



Let's just say it never happened: Considerations for faster economic recovery – what banks, companies and regulators can do



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Businesses across industry sectors are likely to go through an extended, though finite, period of reduced revenues and continuing fixed costs. While some businesses may seem resilient, and some may even do better. Most businesses are likely to suffer large costs/losses.

These are essentially “COVID Crisis Investments” being made by businesses along with the government in the fight against the pandemic.

A complete halt in all business operations has already led to a strain on the cash position and working capital. Businesses are likely to require additional liquidity support to restart once the situation normalises and operations reach optimal levels. The liquidity crunch may also shift downstream to the vendors in their supply-chain, the customers, and their related ecosystems.

The industry is apprehensive of the following sequence of events, as a result of impaired operations during the period of lockdown and resultant abnormal losses:

- Breach of lending covenants—financial ratios and business metrics—agreed in lending covenants
- Downgrade of ratings, potentially triggering accelerated redemptions on instruments not under the RBI moratorium
- Increase in cost of incremental debt from existing lenders due to lower ratings, as well as liquidity challenges as lenders may be averse to lending below certain thresholds.

Businesses which otherwise are sustainable in the long term, may also choke and default. The government, RBI, and banks need to collectively take measures to ensure that businesses do not collapse en masse and in turn, push banks into a systemic lockdown/failure.

# Proposed solution

Negative impact on profitability and liquidity metrics due to the losses incurred during the primary impact period of COVID-19 needs to be segregated to identify businesses that continue to remain viable with some support. A simple and systematic two-step approach to isolate the impact of COVID on businesses, with suggestions to provide necessary liquidity support by banks to businesses that remain sustainable post COVID, with or without restructuring of existing liabilities, is proposed.

The banking sector could step in to provide the desired and a focussed relief in the form of Crisis Liquidity Bridge through additional Working Capital Term Loan (WCTL), Funded Interest Term Loan (FITL), and other relevant facilities that businesses may require to overcome the COVID impact.

The proposed solution avoids a direct budgetary support by the government to businesses and the potential waste of additional liquidity due to a lack of rigor in determining rightful recipients.

## Two-step approach



As the first step, the balance sheets of businesses need to be repaired by moving the impact on account of COVID from P&L to the balance sheet.

- The excess of costs (including non-cash and finance costs) over revenue during the COVID impact period may be quantified on a quarterly basis, and capitalised as a COVID Crisis Investment in the balance sheet. It may be then amortised over a period of say, five years, and treated as special deferred expenditure as part of long-term sources until fully amortised. The amortised amount would continue to be treated as tax deductible expenses so that the tax shield, on loss incurred due to COVID, continues to be available with businesses for utilisation over a period.
- Businesses that project forward as sustainable, after adjustment on account of moving impact of COVID Crisis Investment to the balance sheet and assumed disbursement of additional liquidity up to similar amount "Crisis Liquidity Bridge", with or without some restructuring of their existing liabilities, would qualify as sustainable or potentially sustainable businesses.
- The banks may continue to classify accounts per prevailing guidelines, and follow RBI's policies for Income Recognition and Asset Classification.



In the second step, additional liquidity support (Crisis Liquidity Bridge) of up to the amount of the COVID Crisis Investment is to be provided by banks to businesses meeting the aforementioned sustainability test. Banks may consider corrective actions for businesses that do not qualify as sustainable post COVID.

## Manufacturing business: Illustrative example

### Profit & Loss Statement

	Pre-COVID	Post COVID				Post BS repair
Months	1	1	1	1	3	3
Period	1 Mar-20	1 Apr-20	1 May-20	1 Jun-20	3 Q1 FY2021	3 Q1 FY2021
<b>Revenue</b>	<b>500</b>	-	<b>100</b>	<b>300</b>	400	400
Variable costs	325	-	70	210	280	280
Employee costs	45	45	45	45	135	120
Other expenses	65	52	55	59	166	
<b>EBITDA</b>	<b>65</b>	<b>-97</b>	<b>-70</b>	<b>-14</b>	<b>-181</b>	-
Depreciation	12	12	12	12	36	-
Interest	15	15	15	15	45	-
<b>PBT</b>	<b>38</b>	<b>-124</b>	<b>-97</b>	<b>-41</b>	<b>-262</b>	-
Tax	8				-	-
<b>PAT</b>	<b>30</b>	<b>-124</b>	<b>-97</b>	<b>-41</b>	<b>-262</b>	-

