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Banks can now use provisional ratings for rejigging loans

 BY [SUGATA GHOSH](#), ET BUREAU | NOV 28, 2017, 07.49 AM IST

MUMBAI: The Reserve Bank of India has allowed lenders to rely on 'provisional ratings' — which will not be disclosed to the market — for rejigging loans to distressed companies before resorting to the [insolvency](#) mechanism. Over the next one month, large [banks](#) will attempt to spot distressed companies whose loans can be restructured based on provisional ratings.

Big Change:
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Till now, all upgrades, downgrades and outlook on debts by credit rating agencies were put out in the public domain. Faced with a mountain of bad loans and few resolutions, financial regulators are making an exception.

[NPA](#) loans have a 'D' or 'default grade' rating. The provisional rating will capture whether the execution of the restructuring proposal would upgrade the rating to 'investment grade'.

However, the information of a provisional 'upgrade' of the debt (from 'D' to 'investment grade') would be primarily meant for banks and [RBI](#). In such cases, the Securities and Exchange Board of India has exempted rating agencies from the rule that requires any rating action to be immediately communicated to financial markets.

Such ratings have to be of minimum investment grade and obtained from two rating agencies. This will enable banks to evaluate the viability of a corporate borrower and its ability to service loans left after haircut.

"If there is provisional upgrade, banks and RBI would have comfort in approving the restructuring instead of referring the borrower to [NCLT](#) (National Company Law Tribunal). RBI has recently informed the decision to banks and agencies," a banker told ET.

Provisional ratings will depend entirely on the [loan](#) restructuring terms — which typically entail easier repayment terms, lower interest and haircut against commitment of fund infusion, sale of idle or loss-making assets and furnishing of guarantee and additional security. Lenders will give rating agencies the mandate to evaluate whether a loan account qualifies for provisional upgrade based on a specific restructuring proposal.

"These will be largely out of pre-NCLT accounts and companies where bankers feel there is a possibility of turnaround," said a banker. Soon after a default, any financial creditor (among others) can file a petition before NCLT to initiate proceedings under the Insolvency and Bankruptcy Code.

"Many earlier loan restructuring plans did not work out or result in any rating upgrades. So, we believe RBI wants rating agencies and banks to check the viability and see whether a company deserves a lifeline. Rating agencies have probably been brought in for external validation," said a person dealing with stressed assets.

The regulator has clarified that rating agencies will not carry out advisory services in estimating a company's 'sustainable debt' — the quantum of debt that a distressed company would be able to service. Say, of the Rs 1,000 crore debt on the books of a borrower, the unsustainable portion of Rs 400 crore is converted into equity while the balance Rs 600 left as debt as the sustainable part.

Last Chance?

- Banks will need 2 'Investment grade' ratings to restructure loans

Rating agencies will evaluate whether this sustainable debt is worthy of investment grade rating while lenders will carry out due diligence to estimate the quantum of such debt. The exercise will test the ability of banks as well as rating agencies in finding a way out for debt-laden companies. The possibility of additional endorsement on loan restructuring by an external agency (like a rating agency) was flagged off by a regulatory official earlier this year. RBI has now formalised the mechanism through recent communications.

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ratings' which will not be disclosed

- Ratings will let banks evaluate sustainability
- Financial market regulators have okayed the arrangement
- The aim is to give companies a chance before referring them for insolvency



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