

RESERVE BANK OF INDIA

**CO-ORDINATION BETWEEN TERM
LENDING INSTITUTIONS AND
COMMERCIAL BANKS**

REPORT OF THE INTER-INSTITUTIONAL GROUP



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**RESERVE BANK OF INDIA
BOMBAY
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ABBREVIATIONS USED IN THE REPORT

BSR	—	Basic Statistical Return.
ICICI	—	Industrial Credit and Investment Corporation of India Ltd.
IDBI	—	Industrial Development Bank of India.
IFCI	—	Industrial Finance Corporation of India.
IIM	—	Inter-Institutional Meeting.
IRCI	—	Industrial Reconstruction Corporation of India Ltd.
LIC	—	Life Insurance Corporation of India.
NWC	—	Net Working Capital.
PBF	—	Permissible Bank Finance.
RBL	—	Reserve Bank of India.
WCG	—	Working Capital Gap.
WCTL	—	Working Capital Term Loan.

CHAPTER 1

INTRODUCTION

1.1 *Constitution of the Inter-Institutional Group*

In pursuance of the decision taken at the Governor's meeting with the Chairmen of the term lending institutions and commercial banks on the 28th March 1978, the Reserve Bank of India constituted an inter-institutional group with the following members to elucidate and review the matters relating to co-ordination of the lending operations of the term lending institutions and banks raised at the aforesaid meeting :—

1. Shri A. K. Bhuchar, Convenor
Additional Chief Officer,
Department of Banking Operations and Development,
Reserve Bank of India,
Central Office,
Bombay.
2. Shri D. G. Borkar,
Deputy Chief Officer,
Credit Planning and Banking
Development Cell,
Reserve Bank of India,
Central Office,
Bombay.
3. Dr. S. A. Dave,
Economic Adviser,
Industrial Development Bank of
India,
Bombay.
4. Shri H. S. Majumder,
Deputy Managing Director
(Operations),
State Bank of India,
Central Office,
Bombay.

5. Shri S. S. Nadkarni,
Joint General Manager,
Industrial Credit & Investment
Corporation of India Ltd.,
Bombay.
6. Shri B. V. Sonalker,
(Representing Indian
Banks' Association)
General Manager,
Bank of India,
Head Office,
Bombay.

1.2 *Terms of reference*

The terms of reference of the Group are to examine and make recommendations on the following points :

- (i) Criteria for sharing term loans between term lending institutions and commercial banks;
- (ii) Provision of adequate and timely working capital finance to units to whom term loans (including soft loans) have been sanctioned by term lending institutions;
- (iii) Problems connected with disbursement of soft loans by term lending institutions in cases involving commercial banks;
- (iv) Establishment of letters of credit by banks for large amounts before a project is appraised;
- (v) Sharing of securities between term lending institutions and commercial banks;
- (vi) Standardisation of documents to reduce the time lag between sanction and disbursement of loans;
- (vii) Guarantees by commercial banks for bridging finance;
- (viii) Sharing of cash flows;
- (ix) Nursing of sick units—in particular financing of cash losses;
- (x) Exchange of information between term lending institutions and banks;
- (xi) Need for an on-going mechanism for co-ordination;
- (xii) To make recommendations on any other related matter as the Group may consider germane to the subject to enquiry or any other allied matter which may be specifically referred to it by the Reserve Bank of India.

1.3 *Meetings of the Group*

The Group held nine meetings, all in Bombay. The first meeting was held on the 5th April 1978. Dr. S. A. Dave could attend only the first two meetings as he proceeded on leave thereafter.

1.4 *Existing arrangements and need for co-ordination*

Term lending institutions perform a specialised function of, *inter alia*, providing medium and long term credit required for creation of industrial capacity either by setting up of new units or by expansion/modernisation/diversification of existing units. Commercial banks on the other hand have been mainly providing working capital credit for operating the units and utilising the capacity that has been created. The banks and term lending institutions have thus been performing complementary roles but without systematic co-ordination. Further, commercial banks have also been providing term loans for small amounts on their own and for larger amounts in participation with term lending institutions. Over a period the involvement of commercial banks in term lending either in participation with term lending institutions or otherwise has gradually increased again emphasizing the need for close co-ordination. Further still, the growing sickness in industry requiring systematic efforts to control it and rehabilitate the afflicted units has thrown new challenges calling for close and effective co-ordination between term lending institutions and the commercial banks not only in their policies but also in their attitudes and approach towards the problems of industry. The absence of such an understanding and system of co-ordination acts to the detriment of not only the industry but also the interests of the term lending institutions and commercial banks themselves.

1.5 *Approach to the terms of reference*

In examining the question of co-ordination between the term lending institutions and banks in the areas covered by the terms of reference, the Group's approach was guided by the following considerations :—

- (i) The roles of the term lending institutions and banks in financing a unit, as stated above, are complementary in nature. Their interests co-exist inasmuch as safety and realisability of the funds lent depend primarily on the success of the venture.
- (ii) The security for the lending institutions really lies in the viability of the unit as seen in its ability to generate surplus and repay the loans within a reasonable period and not so much in the value of physical assets or margin though their importance cannot be minimized.
- (iii) Any system of co-ordination should aim at reducing the time factor in decision making to a significant extent so that timely assistance is provided to the industry.

- (iv) Co-ordination should ensure that while the institutional policies are in alignment with each other, these should aim at serving the genuine needs of the industry. In other words, the focus of the policies (as also systems and procedures) should be to meet the needs of the borrower in time without jeopardizing the interests of the lending institutions. At the same time, the borrower has an obligation not only to give unstinted co-operation to the lending institutions at every stage but also to account for effective and economical use of the borrowed funds so that the assets to be created are put to productive use as early as possible and at minimum cost.
- (v) Co-ordination is a continuing need right from the pre-sanction stage through the loan disbursal and post-disbursal stages till the entire institutional dues are repaid.
- (vi) Promoters should have continuing commitment and stake in the assisted unit and should continue to perform the entrepreneurial functions essential for the success of the venture; the lending institutions (which expression includes term lending institutions and commercial banks) could only supplement their resources for achieving the desired objectives.

CHAPTER 2

SHARING OF TERM LOANS AND PROVISION OF ADEQUATE AND TIMELY WORKING CAPITAL FINANCE

2.1 As stated earlier, term lending institutions are specialised institutions set up for providing term finance while the commercial banks mainly provide short term funds required for working capital purposes. The banks also provide term finance, to a limited extent, individually as well as in participation with the term lending institutions and their involvement in this area has shown an increasing trend in recent years. Term loans granted by commercial banks* to industries which aggregated about Rs. 375 crores as at the end of December 1972 and constituted 10.8% of total bank credit to industries, increased to Rs. 968 crores (15.4%) as at the end of June 1976. In several cases, commercial banks have shared term loans with the term lending institutions but the sharing ratio was in all cases decided in an ad hoc manner in the absence of any set criteria. On an examination of the term loans sanctioned by all-India term lending institutions during 1976 and 1977, it was observed that there was no set pattern of sharing in individual cases but on an aggregate basis, the share of commercial banks amounted to 12.7% in 1976 and 22.1% in 1977. The absence of an agreed basis for sharing term loans between the term lending institutions and banks creates problems in regard to credit planning both from the point of the banking system as a whole as also the individual banks.

2.2 We feel that while the provision of term finance is primarily the function of term lending institutions, as banks do participate in such financing in certain cases, there should be an agreed basis for broadly sharing the term loans between the term lending institutions and banks. We recommend the following criteria for deciding the participation.

- (a) The term lending institutions should fix a cut-off point below which they would not ordinarily expect banks to participate. The cut-off point should be conveyed to the banks. However, if in any particular case the borrower wants his banker to participate, the term lending institutions may consider the request on merit.
- (b) In individual cases above the cut-off point where both the term lending institutions and banks participate, the share of the banks should broadly be within 25 to 30% of the term loans sanctioned.

* Source BSR data

The above criteria should be reviewed by the Industrial Development Bank of India periodically, say, once a year in consultation with Reserve Bank of India and modified if necessary to, *inter alia*, ensure that the share of the banking system on an aggregate basis does not exceed about 25% of the total term loans sanctioned by the term lending institutions (including the share of the banks and loans below the cut-off point) over a year. This function can be taken over by the Standing Co-ordination Committee as and when set up in terms of our recommendation contained in paragraph 8.2 of this report.