Excess costs over revenue of 262 are capitalized as Covid Crisis Investment in balance sheet

### Balance Sheet

	Pre-COVID	Post COVID	Post BS repair
Liabilities	31 Mar-20	30 Jun-20	30 Jun-20
Equity Capital	150	150	150
Reserves And Surplus	725	463	725
<b>Shareholder Funds</b>	<b>875</b>	<b>613</b>	<b>875</b>
Bank borrowings	600	600	600
Other long term liabilities	75	75	75
<b>Total Liabilities</b>	<b>1,550</b>	<b>1,288</b>	<b>1,550</b>
Assets	31 Mar-20	30 Jun-20	30 Jun-20
Net Fixed Assets	1000	964	1000
<b>COVID Crisis Investment</b>			<b>262</b>
Other net current assets	250	250	214
Cash and bank balances	300	74	74
Net current assets incl cash	550	324	288
<b>Total Assets</b>	<b>1,550</b>	<b>1,288</b>	<b>1,550</b>

{ Network is maintained

{ COVID Crisis Investment is capitalised

{ Asset size is maintained

Companies may be allowed an option to adopt the above accounting treatments of capitalising the COVID Crisis Investment in the balance sheet, or continue with it being expensed out in the profit & loss statement.

## Implementing the two-step approach



Statutory auditor of businesses to confirm provisional COVID Crisis Investment for each quarter starting 1 April 2020 and within seven working days of the quarter ending



At the end of the second month of each quarter, the government to announce whether COVID Crisis Investment will be permissible for the current quarter



Investment from each quarter to be provisionally reviewed and provided for in the business' balance sheet



Those businesses that have a surplus on account of the revenues over costs in a particular quarter would be deemed to have zero COVID Crisis Investment for that particular quarter



Thereafter, the business shall apply for funding, on a quarterly basis, if required, to the lead bank of the consortium or the largest lender to the business (the Processing Bank), as the case may be.

The Processing Bank could then, with the assistance of suitable external experts, if required, carry out an internal rating exercise after adjusting for the COVID Crisis Investment and assumed disbursement of the Crisis Liquidity Bridge. If the organisation's revised rating is not two notches lower than the organisation's last rating and more than RP4, then the companies can be objectively categorised as the following:



- Category A: If no additional support is required to establish their sustainability
- Category B: If with additional support, in the form of restructuring of their existing liabilities, sustainability of companies can be established
- Category C: Businesses that after COVID are unsustainable or where the promoter's integrity/capability is considered doubtful would fall under this category.



The Processing Bank shall form a committee, which shall be the single window for clearance of such Crisis Liquidity Bridge for companies in category A and B, and review of the credit for the bridge. If approved, the amount of the Crisis Liquidity Bridge shall be disbursed on a pro-rata basis by Indian banks, NBFCs, and financial institutions to their current lending as a share of the total lending by Indian banks, NBFCs, and institutions to the organisation, unless the Processing Bank decides to disburse the entire amount itself.



The Processing Bank and other Indian banks, NBFCs, and institutions shall disburse the Crisis Liquidity Bridge amount within three working days from its approval by the Processing Bank. As the proposed borrowing by banks from RBI, as well as the subsequent lending by banks of Crisis Liquidity Bridge to businesses is guaranteed by the government, banks should consider extending this funding to businesses at 100 basis points above their cost of borrowing from RBI as above



Banks shall review performance and cash flow position of borrowers on an annual basis:

- If earlier repayment is possible, then business shall be required to repay the Crisis Liquidity Bridge funding earlier. The amortisation of the COVID Crisis Investment and quantum of tax deductible benefit may be linked to repayment of the Crisis Liquidity Bridge.
- If borrowers require additional repayment time, or additional funding support to remain sustainable, then banks may assess providing such support on a case-by-case basis.

The entire evaluation-to-disbursement process is to be completed in a time bound manner [15 to 20 days].



