October 2020 CNK & Associates LLP Quarterly Insights

This issue

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RBI P.2

In brief

'Caution/De-caution Listing of Exporters' in the EDPMS, by the RBI will now be based on the recommendations of the concerned AD bank depending upon the exporters track record with the AD bank and adverse notice of investigative agencies

Foreign Exchange Management Act, 1999 (FEMA)

Export Data Processing and Monitoring System (EDPMS) Module for 'Caution / De-caution Listing of Exporters'

RBI/2020-2021/50 dated 9th October 2020

Vide the above Circular, Para 3.1(i) and 3.1(ii) of the APDIR Circular No. 74 dated 26th May 2016 on the Module for 'Caution/ De-caution Listing of Exporters' in the EDPMS has been withdrawn with a view to make system more exporter friendly and equitable. Earlier, the exporters would be caution-listed if any shipping bill against them remained open for more than 2 years in EDPMS, provided Authorized Dealer Category – I banks **(AD banks)**/ RBI had granted no extension. Once related bills were realized and closed or extension for realization was granted, the exporter would automatically be de-caution listed.

Now, under the revised procedure, an exporter would be caution-listed by the RBI based on the recommendations of the AD bank concerned, depending upon the exporters track record with the AD bank and investigative agencies. The AD bank would make recommendations in this regard to the Regional Office concerned of the Foreign Exchange Department of the RBI in case the exporter has come to the adverse notice of the Enforcement Directorate (ED)/Central Bureau of Investigation (CBI)/Directorate of Revenue Intelligence (DRI)/any such other law enforcement agency and/or the exporter is not traceable and/or is not making sincere efforts to realize the export proceeds. Similarly, the AD bank would also make recommendations to the Regional Office of the RBI for de-caution-listing an exporter as per the laid down procedure.

The directions contained in this Circular are without prejudice to permissions/approvals, if any, required under any other law.

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Criteria for classifying Micro, Small and Medium enterprises revised.

Clarification issued on implementation of Ind AS by NBFCs and ARCs

Resolution Framework for COVID- 19 related Stress announced to enable the lenders to implement a resolution plan in respect of eligible corporate exposures without change in ownership, and personal loans, while classifying such exposures as Standard

Reserve Bank of India (RBI)

Credit flow to Micro, Small and Medium Enterprises Sector

RBI/2020-2021/10 dated 2nd July 2020

The RBI has notified new criteria for classifying the enterprises as Micro, Small and Medium enterprises. The new criteria has come into effect from 1st July 2020.

An enterprise will be classified as a Micro, Small or Medium enterprise on the basis of the following criteria, namely:

- a micro enterprise, where the investment in plant and machinery or equipment is not more than Rs. 1 crore and turnover is not more than Rs. 5 crores;
- a small enterprise, where the investment in plant and machinery or equipment is not more than Rs.10 crores and turnover is not more than Rs, 50 crores; and
- a medium enterprise, where the investment in plant and machinery or equipment is not more than Rs. 50 crores and turnover is not more than Rs.250 crores.

Implementation of Indian Accounting Standards (Ind AS)

RBI/2020-21/15 dated 24th July 2020

As per Circular dated 13th March 2020, on the captioned subject, RBI had stated that any net unrealised gains arising on fair valuation of financial instruments, should not be included in owned funds whereas all such net losses should be considered.

RBI has clarified that the unrealised gain/loss on a derivative transaction undertaken for hedging may be offset against the unrealised loss/gain recognized in the capital (either through Profit or Loss or through Other Comprehensive Income) on the corresponding underlying hedged instrument. If after such offset and netting with unrealised gains/losses on other financial instruments, there are still net unrealised gains, the same should be excluded from regulatory capital.

RBI also clarified that unrealised gains/losses should be considered net of the effect of taxation.