2.3 Guarantees and acceptances of deferred credit being in the nature of term loans, except that laying of funds is not involved, should be treated as term loans for the purpose of sharing. In individual cases, therefore, if the pattern of financing includes both guarantees/acceptances of deferred credit and term loans, the share of respective institutions/banks should be determined on the basis of the total of both types of assistance.

2.4 The customer should, at an early stage, indicate the banker/s which will participate in providing the term loans (as also grant working capital finance).

2.5 If the designated bank for any reason is not in a position to fully take up its share, it should find other banks which would be willing to participate. The number of banks should, however, be kept as few as possible consistent with the size of the project for operational convenience.

2.6 Where more than one bank participates in the term loan, the banks in consultation with the borrower should designate one of themselves as the lead bank for the project in question keeping in view its share in financing, specialisation on industry basis, location, etc. So far as term lending institutions are concerned they have already the practice of nominating one of themselves as 'lead institution' for the project.

2.7 In the case of very large projects where the share of banking system in the total term loan assistance is likely to be substantial, the lead term lending institution/bank should consult the Reserve Bank of India at the initial stage itself indicating the banks which are to be invited to join the consortium and in determining their respective shares. While this is suggested because of the impact of large participation by banks on the resources position of the banking system as a whole as also of individual banks and consequently on credit planning, we do realise that the primary responsibility of finding the banks to finance the project rests with the promoters themselves. The Reserve Bank may take a view from time to time as to the limit that is to be set for the aforesaid purpose and advise the banks as also IDBI appropriately.

2.8 In cases where the lending institutions decide to finance the overruns in the assisted projects on merits of individual cases, the additional loans should

normally be shared by the institutions in the same proportion in which the original term loans were shared.

2.9 As a part of project assistance, the term lending institutions have been providing underwriting assistance to a significant extent. In select cases, banks have participated in this regard but their involvement has been nominal. We have not, however, gone into this aspect to offer any comments.



CHAPTER 3

APPRAISAL

3.1 At present, there is no satisfactory system of associating the bank/s with the appraisal of projects and consequently they remain in dark about the nature of the project and its merits till the borrower approaches them for grant of working capital finance or they are called upon to share in term finance. The banks are, therefore, unable to give any commitment at the appropriate stage in many cases, that they would provide the necessary working capital finance when the unit goes into operation. Further, while the nature of the exercise banks do for assessing working capital needs is entirely different from the term loan appraisals, they do look into the feasibility of the project as also its funding to see whether the industrial unit would have adequate long term funds for working capital margin as per the criteria laid down by the Reserve Bank. Thus, in the course of working capital assessment, banker goes through a part of the exercise already done by term lending institutions. If for any reason the working capital requirements are underestimated and a lesser provision is made towards margin for working capital or if margin provided has been eroded due to overruns, the banks will find it difficult to sanction adequate working capital finance.

3.2 Joint appraisal of term loans (including under Soft Loan Scheme) by the term lending institutions and banks (whether the banks participate in term loans or not) would help develop better understanding of the project and lead to timely sanction of adequate working capital limits. It is, therefore, advisable for the term lending institutions to associate the financing bank/s at the appraisal stage itself. The promoters should be asked to indicate the name of the bank which will provide working capital finance. The specified bank should be invited by the term lending institutions to each meeting during the appraisal stage. If more than one bank is proposed to provide working capital finance, all the banks need not be invited. The lead bank and one of the remaining banks only may participate to keep the size of the appraisal team within manageable limit for meaningful discussions and avoiding delays. The bank other than lead bank should preferably be a small bank, as this type of association would expose its officers to the techniques of term financing. It should be the responsibility of the lead bank to keep the other participating banks informed and seek their advice from time to time.

3.3 The stage at which the bank is to be involved could be after the term lending institution completes the preliminary examination of the proposal and

considers it worthwhile for further processing; it should at any rate be before the joint site inspection is taken up.

3.4 While the banks will be associated with the appraisal, the main responsibility for appraisal involved will have to remain with the term lending institutions.

3.5 In funding the project, it should be, *inter alia*, ensured that the gross working capital requirements are estimated on a realistic basis in consultation with the banks so that the margin provision will be adequate initially as well as when the unit attains the normal level of operations and the borrower will have no problem in complying with the criteria laid down by the Reserve Bank of India.

3.6 The appraisal team should prepare a joint appraisal note which would form the basis for preparing the Board memoranda by the respective term lending institutions and banks. The participating institutions/banks may also exchange the memoranda with each other, for information.

3.7 In case the requested loan assistance is for relatively small amounts, say for purchasing balancing equipments, etc., the appraisal need not be a joint exercise; the other institutions should, however, be kept informed.

3.8 For the purpose of co-ordination, each bank and term lending institution should have a focal point within their Head/Central Offices. Further, for each project they should designate a senior official (with an alternative) who will be the contact point for the purposes of that project.

3.9 There should be timely exchange of information and discussions between the term lending institutions and banks on overruns of projects in time and costs and they may jointly take up the matter with the promoters for bringing in additional funds so that the borrower will maintain balanced financial structure and there is no diversion of short term funds towards capital costs. If the circumstances so warrant, the participating institutions may consider additional term loans by taking such safeguards as may be necessary.

3.10. There should be a joint in-depth review of the progress made in the implementation of the project so that corrective steps, if necessary, could be taken well in time. Such a review may be done, every half-year. A review should also be undertaken after the borrowers have committed 75 per cent of the project costs (including letters of credit) or three months before the scheduled date for completion of the project, whichever is earlier. Such a system would enable the term lending institutions to detect the overruns also and to take necessary steps.

3.11 Working capital limits should be sanctioned by banks at least three months before the date set for commencement of commercial production.

Establishment of letters of credit by banks for large amounts before a project is appraised

3.12 Quite often promoters request the banks to establish letters of credit for import of capital equipment pending sanction of term loans by the term lending institutions, in view of the long time involved in obtaining supplies or to protect against price rise. This creates problems for the banks as in the event of the term loans not being sanctioned, they have no way of realising the dues. The banks should not, therefore, consider establishing letters of credit for import of capital equipment until the term loans for financing the project are committed. When letters of credit are actually established after the term loans are committed, the lending institutions should agree to specify the term loan/s which will be utilised for payment of bills negotiated under the letters of credit in question.

3.13 In exceptional cases, if the bank is fully satisfied that the existing unit would be able to pay the bills out of its normal cash generation irrespective of the sanction of the loan or when the bank feels that in the event of the term lending institution not sanctioning the loan it could meet the requirements of funds on its own, it may agree to establish letters of credit.

3.14 In the case of large projects of national importance, if it is felt that the loan assistance is not likely to be denied on any account, banks may consider establishing the letters of credit, where necessary, only after IIM has tentatively cleared the project and in consultation with RBI and IDBI.

Guarantees by commercial banks for bridging finance

3.15 As a measure of expediting utilisation of assistance sanctioned term lending institutions grant bridging loans for a maximum period of one year to borrowers who have been sanctioned term/soft loans, pending execution of security documents and compliance with various stipulations, which take time. Sometimes, the financial institutions require the borrowers to furnish bank guarantees for sanction of bridge loans.

3.16. Issue of bank guarantee for bridge loan involves several considerations; firstly, the risk attached to defective title or the customer not complying with the stipulated terms and conditions and secondly, the availability of security. Furnishing of guarantee becomes all the more difficult when a banker does not know the merits of the project, not having been involved in its appraisal. Banks are, therefore, reluctant to provide such guarantees. It is urged by them that as the term lending institutions have since evolved procedures for disbursing bridge finance on the strength of personal guarantees of promoters, hypothecation of assets proposed to be acquired, etc., the latter should secure their position accordingly and that the borrowers should not be required to furnish bank guarantee for disbursal of bridge finance. We agree with this view as the suggested

procedure will not only expedite disbursement of bridge loans but also result in saving to the borrower of the guarantee commission which he would have otherwise paid to the guarantor bank. For the same reasons banks should not generally grant bridge loans against the commitment of other lending institutions.