## Support required from the RBI and the government

The proposed solution requires limited support, primarily from the RBI and government in the form of the following:

- An amendment to the accounting standards or release of a new accounting treatment by the Ministry of Corporate Affairs (MCA) or the Institute of Chartered Accountants of India (ICAI), in connection with the existing accounting standards and suitable clarification to provisions of the Companies Act, 2013 to allow capitalisation of the COVID Crisis Investment and its subsequent amortisation over a period of five years
- This adjustment should also be applicable for listed bonds that the SEBI governs. The SEBI should also recognise and allow the amortisation. The RBI and SEBI can also consider making this adjustment applicable for rating agencies during their evaluations.
- Government to guarantee bonds issued by banks to raise funds for providing the Crisis Liquidity Bridge
- Government to provide guarantee to lending banks for the Crisis Liquidity Bridge provided by them to each qualifying organisation for the bank's benefit against any loss/default
- The RBI to amend the Prudential Framework for the Resolution of Stressed Assets dated 7 June 2019; its recommendations to be considered in conjunction with the impact of the potential Crisis Liquidity Bridge

The Crisis Liquidity Bridge support requirement by the industry is estimated to be INR 3- 4 lakh crore assuming that the impact of COVID will continue on businesses for two quarters.

### Estimates of cost to government



- Default on the Crisis Liquidity Bridge repayment by businesses assumed to be 5-10 percent
- Government may have to provide INR 30,000-40,000 crore support to banks for their benefit against default by businesses in repayment of the Crisis Liquidity Bridge over a period of five years

### Likely benefits to government



- Speedy recovery of economy and preservation of employment
- Mitigation of significant potential exposure of banks towards NPA of >INR 3 lakh crore (at 10 percent default on bank credit to industry), and subsequent government support towards capitalisation of banks to address their capital erosion due to loss of interest and additional provisioning
- Faster growth of GST and Income Tax collections for government: Assuming monthly GST collections have declined by 50 percent to INR 50,000 crore per month post COVID, and with proposed liquidity support through banks, the GST collections revive at an accelerated rate, then the government would be able to collect more during the five-year period
- Assuming a 1 percent spread over banks' borrowing and other costs, banks' annual earnings will improve by INR 3- 4 thousand crore and provide a cushion to absorb potential default by businesses

The proposed solution avoids direct budgetary support from the government to businesses and potential waste of additional liquidity due to lack of rigor in determining the rightful recipients.

## Indicative sequence of actions:

Responsible Party	Action	Impact
RBI	Suspend ratings for three quarters.	Downgrade of rating on account of COVID will, <ul style="list-style-type: none"> <li>• Increase the cost of incremental debt from existing lenders</li> <li>• Lead to a liquidity challenge as new banks/lenders would be averse to lending to businesses with rating below certain thresholds</li> <li>• Potentially trigger accelerated redemptions on instruments that are not under the RBI moratorium</li> </ul>
MCA (or ICAI)	Amend the accounting standards or release a new accounting treatment to allow for capitalisation of the COVID Crisis Investment and their subsequent amortisation over a period of five years, and their treatment as special deferred expenditure as part of long-term sources until they are fully amortised.	<ul style="list-style-type: none"> <li>• The impact on account of COVID Crisis Investment is being moved from P&amp;L account to the balance sheet. While it would have earlier reduced reserves and surplus, it would appear as the COVID Crisis Investment in lieu of cash/liquidity erosion on the asset side post amendment</li> <li>• This may gradually help bring the financial ratios and business metrics back to normal</li> </ul>
RBI	Issue requisite guidelines for banks to consider the following: <ul style="list-style-type: none"> <li>• Evaluate businesses' profitability/feasibility after making requisite adjustments on account of the COVID Crisis Investment</li> <li>• Categorise businesses in-line with a predetermined criterion, to avoid any scrutiny in the future, and proceed with resolution applicable to category of business</li> </ul>	It will facilitate efficient implementation by banks and objective categorisation of businesses
SEBI	Make applicable the adjustment for COVID Crisis Investment for listed bonds that the SEBI governs, and for consideration by rating agencies during their evaluations.	
Companies	Get COVID Crisis Investment reviewed by statutory auditors on a quarterly basis and apply for the Crisis Liquidity Bridge funding to lead/largest lender.	This helps quantify the COVID Crisis Investment by companies.
Banks	<ul style="list-style-type: none"> <li>• Categorise businesses based on feasibility of businesses post COVID, after adjustment on account of moving the impact of COVID Crisis Investment to balance sheet and assumed disbursement of additional liquidity up to a similar amount, with or without some restructuring of their existing liabilities.</li> <li>• Revised rating for sustainable and potentially sustainable businesses should not be substantially lower than last rating, and should be more than RP4.</li> <li>• The processing bank to form a single-window committee to review and approve Crisis Liquidity Bridge funding.</li> <li>• Upon approval, the amount of the Crisis Liquidity Bridge shall be disbursed by Indian banks, NBFCs, and financial institutions in proportion to their debt exposure within three working days of approval, unless the processing bank decides to disburse the entire amount itself.</li> </ul>	<ul style="list-style-type: none"> <li>• Categorisation of businesses is done in an objective manner</li> <li>• Relief is targeted towards rightful recipients</li> </ul> Timely support is provided



