issued from time to time by Technical Appraisal Department, Head Office to be followed.

(Amt in crores)

Authority	**Limit (As per last sanction)**				
	Scale I	**Scale II**	**Scale III**	**Scale IV**	**Scale V**
Branch Manager	0.25	1.00	2.00	4.00	6.00
ZLCC	Above 6.00				

c. The declaration of the unit as unviable, as evidenced by the viability study, should have the approval of the next higher authority. In case such a unit is declared as unviable, an opportunity should be given to the unit to present the case before the next higher authority.

बैंक ऑफ इंडिया/BANK OF INDIA
बोर्ड बैठक
Board Meeting
8
17 APR 2013
बोर्ड सचिवालय
BOARD SECRETARIAT
प्र. का./HEAD OFFICE

d. The modalities for presenting the case to the next higher authority should cover broadly the various aspect as brought out under para 8 above.

e. Decision of the higher authority should be informed to the promoters in writing. The above process should be completed in a time bound manner not later than 3 months.

f. The Competent Authority may however, take decision in cases of malfeasance or fraud without following the above procedure.

g. For sick units declared unviable, with credit facilities of Rs.1 crore and above, a Committee approach may be adopted to reexamine the viability of unit as detailed in para 8.2 below,

8.2 Constitution of Committee:

a. For the purpose of examining the viability of unit considered unviable by the Branch Manager, a committee should be formed at all the Zonal Offices to review the decision of the Branch Manager on the viability of the unit. The Committee should be constituted by the Zonal Manager constituting 3 members comprising preferably Head Credit, Head Credit Monitoring and Head Asset Recovery. However, in absence of such officers in the administrative set up Zonal Manager may decide keeping other officers of credit background in the committee. Minimum quorum will be 2 members of the committee.

b. For units with aggregate exposure in excess of Rs.6.00 crore and such other cases where the authority for examining the viability of unit is vested with ZLCC, and when considered unviable by ZLCC , a committee should be formed at all the NBG Unit to review the decision of ZLCC on the viability of the unit. The Committee should be constituted by the General Manager – National Banking Unit, constituting 3 members comprising preferably Head Credit, Head Credit Monitoring and Head Asset Recovery. However, in absence of such officers in the administrative set up the General Manager- NBG unit may decide keeping other officers of credit background in the committee. Minimum quorum will be 2 members of the committee.

9. <u>Restructuring/Rehabilitation Methods:</u>

Restructuring may involve:

- Re-phasement of repayment 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.

बैंक ऑफ इंडिया/BANK OF INDIA
बोर्ड बैठक
Board Meeting
9
17 APR 2013
बोर्ड सचिवालय
BOARD SECRETARIAT
प्र. का. मुंबई/HEAD OFFICE

- 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, Modernization, etc,. Working Capital may be required over short/medium/long term basis within the restructuring/rehabilitation frame work

9.1 <u>Holding On Operations:</u>

While identifying and implementing the restructuring/rehabilitation package, "holding on operation" may be considered for a period of 6 months. This will allow MSME 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 on operation" less pre-agreed cutbacks, if any, 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 LCs 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 over dues.
- 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 reporting to the next higher authority within 10 days.
- Grant of over limits/ad-hoc limits may also be required as a part of Holding on Operation but should be dealt with as per delegation.

10. Delegation: (HOBC 106/141 dated 18.12.2012) or such other <u>instructions issued by Head Office from time to time</u>

1. Restructuring of advance to be considered at one level above than the sanctioning authority.
2. In case of concession / sacrifice, the same may be considered by a delegate one level higher than the sanctioning authority, under whose power limits fall for sanction, provided such sanctioning authority should not have sanctioned the proposal earlier.

Board Meeting
10
17 APR 2013
BOARD SECRETARIAT
HEAD OFFICE

3. Guidelines issued by Credit Monitoring Department , HO, from time to time , in this regard , to be adhered to.

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 (to be read with para 8.1.b).

12. Prudential Norms for Asset Classification;

Restructuring of advances could take place in the following stages;

a. Before commencement of commercial production/operation
b. After commencement of commercial production / operation but before the asset has been classified as "Sub Standard".
c. After commencement of commercial production / operation and the asset has been classified as 'Sub Standard' or 'doubtful'

12.1. The accounts classified as 'Standard assets' should be immediately re-classified as 'sub-standard assets' upon restructuring except for the accounts where benefits of quick implementation of restructuring/ rehabilitation package is extended, as detailed in para 13 below .

12.2 The non-performing assets, upon restructuring, would continue to have the same asset classification as prior to restructuring and slip into further lower asset classification categories as per extant asset classification norms with reference to the pre-structuring repayment schedule except for the accounts where benefits of quick implementation of restructuring/ rehabilitation package is extended, as detailed in para 13 below .