3.17 There could be no objection if in any particular case the bank volunteers to furnish the guarantee having regard to the amount involved, the security available with it and the value of the connection.

Sharing of securities between term lending institutions and banks

3.18 Normally, the term lending institutions and banks would not face any problem in sharing the securities of the borrower if the former has extended term loans and the latter working capital funds only. The term lending institutions will have first charge over the fixed assets for the term loans while the banks will have first charge over the current assets for the working capital funds provided by them. There will also not be any problem if the banks participate with the term lending institutions in term financing, sharing the fixed assets with the former on *pari passu* basis. But very often problems do arise in sharing the securities generally in the following types of situations :

- (i) Where the banks are holding first charge over the fixed assets as collateral or even prime securities for working capital advances, due to weak financial position of the borrower and deficiencies in margin, etc., and the term lending institutions want the banks to release their prior charge for soft loans/other term loans they propose to grant.
- (ii) Where the charge over fixed assets is held by term lending institutions, they are reluctant to concede *pari passu* charge in favour of the banks for advances granted by them as a part of nursing/holding operation with low margin or without margin or even without security, due to cash losses incurred by the unit.
- (iii) Banks have lent beyond the permissible limits owing to inadequate provision of the working capital margin while funding the project or erosion of the margin due to overruns in cost or diversion of short term funds for acquisition of non-current assets, etc., and would like to identify the excess borrowing and convert it into working capital term loan with a *pari passu* charge over fixed assets with a view to correcting the imbalance.

3.19 We are of the considered view that it is in the mutual interests of the term lending institutions and banks not to delay financial assistance (where such assistance is otherwise justified), while discussions are going on in regard to sharing of securities. We, therefore, stress that the principle for sharing the available securities should be that no institution tries to oversecure its position at

the cost of other institutions. In this view and considering all other relevant aspects, we are of the opinion that sharing of securities as between the term lending institutions and banks should be on the following basis :

- | | |
|--|---|
| (a) For soft loans, term loans, WCTL and guarantees/acceptances of deferred credit | Term lending institutions and banks should have <i>pari passu</i> charge over the entire fixed assets of the assisted units. Banks should be given second charge for working capital limits, in case they so request on account of weak financial position or other acceptable reasons. |
| (b) For working capital facilities | Banks will have exclusive charge over the current assets. They should concede second charge over these assets in favour of term lending institutions, when requested. |

3.20 Term loans for the above purpose will include all loans stipulated to be repayable out of the future cash generation of the unit and granted for the purpose of investment or remedying the deficiency in working capital margin or meeting cash losses. If the banks have already financed any of the above purposes by allowing excess drawings in cash credit, etc., (i.e., over and above permissible bank finance), there should be no objection to the banks converting such excess into a term loan (WCTL) for sharing the security of block assets on *pari passu* basis. In some cases the deficiency may increase over a period due to additional losses, shortfall in stock, etc., necessitating additional term loans (in the nature of working capital term loan) and in that event there should be no objection to extend *pari passu* charge over the fixed assets in respect of such loans. The situations referred to above are only illustrative in nature. While the guidelines given above would, by and large, meet all situations, there may be certain circumstances when it will be necessary to modify the formula to suit the specific needs. Therefore, in all cases there should be dialogue between the lending institutions to arrive at an acceptable basis in sharing the securities. In addition, the banks may have a second charge on fixed assets in respect of working capital finance in such cases. When such second charge exists in favour of the banks, the term lending institutions should obtain the consent of the banks before sanctioning additional term loans to the unit as this might affect the banks' overall security.

3.21 Banks/financial institutions expect certain minimum margin in respect of term loans and that the value of fixed assets of the borrower would be adequate to provide such margin. If in a particular case, it becomes necessary for one of the institutions to grant loans for meeting the cash losses during holding operations

till long-term solutions of the problems of the borrower are found, the institutions having first charge over the fixed assets should not refuse to concede *pari passu* charge in respect of such loans for the reason that the resultant margin will be diluted to a level lower than the margin normally maintained. In other words, once the loan is considered as eligible for *pari passu* charge as per the suggestions given above, considerations such as inadequacy of margin, etc., should not come in the way of conceding *pari passu* charge.

3.22 If the financing bank has not already granted a term loan but is holding first charge over the block assets of the unit as collateral security for working capital limits and the term lending institution proposes to grant soft loans to such a unit, the bank should concede prior charge in respect of the proposed soft loan. However, if there is an excess borrowing due to deficiency in the net working capital of the unit, the bank should identify the excess and convert it into working capital term loan for sharing the security on *pari passu* basis with the term lending institution as stated in the previous paragraph. While doing so, if the normal margin is available for the term loans and working capital term loan, there will be no problem. But there may be cases where due to very weak financial position of the unit, the margin available to the institutions/banks for the proposed soft loan/working capital term loan may be too inadequate to risk the venture. This may be illustrated in the following two hypothetical examples :

Illustration 1

(In lakhs of rupees)

Liabilities		Assets	
Capital	80	Fixed assets	100
Other creditors	40	Current assets	100
Bank	80		
	200		200
	200		200

Illustration 2

Capital	80	Fixed assets	100
Creditors	40	Current assets	100
Bank	110	Loss balance	30
	230		230
	230		230

In both the cases, the net working capital gap (WCG) will be Rs. 60 lakhs [Current assets—Current liabilities (other than bank borrowings), i.e., 100 — 40 = 60]. The permissible bank finance (PBF) at 75 per cent of WCG will be Rs. 45 lakhs. Working Capital Term Loan (WCTL) = Bank borrowings — PBF.

In Illustration 1 : WCTL = 80 — 45 = 35

In Illustration 2 : WCTL = 110 — 45 = 65

Assuming that out of a soft loan of Rs. 60 lakhs, only Rs. 40 lakhs will be utilised for acquisition of fixed assets, the position of the aggregate term loans vis-a-vis securities will be as under :

Illustration 1

Total loans		Security	
Soft loan	60	Original	100
WCTL	35	Addition	40
	<hr/>		<hr/>
	95		140
	<hr/>		<hr/>

Margin available : about 32 per cent

Illustration 2

Soft loan	60	Original	100
WCTL	65	Addition	40
	<hr/>		<hr/>
	125		140
	<hr/>		<hr/>

Margin available : about 10 per cent

In cases of the type referred to in Illustration 1, there should not be any problem in granting the soft loan and ranking it *pari passu* with working capital term loan as adequate margin is available.

In cases, however, of the type referred to in Illustration 2 or in any worse situation, as the margin available is below the level normally expected, the lending institutions might hesitate to agree to *pari passu* charge in respect of the soft loan and WCTL.

3.23 In such cases where the available margin is too inadequate, we suggest that the promoters should be asked to bring in funds and if they are not capable of raising the resources and the term lending institutions and the banks are satisfied about the merits of the case, they may deal with the problem in the following manner :

- (i) Term lending institutions/banks may consider a lower margin in respect of soft loan/WCTL to the extent they deem proper depending upon the merits of the case.
- (ii) Financing banks may consider liberalising the lending norm to some extent thereby reducing the quantum of WCTL but in any case the resultant current ratio should not be worse than 1 : 1.

- (iii) Where necessary, the term lending institutions and banks may suggest to the Government to infuse unsecured interest-free long term loans, etc., if the revival of the unit is considered essential in public interest.

3.24 Where securities have been shared by the term lending institutions and banks and it is proposed to take legal action or enforce the security, there should be prior consultations among them. The lending institution which has second charge over the fixed or current assets should not enforce its right on such assets without the consent of the institution holding the prior charge. Conversely, the lending institution having first charge should not enforce its rights on such assets without the consent of the institutions holding second charge.

3.25 Guarantees/acceptances of deferred credit should be treated as term loans for the purposes of sharing the security. Banks are generally called upon to issue guarantees/acceptances of deferred credit for purchase of balancing equipments, etc., from time to time. Although the amount of individual transaction may not appear large, they are numerous and the aggregate of such commitments over a period becomes substantial. Therefore, in principle, there should not be any objection to the banks having a *pari passu* charge over the fixed assets in respect of guarantees/acceptances of deferred credit also. However, there are certain cumbersome formalities in extending such *pari passu* charge which are discussed in detail in paragraph 4.8 of the report.

