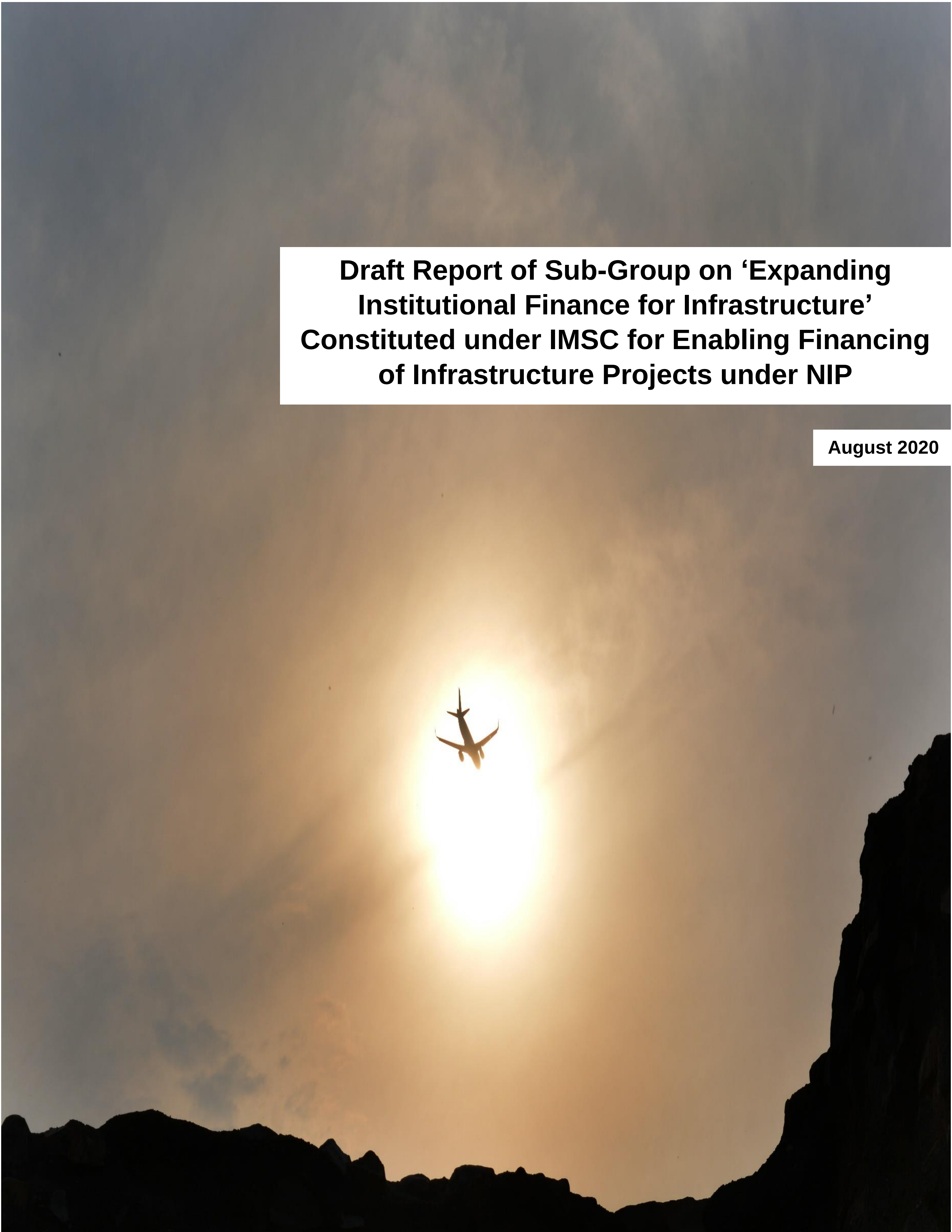

Draft Report of Sub-Group on 'Expanding Institutional Finance for Infrastructure' Constituted under IMSC for Enabling Financing of Infrastructure Projects under NIP

August 2020

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Abbreviations

ABFL	Aditya Birla Finance Limited
AIFI	All India Financial Institutions
APLMA	Asia Pacific Loan Market Association
BOT	Build Operate Transfer
CAGR	Compound Annual Growth Rate
Capex	Capital Expenditure
CBDT	Central Board of Direct Taxes
CDB	China Development Bank
CEPA	Cambridge Economic Policy Associates
COD	Commercial Operations Date
DBs	Development Banks
DBSA	Development Bank of Southern Africa
DCCO	Date of Commencement of Commercial Operation
DEA	Department of Economic Affairs
DFI	Development Financial Institution
DFS	Department of Financial Services, Ministry of Finance
DISCOM	Distribution Company
DSCR	Debt Service Coverage Ratio
ECB	External Commercial Borrowing
EPC	Engineering, Procurement and Construction
EPFO	Employees' Provident Fund Organisation
FDI	Foreign Direct Investment
FI	Financial Institutions
FPI	Foreign Portfolio Investment
FY	Financial Year
GDP	Gross Domestic Product
HR	Human Resources
IBA	Indian Banks' Association
ICA	Inter Creditor Agreement
ICICI	Industrial Credit and Investment Corporation of India
IDBI	Industrial Development Bank of India
IDF	Infrastructure Debt Fund
IDFC	Infrastructure Development Finance Company
IFCs	Infrastructure Finance Companies
IFCI	Industrial Finance Corporation of India
IIFCL	India Infrastructure Finance Company Limited
IIM	Indian Institute of Management
IMSC	Inter-Ministerial Steering Committee
InvIT	Infrastructure Investment Trust
IPAT	Infrastructure PPP Adjudication Tribunal
IPRC	Infrastructure PPP Project Review Committee
IREDA	Indian Renewable Energy Development Agency Ltd
IRFC	Indian Railway Finance Corporation

Abbreviations

LMA	Loan Market Association
MCA	Ministry of Corporate Affairs
MCLR	Marginal Cost of Funds-based Lending Rate
MoF	Ministry of Finance
MoRTH	Ministry of Road Transport and Highways
NBFC	Non-Banking Financial Companies
NDB	National Development Bank
NFC	National Facilitation Committee
NHAI	National Highways Authority of India
NIIF	National Investment and Infrastructure Fund
NIP	National Infrastructure Pipeline
NOC	No Objection Certificate
NPA	Non-performing Asset
O&M	Operations & Maintenance
OMT	Operate, Maintain and Transfer
PF	Provident Fund
PFC	Power Finance Corporation Limited
PFRDA	Pension Fund Regulatory and Development Authority
PPF	Project Preparation Facility
PPP	Public-Private Partnership
PSB	Public Sector Banks
PSU	Public Sector Unit
PTC	Pass Through Certificate
RBI	Reserve Bank of India
RBI-LTO Funds	Reserve Bank of India – Long Terms Operations Funds
REC	Rural Electrification Corporation Limited
RoW	Right of Way
RP	Resolution Plan
SBI	State Bank of India
SBLC	Standby Letter of Credit
SLR	Statutory Liquidity Ratio
SME	Small and Medium Enterprises
SPV	Special Purpose Vehicle
ToR	Terms of Reference
TOT	Toll Operate Transfer
UK	United Kingdom
US	United States of America
USD	United States Dollar
VC	Video Conference
YoY	Year on Year
ZCB	Zero Coupon Bonds

Conversion Factor

10 Lakh	1 million
1 Crore	10 million
100 Crore	1 billion
1 Lakh Crore	1 trillion

Sub-committee members and terms of reference

Sub-committee members

Additional Secretary, DFS	Chair
MD & CEO, IFCI	Member
Chairman & Managing Director, REC Limited (superannuated on 29.05.2020)	Member
Chairman, Feedback Infra	Member
Professor, Finance & Accounts, IIM Ahmedabad	Member
Executive Vice President – SBICAPS	Member
Head -Investments, NIIF	Member
KPMG, India	Member, and Advisor to IMSC
Representative of DEA (Convener)	Member

Terms of reference

1. Review the current state of infrastructure finance in India and likely availability of infrastructure debt (out of the Rs 111 lakh crores) required by 2025 by covering roles of each category of market participants such as scheduled commercial banks (public and private sector), non-banking financial companies (by both infra and general purpose NBFCs) and other participants of the financial system.

2. The sub-group should identify taxation, legal and regulatory policy gaps and strategies to enable debt financing for infrastructure from FIs and NBFCs.

3. Make recommendations for bridging the gap via institutional interventions, reforms/ amendments in regulation, governance arrangements and capacity building of the current institutions.

4. Propose key features of the Development Finance Institution (DFI) necessary to achieve goals of the National Infrastructure Pipeline (NIP) including ownership pattern, institutional and governance arrangements, liability side interventions, product offering etc.

Note from the Chairman

.

1. Context

The National Infrastructure Pipeline (NIP) envisages an investment of ~INR 111 Lakh crore over a period six years from FY-20 to FY-25. It's an ambitious target, considering the expected investment is more than twice of that invested in past six years (i.e. from FY-14 to FY-19). The step change in infrastructure investment is reflective of country's aspiration to accelerate the transition to USD 5 Tn economy.

The implementation of NIP projects is heavily tilted towards EPC projects and consequently there is substantial reliance on state and central government budgetary support for funding these projects. The budgetary support is envisaged to fulfill 44% of the total funding requirement (~ INR 49 Lakh Crore). Further, the NIP estimates that the existing financing resources put together may not be adequate to finance the NIP projects in its entirety, leading to a funding gap of 10% around Rs11.1 Lakh Cr.

As we all know, post COVID world is a 'new world order' which is going to have a severe impact on the global economy, ways of working, demand appetite and so on. India is also not going to be left untouched by its impact, and revised forecasts of the economic growth has been presented by various agencies in such a context.

Considering the changed circumstances and revised macroeconomic scenario, it may be prudent to assume that that there shall be reprioritization of government spending - on one hand some of the projects originally envisaged under NIP may get deferred, whereas some of the other projects having greater scope of mitigating the immediate impact may get prioritized. Despite short term deferrals and reprioritization, we expect the overall CAPEX to broadly remain the same in long run considering the aspiration to continue with the similar growth trajectory as was envisaged before the onset of pandemic.[1]

However, one thing is certain. There is going to be a considerable strain on government finances due to changed macroeconomic scenario. Same will largely apply to State government resources as well. Further, there are going to be increased demand on government resources from sectors like healthcare, relief measures and the like given the post COVID world. In such a context, the preponderance of EPC as preferred mode of implementation shall be an additional burden on already stretched government finances. Even under steady state scenario, the existing financing resources were deemed inadequate to finance the NIP, the estimated funding gap of 10% shall only increase substantially in the current scenario.

Now, if one looks at the supply side, one would note that even in a pre-COVID world, the banks and financial institutions (FIs) have failed to play an active role in greenfield and brown field infrastructure project financing. Over a period of time they have been steadily withdrawing from this space. At the same time even Private banks and NBFC's have largely stepped away from financing of infrastructure projects due to their own problems, and also due to crisis that hit the NBFCs space in the recent past. In a post COVID world, ability of these institutions to do anything

[1] Using a top down approach, Infrastructure CAPEX aggregating to ~ 97 Lakh Crore- 103 Lakh crore would be required to support a real GDP growth of 6%-8% from FY-20-25. The CAPEX over corresponding period in NIP is INR 111 Lakh Crore.

substantive to finance large greenfield Infrastructure projects remains highly doubtful, let alone their ability to provide long term funding to this space that has always been the key requirement.

Infrastructure by its very nature requires long term finance which conflicts with the asset profile of the banks and FI's. Due to the externalities, many of the infrastructure projects, particularly in social and urban infrastructure sector, have subdued returns that do not align with the mandate of such commercial institutions.

The reluctance of existing banks and financial institutions to lend to infrastructure, may be attributed to 'gap in market architecture' i.e. lack of dedicated infrastructure finance institutions that can provide long term concession linked finance, which has a range of 'products' that's required by this sector in current times, subdued financial returns of the infrastructure projects, and the pro-cyclic nature of banks and Financial Institutions to step away from financing during economic downturn.

India's development needs are enormous and require huge financial resources. Infrastructure creation and therefore, its financing is extremely critical to fulfill Nation's ambition of a 5 tn USD Economy. The existing institutional financing ecosystem is inadequate to cater to the needs of the growing economy. The situation is further aggravated by the infancy of corporate bond market.

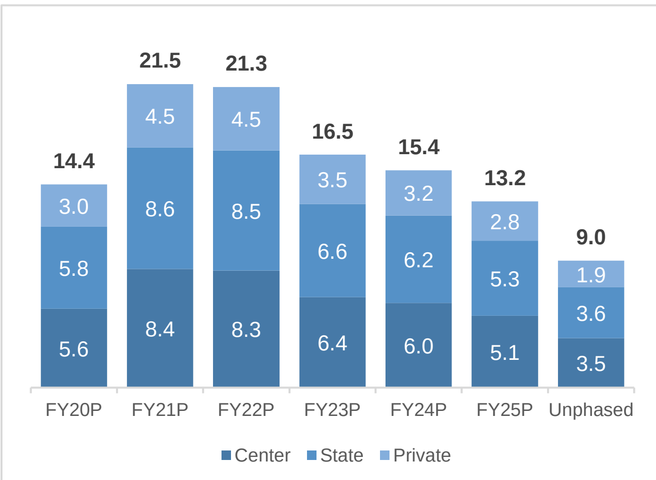
Thus, there is an urgent need to create a counter cyclical institution to provide long term, concessional financing to infrastructure to kickstart the economy. Many infrastructure projects have subdued financial returns that do not appeal to the commercial banks and financial institutions. This gets further aggravated by lack of long tenor, multiple product suite kind of financing requirements which is currently not available to the Infrastructure space. Considering significant externalities and desirable economic and social outcomes of infrastructure projects, the need to prioritize economic returns over financial returns cannot be understated. The development of such institution cannot be left to competitive forces alone considering 'public good' nature of infrastructure projects.

