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Mr Vaibhav Chaturvedi
Chief General Manager
Reserve Bank of India

Dear Mr Chaturvedi,

Greetings from FICCI!

Feedback on RBI's draft Circular dated 3rd May 2024 titled 'Prudential Framework for Income Recognition,
Asset Classification and Provisioning pertaining to Advances – Projects Under Implementation'

I take this opportunity to write to you regarding the draft prudential framework for 'Income Recognition, Asset Classification and Provisioning pertaining to Advances – Projects Under Implementation.'

FICCI has received feedback from its members that shows that the draft framework, though well-intended in terms of strengthening governance standards and transparency, is expected to have significant implications on infrastructure/project financing. The draft norms need to be especially considered in light of the fact that there remains an evident gap in infrastructure/project financing in India and the sector continues to be largely dependent on banking to meet its credit needs.

Some of the key areas of impact foreseen in implementing the draft guidelines are as under:

- **Provisioning of under construction accounts in the standard category:** The sharp increase in provision for standard assets from existing 0.4% to 5% for all new as well as existing project loans will have a direct impact on the cost of debt. This would reduce the bidding appetite of infrastructure developers. Furthermore, as these higher loss provisioning on projects will have to be made retrospectively, this could also make current projects unviable on account of higher interest cost and limiting the access to funds. Further, in some cases, end-user charges could also go up, particularly in regulated sectors where cost recovery depends on user willingness and ability to pay.

- **Provisioning for operational projects:** The reduction in provision for even operational assets has been proposed only after meeting stringent conditions such as repayment of 20% of debt.

Most infrastructure projects have 30-45 years life, and the operation and volume ramp up is slow in the initial years. As a result, many projects do not generate sufficient cash flow in initial years to accommodate 20% debt repayment. Banks and Financial Institutions carefully analyse the cash flow profile and accordingly design the repayment schedule including moratorium period. The implementation of repayment of 20% debt will put significant pressure on Borrower's Debt Service Coverage Ratio (DSCR) in the initial years of operations and even run the risk continuing higher provisioning for longer period. Many projects which are otherwise viable over entire duration, will appear non-viable if tested on this condition of 20% repayment in initial years.

The aforementioned condition for reducing provisions post-DCCO could also make refinancing more difficult and expensive, impacting project liquidity and financial stability. The proposed framework could also necessitate lenders to adopt risk management practices such that approval processes could be longer – extending project timelines.

- **Availability of land before financial closure:** Shifting the condition of minimum unencumbered land availability to the pre-sanction stage from the existing pre-disbursement stage will lead to a delay in achieving financial closure.

Land acquisition has several unique challenges. State governments have their own land use policies and regulations, which can vary widely. Collaboration between developers, government agencies, local communities, and civil society organizations is essential for overcoming land acquisition challenges. Linking 50% of clear land acquisition with financial closure will be a big deterrent for implementing the projects on time and thereby achieving the commencement of operation date.

- **Allowable deferment of DCCO while retaining standard asset classification:** Limiting the timeline for cumulative deferment of DCCO for infrastructure projects to 3 years from the existing 4 years including for reasons attributable to litigation is tight, as litigation cases require longer time to resolve. For instance, there have been cases where Environmental Clearance has taken more than a year which leads to cost and time implication on the Project. Although these projects will continue to be operationally viable, technically they may result in the re-classification of such exposures (at the lender's end) and a consequent step-up in borrowing costs during the implementation phase.

It is well known that infrastructure projects are capital intensive with long gestation periods and thin margins. Project proponents in the infrastructure sector take a long-term view of their investment as such projects are fraught with uncertainties and market risks. Despite best efforts by the project promotors/Concessionaire, date of commencement of commercial operations (DCCO) often gets delayed due to factors not within their control. Additional provision requirement and additional risk premium on 'Standby Credit Facility' proposed in case of deferment of DCCO would cause further stress on the project. A straight jacketed approach to penalize promoters in case of deferment in DCCO without examining its causes could be counterproductive.

- **Limiting Loan Tenure**: Limiting the repayment tenor, including the moratorium period, if any, to maximum 85% of the economic life of the project is estimated to increase equity requirements by 8-10% for realigning loan tenor to 85% of economic life. It may also inhibit top-up loan-raising abilities of all types of infrastructure projects.

The moratorium period is proposed to be limited to a maximum of six months from the date commencement of commercial operations, which is currently 2 yrs. Most of the greenfield infrastructure projects face demand risk and require a longer gestation period. Infra projects do not generate sufficient cash in the beginning as building up critical volume takes time. Therefore, a six-month moratorium may be inadequate for infrastructure projects with long gestation and high demand risk and hence we request a review of this proposal.

Considering all the points mentioned above, it is submitted that a moderate increase in provisioning requirements at 1% may be considered, allowing for subsequent review based on actual impact on project financing and economic growth. Also, as projects progress to the operational phase, provisions may be allowed to reduce to 0.4%.

Additionally, different infrastructure sectors (e.g., roads, power, railways, renewable energy, etc.) have varying commercial dynamics. It is thus suggested that sector-specific provisions are adequately factored into the guidelines to ensure robust revenue models and stable cash flows. The Reserve Bank of India is requested to develop industry specific risk parameters.

For instance, in case of PPP projects in some infrastructure sectors, the Government (1) plays a key role in monitoring the progress and facilitating approvals, and/ or (2) has put in place an independent economic regulatory regime providing structural stability to revenue and debt service for 'economic and viable" operations. Economic regulation together with credit protection to the lenders by the concessioning authority (Union/ State Governments) substantially mitigate risk to lenders. Accordingly, the Prudential Framework should take into account such considerations.

Further, land availability and applicable clearances for any project be kept as pre-disbursement or subsequent disbursement in nature.

Considering the above, it is requested that the framework be revisited to create a balanced regulatory environment that supports both financial stability and infrastructure advancement. Additionally, the idea of retrospective applicability of the draft Circular on the existing ongoing projects should be reconsidered to prevent setbacks to their implementation.

Looking forward to your favourable consideration of the above request.

With best regards,

BVN Rao
Chairman
FICCI Committee on Transport Infrastructure