Problems connected with the disbursement of soft loans

3.26 At present, there being no consensus or understanding between the term lending institutions and banks on some of the major issues, such as, sharing of securities and cash flows, financing of cash losses, etc., problems arise in sanction and disbursement of soft loans, particularly in the case of weak and sick units. One of the major problems arises when the financing bank is already having first charge on the fixed assets of the assisted unit which is being considered by the term lending institutions for sanction of soft loans, inasmuch as the latter want the financing bank/s to vacate their charge in favour of the term lending institutions to secure the soft loans with the first charge over the fixed assets of the unit. This problem has already been discussed by us and solution suggested in paragraph 3.23.

3.27 Besides, term lending institutions generally stipulate that the banks should also allow certain reliefs to the units by way of conversion of the irregular/overdrawn portion of the cash credit/overdraft accounts into term loans, scaling down of interest rates, funding of arrear interest, etc., to make them viable.

3.28 We are of the view that the lending institutions may consider, as a part of nursing programme, funding of arrear interest, conversion of excess drawings

in the cash credit accounts into term loans, reducing the rate of interest and margins appropriately, provided such concessions are necessary to make the unit viable. If the term lending institutions are of the opinion (while granting soft loans) that such concessions are necessary, they should discuss these aspects with the financing banks before stipulating such conditions in soft loan sanctions. This problem may be mitigated in future as the proposed joint appraisal would afford enough opportunities to exchange the view points and arrive at a consensus.

CHAPTER 4

STANDARDISATION OF DOCUMENTS

4.1 Among the various reasons for the delay in the disbursal of loans after sanction, the most important is the time taken in the scrutiny of the title to property, search of land records, etc., and documentation. The delay is all the more when each of the participating institutions/banks makes the same exercise separately. There is, therefore, need for standardisation and simplification of loan documents, agreements, etc., to avoid delay and reduce the costs involved.

4.2 Scrutiny of title to property should not be done separately by each of the participating institutions/banks. IFCI is reported to be having a full fledged Legal Department to examine the title to property and draft the documents and the other term lending institutions are at present accepting the opinion of the Legal Department of IFCI as sufficient. Banks may also accept the examination of title deeds by IFCI, where IFCI is involved in financing. In other cases, the title should be got examined and the documents drafted by a solicitor acceptable to the participating institutions.

4.3 Scrutiny of title deeds, search of land records, obtaining the permission from the appropriate authority under the Urban Land Ceiling Act, where required, etc., should be taken up simultaneously with the appraisal of loan proposal to reduce the time lag between the sanction and the first disbursement of loan.

4.4 Lead institution/lead bank should undertake the responsibility of preparing/finalising the documents.

4.5 The present practice in regard to documentation obtaining among the term lending institutions is that LIC or one of the other institutions (which has smallest share) takes a legal mortgage in English form and all the other participating term lending institutions take a joint equitable mortgage by deposit of title deeds with one of the institutions, creating first charge in respect of the borrowing unit's fixed assets and separate deeds of hypothecation creating second charge in their favour in respect of the unit's current assets (first charge being in favour of the banks providing working capital funds), both charges ranking *pari passu inter se*. This practice is reported to have been extended, in certain cases, to cover also the banks who participate in term financing with the term lending institutions. We suggest that the practice as above should be extended to all cases uniformly where the banks participate in the consortium in term financing.

4.6 As regards the loan document which is taken by the lending institutions, we are advised that it is legally feasible to have one standard format applicable to all the participating institutions. The only major problem seems to be that generally there is a wide time gap between the dates of sanction of loans by the participating institutions and unless the sanctions of all the institutions are received, the common loan agreement cannot be executed. We feel that this is an administrative problem and would be considerably mitigated in future in view of the joint appraisal and joint preparation of appraisal note for the Boards of the respective institution recommended in paragraph 3.6 of the report. We, therefore, recommend that standard loan agreement should be devised by Industrial Development Bank of India for adoption by banks and term lending institutions. Conscious efforts should also be made by the institutions to cut delays and ensure more or less simultaneous sanction of the loans.

4.7 Further, in order to facilitate execution of joint loan documents, the participating institutions/banks should stipulate same terms and conditions as far as possible while sanctioning the loans. There may be variations in the rates of interest and terms of repayment stipulated by the different lending institutions. We understand that these variations will necessitate only minor modification to the standard documents.

4.8 As regards the guarantees/acceptances of deferred credit subsequently issued by the banks from time to time on behalf of the borrowing unit for purchase of equipments, etc., the existing practice is that such guarantees/acceptances of deferred credit are secured by a first hypothecation charge in favour of the bank granting such facility on the specific equipment purchased under such facility. The other participating institutions/banks already having a charge on all the fixed assets of the borrower release the prior charge on the specific item in favour of the bank concerned by issuing a release letter. As mentioned in paragraph 3.25 of the report, since these commitments amount to a substantial sum in many cases, banks are of the view that the overall *pari passu* charge given to them should be enhanced to cover the subsequent guarantees/acceptances of deferred credit also. While there may not be any objection to this in principle, there will be procedural difficulties as the original mortgage will have to be reopened and a supplemental deed to be executed each time the *pari passu* charge has to be enhanced. This difficulty could be minimised to some extent by the banks ascertaining from the borrowers the aggregate amount of guarantees/acceptances of deferred credit they would be requiring in the following year, and then sanctioning a single limit for the whole amount and obtaining necessary supplemental deeds at a time. However, this is not necessarily a complete solution to the problem. Besides, this does involve certain amount of procedural work and adds to the cost of stamp duty. The banks should, therefore, consider this aspect in individual cases and decide whether the advantages of enhancing the regular

mortgage charge outweigh the disadvantages or whether because of the smallness of the amount involved, they would prefer to follow the existing practice of securing guarantees/acceptances of deferred credit by a hypothecation charge on the specific assets and getting a release of the prior charge from other institutions. But if a bank ultimately decides to enhance its mortgage charge, the term lending institutions should agree to it.

CHAPTER 5

EXCHANGE OF INFORMATION

5.1 Term lending institutions generally request the commercial banks to furnish credit reports on the entrepreneurs who apply for loan assistance. It has been the experience that the credit reports received are stereotyped and convey very little helpful information. We are, therefore, of the view that whenever term lending institutions specifically request for detailed report on the entrepreneurs to consider their new schemes, the banks should report in a more detailed manner covering the background of the entrepreneur, his capabilities as seen from the performance of his other concerns, his dealings and conduct of accounts, etc.

5.2 We have suggested earlier that the financing banks should be associated with the appraisal by the term lending institutions and that a common memorandum for use by the various institutions should be prepared. With the improvement in credit reporting by the commercial banks and their association with appraisal of term loans, as suggested, there would be sufficient exchange of information between institutions at the pre-sanction stage. There is, however, need for close co-ordination even at the post-disbursement stage as the soundness and realisability of the loans granted to industrial concerns whether by the term lending institutions or commercial banks depend on how successful the borrowing unit proves to be in utilising capital assets and generating adequate surplus to service the debts, besides meeting the growth requirements. Although both the term lending institutions and the commercial banks broadly look for the same aspects as a part of follow-up, they monitor the performance separately without sharing the information systematically on an on-going basis. This sometimes leads to duplication of efforts and results in the institutions working at cross purposes. This could be avoided by a system of mutual exchange of information.

5.3 Commercial banks are in a better position to monitor the performance and state of affairs of the borrowers and detect the weaknesses, if any, at the incipient stage. However, they need not pass on to the term lending institutions all the information they come across in the course of day-to-day operations. The banks should, however, brief the term lending institutions of the major developments which are likely to affect their interests and signs of incipient sickness noticed in the assisted units, such as, adverse trends noticed in sales/production or failure to generate estimated profits, serious irregularities observed in the conduct of the account or breach of financial discipline or any major undesirable features noticed during periodical inspections and other serious developments.