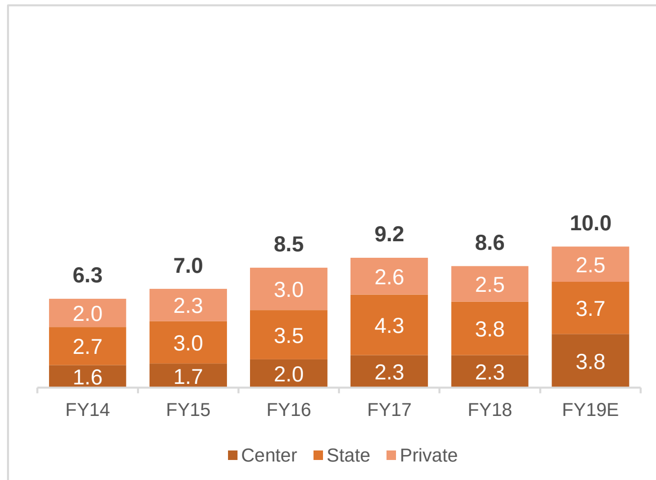
There are many DFI's that are successfully operating in both emerging markets as well as developed economies. DFI's in India have a checkered past, although they contributed significantly towards India's industrialization in pre liberalization era, their performance post liberalization left much to be desired. Important lessons can be drawn from past shortcomings to create an institution that is resilient to changes in market architecture and broader economic ecosystem. Such an institution which is resilient and sustainable in long run like the other DFI's existing in the developing countries can play a pivotal role in funding world class infrastructure and be a developmental catalyst in the banking and financial markets and be enabler in in transition from an emerging market to a developed market economy, thus realizing the vision of Hon'ble PM for making India a 5 tn USD Economy.

2. Overview of NIP

2.1. Capex Profile

The NIP envisages the implementation of around 6800 projects over a period of six years from FY-20 to FY-25 at a total investment of INR 111 lakh crore. The estimated capex to be incurred in FY20 for NIP projects is about INR 14.4 lakh crore. The balance capex of approximately INR 97 lakh crore, including unphased CAPEX, is expected to be incurred over FY21 to FY25. The charts below show YoY capex phasing envisaged under NIP vs Infrastructure CAPEX expended in preceding 6 years.



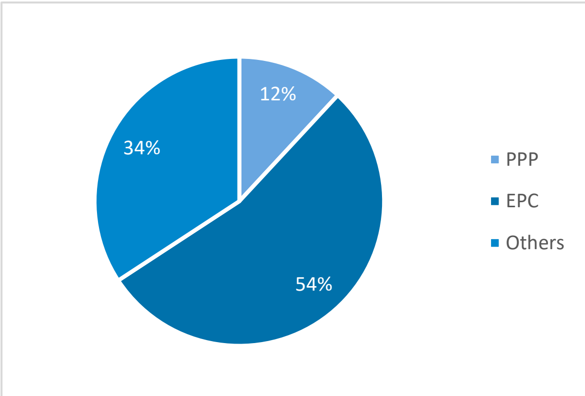


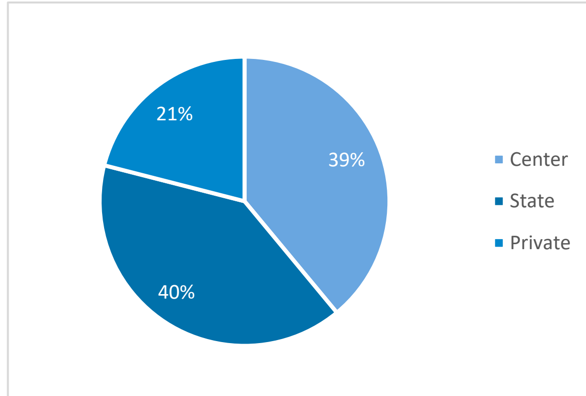
Source: Report of the task force - National Infrastructure Pipeline (Volume i -Table 3 and Volume ii Table 1)

As is evident from the above charts the envisaged capex is more than double of what has been historically spent in infrastructure in corresponding period. If we delve a bit deeper and look at the sectoral mix, we find 73% of CAPEX was spent on traditional infrastructure subsectors comprising of energy, roads, urban infra and railways in past 5 years(i.e. from FY-15-FY-19), a mix, which largely remains unchanged in the coming five years[2].

With regards to mode of implementation, majority of the capex is expected to be implemented through EPC mode. Chart below represents the break-up of total capex by implementation modes and breakup of contribution from state, center and private sector in funding NIP projects.

2 The Contribution of CAPEX on energy, roads, urban infra and railways in NIP projects from FY-21-FY25 is ~ 72% (Report of the Task Force – NIP, Volume 1, Table 3)



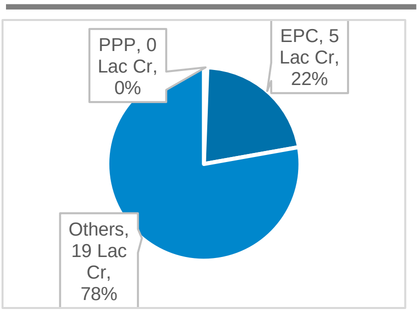


Source: Report of the task force - National Infrastructure Pipeline – Figure 12 Volume i and Project Pipeline

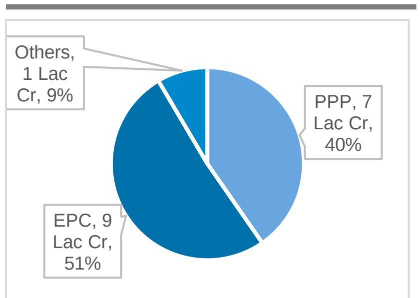
The implementation of NIP clearly articulates the preference towards EPC as compared to other sophisticated modes of implementation (e.g. PPP). Preponderance of EPC in the implementation mix renders realization of NIP critically dependent on the state of government finances.

The following chart depicts the sectoral breakup of NIP in terms of modes of implementation

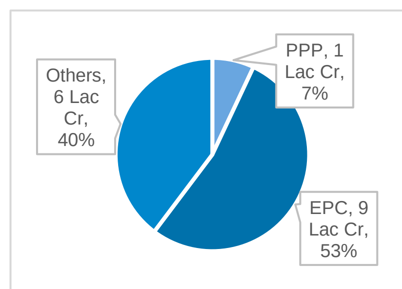
Power – Total Capex of INR 24 Lakh Crore



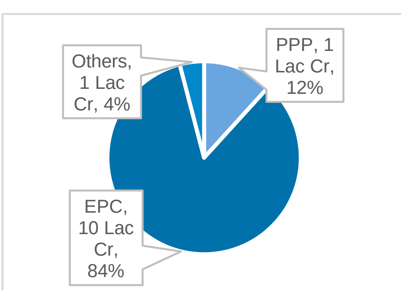
Roads – Total Capex of INR 17 Lakh Crore



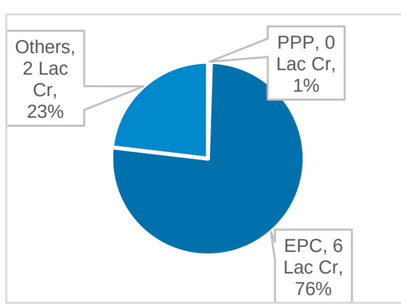
Urban Infra – Total Capex of INR 16 Lakh Crore



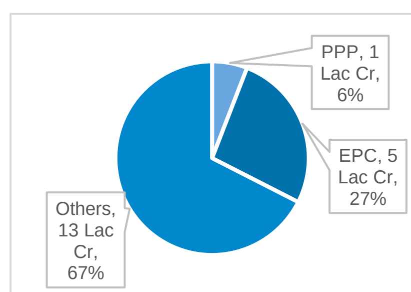
Railways – Total Capex of INR 12 Lakh Crore



Irrigation – Total Capex of INR 8 Lakh Crore



Other Sectors* – Total Capex of INR 19 Lakh Crore



*Rural, Agri, Social, Industrial and Digital Infra, Airports, and Ports

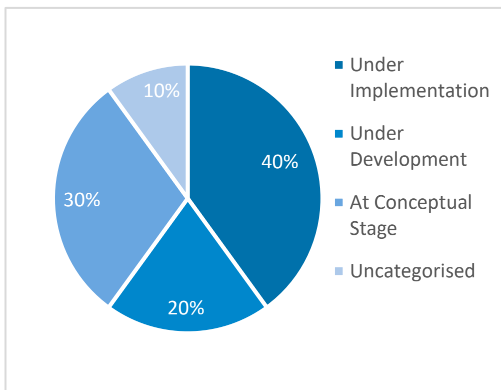
Source: Report of the task force - National Infrastructure Pipeline – Project Pipeline

The sectors primarily dependent on EPC include Roads, Railways, Urban Infra, and Irrigation.

Despite roads contributing to majority of projects undertaken in PPP's, EPC still accounts for more than 50% estimated expended CAPEX. It may be noted that even in PPP of varioius infra projects the EPC is dominant cost factor which varies from 50% to 65% of various Infra sectors. Roads contribute to majority of PPP's (~ 70%) and balance being largely contributed by other sectors such as Railways and Urban Infra. From the above it can be inferred that the predominant need is arising for the Structured Corporate Finance a combination of different Debt and Equity linked instruments depending on the Cash Flow patterns and features of a Infra sector to make the NIP and beyond successful with the proposed new DFI

If we analyse the sector wise investment from center, state and private capital, c. 80% of the capex is envisaged to be funded by state and central government. While majority of the state investments are envisaged in urban infrastructure, irrigation, transport and sectors such agriculture and healthcare among others, central government investments are largely expected to go towards railways, roads and power.

The following chart depicts the status of implementation of various project envisaged under NIP.



Source: Report of the task force - National Infrastructure Pipeline – Figure 13 Volume i

Around 30% of NIP projects are in conceptual stage, it provides an opportunity to the government to realign some of the conceptual stage projects presently envisaged under EPC to PPP. A 10% shift of overall CAPEX from EPC mode to PPP mode will reduce the burden by ~ 11 Lac crore, without impairing the project pipeline.

We understand, the ability to realign project implementation would depend upon the specific nature of the project, the evolution of bankable PPP framework in sectors such as Railways, irrigation and urban Infrastructure shall help alleviating significant burden from state and central government finances.

At this stage we would like to draw attention towards the seminal work done by Kelkar Committee for revitalizing PPP's in India. Many of the Kelkar committee recommendations are yet to be implemented. The recommendations are critical for reviving investor confidence and accelerate the acceptability of PPP's, it's an opportune time for the same to be implemented to facilitate realization of NIP.

A list of Kelkar Committee recommendations critical or reviving PPP's and their current status of implementation is placed as an Annexure to the report.

2.2. Financing of NIP

NIP is proposed to be financed through various sources like budgetary support from state and central government, internal accruals of PSUs, proceeds from asset monetisation, equity raise, bonds, debt from banks and NBFCs, funding from multilateral/bilateral etc. based on historical trends and estimated future growth of the economy. The table below provides source wise break-up of NIP financing –

Source	Estimated Share of NIP being financed
Centre's budget	18-20%
State's Budget	24-26%
Internal Accruals – PSUs	1-3%
Bond Markets	6-8%
Equity	2-4%
Multilaterals/Bilaterals	1-3%
New DFIs	2-3%
Asset Monetisation – Centre	2-3%
Asset Monetisation – States	1-2%
Others	3-5%
Banks	8-10%
Infra NBFCs (PFC, REC, IRFC, IREDA, IIFCL and private sector NBFCs)	15-17%
Shortfall	**8-10%**

Source: NIP, Volume-II

About half of the NIP projects are expected to be financed through budgetary support (~ 42%-46%) and a quarter of financing is expected to come from existing banks and financial institution (~ 23%-27%). The balance 25% is envisaged to be financed through multiple sources including Multilaterals, Internal Accrual, Equity and asset monetization among others. Despite considering the existing and new financing sources (e.g. new DFI's and Asset Recycling) the NIP estimates a financing gap of ~ 8-10%.

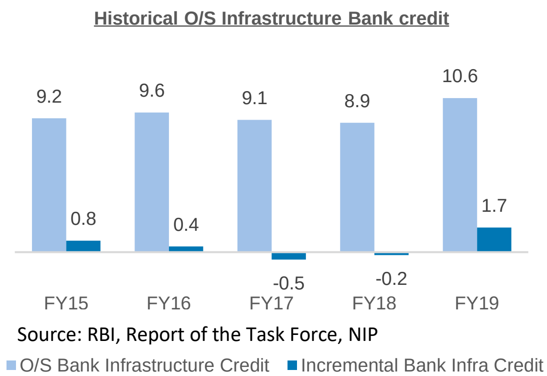
The following section of the report assess the ability of banks and NBFC's to meet the desired financing objective envisaged in NIP.

