

BOX 3

The Establishment of Business Revival Units in Licensed Banks to Support Sustainable Economic Recovery

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Background

The challenging macroeconomic environment that prevailed during the recent years disrupted many business entities limiting their income-generating capabilities and hence forcing them to avoid making timely payments of loans, which resulted in impairing the recovery process of licensed banks (LBs)¹. As evidenced by the increase of non-performing loans² of LBs from 5.2 per cent at end-2019 to 13.6 per cent by the end of Quarter 3 in 2023, which marginally improved later to 12.8 per cent by the end of 2023, the credit quality of the banking sector has deteriorated significantly. The revival of such businesses would enhance economic activities and employment opportunities and hence, contribute to the rebound of the national economy.

With the negative impact of the Easter Sunday attacks in 2019, COVID-19 pandemic and adverse macroeconomic conditions that prevailed during the economic crisis, the Central Bank of Sri Lanka (CBSL) issued multiple guidelines from time to time to LBs to provide relief to the affected borrowers whose debt servicing capacities were impaired. Currently, LBs have established Post COVID-19 Revival Units, and it is a timely requirement for considering a more standardised framework with an enhanced scope in reviving fundamentally viable borrowers, by guiding LBs on eligibility criteria for selection of borrowers, revival mechanisms, corporate workout frameworks and governance framework.

With the onset of slowing down of economies owing to multiple reasons, the business revival frameworks became widely accepted in many countries. The “Out-of-Court Workouts” are negotiated restructurings between the borrower and lender/s with or without the administrative guidelines. The main advantages of “Out-of-Court Workouts” are the expeditious implementation, relatively low-cost, preservation of confidentiality and greater flexibility with respect to the terms and conditions of the restructuring.

Alternatively, some countries practice the business revival processes through the involvement of judicial procedures usually within the legal framework provided by the insolvency laws.

By considering the above factors, to facilitate the sustainable economic revival of businesses affected

by the extraordinary macroeconomic circumstances and to ensure a transparent and effective resolution policy framework on reviving the stressed borrowers of LBs, the CBSL issued a Circular in March 2024 on “Guidelines for the Establishment of Business Revival Units in Licensed Banks”. The Circular includes broad guidelines to give effect to further strengthen the already established Post COVID-19 Revival Units of LBs on Governance Framework and Resources, Eligibility Criteria for Selection of Borrowers, Revival Mechanisms, Framework for Corporate Workouts, Accounting Considerations and Regulatory Reporting.

Objectives of Establishing Business Revival Units in Licensed Banks

The purpose of Business Revival Units is to identify and assist performing and non-performing borrowers of LBs who are facing challenges or may face potential financial (and/or business) difficulties due to a reduction of income, cash flows or sales, reduction or impairment of business operations or temporary closure of business emanating from extraordinary macroeconomic circumstances.

The Unit aims to revive businesses that are facing actual or potential financial difficulties but are fundamentally viable, intending to provide benefits to such borrowers, leading to the revival of such businesses, enhancing economic activities and contributing to the development of the national economy.

Governance and Operational Framework of Business Revival Units

With a view to reviving viable businesses of borrowers of banks, LBs shall formulate a revival and rehabilitation policy for borrowers who are facing actual or potential financial difficulties but are fundamentally viable, and these policies need to be reviewed and updated, at least annually.

A Business Revival Unit is expected to work in an orderly and an independent manner with Loan Origination, Legal, Risk Management and Credit Enforcement units to ensure that all relevant information and system access for the loans that may fall under the purview of the Business Revival Unit are shared effectively. Further, LBs are required to provide the necessary staff and other resources to establish Business Revival Units, and LBs whose operations are geographically spread across the island are

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encouraged to have the units regionally, based on the effectiveness of the operation.

Fundamental viability assessment will be a crucial task under the business revival process as the viability assessment procedures should be both effective and transparent. Under the fundamental viability assessment, both quantitative and qualitative indicators will be considered on a prudential basis. These indicators may include the assessment regarding the profitability, leverage, liquidity, maturity profile of liabilities and other relevant qualitative criteria. The viability assessment, to the extent possible, needs to be based on the audited financial statements of the borrower. However, in the absence of audited financial statements for the borrower owing to justifiable reasons, LBs may use appropriate and credible sources of information at the discretion of the bank. In this regard, it will be important for LBs to ensure that borrowers are cooperative, as LBs will consider only such borrowers for revival.

Further, LBs are encouraged to disclose their governance framework, operational procedures and viability assessment methodologies in their Annual Report or any other published reports to enhance accountability and transparency.

Revival Mechanisms: Financial and Operational

The Business Revival Unit shall use financial and/ or operational restructuring tools and techniques or any combination thereof to revive distressed but viable businesses.

- Financial restructuring tools would include debt forgiveness, debt rescheduling including grace periods for the payment of principal and interest, adjustment of interest rates, maturity extensions, and provision of new financing, including interim financing and exit financing.
- Under operational restructuring, the Business Revival Unit may consider proposing fundamental changes in the business's operations or assets to restore commercial viability, developing a new business plan/strategy, and enhancing operational efficiency and profitability of such businesses, improving cash management systems, reviewing pricing strategy, and reviewing customer retention and/or acquisition strategies. Moreover, the Unit may also conduct awareness programmes on rehabilitation initiatives, and provide credit counselling and business advisory services, in reaching out to potential investors.

A Framework for Corporate Workouts

Under the business revival process a Framework for Corporate Workouts is a newly introduced mechanism as an overarching framework for a mutually agreeable business revival plan between a borrower and multiple banks as creditors. Since this is a mutual agreement between parties, a court intervention would not be required. LBs may adopt a collaborative approach to develop a common model for a Framework Agreement for Corporate Workouts that will govern negotiations of a workout agreement between LBs and any eligible corporate borrower that seeks to avail of the Corporate Workout Framework. Currently, a common model is being developed by LBs. Given due consideration to the possible complexities and cost involvement that may arise in the process of negotiating mutually agreeable conditions, this framework is recommended for corporate borrowers.

Way Forward

As per the proposed business revival mechanism of LBs, it is expected that distressed borrowers who are engaged in business activities will be able to revive their businesses with the guidance of LBs, and improved cash flows will be utilised to repay their non-performing loans and thereby improving asset quality of the banking sector.

Further, with the improvement in the macroeconomic environment of the country, the revival of businesses, especially the Micro, Small & Medium Enterprises (MSMEs), would promote sustainable economic growth and employment opportunities and hence, contribute to the sustained development of the national economy. In addition, the other measures, which are in progress, such as establishment of National Credit Guarantee Institution (NCGI), implementation of an enhanced legal framework through the Secured Transactions Act and the expansion of MSME definition to cover a wide scale of businesses will be conducive to revive the affected businesses and accordingly, to contribute the enhancement of economic activities.

Notes

1. Licensed Banks include both licensed commercial banks and licensed specialised banks, licensed under the Banking Act No.30 of 1988, as amended.
2. Non-performing loan means where contractual payments of a customer are past due for more than 90 days or have remained in excess of the sanctioned limit for more than 90 days and any other credit facilities classified as Stage 3 credit facilities under Sri Lanka Accounting Standard 9 (SLFRS 09) (based on potential risk and impaired status at origination).