CHAPTER 6

SHARING OF CASH FLOWS

6.1 The repayment schedules are fixed on the basis of estimated profitability and cash generation. If the estimates turn out to be unrealistic, the cash flow may be inadequate to meet the obligations for repayments. In the absence of an understanding between the term lending institutions and banks, the borrower exercises his own judgement in what proportion to meet his obligations to the banks or the term lending institutions or partly to both. At times the working capital provided by banks is diverted for repayment of term loans granted by the term lending institutions even at the cost of affecting liquidity. Sometimes the dues to the banks are repaid and defaults are committed with the term lending institutions. Such a position is neither in the interest of the banks nor of the term lending institutions as both of them look to the viability of operations and the growth of the assisted unit as essential for securing repayment of their loans. Diversion of cash generation towards repayment of loans without providing for minimum funds needed for increasing working capital requirements arising out of growth in production/sales would impair the ability of the unit to attain the targeted levels of operations and ultimately jeopardise the security. It is in this context that the units assisted by commercial banks are required to maintain certain minimum net working capital as laid down by the Reserve Bank. In case, therefore, cash generation is not sufficient, there is need for joint consideration of the priorities according to which this should be utilised. But at present mechanism does not exist for the purpose of refixing of repayment schedules of term loans granted by banks and institutions, sharing the cash flows generated by the assisted units and for the restructuring of the term obligations when it becomes necessary. It is, therefore, important that the lending institutions appreciate the position and observe certain agreed codes in mutual interest.

6.2 If the cash accruals are achieved as per the projections and the net working capital is expected to be maintained at the existing or the desired minimum level as laid down by the Reserve Bank, the cash accruals may be apportioned between the banks and term lending institutions as per the respective amortisation schedules initially agreed upon, which should be generally longer for institutions (say upto 10 years) and shorter for banks (say upto 7 years) in view of the short term nature of bank funds. The repayment schedule of working capital term loans and loans granted for financing cash losses could be of shorter duration.

6.3 If in any particular year the cash flows are higher than the projections, such surpluses may be retained with the units to strengthen the net working capital

position so as to act as buffer to absorb future set-backs. However, care has to be taken to ensure that such surpluses are not frittered away by the units by payment of higher dividends or by diversion or otherwise. Accelerated repayment of instalments of term loans may also be considered by mutual consultation between banks and institutions.

6.4 In case the cash generation is not adequate to meet the predetermined term loan obligations, both the banks and institutions should insist on the borrower bringing in funds to meet not only the repayment obligations, but also to maintain the required liquidity.

6.5 In cases where the borrower fails to infuse funds, the financial institutions and banks should have a dialogue to review the position and if they are satisfied with the merits of the case, they may consider postponement of recovery of instalments.

6.6 However, in cases where cash generation is not sufficient and there is already an imbalance in the financial structure due to deficiency in NWC, in any consideration as to how such cash generation should be apportioned, in our opinion, the first priority should be to provide for the additional working capital needs that may arise to increase the production and to strengthen the liquidity of the borrowing unit, besides payment of the statutory dues. In view of the importance of liquidity for proper functioning of an industrial undertaking and its healthy growth, Reserve Bank of India has laid down certain standards of minimum net working capital. The cash generated by the unit should be fully retained in the business so long as these minimum standards of net working capital are not attained. If after meeting such requirements and after payment of statutory dues there remains a surplus, it should be utilised broadly in the following order of priority :

- (i) Payment of interest proportionately to all the institutional lenders.
- (ii) Payment of instalments of principal proportionately to all institutional lenders.
- (iii) Creation or strengthening of reserves.
- (iv) Payment of other liabilities.

6.7 In cases where the projections of cash accruals do not come true, the position sometimes comes to the notice of banks/institutions after the borrowers commit defaults in payment of interest or repayment of instalment by which time the unit might have suffered cash losses causing erosion of margin for working capital and consequent lack of liquidity. Such eventuality could be avoided if the concerned banks/institutions undertake a mid-term review of the unit's cash flow position. Similarly, there should be a joint review of cash flows at periodical intervals in the case of sick units.

5.4 The term lending institutions on their part should furnish to the financing banks the financial and technical appraisal notes and gist of the important reports submitted by the nominees of the term lending institutions on the Boards of the assisted units. They should also advise regarding breach of important covenants stipulated while sanctioning loans, major defaults committed by the borrowers, etc. Overruns in costs of projects and time schedules should also be brought to the notice of the banks and there should be joint discussions on remedial measures.

5.5 Close rapport should also be maintained between nominees of term lending institutions and banks, if any, appointed on the Board of Directors of the assisted units. They should work in a cohesive manner. In the case of units where banks do not have a right to appoint nominees but their stake in the units is substantial, term lending institutions should also consider appointing the concerned bank officials as their nominees.

5.6 All industry studies, inter-firm comparisons and other special studies undertaken by either the banks or the institutions which are of common interest may be shared with the other, on request.

5.7 Exchange of information from time to time though helpful may not be sufficient. This should be supplemented by the lead bank and the lead term lending institution jointly carrying out the follow-up inspection at least once in a year. The inspecting officials should submit a joint report covering the performance of the unit, its strengths and weaknesses or deficiencies in its organisation and working (including technical aspects) and corrective measures needed. A meeting of the term lending institutions and financing banks should be convened by the lead institutions to discuss the reports and decide upon the action, if any, to be taken.

CHAPTER 7

NURSING OF SICK UNITS-IN PARTICULAR FINANCING OF CASH LOSSES

7.1 Rehabilitation of sick units calls for close coordination and concerted action by banks and term lending institutions. The areas calling for coordinated action include identification of the causes of sickness, determination of potential viability of the unit, evolving a nursing programme and monitoring. Invariably affairs of the sick units would be far from satisfactory and the units would require assistance on soft terms. While trying to restore health to such units, the banks and the term lending institutions should display understanding and patience rather than each try to oversecure its position at the expense of the other. The viability of the unit and its ability to repay the dues in a reasonable period and not the security alone, should be the guiding factors and form the basis in formulating the lending approach in respect of these units.

7.2 The cash losses incurred by the sick units drain the current assets and such units generally try to overcome the situation by resorting to excess borrowings from the banks, delaying payments to suppliers, etc. This ultimately leads to the stoppage of supplies by the suppliers, decline in production and further increase in losses. While implementing any nursing programme and taking corrective measures, it is essential to bear in mind that unless funds at the disposal of the unit are adequate for attaining the requisite production, nursing efforts would not be fruitful.

7.3 We are of the firm view that it is the responsibility of the promoters to infuse funds as and when it becomes necessary (due to incurring of cash losses, etc.) to maintain their stake in the enterprise. If they have no capacity to raise the necessary resources, the term lending institutions/banks may consider filling the gap subject to adequate safeguards provided there are reasonable prospects of the unit becoming viable and the credit risk is reasonable in their opinion.

7.4 In regard to financing of nursing programme there could be two types of situations :

(i) where banks have assisted the sick unit and term lending institutions are not already involved.

(ii) where both banks and term lending institutions have assisted the unit.

7.5 In the case of sick units assisted only by banks, the term lending institutions according to their present policy do not participate in rehabilitation assistance

unless it involves fresh capital investment programme and even then their assistance is restricted to acquiring fixed assets. In other words, they are not stepping in merely because there is a long term fund need. In view of the developmental role these institutions are expected to play, it may not, perhaps, be unreasonable to expect them to step in to salvage the productive assets of sick units which would otherwise lie idle. Moreover, having regard to the expertise these institutions have built up over a period and the long term nature of funds required by the sick units, the term lending institutions should come forward to provide term loans to these units irrespective of whether the scheme involves creation of new capital assets or not. The magnitude and complexity of the challenge of industrial sickness is such that the banks need the cooperation of term lending institutions in tackling the problem.