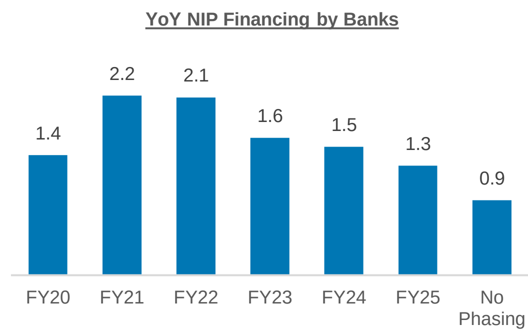
2.2.1. Current Status of Banks' lending to infrastructure projects

In India, the infrastructure financing landscape has been historically dominated by bank and sector specific NBFC's. The total outstanding credit to the infrastructure sector, as a percentage of gross non-food credit, by banks was around 15% until fiscal 2016. However, declining asset quality of infrastructure assets, asset liability mismatch, group concentration limits and capital constraints have resulted in banks taking a cautious approach to financing the infrastructure projects. The share of outstanding credit to infrastructure sector, as a percentage of gross non-food credit, has declined to 12% in fiscal 2019[3] This is largely attributed to degrowth in infra loan portfolio of banks in FY-2017 and 2018.

However, The NIP envisages banks to contribute to INR 1.5-2.5 lakh crore annually towards financing infrastructure projects.

The charts below represent the historical bank infrastructure credit outstanding and YoY financing envisaged under NIP[4] -





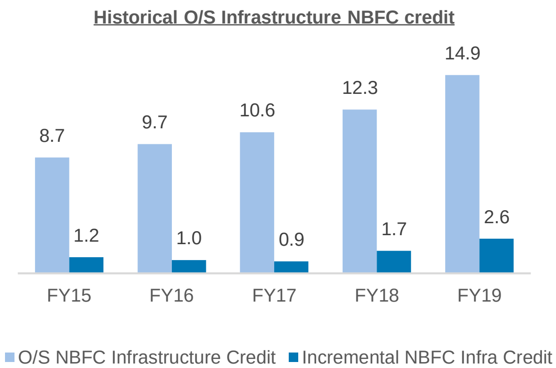
NBFC credit to infrastructure has recorded a CAGR of 13.2%, on average, during fiscal 2014 to fiscal 2018. The Report of the Task Force on NIP envisages 12% growth for public-sector NBFCs and 15% growth for NBFCs in private sector in infrastructure lending.[5] India has dedicated financing institution for power and railways sector that have been major contributors in financing projects in these sectors. However, there is no dedicated institution for financing projects in roads and urban infra sector which has largely been financed by banks and sector agnostic NBFC's. Hence, apart from power and railways, other infra NBFC's need to significantly scale up resources to support the lending envisaged under NIP.

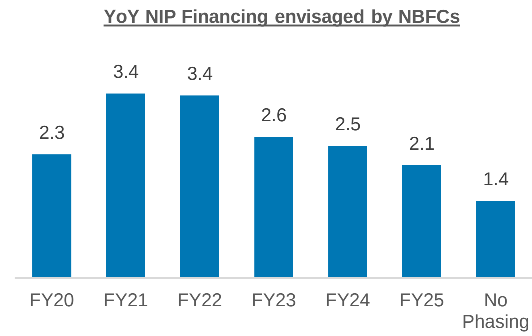
The gross disbursement of NBFC-IFC's in FY-19 was INR 3.6 lakh crore, out of which the gross disbursement of NBFC's dedicated for power[6] and railways[7] was 1.56 lakh crore and 0.52 lakh crore respectively. The annual funding envisaged from NBFC-IFC ranges from INR 2.3-3.6 lakh crore. Given the integral role played by government owned power NBFC's in supporting working capital cycle of DISCOM's, only part of gross disbursement of power NBFC's is channelised for

[3] RBI-Sectoral Deployment of Bank Credit
[4] RBI, Report of the Task Force, NIP
[5] Report of the Task Force, NIP
[6] PFC, REC and IREDA
[7] IRFC

greenfield asset creation. For example, out of PFC's disbursement in past 5 years, around ~47% were disbursed for greenfield project finance[8].

The chart below represents the historical infrastructure outstanding and YoY financing envisaged under NIP:





Source: Annual Reports, Report of the Task Force, NIP

2.3. Conclusion

As is evident from above, NIP assumption around financing from banks and NBFC's is largely incongruous with the ground reality. Given the negative growth in lending to infrastructure by banks and negligible lending by NBFCs to greenfield infrastructure assets, the expectation of 25% of NIP financing by banks and NBFCs appears to be a difficult proposition for the following reasons

- Decline in 2 out of last 3 years in infra finance from banks
- Exits by Axis Bank, IDFC First, Yes amongst banks, by ABFL and others in NBFCs
- COVID impact on Bank Balance Sheet
- COVID impact on project execution
- COVID impact on viability of projects
- The impact of Covid and likely contraction of GDP for FY20-21
- Amongst NBFCs, PFC and REC, which have been major contributors will in 2020-21 be focused on financing DISCOM dues and they are not likely to contribute in financing new asset creation.

[8] PFC

3. Steps to enhance institutional finance in infrastructure

It's evident from the previous section of the report that current institutional financing ecosystem is not geared to meet the financing challenge posed by NIP without large scale structural reforms. The ambitious target set out in NIP would require banks and NBFC's to substantially revamp their resource-raising and credit-deployment strategy. The section of the report delves into some specific recommendations that shall enable banks and NBFC's to raise incremental resources and improve credit deployment enabling financing the NIP.[9] The recommendations are equally relevant to the proposed new DFI for mitigating the financing gap.

The following table attempts to chart-out specific recommendations relevant to the new DFI and how implementation of those shall impact the infrastructure asset financing ecosystem.

Product/Asset Profile	Greenfield	Brownfield
Debt	• Zero-Coupon bonds • Inter Creditor Agreement • Standardisation of Loan Agreement • Standardized payment security mechanism • Project Preparation Facility	• Credit Enhanced Infrastructure Asset Securitisation • Credit Guarantee/First Loss support through a specialized financial institution • Expanding the scope of Take Out Financing and stimulating refinancing of operational assets • Rationalisation of provisioning norms
Debt	• Withholding tax exemption for Masala Bonds • Tax paid bonds • Group exposure limit exemption to banks for companies merged or acquired pursuant to government mandate	

3.1. Recommendations specific to Greenfield Asset Financing

3.1.1. Zero Coupon Bonds

Zero Coupon Bonds (ZCBs) are bonds in respect of which no payment and benefit is received or receivable before maturity. Zero Coupon Bonds (ZCBs) carry lower tax as they do not have annual coupons. ZCBs would help in better management of asset portfolio of banks and FIs and are ideal for greenfield asset financing. ZCB's are also preferred for financing operational projects making such projects flexible and resilient in overcoming volatility in operational cash flows e.g. operational BOT road projects.

Investors in ZCBs pay capital gains tax on redemption premium (instead on income tax on coupon as is the case in plain vanilla bonds) which gives them a higher return. This will enable tapping of

[9] IMSC Report of Project Finance/Refinance Subgroup

funds from retail investors, HNIs, charitable and religious trusts, family offices, debt mutual funds, corporate treasuries for infrastructure.

However, CBDT approval under IT Rule 8B is required for issuing ZCB. The application is to be submitted at least 3 months prior to the launch of issue which is very long period considering the immediate liquidity requirement and volatile bond markets. Hence it is recommended that automatic approval route in line with ECB may be given to government owned banks and NBFC-IFCs for which no prior approval is required from any authorities upto certain ceiling.

3.1.2. Intercreditor Agreement of Stressed Assets

ICA facilitates in crystallising a uniform view of financial institutions towards effective resolution of asset. ICA avoids ambiguity in decision making across multiple lenders facilitating quick resolution and effective recovery.

RBI vide circular no DBR.No.BP.BC.45/21.04.048/2018-19 “Prudential Framework for Resolution of Stressed Assets” has made it mandatory for banks to sign the ICA in cases where Resolution Plan (RP) is to be implemented. All lenders would enter into an inter-creditor agreement (ICA) to provide for ground rules for finalisation and implementation of the RP in respect of borrowers with credit facilities from more than one lender.

ICA defines the roles and responsibilities of different lenders in the consortium, the role of lead, quorum and process to be followed for decision making in relation to the projects.

It is recommended that RBI may issue similar directions mandating execution of ICA for greenfield asset financing as well.

It is suggested that suitable provisions in ICA may be included to ensure that appraisal of lead bank/institution is followed and no additional terms and conditions beyond lead banks stipulation may be stipulated by other participating lenders.

It is also recommended that a mechanism for provision of standby facility for cost overrun can be included as part of ICA. The quantum of such a facility would vary on a case to case basis. Such facility would be disbursed only in case of cost overrun caused by events beyond reasonable control of the borrower. Incorporation of such a provision and uniform view of lenders of decision making shall ensure that projects do not get stuck due to tardy decision making by few of lenders in the consortium and would facilitate project implementation.

3.1.3. Standardisation of loan agreement.

Each bank has its own set of standardised loan documents. However, large infrastructure projects require consortium of Banks, FIs, NBFCs, IDFs, etc joining hands to put through a deal and in such cases, it is very difficult to arrive at a common base document and takes good amount of time for consensus building amongst the different types of lenders. A body similar to the Asia Pacific Loan Market Association (APLMA) should be formed by the major banks and financial institutions in India which would consult various stakeholders and make standardised loan documents. From time to time, the body would also be responsible for making amendments to such documents as per the need of the hour and the present business requirements.

3.1.4. Standardised payment security mechanism

It is recommended that states and centre align to a standardised payment security mechanism (including LC, Trust and Retention A/c and escrow A/C which has are to designed by the DFI for each sector of Infra as their nature of cash flows patterns are different. Earlier IDBI had designed the required security mechanaism documents in consultations with DOT and SPV for telecom and similarly with State SEB/Discom and SPV) for various Infrastructure sectors which act as a deterrent for default by counterparties. Alternatively, state or central govt. authorities can have an arrangement with multilateral agencies like World Bank which can step in enhance overall structure with some sort of credit enhancement like SBLCs.

3.1.5. Project Preparation Facility

The Union Finance Minister in the Budget Speech 2020-21 has proposed to setup a Project Preparation Facility(‘PPF’). The PPF would address lack of appropriately structured bankable projects due to inadequate preparatory work, unbalanced risk allocations, contractual frameworks, poor demand assessment etc. and ensure the adequate flow of capital from private sector.

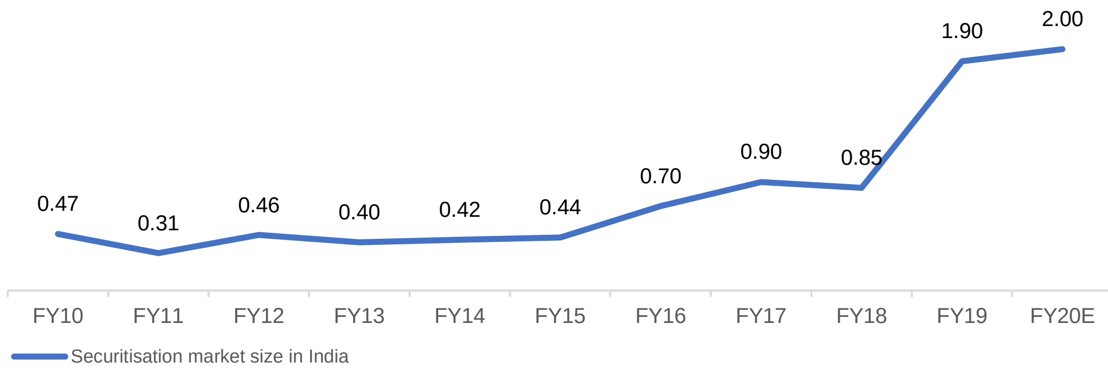
A dedicated PPF set up for project development activities would assist in translating the demand for infrastructure into credible projects which could help the investor in weighing the risk return trade off. Project preparation includes the work required towards taking projects from a concept to award of contract. Key underlying principles of PPF may include:

- Understanding the investor requirements and structuring the project to suit the requirements
- Due diligence and identification of associated risks and its mitigants.
- Enable regulatory and institutional framework to balance the risk sharing between government and private investor

3.2. Recommendations specific to Brownfield Asset Financing /Refinancing

3.2.1. Credit Enhanced Infrastructure Asset Securitisation

Currently the asset securitisation market is dominated by retail and priority sector loans. Mortgages, vehicle loans and microfinance loan constituted the three major asset class comprising 84% of the total volume. The following chart depicts the historical growth of securitisation market in India.



Source – CRISIL, ICRA

Recently RBI, on June 8, 2020, has come up with draft framework for securitisation of standard assets and a framework for sale of loan exposures. The purpose of the proposed revisions is to specify criteria to inter alia bring securitisation in line with Basel III requirements and to deepen the secondary loan trading market.

Besides expanding the contours of securitisation transactions, the framework clarifies the permissibility of certain structures that were uncertain earlier.

Securitisation can be an effective option to lenders to monetise infrastructure assets and raise resources for incremental lending. However, securitisation for infrastructure as asset class is yet to take off in India. The credit enhancement covered in previous section along with credit tranching of asset portfolio can provide the necessary impetus in developing securitisation market for infrastructure assets in India. The funds unlocked through securitisation can be recycled by banks and NBFC-IFCs towards incremental greenfield asset financing.

