INFOLEX
NEWSALERT

June 2016

REFINANCING OF PROJECT LOANS BY NON-BANKING FINANCIAL COMPANIES

The Reserve Bank of India (the "**RBI**") has recently allowed non-banking finance companies ("**NBFCs**") to refinance any existing infrastructure or other project loans by way of take-out financing, pursuant to a notification dated June 2, 2016 (the "**June 2016 Notification**").[1]

A summary of the key provisions of the Notification are set out below, together with our view on those changes.

1. BACKGROUND

Back in January 2014[2], the RBI (through the Department of Non-Banking Supervision) released the *Framework for Revitalising Distressed Assets in the Economy*, detailing guidelines to all Scheduled Commercial Banks and All-India Term-lending and Refinancing Institutions (such as Exim Bank, NABARD, NHB and SIDBI) on the refinancing of project loans and the sale of non-performing assets ("**NPAs**") by banks and other regulatory measures pursuant to a circular dated February 26, 2014 (the "**February 2014 Circular**")[3] and issued further conditions in relation to these issues pursuant to a circular dated August 7, 2014 (the "**August 2014 Circular**").[4]

2. REVISED APPLICABILITY AND CONDITIONS

The RBI has now, pursuant to the June 2016 Notification extended the applicability of the conditions specified in the February 2014 Circular and the August 2014 Circular to NBFCs, essentially permitting NBFCs to refinance any existing infrastructure or other project loans by way of take-out financing, without a pre-determined agreement with other lenders, and fix a longer repayment period.

Further, such refinancing of loans would not be considered as restructuring if the following conditions are satisfied.

2.1 For loans up to Indian Rupees One Thousand Crore (Approximately USD 150 Million)

(a) The loans should be 'standard' in the books of the existing lenders, and should have not been restructured in the past;

1 Notification RBI/2015-16/417DNBR.CC.PD.No.082/03.10.001/2015-16 dated June 02, 2016: https://rbi.org.in/Scripts/NotificationUser.aspx?Id=10434&Mode=0

2 https://rbidocs.rbi.org.in/rdocs/content/pdfs/NPA300114RFF.pdf

3 OD.BP.BC.No.98/21.04.132/2013-14: https://rbi.org.in/Scripts/NotificationUser.aspx?Id=8756&Mode=0

4 DBOD.BP.BC.No.31/21.04.132/2014-15: https://rbi.org.in/Scripts/NotificationUser.aspx?Id=9157&Mode=0

(b) The loans should be substantially taken over (more than 50 per cent of the outstanding loan by value) from the existing financing lenders; and

(c) The repayment period should be fixed by taking into account the life cycle of the project and cash flows from the project.

2.2 For loans above Indian Rupees One Thousand Crore (Approximately USD 150 Million)

(a) The project should have started commercial operation after achieving the Date of Commencement of Commercial Operation;

(b) The repayment period should be fixed by taking into account the life cycle and cash flows from the project, and the boards of the existing and new lenders should be satisfied with the viability of the project. Further, the total repayment period should not exceed 85 per cent of the initial economic life of the project (or concession period in the case of PPP projects);

(c) The loans should be 'standard' in the books of the existing lenders at the time of the refinancing;

(d) In case of partial take-out, a significant amount of the loan (a minimum 25 per cent of the outstanding loan by value) should be taken over by a new set of lenders from the existing financing lenders; and

(e) The promoters should bring in additional equity, if required, so as to reduce the debt to make the current debt-equity ratio and debt service coverage ratio (DSCR) of the project loan acceptable to the NBFC.

It has been further specified that a lender who has extended only working capital finance for a project may be treated as '*new lender*' for taking over a part of the project term loan as required under the guidelines.

IndusLaw View:

The June 2016 Notification allows NBFCs to further access the project financing market and also *broadens* the option for project companies to seek funding from entities other than Scheduled Commercial Banks and All-India Term-lending and Refinancing Institutions.

It also aims to complement the government's focus on the infrastructure sector, by making refinancing of projects easier which in turn, should help financial institutions control their asset quality in relation to their exposure and further contribute to a secondary debt market in the infrastructure sector.

In this context, it must be acknowledged that secondary debt markets are generally driven by the incoming lender's view of the profitability of the project and it remains to be seen whether the ability to provide take out financing on these terms will entice NBFCs into the market.

Although it is no longer a *regulatory requirement*, should NBFCs refinance a project without a pre-determined agreement with existing lenders, it will put them at risk if the take out financing is only *partial*.

Projects often have a syndicate of lenders who normally sign up to an inter-creditor arrangement, regulating the distribution of re-payments and proceeds in a default scenario through a '*waterfall*'.

Commercially, NBFCs would still need to enter into inter-creditor arrangements with existing lenders, if the take out financing is less than the outstanding debt that the borrower owes to its existing project lenders.

Without an inter-creditor arrangement, there would be no contractual clarity on the right of repayment in a default scenario and what position the NBFC will take in the '*waterfall*'.

We would also question whether there should be a distinction in the criteria between project debt falling above or below Indian Rupees One Thousand Crore and whether it serves a useful purpose.

Irrespective of the size of the project, a refinancing of a distressed asset is likely to see the new lenders require equity infusions from the shareholders to ensure debt to equity levels are maintained.

Authors: Ran Chakrabarti, Arijit Sarkar and Priyank Nanavaty

Disclaimer

This alert is for information purposes only. Nothing contained herein is, purports to be, or is intended as legal advice and you should seek legal advice before you act on any information or view expressed herein. Although we have endeavored to accurately reflect the subject matter of this alert, we make no representation or warranty, express or implied, in any manner whatsoever in connection with the contents of this alert.

No recipient of this alert should construe this alert as an attempt to solicit business in any manner whatsoever.