7.6 In case, it is decided that the term lending institutions may not provide long term finance to sick units except on a very selective basis and that too for acquiring additional fixed assets, alternatives will have to be thought of. Examining the potential viability of the sick units and nursing them back to health raise problems of a complex nature. According to the available information, nearly 300 large units (i.e., those enjoying bank credit of more than Rs. 1 crore each) are sick, accounting for an aggregate bank credit of nearly Rs. 800 crores. Having regard to the magnitude of the bank funds involved and the complexities of the problem, there seems to be justification for establishment of a specialised institution on the lines of IRCI which would provide not only funds on soft terms but also management support and efficient monitoring. In this connection, the first thought that would arise is, whether IRCI's operations can be enlarged to take care of the problems of the sick units all over India. Although IRCI by constitution is an all-India institution, for historical reasons it has confined its activities mainly to West Bengal. As most of the sick units are mainly concentrated in the States of Maharashtra and Tamil Nadu besides West Bengal, IRCI may have to extend its activities to these States in a big way. An alternative would be to establish three additional regional institutions on the lines of IRCI, one each for Northern, Western and Southern regions, to take care of the credit and allied problems of the sick units.

7.7 Where both the banks and term lending institutions are already involved, in some of the cases they have been jointly financing the cash losses, where necessary. Having regard to the structure and functions of the respective institutions, we are of the view that the financing of cash losses as a holding operation, if potential viability is established, should be shared by the term lending institutions and banks in all cases, where they are already jointly involved, in the same ratio as has been suggested for term loans in general. In determining their respective shares, the lending institutions may ensure that the loans provided by them do not go to pay the interest dues of other lending institutions.

7.8 In case where both term lending institutions and banks are financing a unit, but the bank finances the cash losses on its own, it should do so by way of a loan repayable over a period. In such an event, the term lending institutions, which may be holding first charge on the fixed assets of the unit, should concede *pari passu* charge in favour of the bank in respect of such loans.

7.9 As and when incipient sickness is noticed in a unit, there should be consultations among the term lending institutions and the banks and they should constitute a "task force" consisting of experts (including technical people) within their institutions and outsiders, if necessary, to carry out an indepth study of the working of the unit and recommend a package of corrective measures. The report of the "task force" should be discussed by the institutions and decision taken without delay.

7.10 Close watch is necessary on the implementation of the suggestions and the progress made by the unit from time to time. In the case of large projects, the lending institutions may avail themselves of the services of consultants/professionals for monitoring purposes, where necessary.

7.11 There should be periodical meetings between the lending institutions to review the performance of the assisted unit, consider fresh corrective measures needed and for sharing of cash flows.

7.12 There are certain other areas where co-ordinated action is desirable between banks and term lending institutions, such as, negotiation with labour and Government, stalling legal proceedings against assisted units in the form of winding up petitions, etc.

CHAPTER 8

ON-GOING CO-ORDINATION

8.1 In the preceding chapters we have made recommendations on the specific issues where there is need for co-ordination between the commercial banks and term lending institutions with a view to providing better service to the industrial units. In the course of day-to-day working and implementation of these recommendations new problems might arise. At present, there is no standing forum for sorting out such problems between the banks and the term lending institutions. As a result both of them may often adopt different attitudes to many of these problems which may not only cause conflict and confusion but may also harm their own interest as also that of the assisted unit. It is, therefore, essential that there should be a high level body which may meet at periodical intervals to consider policy issues pertaining to co-ordination between banks and term lending institutions.

8.2 We suggest that a Standing Co-ordination Committee at a high level may be set up comprising representatives of the Reserve Bank, commercial banks and term lending institutions. The committee may be set up under the auspices of the Reserve Bank.

CHAPTER 9

ACKNOWLEDGEMENT

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CHAPTER 10

SUMMARY OF RECOMMENDATIONS

1. There should be an agreed basis for broadly sharing the term loans between the term lending institutions and banks.

For deciding the participation, the following criteria should be followed :

(a) The term lending institutions should fix a cut-off point below which they would not ordinarily expect banks to participate. The cut-off point should be conveyed to the banks. However, if in any particular case, the borrower wants his banker to participate, the term lending institutions may consider the request on merit.

(b) In individual cases above the cut-off point where both the term lending institutions and banks participate, the share of the banks should be within 25% to 30% of the term loans sanctioned.

The above criteria should be reviewed by the Industrial Development Bank of India, periodically, say, once a year in consultation with the Reserve Bank of India and modified, if necessary to, *inter alia*, ensure that the share of the banking system on an aggregate basis does not exceed about 25% of the total term loans sanctioned by the term lending institutions (including the share of the banks and loans below the cut-off point) over a year. This function can be taken over by the Standing Co-ordination Committee as and when set up in terms of our recommendation contained in paragraph 8.2 of this report. (Para 2.2)

2. Guarantees/acceptances of deferred credit being in the nature of term loans should be treated as such for the purpose of sharing. In individual cases, therefore, if the pattern of financing includes both term loans and guarantees/acceptances of deferred credit, the share of respective institutions/banks should be determined on the basis of the total of both types of assistance. (Para 2.3)

3. The customer should, at an early stage, indicate the banker/s which will participate in providing the term loans (as also grant working capital finance). (Para 2.4)

4. If the designated bank for any reason is not in a position to fully take up its share, it should find other banks which would be willing to participate. The number of banks should, however, be kept as few as possible, consistent with the size of the project for operational convenience. (Para 2.5)

5. In the case of very large projects where the share of banking system in the ~~total term loan assistance~~ is likely to be substantial, the lead term lending institutions/bank should consult the Reserve Bank of India at the initial stage as well as to the banks which are to be invited to join the consortium and in determining their respective shares.

The Reserve Bank of India may take a view from time to time as to the limit that is to be set up for the aforesaid purpose and advise the banks as also IDBI appropriately. (Para 2.7)

6. In cases where the lending institutions decide to finance the overruns in the assisted projects on merits of individual cases, the additional loans should normally be shared by the institutions in the same proportion in which the original term loans were shared. (Para 2.8)

7. There should be joint appraisal of term loans (including under Soft Loan Scheme) by the term lending institutions and banks (whether the banks participate in term loans or not) to help better understanding of the project and lead to timely sanction of adequate working capital limits. The promoters should be asked to indicate the name of the bank which will provide working capital finance. The specified bank should be invited by the term lending institution to each meeting during the appraisal stage. If more than one bank is proposed to provide working capital finance, all the banks need not be invited; the "lead bank" and one of the remaining banks only may participate to keep the size of appraisal team within manageable limit for meaningful discussions and avoiding delays. The bank, other than lead bank, should preferably be a small bank, as this type of association would expose its officers to the techniques of term financing. It should be the responsibility of the lead bank to keep the other participating banks informed and seek their advice from time to time. (Para 3.2)

8. The stage at which the bank is to be involved could be after the term lending institution completes the preliminary examination of the proposal and considers it worthwhile for further processing; it should at any rate be before the joint site inspection is taken up. (Para 3.3)

9. While the banks will be associated with the appraisal, the main responsibility for appraisal will have to remain with the term lending institutions. (Para 3.4)

10. In funding the project, it should be, *inter alia*, ensured that the gross working capital requirements are estimated on a realistic basis in consultation with the banks, so that the margin provision will be adequate initially as well as when the unit attains the normal level of operations and the borrower will have no problem in complying with the criteria laid down by the Reserve Bank of India (Para 3.5)

11. The appraisal team (consisting of the officials of term lending institutions and banks) should prepare a joint appraisal note which would form the basis for *preparing the Board memoranda by the respective term lending institutions and banks*. The participating institutions/banks may also exchange the memoranda with others, for information. (Para 3.6)

12. In case the requested loan assistance is for relatively small amounts, say, for purchasing balancing equipments, etc., the appraisal need not be a joint exercise; the other institutions should, however, be kept informed. (Para 3.7)

13. For the purpose of co-ordination, each bank and term lending institution should have a focal point within their Head/Central Offices. Further, for each project they should designate a senior official (with an alternative) who will be the contact point for the purposes of that project. (Para 3.8)

14. There should be timely exchange of information and discussions between the term lending institutions and banks on overruns of projects in time and costs and they may jointly take up the matter with the borrower for bringing in additional funds so that the borrower will maintain a balanced financial structure and there is no diversion of short term funds towards capital costs. If the circumstances so warrant, the participating institutions may consider additional term loans by taking such safeguards as may be necessary. (Para 3.9)

15. There should be a joint in-depth review of the progress made in the implementation of the project so that corrective steps, if necessary, could be taken well in time. Such a review may be done every half-year. A review should also be undertaken after the borrowers have committed 75% of the project costs (including letters of credit) or three months before the scheduled date for completion of the project whichever is earlier. (Para 3.10)