However, the current securitization framework doesn't address some of the issues hampering the widening of securtization transactions. The following interventions may be considered for deepening of securitisation market in India:

(a) Clarity on validity of contracted credit enhancement for securitised cash flow pools

Securitised cash flows are intended to be ring fenced vis a vis the various parties to the transaction. There is a lack of clarity relating to legal interpretation of the ring-fencing status of securitised cash flows in insolvency proceedings. MCA issued Rule 10 which provides partial clarity. But a different view has been taken by the administrator for DHFL's insolvency proceedings regarding the validity of previously provided credit enhancement to cash flow pools. In the absence of this clarity, rating agencies have / are downgrading the securitised pools.

It is suggested that MCA could explicitly clarify & reiterate the validity of contracted credit enhancement for the securitised cash flow pools, which could impact ratings positively.

(b) Addressing possible conflict in pooling of assets

Unlike housing loans, retail loans or car loans portfolio where there is a standard template of loan agreement, infrastructure loans are individually negotiated since project and sectoral characteristics are fundamentally dissimilar. The lending clauses will may be conflicting and pose challenges for PTC issuance to investors. Standardisation of loan documents would help in avoiding potential conflict in this regard.

(c) Addressing interest rate risk in floating rate loans

Majority of the infrastructure debt in India are based on floating interest rates, linked to banks' base rate, MCLR. The investors generally prefer fixed rate instruments as this makes their returns & cash inflow fairly predictable. Interest rate swap enables investors to convert floating to fixed rate thus improving the appetite of investors towards such securitised paper.

The recent move by RBI to move to a single benchmark for interest rate is a positive step and will help in the deepening of IRS market for mitigating the risk. Till the time a suitable IRS market evolves, the floating rate risk may be preferred to be transferred to investors.

(d) Addressing prepayment risk

The investors generally prefer investing in instruments having fairly predictable cash flows. Premature repayment of underlying loan introduces volatility and makes it difficult for investor to predict cash flows over a long period of time.

One of the ways to address prepayment would be to replenish the securitized pool with similar asset as the one prepaid however, current RBI guidelines on securitization do not allow revolving assets to be securitized. Hence, the prepayment risk will have to be borne by the investors.

Structural solutions such as dedicated prepayment strips can be sold to specific investors insulating majority of securitized investors from the prepayment risk.

(e) Institutional monitoring mechanism

Unlike home and vehicle loan, infrastructure assets are complex to appraise and monitor. A third-party institutional monitoring and oversight would provide comfort to investors to invest in such a complex asset class.

It's recommended that "Infrastructure Investment Manager" could handhold insurers and provident funds (who lack experience in respect to structuring financing for infrastructure projects and monitoring) in monitoring the quality of underlying assets.

Given the large book size, securitisation of infrastructure asset has significant potential to raise incremental resources for banks and NBFC's

(f) Setting up a third-party Servicing Agency

Currently there is a perceived conflict of interest between the originators business and PTC holders limiting holistic acceptability of securitized instruments. In case of any difficulties in the originators business, the PTC holders do not have an option to shift servicing agents.

It’s suggested that public sector banks with strong collection operations may setup a separate third-party servicing agent business to facilitate holistic adoption of securitized instruments.

(g) Standardized clause in loan agreement for allowing banks to securitize their share

Majority of the infrastructure loans in the country are provided by multiple bankers through a syndicate for the purpose of risk diversification and to comply with regulations on exposure limits

Securitization of such loan exposure requires NOC from each of the consortium lenders. Further many of the loan agreements have clauses specifically prohibiting the securitization of loans at a later stage

It’s recommended that standardized clause may be added to loan agreements allowing lenders to securitize their portion of the loan without any prohibitions.

3.2.2. Credit guarantee fund/first loss support through a specialized institution

Pension/ insurance funds usually invest in AA (or above) rated bonds while the majority of bonds of infrastructure projects/ companies are rated in BBB grade. Credit enhancement of these bonds to AA category would bring a large set of projects into the “acceptable” category for investments by pension and insurance companies. The credit enhancement can be provided both to individual as well as portfolio of projects.

Hence it is recommended to implement credit enhancement mechanisms providing first-loss support/guarantee to boost investor confidence and help deepening of the corporate bond markets. For addressing issues on availability of long-term financings beyond 10 years, specific guarantee product on stub portions which will need to be refinanced at the end of the bond tenor can be explored. This will give confidence to investors to run refinancing risk beyond say 10/12 years.

Such guarantees structures like Guranatee cum Take out (with condition and without condition) were earlier used by IDFC in 2002 for the infra projects long term sustainability and comforts to banks for lending can be channelled by suitably scaling up capabilities of existing institutions (e.g. IIFCL) or through a specialised financing institution with a clear focus on infrastructure sector. Here it may be mentioned that to keep the guarantee costs minimum and to conserve the capital the risk weight on guarantee should be between to 25 to 30% to do this product by the DFI

3.2.3. Expanding the scope of take-out financing and stimulating refinancing of operational assets

(a) Takeout Financing

There is a need to broaden the scope of take-out financing for it to play meaningful role in churning the resources for greenfield asset financing.

For takeout to be effective, the entire exposure of existing lender needs to be taken out. The current takeout financing scheme of IIFCL permits takeout of a maximum of 51% of total outstanding project loan, resulting in suboptimal outcome as both residual capital and management bandwidth in monitoring the asset of remains blocked for the taken-out institution. For true takeout it is recommended that 100% of exposure of the institution financing the construction should be taken out. This would free-up the headroom as well as management and monitoring bandwidth of existing specialised green field financiers to take up more green field projects.

It is recommended that the existing scope of IIFCL take-out scheme may be suitably amended or a fresh take-out scheme administered by a Specialised Development Financial Institution may be designed to implement the same.

(b) Re-financing

RBI vide its circular DBOD.No.BP.BC.31/21.04.132/2014-15 – Refinancing of Project Loans dated August 7, 2014 had provided for specific guidelines in relation to refinancing of project loans to infrastructure and core Industries. Under the said guidelines, existing lenders were also allowed to elongate the tenor of the loans upon take out refinancing, subject to certain conditions. However, following the issuance of Prudential Framework for Resolution of Stressed Assets dated June 7, 2020, the aforementioned circular on refinancing of project loans was repealed. As a result, there is lack of clarity in relation to asset classification in case of refinancing of such project loans carried out purely on commercial considerations. Accordingly, clarification from RBI in this regard would be helpful in terms of removing the ambiguity that currently exists on takeout refinancing. It will also help the lending institutions in sanctioning long term loans for infrastructure projects, in line with the life of the asset / concession period and open up long term refinancing opportunities.

This will facilitate banks and financial institutions to extend their financial assistance suited to their leveraging capacities in terms of quantum and tenor, which will be in the best interest of infrastructure projects and all its stakeholders. To enable establishing such a financing mechanism in the country where completed projects loans are taken over/ refinanced by banks, DFI/ FI, by offering long term funds to the projects, extending the tenor of standard loans up-to the RBI prescribed 85% of the economic life of the project may be allowed without classifying the same as ‘restructured’.

RBI may consider the below mentioned clarification.

In respect of existing project loans to Infrastructure companies, banks and NBFC’s may refinance such loans by way of full or partial take-out financing, even without a pre-determined agreement with other banks / FIs, and fix a longer repayment period, and the same would not be considered as restructuring in the books of the existing as well as taking over lenders, if the following conditions are satisfied:

i. The project should have started commercial operation after achieving Date of Commencement of Commercial Operation (DCCO);
ii. The repayment period should be fixed by taking into account the life cycle of and cash flows from the project, and, the existing and new lenders should be satisfied with the viability of the project. Further, the total repayment period should not exceed 85% of the initial economic life of the project / concession period in the case of PPP projects;

iii. The loan account should be standard in the books of the existing lenders and there should no continuing payment default at the time of the refinancing;
iv. In case of partial take-out, a significant amount of the loan (a minimum 25% of the outstanding loan by value) should be taken over by a new set of lenders from the existing financing banks/Financial Institutions; and
v. The promoters should bring in additional equity, if required, so as to reduce the debt to make the current debt-equity ratio and Debt Service Coverage Ratio (DSCR) of the project loan acceptable to the lenders.

The above facility may be made available only once during the life of the existing project loans to Infrastructure companies.

(c) Reintroduction of 5-25 scheme

The 5/25 Scheme was announced in the Union Budget 2014-15 in July 2014 to encourage banks extend long term loans to infrastructure sector. The announcement read as under:

"Long term financing for infrastructure has been a major constraint in encouraging larger private sector participation in this sector. On the asset side, banks will be encouraged to extend long term loans to infrastructure sector with flexible structuring to absorb potential adverse contingencies, sometimes known as the 5/25 structure."

Subsequently, the Reserve Bank of India (RBI), vide notification no. RBI/2014-15/126DBOD.No.BP.BC.24/21.04.132/2014-15 dated July 15, 2014 notified the norms for the 5/25 Scheme for new loans to infrastructure projects and core industries projects.

RBI clarified that Banks are already allowed to refinance loans even if there is no pre-determined agreement and these instructions do not come in the way of banks' structuring long term project financing products. Further it has been clarified that such refinancing may not be construed as restructuring or repeated restructuring (in case of a restructured asset).

The norms were further extended to existing projects as well by the RBI vide notification no. RBI/2014-15/354 DBR.No.BP.BC.53/21.04.132/2014-15 dated December 15, 2014. Subsequently, RBI, vide circular no. RBI/2017-18/131DBR.No.BP.BC.101/21.04.048/2017-18 dated February 12, 2018 withdrew its extant instructions on resolution of stressed assets including the 5/25 Scheme, with immediate effect.

The following needs to be seen in perspective:

- 5/25 Scheme is *not* a restructuring scheme. Therefore, the Feb 12, 2018 circular should exclude this.
- 5/25 scheme was announced in the Union Budget & approved in the Parliament to encourage bank lending for longer tenures.
- 5/25 is a tool of Prudent Risk Management for banks/FIs to better manage their Assets and Liabilities, improve financial viability of infra projects and benefit all parties – Lenders, Project Companies and the overall Economy.

- The 5/25 refinancing is similar to the practise in the market (like Takeout Financing, Working Capital Financing etc.) and RBI has already issued clarifications that such refinancing may not be construed as restructuring.

3.2.4. Rationalization of provisioning norms for restructured accounts

The existing prudential framework for resolution of stressed asset (Ref: RBI/2018-19/203 DBR.No.BP.BC.45/21.04.048/2018-19) accords differential provisioning treatment for the residual debt for resolution plans implemented with or without change in ownership.

In case of change in ownership, the residual debt can be immediately classified as standard thus saving on progressive provisioning requirement for lending institutions, which shall not be the case where resolution plan is implemented with the same sponsor/promoter despite the fact that unsustainable debt is fully provided in the books and carved out from the loan book.

The guidelines provide for a specific carveout for borrower who have committed frauds/malfeasance/wilful default and are not eligible for restructuring. Fundamentally, the overarching principle for assessing the cash flows of the borrower with or without change in ownership shall remain the same. The lending institutions shall apply similar conservatism if not more while assessing the cashflows for borrowers where there is no change in management as compared to cases involving change in management. The norms mandate requirement of independent credit evaluation by credit rating agencies and a minimum threshold rating for the implementation of such a plan. Considering the above, the fundamental risk profile of cashflows supporting the residual debt is likely to remain the same with or without change in management. Rationalisation/uniform treatment of asset classification, with or without change in management shall help the lending institution in conserving capital by saving on incremental provisioning.

Further, considering the current macro-economic situation and constrained liquidity position with most of the corporates, there's' limited appetite of developers/corporates to bid for change in management of stressed accounts.

Therefore, it is recommended that this dispensation may be made available to large projects which have gone through detailed project appraisal and due diligence at the time of sanction of loan and the reasons of stress are beyond the control of promoters/sponsors.

3.3. Recommendations agnostic to asset lifecycle

3.3.1. Withholding tax exemption on Masala bonds for 12 months

In line with NIP Task Force recommendation for a positive tax-free or low-tax regime for long-term bonds, exemption from with-holding tax for raising funds through issue of masala bonds for a period of 12 months (on the lines as permitted in FY2019) may be permitted. This would enable additional FPI investments in banks, NBFC-IFCs and IDF-NBFCs, IDF-MF's and AIF-II which would be used to financing/refinance infrastructure projects.

It may be noted that masala bonds are bonds denominated in INR; these would not lead to any forex risk.

A similar dispensation (exemption from withholding tax for masala bonds) was provided by the Govt of India for a short period for part of the year in FY 2019 which resulted in significantly increased fund raising through masala bonds by almost 4x as compared to the period in which this benefit did not exist. It may be noted that this would not reduce the existing tax revenue of the government. Further, due to the multiplier effect of channelizing these funds to viable and profitable infrastructure projects, it would enhance the tax revenue of the government in future years.

Masala bonds will provide a new avenue for banks and NBFCs for raising funds and help diversify the sources of funds. The withholding tax exemption is required to bring the masala bond cost on par or slightly lower than that of domestic fund raising in the current market.

Once the masala bonds are issued for the 1st time with the help of the withholding tax exemption window during the first 12 months and the Indian financial institutions establish themselves as a reputed issuer with sufficient liquidity (trading) in its bonds, they will be able to continue to tap this market for more funds in future years as well, even without the withholding tax.

3.3.2. Tax Paid Bonds

Government owned banks, NBFC-IFCs and their subsidiaries may be allowed to issue tax paid bonds to tap funding from retail investors. The proposed tax paid bond features would be a combination of both the taxable bond and tax-free bond. Proposed tax-paid bonds will have no tax implications on the investors. Tax impact will be shared between the issuer and the Government. Further, to make the instrument attractive to channelise the resource, A special tax rate of 10% may be notified. The tenor of the bonds would be long term only i.e. 10-20 years.