12.3 All restructured accounts which have been classified as non- performing assets upon restructuring , would be eligible for up- gradation to the 'standard' category after observation of 'satisfactory performance' during the 'specified period' i.e a period of 1 year from the date when the first payment of interest or installment of principal falls due under the terms of restructuring package. However, 'specified period' is redefined in cases of restructuring of accounts with multiple credit facilities as '1 year from the commencement of the first payment of interest or principal, whichever is later, for the credit facility(ies) with longest period of moratorium. Further, the accounts classified as NPA on restructuring can be upgraded only when all the outstanding loans /facilities in the account perform satisfactorily during the specified period.

12.4 In case, however, satisfactory performance after the specified period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule.

Board Meeting
11
17 APR 2013

12.5 **Additional finance**, if any, may be treated as 'standard asset', upto a period of 1 year after the first interest / principal payment , whichever is earlier, falls due under the approved restructuring package. However, in the case of accounts where the pre restructuring facilities were classified as 'substandard' and 'doubtful', interest income on the additional finance should be recognized only on cash basis. If the restructured asset does not quality for up gradation at the end of the above specified 1 year period , the additional finance shall be placed in the same asset classification category as the restructured debt.

12.6 **Repeated Re-structuring:** In case a restructured asset, which is a standard asset on restructuring, is subjected to restructuring on a subsequent occasion (repeated re-structuring), it should be classified as substandard.

If the restructured asset is a sub- standard or a doubtful asset and is subjected to restructuring, on a subsequent occasion, its asset classification will be reckoned from the date when it first became NPA . However, such advances restructured on second or more occasions may be allowed to be upgraded to standard category after one year from the date of first payment of interest or repayment of principal; whichever falls due earlier in terms of the current restructuring package subject to satisfactory performance.

If the second restructuring takes place after the period up to which the concession were extended under the terms of the first restructuring the account shall not be reckoned as a repeated structuring.

12.7 **Restructuring of Short-Term Loans:** Restructuring would normally involve modification of terms of the advances/securities , which would generally include, among others, alteration of repayment period / repayable amount / the amount of installments/ rate of interest (due to other than competitive reasons). In view of the extant definition, any roll over of a short term loan will be considered as 'restructuring'.

However, following working group recommendations, RBI has clarified that the cases of roll – over of short term loans, where proper pre-sanction assessment has been made, such roll over is allowed depending upon the actual requirement of the borrower and no concession has been provided due to weakness of the borrower, then these might not be considered as re-structured accounts. However, if such accounts are rolled over for more than 2 times then third roll – over onwards the account would have to be treated as a restructured account.

बैंक ऑफ इंडिया/BANK OF INDIA
बोर्ड बैठक
Board Meeting
12
17 APR 2013
बोर्ड सचिवालय
BOARD SECRETARIAT
प्रधान कार्यालय/HEAD OFFICE

13. <u>Benefits for quick implementation of restructuring package</u>

Special Regulatory Treatment for Asset classification may be meted out to such Standard / Sub-standard / Doubtful accounts where restructuring / rehabilitation package have been implemented within 120 days from the date of receipt of restructuring request / application from the borrower. It is termed as quick implementation of the restructuring package.

In the event of quick implementation of restructuring package following benefits may be extended to different category of assets, enumerated as under, however subject to fulfillment of conditions as brought out in para 13.1 below ;

a) An existing "Standard Asset" will not be downgraded to the sub-standard category upon restructuring i.e will continue to be classified as Standard Asset.

b) Asset classification of the substandard / doubtful accounts will not deteriorate upon restructuring, if satisfactory performance is demonstrated during the specified period.

c) The benefits of quick implementation is available only for those accounts / units where restructuring package is implemented on or before 31st March 2015 i.e. quick implementation benefit is withdrawn w.e.f. 01.04.2015.

13.1 <u>Conditions for extending benefits under quick implementation Package ;</u>

a) The dues to the bank (as per restructured terms) are fully secured (Tangible Principal + Collateral security both) however, MSME borrowers having outstanding upto Rs.25 lacs are exempted from this proviso.
b) The unit becomes viable in 5 years;
c) The repayment period of the restructured advance including the moratorium, if any, should not exceed 10 years.
d) LTV (Loan to value ratio) is not more than 75% i.e Minimum Asset cover (ACR) is 133%
e) Promoters' to bring / infuse minimum additional funds of 15% at bank's sacrifice (erosion in the fair value of the advance) or 2% of the restructured debt, whichever is higher. However, on case to case basis the promoter may be allowed to bring half of the bank's sacrifice i.e 7.5% (or 1% as the case may be) upfront and balance within a period of one year which need not necessarily be brought in cash and can be brought in the form of de-rating equity, conversion of USL brought by the promoter into equity and interest free loans. <u>However, in case the promoters fail to bring in their balance share of sacrifice within the extended time limit of one year , the asset classification benefits derived will cease to accrue and branch will have to revert to classifying such</u>

BANK OF INDIA
Board Meeting 13
17 APR 2013
BOARD SECRETARIAT
HEAD OFFICE