16. Working capital limits should be sanctioned by banks at least three months before the date set for commencement of commercial production. (Para 3.11)

17. The banks should not consider establishing letters of credit in favour of the borrowers for import of capital equipment until the term loans for financing the project are committed. (Para 3.12)

18. In exceptional cases, if the bank is fully satisfied that the borrower would be able to pay the bills out of its normal cash generation irrespective of the sanction of the loan or when the bank feels that in the event of the term lending institution not sanctioning the loan it could meet the requirements of funds on its own, it may agree to establish letters of credit. (Para 3.13)

19. In the case of large projects of national importance, if it is felt that the loan assistance is not likely to be denied on any account, banks may consider establishing the letters of credit, where necessary, only after IIM has tentatively cleared the project and in consultation with RBI and IDBI. (Para 3.14)

20. Banks are reluctant to issue guarantees for the bridge loans granted by the term lending institutions in view of the risks involved. As the term lending institutions have since evolved procedures for disbursing bridge finance on the strength of personal guarantees of promoters, hypothecation of assets proposed to be acquired, etc., they should secure their position accordingly and should not require the borrowers to furnish bank guarantee for disbursement of bridge finance. This will not only expedite disbursement of bridge loans but also result in saving to the borrower of the guarantee commission. For the same reasons banks should not generally grant bridge loans against the commitment of other lending institutions. (Para 3.16)

21. There could be no objection if in any particular case the bank volunteers to furnish the guarantee having regard to the amount involved, the security available with it and the value of connection. (Para 3.17)

22. It is in the mutual interests of the term lending institutions and banks not to delay financial assistance (where such assistance is otherwise justified), while discussions are going on in regard to sharing of securities. The principle of sharing the available securities of the borrower as between the term lending institutions and banks should be that no institution tries to oversecure its position at the cost of other institutions.

In this view and in consideration of all other relevant aspects, the sharing of securities as between the term lending institutions and banks should be on the following basis :

(a) For soft loans, term loans, WCTL and guarantees/acceptances of deferred credit.

Term lending institutions and banks should have *pari passu* charge over the entire fixed assets of the assisted units. Banks should be given second charge for working capital limits, in case they so request on account of weak financial position or other acceptable reasons.

(b) For working capital facilities.

Banks will have exclusive charge over the current assets. They should concede second charge over these assets in favour of term lending institutions, when requested. (Para 3.19)

23. When second charge on fixed assets of the borrowing unit exists in favour of the banks, the term lending institutions should obtain the consent of the banks before sanctioning additional term loans to it as this might affect the banks' overall security. (Para 3.20)

24. If in a particular case, it becomes necessary for one of the institutions to grant loans for meeting the cash losses during holding operations till long term solutions to the problems of the borrower are found, the institutions having first charge over the fixed assets should not refuse to concede *pari passu* charge in respect of such loans for the reason that the resultant margin will be diluted to a level lower than the margin normally maintained. (Para 3.21)

25. If the financing bank not having already granted a term loan is holding first charge over the block assets of the unit as collateral security for working capital limits and the term lending institution proposes to grant soft loans to such a unit, the bank should concede prior charge in respect of the proposed soft loan. Any excess borrowing, however, due to the deficiency in the NWC of the unit should be identified and converted into WCTL by the bank for sharing the security on *pari passu* basis with the term lending institution. (Para 3.22)

26. While doing so, if the available margin for the term loans and WCTL is too inadequate, the promoters should be asked to bring in funds and if they are not capable of raising the resources and the term lending institutions and banks are satisfied about the merits of the case, they may deal with the problem in the following manner :

(i) They may consider a lower margin to the extent they deem proper depending upon the merits of the case.

(ii) Financing banks may consider liberalising the lending norm to some extent thereby reducing the quantum of WCTL but in any case the resultant current ratio should not be less than 1:1.

(iii) Where necessary, the term lending institutions and banks may suggest to the Government to infuse unsecured interest-free long term loans, etc., if the revival of the unit is considered essential in public interest. (Para 3.23)

27. Where securities have been shared by the term lending institutions and banks, there should be prior consultations among them before taking legal action or enforcing the security. The lending institution which has first or second charge over the assets should not enforce its right on such assets without the consent of the institution holding second or first charge respectively. (Para 3.24)

28. Guarantees/acceptances of deferred credit should be treated as term loans for the purpose of sharing the security and there should not be any objection, in

principle, to the banks having a *pari passu* charge over the fixed assets in respect of such guarantees/acceptances of deferred credit. (Para 3.25)

29. Lending institutions may consider as a part of nursing programme funding of accrued interest, conversion of excess drawings in the cash credit accounts into term loans, reducing the rate of interest and margins appropriately, provided such concessions are necessary to make the unit viable. If the term lending institutions are of the opinion (while granting soft loans) that such concessions are necessary, they should discuss these aspects with the financing banks before stipulating such conditions in soft loan sanctions. (Para 3.28)

30. To avoid delay and reduce the costs, scrutiny of title to property should not be done separately by each of the participating institutions/banks. Where IFCI is involved in financing, banks may, like the other term lending institutions, accept the opinion of the Legal Department of IFCI as sufficient. In other cases, the title should be got examined and the documents drafted by a solicitor acceptable to the participating institutions. (Para 4.2)

31. Scrutiny of title deeds, search of land records, obtaining the permission from the appropriate authority under the Urban Land Ceiling Act, where required, etc., should be taken up simultaneously with the appraisal of loan proposal to reduce the time lag between the sanction and the first disbursement of loan. (Para 4.3)

32. Lead institution/lead bank should undertake the responsibility of preparing/finalising the documents. (Para 4.4)

33. The present practice in regard to documentation obtaining among the term lending institutions, viz., LIC or one of the other institutions (which has a smaller share) taking a legal mortgage in English form and all the others taking a joint equitable mortgage by deposit of title deeds with one of the institutions, should be extended to cover also the banks uniformly in all cases where the latter participate in the consortium in term financing. (Para 4.5)

34. Standard format for loan agreement should be devised by IDBI for adoption by banks and term lending institutions and conscious efforts should be made by the institutions to cut delays and ensure more or less simultaneous sanction of the loans to facilitate execution of common loan agreement. (Para 4.6)

35. Further, in order to facilitate execution of joint loan documents, the participating institutions/banks should stipulate same terms and conditions, as far as possible, while sanctioning the loans. (Para 4.7)

36. While there may not be any objection, in principle, to enhancing the overall *pari passu* charge over the fixed assets of the borrower in respect of the guarantees/

acceptances of deferred credit issued subsequently by the banks, there will be procedural difficulties as the original mortgage will have to be reopened and a supplemental deed to be executed each time the *pari passu* charge has to be enhanced. This difficulty could be minimised to some extent by the banks ascertaining from the borrowers the aggregate amount of guarantees/acceptances of deferred credit they would be requiring in the following year and then sanctioning a single limit for the whole amount and obtaining necessary supplemental deeds at a time. However, this is not necessarily a complete solution to the problem. Besides, this does involve certain amount of procedural work and adds to the cost of stamp duty. The banks should, therefore, consider this aspect in individual cases and decide whether the advantages of enhancing the regular mortgage charge outweigh the disadvantages or whether because of the smallness of the amount involved, they would prefer to follow the existing practice of securing the guarantees/acceptances of deferred credit by a hypothecation charge on the specific assets and getting a release of the prior charge from other institutions. But if a bank ultimately decides to enhance its mortgage charge, the term lending institutions should agree to it. (Para 4.8)

37. Whenever term lending institutions specifically request for detailed credit reports on the entrepreneurs to consider their new schemes, the banks should report in a more detailed manner covering the background of the entrepreneur, his capabilities as seen from the performance of his other concerns, his dealings and conduct of accounts, etc. (Para 5.1)

38. There is need for mutual exchange of information between banks and term lending institutions even at the post disbursement stage. The banks should brief the term lending institutions of the major developments which are likely to affect their interests and signs of incipient sickness noticed in the assisted units, such as, adverse trends noticed in sales/production or failure to generate estimated profits, serious irregularities observed in the conduct of the account or breach of financial discipline or any major undesirable features noticed during periodical inspections and other serious developments. (Para 5.3)