Tax incidence on issuer will ensure that there is no administrative burden on investors or tax authorities. The coupon rate could be equivalent or slightly higher than the prevailing coupon rate / yield on the tax-free bond. This will result in higher yield to the investors and unlike Tax free bonds, government will not lose its entire tax revenues.

In case of the tax-free bond, the cost to the issuer is lower but the government loses the tax revenue. The main advantage of the proposed tax paid bond is that the government will not lose the entire tax revenue on interest like tax free bond as tax paid by the Issuer will partially offset the tax loss to the government and the Issuer will be able to raise funds at a cheaper rates.

It is proposed that these eligible companies may be permitted to issue tax paid bonds upto INR 1.5 lakh crore over a period of five years.

Group exposure limit exemption to banks for companies merged or acquired pursuant to government mandate

To make the government divestment programme more effective, it is necessary to have certain framework and regulatory exemptions that the mergers and take over transactions among government owned entities are more effective. In financial sector as well, there are some regulatory exemptions are required to achieve desired synergies post \merger.

Hence it is recommended that a special dispensation for a timeframe as deemed appropriate may be provided to banks with respect to their exposure to government companies and their subsidiaries which are merged or acquired pursuant to government directions.

Please refer to Annexure for summary of above recommendations, concerned authority and likely implementation timelines.

3.4. Addressing the Equity Conundrum

All the above recommendations address only the debt challenge faced by infrastructure projects. The capital structure of project comprises of both debt and equity, debt typically forms the larger part of capital structure. Equity even though taking up smaller piece of overall capital structure is equally important as it represents the risk capital and takes the first loss in case of default. It is imperative that the project has a balanced capital structure at the first place to enable financing.

Equity for greenfield projects have traditionally come from developers. The stressed balance sheet of most of the private sector developers currently makes it difficult for them to demonstrate or arrange equity, the situation is further aggravated due to general macroeconomic downturn in the market. There are hardly any institutional players currently in private sector that are focused on providing equity to greenfield infrastructure projects.

Institutions such as NIIF till date have not been able to fund any sizable greenfield infrastructure project.

The measures taken by government such as rationalizing the performance guarantee or releasing the performance guarantee in-line with project implementation though helpful are insufficient to address the problem to a large extent.

It is imperative that equity issue is addressed hand in hand while addressing the larger debt challenge for realization of NIP. Although solving equity challenge for greenfield infrastructure projects would require a dedicated institution, the new DFI through its extensive product suite can play an important role role in addressing the issue of equity shortfall besieging infrastructure projects. The role that new DFI can play in addressing equity challenge is discussed in detail in the subsequent chapter detailing product suite of DFI.

4. Key learnings from the past experience of DFIs in India and need for a new DFI

4.1. Learnings from past experience with DFI's in India

Development Financial Institutions (DFIs) is a term that encompasses a wide range of financial institutions, some of which are still around. For the purpose of this note, we focus on the three prominent term-lending institutions of the past, namely, IFCI, IDBI and ICICI. (These three DFIs accounted for nearly 80 per cent of the assets of all DFIs).

The three DFIs had a long innings. IFCI was set up in 1948; it was converted into an NBFC in April 2015. The operations of ICICI began in 1955; in 2002, it merged with the bank it had promoted in 1994. IDBI came into being as a subsidiary of RBI in 1964. It was converted into a bank in 2004. In 2005, it merged with its subsidiary, IDBI Bank.

The three institutions focused on term finance even as the commercial banks focused on working capital. Lending to infrastructure was almost exclusively the province of the DFIs until the mid-nineties when the area was opened up to commercial banks. The DFIs also provided term finance to industry. There is a perception that since the three DFIs no longer operate in their original form, the DFI model had failed. It would be useful to understand how these DFIs fared over a long period and what lessons, if any, that might hold for the proposed DFI for infrastructure.

There was a certain logic to the creation of the DFIs. Private investment needed to be supported with suitable finance as the capital markets were in their infancy at the time of independence and were slow to develop in the decades that followed. Banks were not equipped for the role as they had neither access to long-term funds nor did they have the expertise to evaluate projects. DFIs were created to fill the gap as a catalyst an enabler for development finance. It was important that they provided finance at rates they were consistent with the return to capital on long-gestation projects. There was a recognition that this meant making available finance to industry at concessional rates, that is, rates lower than market-determined rates for such loans.

It followed that the DFIs themselves needed to access low-cost finance. This was made possible in several ways. The most significant was the provision of a concessional line of credit by the RBI under the National Industrial Credit Long Term Operations Fund. Further, the DFIs issued bonds that were often guaranteed by the government. Thirdly, they had access to foreign currency funds available through the concessional window of the international multilateral institutions. They were also able to tap long-term finance because of a provision in the Companies Act that allowed long-term funds such as provident funds, superannuation funds and gratuity funds to invest in notified 'Public Financial Institutions'.

The three DFIs performed well right up to the 1990s. In the 1990s, the growth rate of assets of the three DFIs ranged between 10 per cent and 26 per cent annually. (Mathur, 2003). They began to face problems with the liberalization of the Indian economy in the 1990s. A number of factors impacted them adversely. The most important was the decision to withdraw concessional finance to them.

The decision arose from budgetary constraints and also from the belief that, in the move towards a market-determined economy, there was no room for concessional finance for industry and hence no need to persist with DFIs. It was felt that, since banks had access to low cost funds in the form of current and saving accounts, they could meet the needs of term-finance without recourse to any concessional funding.

The Narasimham committee on the financial sector (1998) was of the view that, in the changed context, DFIs should convert themselves into banks or NBFCs. There followed the report of the SH Khan Working Group on S H Khan on 'Harmonising the Role and Operations of Development Financial Institutions and Banks' (1998). The RBI came up with a paper in 1999 on Universal Banks, that is, banks that could meet the entire range of customer requirements. All these contributed to an intellectual climate in which DFIs were seen as no longer relevant.

The cutting off of concessional funds, in particular, was a severe blow to DFIs. By way of illustration, in 1991-92, the RBI had made available long-term loans to the DFIs at a rate of 8 per cent when the prime lending rate of the DFIs was the range of 18-20 per cent. At the same time that concessional funds were withdrawn, banks were allowed to provide long-term finance with the limits on their exposures being progressively relaxed by RBI. DFIs were compelled to lower their lending rates in order to compete for business with banks.

With DFIs being hit both in respect of borrowing rates and lending rates, their interest spread, that is, the difference in average cost of funds and average return on funds, fell steeply from 1995-96 to 2000-01- from 3.6 per cent to 1.6 per cent for IDBI; 4.3 per cent to 1.8 per cent at ICICI; 6.9 per cent to 1.6 per cent at IFCI. (Mathur, 2003)

The compression in spread happened at a time when the non-performing assets at these DFIs rose consequent to the shake-out in Indian industry ushered in by liberalization, including import liberalization. There were inadequacies in project appraisal, perhaps some element of mala fide decisions as well.

However, the shocks administered to Indian industry by import liberalization were not something that could have been anticipated in loan decisions taken prior to liberalization. The DFIs were exposed to a range of industries such steel, petrochemicals and fertilisers that were unable to compete with imports. Post-liberalisation, there was considerable uncertainty in respect of the tariff structure from one year to the next. The ups and downs in tariff movements led to outcomes that bankers could not have possibly factored into their appraisals.

Moreover, the DFIs were the principal financiers of the initial set of Infrastructure projects while the sectoral laws were still evolving. This was also a contributory factor in the increase in NPAs at DFIs. The ratio of net NPAs to net advance at IDBI touched 10.1 per cent in March 1998 and rose further to 14.2 per cent in March 2002; for IFCI, the corresponding figures were 13.6 per cent and 22.5 per cent. (Source: RBI)

Lastly, prudential norms for capital adequacy, income recognition, non-performing assets, etc came to be tightened. These added to the problems that DFIs were facing.

The closing down of the erstwhile DFIs and the entry of banks into lending for infrastructure has not improved matters. Despite their access to low-cost funds, banks have not been able to make a success of lending to infrastructure. On the contrary, we have learnt at great cost that borrowing short and lending long exposes banks to interest rate risk. Nor has bank lending to infrastructure improved the quality of lending; indeed, the contribution of infrastructure to bank NPAs is so large that they are now averse to any further lending to the sector. It may well be that when term finance is part of a much larger bank portfolio, building up the technical expertise for term finance does not get the necessary focus within a bank.

What lessons can we draw from the experience with DFIs and with banks subsequently taking their place in infrastructure finance?

First, we need an institution or institutions that can borrow and lend long term, as the DFIs did successfully for a long period.

Two, it may not be possible to wish away the need for concessional finance for infrastructure. True, Indian financial institutions today have greater access to both domestic and international capital markets and a government-owned financial institution would enjoy a certain financing advantage. Nevertheless, it could be plausibly suggested that, at any point, there will be a certain percentage of infrastructure projects whose economic returns, as distinct from financial returns, require them to be supported with concessional finance. A new DFI would thus have to be supported on the borrowing side in ways that allow it to raise a specified proportion of its funds at a concessional rate.

Thirdly, a part of PF funds and Pension Funds could mandatorily be invested in the DFI This will enable the institution to have access to long term funds. Such a prescription has been successfully practiced in the case of n BNDES, Brazil, and Industrial Development Bank of Turkey. Such investment must, of course, be subject to prudential norms – for instance, a norm that the DFI must obtain a minimum rating of AA by two domestic credit rating agencies.

Fourthly, professionals of high quality with deep sector knowledge are required both for project appraisal and due-diligence for managing borrowings and the governance of the institution needs to be of a higher order than obtains today.

In principle, it may be possible to create these conditions in our larger public sector banks. However, PSBs are under financial stress at the moment. There are constraints on top management bandwidth. There is an urgent need to have an institution that can scale up infrastructure lending quickly and without requiring coordination among several banks. In light of these factors, a new DFI that meets the above conditions commends itself.

Please refer to Annexure for the details on reasons of failure of earlier DFI's and how the new DFI through its construct, contours and product portfolio can mitigate the past shortcomings.

4.2. Need for a new DFI

The realization of NIP is critical to meet the growth aspirations of the country. Despite introducing multiple measures to attract institutional investors to engage in infrastructure finance, the results have fallen short of expectations. Most of the banks and financial institutions have stepped away from infrastructure financing and thus, there is a need to introduce a new player, a specialized financial institution with a specific and defined mandate to fund infrastructure.

As the domestic economy is in the cusp of another bout of infrastructure spending of Rs.111 trillion during next five years to reinvigorate the growth momentum of the economy, and thus there is a need to create an institution that can scale up infrastructure lending quickly in line with the expectations of the NIP. In absence of specialised FIs, again the appraisal will be carried out either by merchant bankers with no skin in the game or by banks having flush with short term liquidity and limited capability to fund long term projects.

A deeper insight to the journey of DFI in India reveals that DFI model has not failed but its transition from DFI model to Commercial Banking model with development mandate without necessary enabler indeed generated pressure towards failure. Many of the reasons that led to the demise of DFI's in India were systemic in nature (e.g. economic liberalization, evolving legal and regulatory ecosystem and technological infancy), the issues either don't exist today or have since been corrected through multiple legal and regulatory reforms. Hence, the DFI of today shall have a much stronger foundation and much greater ability to succeed as compared to earlier DFI's. It is prudent to address experiences of the DFIs and rebuild DFIs rectifying challenges witnessed therefrom. This would facilitate the dream of building a USD 5 trillion-dollar economy by 2025.

Realization of NIP is critical to accelerate country's transaction to a developed market economy. Preponderance of EPC in the implementation mix renders realization of NIP critically dependent on the state of government finances. The advent of COVID has ushered a structural downshift in India's economy adversely impacting the government finances. In the current limited fiscal space, a new financial institution leveraging on specialized appraisal skills, independent governance structure and rationalized prudential norms can serve as an optimal vehicle channelizing government's capital towards development of infrastructure assets.

5. Experience of DFI's elsewhere in the world

Development banks or Development Financial Institutions('DFIs') may be considered as form of government intervention in the financial system that aims to address market failures in the provision of finance or, more generally, to help achieve socio-economic objectives such as equity or poverty reduction.

Although, there is no universal model for development banking as it is influenced by a variety of factors, such as a country's level of development and the sophistication of its financial system, however, the appreciation of experience of successful development banks across the globe, key learnings effectively modulated by particular developmental and financial needs of the country can be leveraged to derive a specific framework of new DFI.

The current chapter evaluates the evolution of few of the successful DFI's across some key dimensions namely, the role of the institution/mandate and sectoral priorities; governance structure, ownership, regulation and supervision; capitalization; and 'products and services' of such institutions.

5.1. Mandate and Sectoral Priorities:

Mandate clarity: the mandate of the development bank must be clearly articulated, as a vaguely defined mandate creates uncertainty for the bank, its stakeholders and the private sector. It allows the bank to pursue activities not intended by the government ('mission drift'), gives the bank more scope to avoid difficult or costly activities ('mission shrink'), reduces accountability, and increases the opportunities for political interference (Diamond & Raghavan, 1982; Shirley, 1989; Caprio et al., 2004; BAR, 2006).