Resolution Framework for COVID-19-related Stress

RBI/2020-21/16 dated 6th August 2020

With the intent to facilitate revival of real sector activities and mitigate the impact on the ultimate borrowers, RBI has decided to provide a window under the Prudential Framework to enable the lenders to implement a resolution plan in respect of eligible corporate exposures without change in ownership, and personal loans, while classifying such exposures as Standard, subject to specified conditions. Key features of Resolution

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of Stress in Personal Loans include-

- This part will be applicable to resolution of personal loans sanctioned to individual borrowers by lending institutions. However, credit facilities provided by lending institutions to their own personnel/staff will not be eligible for resolution under this framework.
- Only those borrower accounts will be eligible for resolution under this framework which were classified as standard, but not in default for more than 30 days with the lending institution as on 1st March 2020.
- The eligible borrowers' accounts should continue to be classified as Standard till the date of invocation of resolution under this framework. For this purpose, the date of invocation will be the date on which both the borrower and lending institution have agreed to proceed with a resolution plan under this framework.
- Resolution under this framework may be invoked not later than 31st December 2020 and must be implemented within 90 days from the date of invocation.
- The resolution plan will be deemed to be implemented only if all of the following conditions are met:
  - all related documentation, including execution of necessary agreements between lending institutions and borrower and collaterals provided, if any, are completed by the lenders concerned in consonance with the resolution plan being implemented;
  - the changes in the terms of conditions of the loans get duly reflected in the books of the lending institutions; and,
  - the borrower is not in default with the lending institution as per the revised terms.
- Lending institutions publishing quarterly statements should, at the minimum, make disclosures as per the format prescribed in their Financial Statements **(FSs)** for the quarters ending 31st March 2021, 30th June 2021 and 30th September 2021.They are also required to make half yearly disclosures in the FSs as on 30th September and 31st March starting from the half-year ending 30th September 2021 till all exposures on which resolution plan was implemented are either fully extinguished or completely slips into NPA, whichever is earlier.

Scheme for Restructuring of Advances for MSME sector extended

Micro, Small and Medium Enterprises (MSME) sector – Restructuring of Advances

RBI/2020-21/17 dated 6th August 2020

In view of the continued need to support the viable MSME entities on account of the fallout of COVID19 and to align these guidelines with the Resolution Framework for COVID 19 – related Stress announced for other advances, it has been decided to extend the scheme permitted in terms of the Circular dated 11th February 2020. Accordingly, existing loans to MSMEs classified as 'standard' may be restructured without a downgrade in the asset classification, subject to the following conditions:

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RBI mandates more disclosures, better risk management and a simpler structure for CICs

- The aggregate exposure, including non-fund based facilities, of banks and Non-Banking Financial Companies (NBFCs) to the borrower does not exceed Rs.25 crore as on 1st March 2020.
- The borrower's account was a 'standard asset' as on 1st March 2020.
- The restructuring of the borrower account is implemented by 31st March 2021.
- The borrowing entity is GST-registered on the date of implementation of the restructuring. However, this condition will not apply to MSMEs that are exempt from GST-registration. This will be determined on the basis of exemption limit obtaining as on 1st March 2020.
- Asset classification of borrowers classified as standard may be retained as such, whereas the accounts which may have slipped into NPA category between 2nd March and date of implementation may be upgraded as 'standard asset', as on the date of implementation of the restructuring plan. The asset classification benefit will be available only if the restructuring is done as per provisions of this circular.

As hitherto, for accounts restructured under these guidelines, banks will maintain additional provision of 5% over and above the provision already held by them.

Review of Guidelines for Core Investment Companies

RBI/2020-21/24 dated 13th August 2020

Based on the recommendations of the Working Group and inputs received from stakeholders, the RBI has been revised the guidelines applicable for Core Investment Companies **(CIC)**. *Inter alia*, the revised guidelines states the following-