Responsible Party	Action	Impact
Government	Announce, at the end of the second month of each quarter, whether the COVID Crisis Investment will be permissible for the current quarter.	As the impact of COVID may continue on business for an extended time, the government may accordingly extend the duration for this support.
Banks	Undertake annual reviews of companies to assess if a) earlier repayment of Crisis Liquidity Bridge is possible, or b) if additional repayment time is required to be given, or additional funding is required for business sustenance.	Based on the individual performance of businesses, the Crisis Liquidity Bridge repayment period can be reconsidered to enable businesses to sustain, as well as utilise it only for targeted purposes.
RBI	<ul style="list-style-type: none"> <li>Amend the Prudential Framework for the Resolution of Stressed Assets dated 7 June 2019 and require its recommendations to be considered in conjunction with the impact of the potential Crisis Liquidity Bridge.</li> <li>Come up with a new framework for assets affected by the crisis and permit resolutions.</li> </ul>	This enables restructuring of existing liabilities of potential sustainable companies post COVID.
RBI	Provide interim liquidity to banks through reduced CRR for a longer duration.	This will help banks access funds to provide additional funding to qualifying companies.
Government	Issue certificates of dues payable by the government (such as tax refunds), with specific provisions made for recognising such a certification as due security.	Instead of immediate cash outflow to support businesses in the form of refunds of tax and other dues, by issuing certificates of dues that can be mortgaged to raise funds, the government is able to preserve its own liquidity for now.
RBI	Allow issuing bonds by banks to the RBI/public at large to raise funds equivalent to the Crisis Liquidity Bridge provided to various qualifying companies by banks.	This helps banks raise funds to return the additional liquidity used during the CRR relaxation.
Government	Provide guarantee to bonds issued by banks to raise funds for the Crisis Liquidity Bridge	It helps reduce cost of capital for banks, and enables them to lend at lower costs to businesses.
Government	Provide guarantee to lending banks for the Crisis Liquidity Bridge provided by them to each qualifying business.	<ul style="list-style-type: none"> <li>It collateralises the loan extended and helps eliminate the need for any additional security creation by businesses for the express disbursement of the Crisis Liquidity Bridge.</li> <li>This secures the bank against any loss/default by businesses on account of the Crisis Liquidity Bridge</li> <li>It reduces the direct budgetary support by government to potential default by businesses against the Crisis Liquidity Bridge only, and is further deferred over several years, hence preventing immediate pressure on the fiscal deficit.</li> </ul>



Responsible Party	Action	Impact
Government	Provide industry-/sector-specific concessions, which may include an additional corpus of funds to be routed through the SIDBI or sector-focussed FIs (e.g., PFC, REC, and IREDA) for equity contribution for restructuring proposals with suitable backstopping arrangements.	This enables restructuring of potentially sustainable businesses post COVID.
RBI	Direct rating agencies to adjust for COVID Crisis Investment and Crisis Liquidity Bridge to monitor current and assess future ratings.	This helps in isolating the impact of COVID on businesses.
RBI	Allow special treatment of bonds in banks' balance sheets issued for Crisis Liquidity Bridge, extended through a special account created in every bank.	
RBI	Facilitate the structuring of banks and segregation of accounts into "good bank" and "bad bank."	This enables banks to focus on their core business of lending.



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