A development bank or a DFI needs an appropriate mandate to ensure it is correctly positioned within the environment. The lessons drawn from the experience of development banking have highlighted the disastrous effects of inappropriate mandates, but countries such as Malaysia, and Brazil show that banks with appropriate and flexible mandates can contribute significantly to development.

The mandate should be reviewed regularly to take account of changing circumstances. Such changes could stem from a general deepening of the financial system, exogenous influences such as new policy directions, or the success of the bank's efforts to strengthen the private financial sector. (BAR, 2006; Thorne, 2008).

The initial focus on BNDES (Banco Nacional de Desenvolvimento Econômico e Social, Brazil) was development of infrastructure in the country, it was later expanded to include technology and SME funding in-line with developmental and economic priorities of the country.

KfW (Kreditanstalt für Wiederaufbau, Germany) was setup to raise capital efficiently to support the provision of public infrastructure, initially in the context of post-war reconstruction and, subsequently, to support wider economic development. In later years, mobilizing private finance became key goal of the government and the mandate of KfW was adapted to help government achieve its objective.

Sectoral Priorities

Both models of institutions focusing on particular sector or themes are prevalent. Whereas KfW focusses on thematic priorities, such as supporting exports or investments in energy efficiency, or renewable energy, PT-SMI (PT Sarana Multi Infrastruktur, Indonesia) has sectoral priorities with a mandate to catalyse infrastructure development in Indonesia.

Please refer to Annexure for details of rationale of establishment of few of the DFI's and their recent mandate to highlight how the mandate has been able to flexibly evolve keeping with changing economic needs of the country.

5.2. Governance, Regulation and Supervision Arrangement and Ownership pattern:

While most of the DFI's are government owned institutions, sound governance is important to ensure that the institution do not crowd out private investment, is operated independently and exercise due care in its dealings. This also guards against negative behaviors such as institutional capture, cronyism and corruption.

Principles of good governance enshrine a combination of market oversight and separation of ownership and supervisory role of the government.

Specific elements of good governance practiced by successful DFI's include:

a. Focusing on additionality.
b. Operating within an agreed strategy and mandate.
c. Independent objective operational management.
d. Maintaining public confidence through transparency.

Please refer to Annexure for the details on the ownership structure, board representation and supervision and regulatory framework of the DFI's studied as part of the Report.

5.3. Resourcing/Capitalization:

Government ownership has been instrumental in enabling DFI's to raise capital efficiently. The low-cost financing provides DFI the ability to on-lend at rates significantly below the rates of other competing sources of commercial finance.

Two versions of the traditional model have emerged which differ in how they were capitalized and resourced:

•Model I - Fiscal transfers from government: BNDES, for example, was largely financed by fiscal transfers; and

• Model II - Direct government equity contributions: KfW, and DBSA (Development Bank of Southern Africa, South Afrcia) were given direct government equity contributions to leverage capital raised in national and international bond markets, typically with different forms of sovereign guarantees, including callable capital.

5.4. Products and Services:

Financing products offered by DFI's have grown in sophistication, where, in addition to senior loans; subordinated debt and equity are also being offered, allowing these institutions to play a more 'catalytic' role.

Apart from financing, these institutions are also playing a greater role in project pipeline development. In many developing markets, a lack of finance is often less of a binding constraint than the lack of well structured, bankable projects. As such, given their positioning as a public sector institution, as well as being a centre of expertise on infrastructure finance, DFI's are deemed as well-placed to alleviate project development bottlenecks.

In Indonesia, PT SMI project preparation services has been created for the exclusive purpose of preparing, structuring and transacting a priority pipeline of PPPs, including concessions and privatisations. BNDES has a unit focused on project structuring for privatisations, concessions and PPPs to assist at various stages of the process, from the planning to signing of contracts.

Asset profile

BNDES, CDB (China Development Bank, China) and DBSA, all three have lending structures/policies that cover national/federal, provincial/state, local governments and urban corridors/cities, but with a very strong anchor in sub-national clients. They also have significant client and geographic concentration. Their infrastructure sectoral priorities emphasise energy and transport, housing and social infrastructure are also present but are marginal in value terms. BNDES is also a major financing platform for Micro, Small and Medium-Sized Enterprises (MSMEs).

Their portfolios are typically over 80 percent domestic, but with more recent regional or global activities, reflecting a strong policy alignment with national governments. With regards to denomination of assistance, the financing is predominantly denominated in local currency, 98% of debt finance provided by DBSA was provided in Rands and 86% of the same provided by BNDEs was denominated in Reals.

5.5. Key Takeaways:

- DFI's are typically instituted to address 'market failures', hence, the mandate of DFI's needs to be carefully crafted to prevent both mission creep and mission shrink.
- There is separation of ownership and supervisory role of government to ensure that the DFI functions independently.
- Most of the DFI's are principally owned by the government. Government ownership helps in raising cheaper resources.
- Given the unique position of the DFI in the financing landscape of the country, demonstrating 'additionality' becomes an important criterion in avoiding 'crowding out' of commercial or private sector financial institutions.
- Although debt remains the principal product offering, the product suite of DFI's is wide enough to enable the institution to play an influential role in catalyzing private sector participation

- As preeminent institutions of infrastructure finance and cluster of infrastructure expertise, DFI’s play an instrumental role in crafting and creating bankable project pipeline for the country.

6. Vision, Construct and Contours of the new DFI

In the previous sections of this report the need for a DFI has been clearly established. The current section of the report attempts to expand the character of such a DFI. While the transformative role of DFI is well understood, it is equally important that we define key Charter Features and parameters around this Institution clearly so that it can achieve the laid-out objectives.

The following section touches upon a general framework and where possible a set of boundary conditions or the hygiene factors necessary for such an institution to function effectively.

The framework and the boundary conditions have been derived keeping in mind the fiscal constraints faced by central and state governments; unavailability of reasonably priced, long term capital sources in private space; and the sizable infrastructure funding gap that's required to be met to realize the objectives of NIP, which in essence is extremely critical to realize the economic vision and growth of the Country.

6.1. Mandate:

The preeminent objective of instituting the new DFI is to fill the infrastructure & core Industry financing gap that currently exists in the country. The DFI is expected to address the market failure of absence of long-term finance for funding infrastructure and foster economic development of the country. Additionally, the institution is expected to spearhead & facilitate financial assistance to mandated assets with significant positive externalities, projects having desirable social and economic outcome, that don't find much favor within the commercial institutional finance ecosystem.

While the institution is expected to play a pre-eminent economic & catalyst role in infrastructure financing and development of physical and social infrastructure in the country, it is equally important that it is not seen as a panacea to cure everything that ails infrastructure financing in the country.

The core mandate of institution should be objective, coherent and in line with the economic objectives of the country. At the same time, it's desirable to have periodic reviews of mandate to ensure that the institution remain relevant with changing times.[10]

We recommend that the mandate of the institution be restricted to financing Infrastructure as defined in the 'Harmonized Master List of Infrastructure Sub-sectors' issued by Ministry of Finance and the institution should prioritize funding of projects having positive externalities.

It is recommended to enshrine the mandate of the institution in the constituting statute itself to avoid mission drift and protect the institution from political vagaries and short-termism.

6.2. Regulatory Framework:

Adherence to a broad-based systemic regulation shall help in maintaining competitive symmetry and ensure a level playing field with other players in the institutional finance ecosystem. Further, the compliance with the systemic regulation shall foster trust of external stakeholders and ensure that the institution is able to raise the resources competitively in future.

[10] World Bank & World Federation of DFIs, 2017.

Although the new DFI is expected to operate within the same financial ecosystem as that of Banks and NBFC's, there are material differences between the character of the new DFI and that of Banks and NBFC's, notable among them being:

1 Significant public policy considerations,
2 Predominance of long-term project loans,
3 Focus on one or few select sectors,
4 Significant exposure to central/state governments as principal or counterparties,
5 Counter cyclical nature of Institution, and
6 Limited freedom to change the portfolio composition given the specific 'Statutory Mandate'.

The above characteristics of DFI are closer to the existing AIFI's (All India Financial Institutions) that are currently operating in the country. The country already has extensive prudential regulations for AIFI's and the same may be adopted for the new DFI.

Rationalized capital norms and ability to optimally leverage the capital contribution under the existing AIFI regulations are other important considerations that weigh in given the limited fiscal space of the government.

6.3. Ownership, Governance Structure and Approach towards Implementation:

a) Ownership structure:

The ownership structure can be decided by looking at experiences of successful Development Banks (DBs)/DFI's in other countries.

Typically, National Development Banks (NDB's) or DFI's are institutions owned, administered, and controlled by the government (state), which provides the strategic direction and appoints their senior management and board members. Almost three quarters of NDBs surveyed by the World Bank are 100% State owned, 21% have between 50 and 90% of State ownership, and in only 5% have government's minority ownership.[11] Many of the successful international DFI's both in emerging markets and developed economies such as Brazil, Germany and South Africa are entirely owned by the government.

The institution is expected to serve as the engine of infrastructure growth of the country and has significant public policy considerations. The institution is supposed to finance projects with significant externalities which possibly cannot be harnessed by private entities. The preference to earn financial returns vs economic return by a private party shall defeat the very purpose of existence of the DFI. Thus, the development of this institution cannot be left to competitive forces or private entities alone. Government must be the preeminent and principal stakeholder for the institution to effectively and efficiently achieve the objective of furthering the economic prosperity of the country.

[11] Luna-Martinez and Vicente, 2012.

b) Governance structure:

The governance structure defines the general superintendence, direction and management of the affairs and business of the DFI. The institution should be capable of functioning independently and should be ring fenced from political considerations and undue influence from the government to be successful. The right corporate governance framework shall foster confidence among investors and other external stakeholders and enable the institution to raise resources at optimal cost in future.

We recommend a single tier governance mechanism for effective control and supervision of affairs of the Institution. A single board having equal representation of Government and Independent Directors may be considered appropriate balancing the aspirations of the principal shareholder (Government) and the expectations of market of having an independent decision-making body confirming to the best corporate governance standards. 50% of board members may be appointed by the government and remaining 50% should be independent Directors, the Chairman should be nominated by the board itself. It's recommended that all the required independent directors should be appointed before operationalizing the institution. The existing framework of appointment of independent directors of AIFI's may be adopted in this regard.

It is also important to mention that the teams are professionally managed, and we staff the Institution with the best professional expertise that's available in the market – be it in public sector or in the private sector. This professionalism will ensure best policies, appraisal, risk, HR and lending systems that's required by the current market.

c) Approach towards implementation:

There are multiple options through which the institution can be implemented. The new DFI can be created either by setting up new institution, consolidating some of the existing institutions or adapting an existing institution for the new role.

Adapting or structuring an existing institution may be preferred due to:

1 Pace of implementation
2 Leveraging the pockets of expertise that already exists within the current institution
3 Leveraging existing capitalization of institution thus reducing incremental capital contribution from the government.

Although consolidation also brings in advantages listed in point 2 and 3 above, however, we believe the pace of implementation would be the slowest in case of consolidation due to presence of public shareholding in many of existing infrastructure NBFC's and challenges in managing the alignment of different organization cultures and values.

While adapting existing institution for the new role has its advantages, we need to ensure that legacy assets of the existing institution are appropriately ring-fenced, and the organization structure is suitably strengthened by bringing on board professionals and specialists to deliver the desired outcome.

100% government ownership and consequent absence of public shareholding in institutions such as IIFCL makes it more adaptable and agile in executing step-changes in their mandate and may be considered as a preferred vehicle for implementing the new DFI.

The Group also deliberated around the issue of whether a 'licensing approach' can be instituted around future DFIs. it was strongly felt that creation of Institutions like DFIs can't be left to market forces alone. The purpose of creating this DFI is to plug a key market gap, to ensure that long term Infrastructure financing takes shape, to ensure that socially and economically desirable projects comes up, which is important for achieving the overall economic vision of the Nation. And therefore, in such a context it will not be best to leave creation of such an Institution to market forces.

6.4. Criterion of Additionality:

It is imperative that the DFI should complement and not compete with existing commercial institutions (Banks, NBFC's and AIFI's). The DFI should be incentivized in taking exposure on infrastructure assets that have desirable social and economic outcomes, the very purpose for which such an institution has been created.

We recommend the 'Test of Additionality' as an integral criterion to be satisfied for the DFI to take exposure; play a lead role or participate in any transaction. Test of Additionality shall require the DFI to demonstrate the project is not financeable without its participation. However, this 'test of additionality' shall be broad based and should not be defined in narrow terms. How can participation of DFI ensure larger participation by other institutions, how can it make the project more financially viable, how large integrated complex projects can be executed, and many more such criterion should be considered while applying this test. Further, the Institution shall not be constrained by putting constraints not to undertake 'refinancing' or 'not to finance IBC debt exposures' etc. It's very important to have desired flexibility to such an Institution so that it can offer a 'solution' where either one does not exist, and / or costs of different solutions will be so prohibitive that it will not make them work.

The test of additionality shall ensure that the DFI does not abuse its dominant position and at the same time is able to make a 'real difference' to the financing market.

6.5. Product Portfolio:

The institution is proposed to be created to address the principal market failure of absence of low cost, long-term finance in infrastructure space in the country. An ancillary objective is to catalyze private sector investment in infrastructure in the country. The above two along with the test of additionality may be treated as the guiding principle for determining the product portfolio of the institution.

The product portfolio should be expansive enough for the institution to play an influential role in the infrastructure financing landscape.