39. The term lending institutions on their part should furnish to the financing banks the financial and technical appraisal notes and gist of the important reports submitted by the nominees of the term lending institutions on the Boards of the assisted units. They should also advise regarding breach of important covenants stipulated while sanctioning loans, major defaults committed by the borrowers, etc. Overruns in cost of projects and time schedule should also be brought to the notice of the banks and there should be joint discussions on remedial measures. (Para 5.4)

40. Close rapport should also be maintained between nominees of term lending institutions and banks, if any, appointed on the Board of Directors of the assisted

units. In the case of units where banks do not have a right to appoint nominees but their stake in the units is substantial, term lending institutions should also consider appointing the concerned bank officials as their nominees. (Para 5.5)

41. All industry studies, inter-firm comparisons and other special studies undertaken by either the banks or the institutions which are of common interest may be shared with the other, on request. (Para 5.6)

42. The lead bank and the lead term lending institution should jointly carry out the follow-up inspection at least once in a year. The inspecting officials should submit a joint report covering the performance of the unit, its strengths and weaknesses or deficiencies in its organisation and working (including technical aspects) and corrective measures needed. A meeting of the term lending institutions and financing banks should be convened by the lead institutions to discuss the reports and decide upon the action, if any, to be taken. (Para 5.7)

43. In case cash generation of a borrowing unit is not sufficient for meeting the repayment obligations and working capital requirements, there is need for joint consideration of the priorities according to which this should be utilised. But at present, mechanism does not exist for the purpose of refixing of repayment schedules of term loans granted by banks and institutions, sharing the cash flows generated by the assisted units and for the restructuring of the term obligations when it becomes necessary. It is, therefore, important that the lending institutions appreciate the position and observe certain agreed codes in mutual interest. (Para 6.1)

44. If the cash accruals are achieved as per the projections and the net working capital is expected to be maintained at the existing or the desired minimum level as laid down by the Reserve Bank, the cash accruals may be apportioned between the banks and term lending institutions as per the respective amortisation schedules initially agreed upon, which should be generally longer for term lending institutions (say upto 10 years) and shorter for banks (say upto 7 years) in view of the short term nature of bank funds. The repayment schedule of working capital term loans and loans granted for financing cash losses could be of shorter duration. (Para 6.2)

45. If in any particular year the cash flows are higher than the projections, such surpluses may be retained with the units to strengthen the net working capital position so as to act as buffer to absorb future set-backs. However, care has to be taken to ensure that such surpluses are not frittered away by the units by payment of higher dividends or by diversion or otherwise. Accelerated repayment of instalments of term loans may also be considered by mutual consultation between banks and institutions. (Para 6.3)

46. In case the cash generation is not adequate to meet the predetermined term loan obligations, both the banks and institutions should insist on the borrower

bringing in funds to meet not only the repayment obligations but also to maintain the required liquidity. (Para 6.4)

47. In cases where the borrower fails to infuse funds, the term lending institutions and banks should have a dialogue to review the position and if they are satisfied with the merits of the case, they may consider postponement of recovery of instalments. (Para 6.5)

48. However, in cases where cash generation is not sufficient and there is already an imbalance in the financial structure due to deficiency in net working capital, in any consideration as to how such cash generation should be apportioned, in our opinion, the first priority should be to provide for the additional working capital needs that may arise due to increase in the production and to strengthen the liquidity of the borrowing unit, besides payment of the statutory dues. Accordingly, the cash generated by the unit should be fully retained in the business so long as the minimum standards of net working capital as prescribed by the Reserve Bank are not attained. If after meeting such requirements and after payment of statutory dues there remains a surplus, it should be utilised broadly in the following order of priority:

- (i) Payment of interest proportionately to all the institutional lenders.
- (ii) Payment of instalments of principal proportionately to all institutional lenders.
- (iii) Creation or strengthening of reserves.
- (iv) Payment of other liabilities. (Para 6.6)

49. The banks and term lending institutions should undertake a mid-term review of the unit's cash flow position to ascertain whether the estimates of cash generation have come true or not. Similarly, there should be a joint review of cash flows at periodical intervals in the case of sick units. (Para 6.7)

50. Rehabilitation of sick units calls for close co-ordination and concerted action by banks and term lending institutions. The areas calling for co-ordinated action include identification of the causes of sickness, determination of potential viability of the unit, evolving a nursing programme and monitoring. The viability of the unit and its ability to repay the dues in a reasonable period and not the security alone, should be the guiding factors and form the basis in formulating the lending approach in respect of these units. (Para 7.1)

51. It is the responsibility of the promoters to infuse funds as and when it becomes necessary (due to incurring of cash losses, etc.) to maintain their stake in the enterprise. If they have no capacity to raise the necessary resources, the term lending institutions/banks may consider filling the gap subject to adequate safe-

guards provided there are reasonable prospects of the unit becoming viable and the credit risk is reasonable in their opinion. (Para 7.3)

52. In the case of sick units assisted only by banks, the term lending institutions according to their present policy do not participate in rehabilitation assistance unless it involves fresh capital investment programme and even then their assistance is restricted to acquiring fixed assets. In view of the developmental role these institutions are expected to play and having regard to the expertise they have built up over a period and the long term nature of funds required by the sick units, the term lending institutions should come forward to provide term loans to these units irrespective of whether the scheme involves creation of new capital assets or not. The magnitude and complexity of the challenge of industrial sickness is such that the banks need the co-operation of term lending institutions in tackling the problem. (Para 7.5)

53. In case it is decided that the term lending institutions may not provide long term finance to sick units except on a very selective basis and that too for acquiring additional fixed assets, alternatives will have to be thought of. Having regard to the magnitude of the bank funds involved and the complexities of the problem, there seems to be justification for establishment of a specialised institution on the lines of IRCI which would provide not only funds on soft terms but also management support and efficient monitoring. As most of the sick units are mainly concentrated in the States of Maharashtra and Tamil Nadu besides West Bengal, either IRCI may have to extend its activities to these states in a big way or alternatively three additional regional institutions may be set up on the lines of IRCI, one each for Northern, Western and Southern regions, to take care of the credit and allied problems of the sick units. (Para 7.6)

54. The financing of cash losses as a holding operation, if potential viability is established, should be shared by the term lending institutions and banks in all cases, where they are already jointly involved, in the same ratio as has been suggested for term loans in general. In determining their relative shares, the lending institutions may ensure that the loans provided by them do not go to pay the interest dues of other lending institutions. (Para 7.7)

55. In case where both term lending institutions and banks are financing a unit but the bank finances the cash losses on its own, it should do so by way of a loan repayable over a period. In such an event, the term lending institutions, which may be holding first charge on the fixed assets of the unit, should concede *pari passu* charge in favour of the bank in respect of such loans. (Para 7.8)

56. As and when incipient sickness is noticed in a unit, there should be consultations among the term lending institutions and the banks and they should constitute

a "task force" consisting of experts (including technical people) within their institutions and outsiders, if necessary, to carry out an in-depth study of the working of the unit and recommend a package of corrective measures. The report of the "task force" should be discussed by the institutions and decision taken without delay. (Para.7.9)

57. Close watch is necessary on the implementation of the suggestions and the progress made by the unit from time to time. In the case of large projects, the lending institutions may avail themselves of the services of consultants/professionals for monitoring purposes, where necessary. (Para 7.10)

58. There should be periodical meetings between the lending institutions to review the performance of the assisted unit, consider fresh corrective measures needed and for sharing of cash flows. (Para 7.11)

59. There are certain other areas where co-ordinated action is desirable between banks and term lending institutions, such as, negotiation with labour and Government, stalling legal proceedings against assisted units in the form of winding up petitions, etc. (Para 7.12)

60. There is need for a high level body which may meet at periodical intervals to consider policy issues pertaining to co-ordination between the banks and term lending institutions.

A standing Co-ordination Committee at a high level may, therefore, be set up comprising representatives of Reserve Bank of India, commercial banks and term lending institutions. The Committee may be set up under the auspices of the Reserve Bank.

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