- Adjusted Net worth (ANW)
  If the direct or indirect capital contribution made by one CIC in another CIC exceeds 10% of the net owned funds of the investing CIC, the capital contribution should be deducted when computing adjusted net worth. The deduction will take place immediately for any investment made by one CIC in another CIC after 13th August 2020. If an investment by a CIC in another CIC is already in excess of 10% as on 13th August 2020, the entity need not deduct the amount till 31st March 2023.
- Corporate Governance and Disclosure Requirements
  Corporate governance requirements will be as per the Companies Act, 2013. Disclosure requirements will be applicable to NBFC-CICs as per the guidelines contained in the Annex of this Circular.
- Consolidation of Financial Statement **(CFS)**
  CICs are required to prepare CFS as per provisions of Companies Act, 2013, so as to provide a clear view of the financials of the group as a whole. However, it is possible that entities that meet the definition of group as per extant regulations are not covered under consolidation due to exemptions granted as per statutory provisions/ applicable accounting standards. For such entities which are not included in the

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consolidation, disclosures should be made in the indicative format mentioned in the Annex of this Circular. In the process of consolidation, the auditor of a CIC, as the 'principal auditor', should use the work of other auditors with respect to the financial information of other respective entities, subject to auditing standards as also guidance notes issued by the Institute of Chartered Accountants of India **(ICAI)** from time to time.

- Others

  CICs implementing Ind AS are required to adhere to the Circular dated 13th March on Implementation of Ind AS

RBI in consultation with ICAI and stakeholders revises LFAR

Long Form Audit Report (LFAR) – Review

RBI/2020-21/33 dated 5th September 2020

A review of the LFAR formats, in consultation with the stakeholders, including the ICAI, was undertaken by the RBI and the changes in the LFAR has been made which include the format of LFAR.

The revised LFAR formats are required to be **put into operation for the period covering FY 2020-21 and onwards**. The mandate and scope of the audit will be as per this format and if the Statutory Central Auditors **(SCA)** feels the need of any material additions, etc., this may be done by giving specific justification by the SCA and with the prior intimation of the bank's Audit Committee of Board (ACB).

The LFAR format and other instructions issued vide RBI Circular No. DBS.CO.PP.BC.11/11.01.005/2001-2002 dated 17th April 2002 stand repealed.

Committee under the chairmanship of Kamath made recommendations on the financial parameters to be considered for the one-time restructuring of loans impacted by the COVID 19 pandemic

Resolution Framework for COVID-19-related Stress – Financial Parameter

RBI/2020-21/34 dated 7th September 2020

An Expert Committee set up by the RBI has submitted its recommendations to the RBI which have been broadly accepted by the RBI. Accordingly, all lending institutions are required to mandatorily consider the certain key ratios while finalizing the resolution plans in respect of eligible borrowers. The key ratios include-

- Total Outside Liabilities / Adjusted Tangible Net Worth **(TOL/ATNW)**
- Total Debt / EBITDA
- Current Ratio
- Debt Service Coverage Ratio
- Average Debt Service Coverage Ratio

The resolution plans should consider the pre-COVID-19 operating and financial performance of the borrower and impact of COVID-19 on its operating and financial performance at the time of finalising the resolution plan, to assess the cash flows in subsequent years, while stipulating appropriate ratios in each case.

The committee has recommended financial ratios for 26 sectors which could be factored by lending institutions while finalizing a resolution plan for a borrower. The financial aspects include those related to leverage, liquidity, debt serviceability.

Lending institutions are expected to ensure compliance to TOL/ATNW agreed as per the resolution plan at the time of implementation itself. However, in all cases, this ratio should be maintained as per the resolution plan by 31st March 2022 and on an ongoing basis thereafter. However, wherever the resolution plan envisages equity infusion, the same may be suitably phased-in over this period. All other key ratios should be maintained as per the resolution plan by 31st March 2022 and on an ongoing basis thereafter.

Key Take Away

- In order to make the Caution/De-caution Listing of Exporters in the EDPMS more exporter friendly and equitable, as per the new system, an exporter would be caution-listed by the RBI based on the recommendations of the AD bank concerned, depending upon the exporter's track record with the AD bank and investigative agencies.

- With COVID-19 continuing to disrupt normal functioning and cash flows, the stress in the MSME sector has got accentuated, warranting further support. The extension of restructuring scheme has provided the much needed relief to a large number of MSMEs.

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