Long term project finance debt should be the principle product offering of the institution. However, the same should be complemented with alternate product profiles or structured credit (e.g. subordinate debt, mezzanine funding and credit guarantees) that are very critical in today's context. The institution may also consider taking equity exposure on a case to case basis.

Keeping the developmental objectives in mind, the institution should not be guided by financial returns alone while determining the product mix. For addressing issues on availability of long-term financings beyond 10 years, specific guarantee product on stub portions which will need to be refinanced at the end of the bond tenor can be explored. It would be preferable to put an overall cap on deployment of structured instruments and equity as a percentage of overall assets of the institution to discourage opportunistic exposure.

The objective of DFI to positively impact infrastructure financing ecosystem would not be achieved without it offering a sustainable solution to stressed assets in the infrastructure space. The exposure on stressed assets should be undertaken keeping overall context in mind. Today many operating Infrastructure assets are undergoing stress on account of multiple reasons and many a times outside their control. Funding for quite of these either not available or may be available at high cost. These assets are operating, well maintained and employs people. Such operating assets in Infrastructure going out of the system may not be desirable. Then there are many that are close to commissioning and require that last mile funding. Proposed DFI should have flexibility to fund such assets as well after proper assessment as per the extant policy framework.

Additionally, the Institution may play a market making role facilitating development of long-term bond market. The institution can also serve as a center of excellence for infrastructure projects assisting in structuring bankable project pipeline for the government.

6.6. Approach towards resource raising:

Development banks or DFI's are often supported by governments or international institutions in the form of tax incentives and/or lines of credit at concessional rates. It's is not possible for the institution to raise finances from the public/private markets at a scale and cost that will enable the institution to meet the desired economic development objectives. The preponderance of assets having subdued financial performance and the preference towards economic development requires the DFI to have access to resources that are at considerable discount to market. This is one area where active government intervention and support shall be required for the DFI to be successful and remain relevant in long run.

The government support can be manifested in form of capital contribution and loans or guarantees enabling the institution to raise less expensive financing. It can be manifested in form of capital contribution and loans or guarantees enabling the institution to raise alternate long term resources.

The RBI-LTO of erstwhile DFI's may be revived for institution to raise low cost funds from RBI. The existing multilateral lines may be consolidated and administered by the new DFI. Institutions having access to long term funds such as EPFO, PFRDA and Insurance companies may be mandated to invest a certain percentage of their corpus in the new DFI. The government may consider specific tax incentives of SLR status to bonds issued by the DFI to raise finances at lower cost.

Given the systemic role proposed to be played by the institution, any withdrawal or curtailment of active role and support of government has the potential of contagion effect on the entire financing ecosystem. Its recommended that the explicit support from government in form of capital, resources and/or guarantees may be enshrined in the constituting statute of the institution. Such a provision will not only insulate the institution and the broader ecosystem from political vagaries but will also give comfort on sustainability of access to such support enabling the institution to raise resources at competitive cost from markets, if required, in future.

7. Concluding Remarks

DFI's world over have played a seminal role in fostering economic growth. DFI's have proved themselves as an important tool in hands of the government to address market failure and catalyze private sector investments.

The existing institutional finance ecosystem in the country is patently inadequate to cater to the needs of the growing economy. It's quite apparent that the ambitious target set up in NIP cannot be realized without introducing a new DFI serving as the lynchpin of infrastructure financing in the country. The counter cyclical role of new DFI becomes even more important in the current scenario to kickstart and bring the economy back on track.

India has had a rich history of DFI's, the learnings of which can be leveraged in crafting the new DFI. It's important that the new institution is set up under a separate statute enshrining the defining characteristics of such institution. The defining statute shall not only be reflective of governments focus and long-term commitment essential for sustainability of such an institution in the long run but shall also serve as an effective bulwark protecting the institution from some of the past mistakes that consigned earlier DFI's into oblivion.

As a mandate, the new DFI may prioritize financing infrastructure assets and focus on projects having significant positive externalities for maximum impact. It is desirable to have periodic reviews of mandate to ensure that it remains relevant to the changing needs of the economy.

The design of the governance structure comprising of board having equal representation of independent and Government Nominee directors facilitates independence, transparency, professionalism and accountability.

It's imperative that the institutional framework and priorities are defined in a manner that enables the institution to collaborate and not compete with the existing players in the financing ecosystem. It's addressed through the 'gap filling role' or the demonstration of additionality that the DFI shall bring though its participation in projects.

Meeting the infrastructure challenge goes beyond lack of funding. Despite introducing multiple measures to attract institutional investors to engage in infrastructure finance, the results have fallen short of expectations. Bridging the investment gap requires the involvement of DFI to provide not only funding but also play a role in catalyzing private sector investments. Accordingly, the DFI needs to have a wide portfolio of products, including debt, mezzanine and subordinate capital, guarantee/credit enhancement and equity, for it to play a defining role in influencing infrastructure finance and catalyze private sector investments.

It's essential that the DFI is adequately resourced with appropriately priced long-term funds to enable it to extend support to projects/sectors that do not meet the risk/return expectations of a typical commercial financing institutions/investors. Reviving access to RBI-LTO funds, consolidating long term multilateral lines given to existing financing institutions, according SLR status to bonds raised by new DFI and mandating EPFO/PFRDA and Insurance companies to invest a predefined corpus are some of the avenues that can be explored in this regard.

Given the limited fiscal space with government, the existing prudential framework applicable to AIFI’s optimizing the need for capitalization is appropriate for the targeted role envisaged for the new DFI.

Because of its long-term perspective, a DFI is an effective tool in modulating and directing policy response to targeted sectors of the economy and hence should be seen differently from other financing institutions. The DFI can play a defining role in supporting an investment-oriented growth strategy by accelerating the deployment of government sponsored infrastructure investment projects bringing significant externalities. Accordingly, government ownership is essential and symbiotic in defining the success and sustainability of such institution in long run.

The pace of implementation is key for the new DFI to play a defining role in infrastructure financing landscape in the country. Existing financial institution such as IIFCL can serve as an excellent platform for operationalizing the new DFI. IIFCL’s experience and expertise in, evaluating sector agnostic infrastructure projects and raising long term funds from capital markets are some of the distinct advantages that ‘weigh-in’ in favor of IIFCL as a preferred platform for the new DFI.

Although NIP is important as a context, but the role of the new DFI in supporting the national economy goes much beyond financing NIP projects envisaged to come up in next five years. A critical mass of DFI is required for it to play an effective counter cyclical role in the economy and stay relevant in long run. As a starting point, an initial capitalization of INR 1 Lakh crore that can levered 10 times, under extant prudential regulations, to create an asset portfolio of around INR 9-10 Lakh crore over period of next 5 years may be considered appropriate. The institution can be suitably resourced based on emerging needs of the economy.

The NIP is reflective of country’s aspiration to accelerate the transition to USD 5 Tn economy and the new DFI shall be a steppingstone helping the country to realize the desired objective. The new DFI can play a pivotal role in funding world class infrastructure and be an enabler in transition from an emerging market to a developed market economy, thus realizing the vision of Hon’ble PM for making India a 5 tn USD Economy.

Annexures

Annexure-I
Reasons for failure of earlier DFI’s

The reasons for DFI failure can be broadly divided in two categories

A. **Absence of conducive ecosystem:** These are legacy issues which were specific to the era that led to demise of erstwhile DFI's in India. The issues over the years have already been addressed through multiple structural and policy reforms by the government. The new DFI shall have a strong foundation to start with due to presence of enabling ecosystem which was not there earlier.
B. **Issues specific to DFI structure, Governance and Risk Management framework:** These are the key learnings from the failure of erstwhile DFI’s and are relevant in current context. The issues have been appropriately mitigated while devising the construct and contours of the new DFI.

A. Absence of conducive ecosystem		
Reason for failure of erstwhile DFIs	**Description of the reason**	**Mitigating mechanism to avoid such failures**
Structural changes in the Indian economy	IDBI and other DFIs had portfolio of Core Industries which enjoyed protection and the appraisals were limited to demand supply within the country and not global demand supply assessment. Once the economy opened up, the viability of some of the projects got eroded as cheaper supply was available. This led to some of the project finance portfolio getting impaired.	Currently the appraisals are being done based on global supply demand analysis and the competitive and comparative advantage the project enjoys vis-a-vis competitors. The Indian economy is broadly opened, and assessments are undertaken without putting much emphasis on the duty protection. **Therefore, such risks of competition and unforeseen duty changes are taken care of. Hence the probability of impairment of portfolio because of such changes are low.**

A. Absence of conducive ecosystem		
Reason for failure of erstwhile DFIs	**Description of the reason**	**Mitigating mechanism to avoid such failures**
Nascent/evolving regulatory and legal framework	(a) Post 1991, there were a series of projects in Infrastructure space especially in Power sector and road sector. However, the sector laws were in nascent stage and all efforts were on generation side without emphasis on distribution reforms. This led to a number of loans getting impaired in case of IPPs especially in the gas fired space. Similarly, the in practice, starting toll collection was difficult in the first few road projects and the lenders to these projects mainly IDBI got into trouble.	Presently, the improvements in the transmission and distribution side of the power business has gained momentum. The sector laws have matured. The payment of water charges, tolls and other user charges have sunk in the minds of the consumers. Although some more improvements need to be done in the Power Distribution sector, which could make the sector self-sustainable. **Proposed DFI will gain from the maturity witnessed by the sector and learning's from past mistakes.**
	(b) Although the first resolution framework viz Recovery of Debt Act was enacted in 1993, the effective recovery mechanism came into being with the enactment of SARFAESI Act in 2002. Therefore, the recovery mechanisms were very weak and were entangled in the protracted legal court cases. Legal system and banking regulations were not helpful in past for recovery of NPAs or take action against defaulting corporates.	Currently, with the IBC framework being in place the resolution and framework is much more robust. This also has instilled a sense of accountability in the minds of the Borrowers who have become more conservative. **This would benefit the proposed DFI.**
Infancy of IT systems and processes restricting transparent flow of information	(a) Till 2004, there was no credit related information sharing in India. although CIBIL was incorporated in 2000 based on RBI Siddiqui Committee recommendations, consumer credit bureau services were launched in 2004 and commercial	In the current lending environment, information sharing is a common practice and enough credit history of the Sponsor/ Borrower is available. This would help in prudent decision making by the DFI. Further, the interests and debt amortisation schedules are aligned

A. Absence of conducive ecosystem		
Reason for failure of erstwhile DFIs	**Description of the reason**	**Mitigating mechanism to avoid such failures**
	bureau operations commenced in 2006. This led to borrowers taking advantage of information advantage. DFIs were on the receiving end as they were dependent on commercial banks where the cash flows of the borrower were flowing through. More often the banks recovered their part of debt service and the DFIs became subordinated lenders in practice	amongst banks and Institutions and therefore possibility of arbitrage of periodicity in payments does not arise. RBI's recent directions of August 6, 2020, whereby the Borrowers need to close all current accounts and route the entire proceeds through an Escrow TRA Account, would ensure proper monitoring and controls.
	(b) IDBI and other DFIs suffered from lapses of security creation and perfection. Since the registration records were not digitised, the errant borrowers took advantage of the same. The lapses came to notice when the recovery efforts were made.	The records are mostly digitised and because of information sharing efforts, possibility of such security creation lapses is not envisaged. The DFI would benefit from this.

B. Issues specific to DFI Structure, Governance and Risk Management Framework			
Reason for failure of erstwhile DFIs	**Description of the reason**	**Mitigating mechanism to avoid such failures**	**How does the new DFI plan to mitigate the risk**
Lack of access to cheaper capital	Access to liability for funding requirement was low. Post 1991, IDBI and other DFIs were dependant on banks and PF Funds for their liabilities. However, the PF Funds also reaches their exposure and the DFIs also were capital starved as the Government did not have adequate resources for capitalisation. GoI drew a line from World Bank for capitalising the banks and the DFIs like IDBI were left on their own.	The proposed DFI would be adequately capitalised at the beginning. Further legislations need to be enacted which would allow a part of the Pension Funds, PF Funds, Gratuity Funds into the proposed DFI on an annual basis. The rating of the DFI should be maintained in a manner so that it could have access to global funds. Therefore, the liability side need to be addressed at the initial stage itself.	It is recommended that the explicit support from government in form of capital, resources and/or guarantees may be enshrined in the constituting statute of the institution. Such a provision will not only insulate the institution and the broader ecosystem from political vagaries but will also give comfort on sustainability of access to such support enabling the institution to raise resources at competitive cost from markets, if required, in future.
Significant government intervention and lack of talent	IDBI and other DFIs had suffered the problem of government interventions. There were a few instances of directed lending. The executives also lacked capacity building as the new types of appraisals and assessment skills were being acquired. Capacity building of the executives had not been undertaken. Therefore, there were errors arising out of ignorance, incompetence and inexperience which led to impairment of the portfolio.	The proposed DFI could attract market-based talents having experience in Project Finance and managing risks associated with such financing. The sector experts and other Independent experts could also be engaged on contractual basis as and when found necessary. The Board of the DFI will have a proper mix of Independent Directors with expertise from the relevant field with a few Directors from the Government. The proposed DFI could attract a few professionals who have worked	**<u>Structure of the Board</u>** A single tier governance mechanism with equal recommendation of independent and government nominee directors is proposed for the for effective control and supervision of affairs of the new DFI. A single board having equal representation of Government and Independent Directors may be considered appropriate balancing the aspirations of the principal shareholder (Government) and the expectations of market of having an independent

B. Issues specific to DFI Structure, Governance and Risk Management Framework			
Reason for failure of erstwhile DFIs	**Description of the reason**	**Mitigating mechanism to avoid such failures**	**How does the new DFI plan to mitigate the risk**
		elsewhere in the globe either in the Management team or in the Board which would enable the Institution to take benefit of global best practices.	decision-making body confirming to the best corporate governance standards. It's further recommended that all the required independent directors should be appointed before operationalizing the institution. **<u>Operational Management</u>** Proposed DFI will be staffed with the best professional expertise that's available in the market – be it in public sector or in the private sector. This professionalism will ensure best policies, appraisal, risk, HR and lending systems that's required by the current market.
Competition with Lenders	DFIs like IDBI witnessed stiff competition from the commercial banks which started lending in Project Finance. the commercial banks started undercutting and DFIs like IDBI were left out and took more risky projects in their books	Currently the commercial banks have low lending appetite. With consolidation of PSU Banks in the last 2 years, unhealthy and irrational risk taking by smaller PSU Banks as lead has also come to an end. IBA has felt the need of a DFI as they believe that such institutions are required to cater to the current project financing needs. The arrangement therefore will be more complimentary rather than	**<u>Test of Additionality</u>** The test of additionality shall ensure that the DFI plays a complementary role in the existing financing ecosystem. Test of Additionality shall ensure that the DFI preferably finance only those projects that are not financeable without its participation. **<u>Mandate of DFI</u>**

B. Issues specific to DFI Structure, Governance and Risk Management Framework			
Reason for failure of erstwhile DFIs	**Description of the reason**	**Mitigating mechanism to avoid such failures**	**How does the new DFI plan to mitigate the risk**
		competitive. Further, it is envisaged that the DFI would also refinance projects; this would enable the banks to release capital for further lending	The mandate of DFI ensures that the institution is incentivized in taking exposure on infrastructure assets, a place which has largely been vacated by existing banks and financial institutions. **<u>Product Portfolio</u>** In addition to greenfield asset financing, the new DFI is also proposed to refinance viable infrastructure projects thus enabling churning of capital for existing banks and financial institutions.
Imprudent risk management practices	IDBI and erstwhile DFIs had been lending to entities wherein the leveraging was high. India lacked equity capital those days. From late 90's the private equity capital and the Institutional capital have made a modest entry in India. Currently some of the funds have gone ahead and contributed 100% of the risk capital. This has resulted in correcting the leveraging. As the leveraging reduced, the projects became more sustainable. IDBI had	Lenders presently have followed a particular leverage ratio and there is a greater emphasis on external credit rating. The projects are therefore structured in a manner so that the projects are rated in the investment grade or higher in the beginning itself. The proposed DFI would also follow this practice.	**<u>AIFI Regulations</u>** The proposed DFI is envisaged to be regulated under extant AIFI regulations. The AIFI regulations have detailed risk management guidelines to address a) Credit Risk Management b) Market risk management and Asset Liability Management c) Operational Risk Management d) Stress Testing e) Liquidity risk management

B. Issues specific to DFI Structure, Governance and Risk Management Framework			
Reason for failure of erstwhile DFIs	**Description of the reason**	**Mitigating mechanism to avoid such failures**	**How does the new DFI plan to mitigate the risk**
	suffered from the highly leveraged projects. Earlier DFIs were not putting much emphasis on the external credit rating of the projects leading to financial stress/ failure of such projects.		f) Strategic and reputational risk management **<u>Operational Management</u>** Proposed DFI will be staffed with the best professional expertise that's available in the market – be it in public sector or in the private sector. This professionalism will ensure best policies, appraisal, risk, HR and lending systems that's required by the current market.

Annexure-II

Institution	Rationale of Establishment	Current Mandate/Key Developments
KfW Germany 1948	To provide financing for the reconstruction of post-war Germany	To improve economic, social and ecological living conditions. Domestically, KfW has focused on small and medium-sized enterprises (SMEs), provision of social infrastructure and renewables.
BNDES Brazil 1952	To implement and carry out the Federal Government's investment policy	To support programs, projects, construction and services related to the country's economic and social development. Since 2015, BNDES has focused on catalysing third-party capital, driven in part by the removal of fiscal support.
DBSA South Africa 1983	To advance the development impact in the region, originally as part of apartheid era homeland system	To expand access to development finance, to integrate and implement sustainable development solutions, to improve quality of life through the development of social infrastructure, support of economic growth and regional integration, and to promote the sustainable use of scarce resources.
PT SMI Indonesia 2009	To catalyse Indonesian infrastructure development	Part of major reform programme to address stagnation following Asian financial crisis in 1998. PT SMI focusses on debt products. There is a complimentary institution PT-IIF, established in 2010 to act more in the private sector space, but also provide equity, FDI and support for capital market development

Source: Guidance Note on National Infrastructure Banks and Similar Financing Facilities

Annexure-III

Institution	Company type	Ownership	Board Members	Supervision and Regulation
BNDES Brazil	Federal Public Company	Wholly owned federal entity	Appointed by the president of Brazil	Central Bank of Brazil
DBSA South Africa	Separate legal and regulatory status under special law	100% Government Owned	Appointed by minister of finance, 10 members are independent non-executives	Government/Treasury
KfW, Germany	Public Law Institution	Government Owned^	Appointed by supervisory board of German ministers	German MoF
PT-SMI, Indonesia	Non-banking financing institution, state owned enterprise	100% Government owned	Appointed by MoF	Regulated by MoF

Source: Guidance Note on National Infrastructure Banks and Similar Financing Facilities

^ 80 percent by the Federal Republic of Germany and 20 percent by the States of Germany

Annexure-IV

Recommendations

(A) Recommendations specific to greenfield asset financing

Recommendation	Rationale and Description	Concerned Authority	Implementation Timeline
Zero Coupon Bonds	Investors in ZCBs pay capital gains tax on redemption premium (instead on income tax on coupon as is the case in plain vanilla bonds) which gives them a higher return. However, CBDT approval under IT Rule 8B is required for issuing ZCB. The application is to be submitted at least 3 months prior to the launch of issue which is very long period considering the immediate liquidity requirement and volatile bond markets. Hence it is recommended that automatic approval route in line with ECB may be given to government owned banks and NBFC-IFCs for which no prior approval is required from any authorities upto certain ceiling. In addition to above, Inclusion of IDF NBFCs within the definition of "Infrastructure Capital Company" u/s 2(26A) will enable fund raising through a new instrument and permit targeting of additional categories of investors.	CBDT/MoF	Immediate-Short Term
Intercreditor Agreement	RBI vide circular no DBR.No.BP.BC.45/21.04.048/2018-19 "Prudential Framework for Resolution of Stressed Assets" has made it mandatory for banks to sign the ICA in cases where Resolution Plan (RP) is to be implemented. It is recommended that RBI may issue similar directions mandating execution of ICA for greenfield asset financing as well.	RBI/DFI	Immediate-Short Term

Recommendation	Rationale and Description	Concerned Authority	Implementation Timeline
	It is suggested that suitable provisions in ICA may be included to ensure that appraisal of lead bank is followed and no additional terms and conditions beyond lead banks stipulation may be stipulated by other participating lenders. It is also recommended that a mechanism for provision of standby facility for cost overrun can be included as part of ICA. The quantum of such a facility would vary on a case to case basis.		
Standardised payment security mechanism	It is recommended that states and centre align to a standardised payment security mechanism (including LC and escrow) for various Infrastructure sectors which act as a deterrent for default by counterparties. Alternatively, state or central govt. authorities can have an arrangement with multilateral agencies like World Bank which can step in enhance overall structure with some sort of credit enhancement like SBLCs.	Ministry of Power/DOT/ DFI	Immediate-Short Term
Standardized Loan Agreement	Each bank has its own set of standardised loan documents. However, large infrastructure projects require multiple Banks, FIs, NBFCs, IDFs, etc. joining hands to put through a deal and in such cases, it is very difficult to arrive at a common base document and takes good amount of time for consensus building amongst the different types of lenders. A body similar to the Asia Pacific Loan Market Association (APLMA) should be formed by the major banks and financial institutions in India which shall consult various stakeholders and make standardised loan documents. From time to time, the body would also be responsible for making amendments to such	RBI, IBA	Short Term

Recommendation	Rationale and Description	Concerned Authority	Implementation Timeline
	documents as per the need of the hour and the present business requirements		
Project Preparation Facility	The Union Finance Minister in the Budget Speech 2020-21 has proposed to setup a Project Preparation Facility(‘PPF’) . PPF shall address the issue of lack of appropriately structured bankable projects due to inadequate preparatory work, unbalanced risk allocations, contractual frameworks, poor demand assessment etc. and ensure the adequate flow of capital from private sector. A dedicated project preparation facility (PPF) set up for Project Development activities would assist in translating the demand for infrastructure into credible projects which could help the investor in weighing the risk return trade off. Project preparation includes the work required towards taking projects from a concept to award of contract	DEA	Medium Term

(B) Recommendations Specific to brownfield asset financing/refinancing

Recommendation	Rationale and Description	Concerned Authority	Implementation Timeline
Expanding the scope of take-out financing and stimulating refinancing of operational assets	<u>Takeout Financing</u> The current takeout financing scheme of IIFCL permits takeout of a maximum of 51% of total outstanding project loan, resulting in suboptimal outcome as both residual capital and management bandwidth in monitoring the asset remains blocked for the taken-out institution. Hence, it is recommended that 100% of exposure of the institution financing the construction be taken out. <u>Refinancing</u> In respect of existing project loans to Infrastructure companies, banks and NBFC's may refinance such loans by way of full or partial take-out financing, even without a pre-determined agreement with other banks / FIs, and fix a longer repayment period, and the same would not be considered as restructuring in the books of the existing as well as taking over lenders, if the following conditions are satisfied: • The project should have started commercial operation after achieving Date of Commencement of Commercial Operation; • The repayment period should be fixed by taking into account the life cycle of and cash flows from the project, and, the existing and new lenders should be satisfied with the viability of the project. Further, the total repayment period should not exceed 85% of the initial economic life of the project / concession period in the case of PPP projects;	RBI	Immediate - Short-Term

Recommendation	Rationale and Description	Concerned Authority	Implementation Timeline
	• The loan account should be standard in the books of the existing lenders and there should no continuing payment default at the time of the refinancing; • In case of partial take-out, a significant amount of the loan (a minimum 25% of the outstanding loan by value) should be taken over by a new set of lenders from the existing financing banks/Financial Institutions; and • The promoters should bring in additional equity, if required, so as to reduce the debt to make the current debt-equity ratio and Debt Service Coverage Ratio (DSCR) of the project loan acceptable to the lenders. <u>Reintroduction of 5-25 scheme</u> 5/25 Scheme is not a restructuring scheme. Therefore, the Feb 12, 2018 circular should exclude this. The 5/25 refinancing is similar to the practise in the market (like Takeout Financing, Working Capital Financing etc.) and RBI has already issued clarifications that such refinancing may not be construed as restructuring.		
	<u>Refinancing/Take-Out Guarantee</u> For addressing issues on availability of long-term financings beyond 10 years, government guarantee on stub portions which will need to be refinanced at the end of the bond tenor can be explored. This will give confidence to investors to run refinancing risk beyond say 10/12 years.	Proposed New DFI	Short/Medium Term

Recommendation	Rationale and Description	Concerned Authority	Implementation Timeline
Credit guarantee fund/first loss support through a specialized institution.	Pension/ insurance funds usually prefer to invest in AA (or above) rated bonds only while the majority of bonds of infrastructure projects/ companies are normally rated BBB to A. Credit enhancement of these bonds to AA category would bring a large set of projects into the "eligible" category for investments by pension and insurance companies. Hence it is recommended to implement Credit Enhancement mechanisms providing first-loss support/guarantee to boost investor confidence help deepening of corporate bond markets. Such guarantees structures can be channelled by suitably scaling up capabilities of existing institutions (e.g. IIFCL) or through a specialized financing institution.	MoF	Short-Medium Term
Credit Enhanced Infrastructure Asset Securitisation	Currently the asset securitization market is dominated by retail and priority sector loans. Mortgages, vehicle loans and microfinance loan constituted the three major asset class comprising 84% of the total volume in last financial year. Recently RBI on June 8, 2020 has come up with draft framework for securitisation of standard assets and a framework for sale of loan exposures. The purpose of the proposed revisions is to specify criteria to inter alia bring securitisation in line with Basel III requirements and to deepen the secondary loan trading market. The following interventions may be considered for deepening of securitization market in India • Clarity from MCA on validity of contracted credit enhancement for securitised cash flow pools	RBI, MCA	Short-Medium Term

Recommendation	Rationale and Description	Concerned Authority	Implementation Timeline
	• Addressing possible conflict in pooling of assets • Expansion of interest rate swaps market for domestic loans • Institutional monitoring mechanism		
	Market driven interest rates Currently in India, Loans are priced based on respective banks' MCLR which is not a traded benchmark. Since PTC investors favour fixed returns. In the absence of any swap available for converting floating bank rates to fixed, the risk will be borne by the SPV. This will result in lower credit rating for the PTC's and require higher support from the originator In order to mitigate this issue, It is recommended moving to a market determined benchmark rate/Floating rate risk to be borne by the investors	RBI/MoF	Short/Medium Term
	Prepayment Risk avoidance Currently, there is a risk of the underlying loans in a securitized pool being prematurely repaid by the borrower. Current RBI guidelines on securitization do not allow revolving assets to be securitized. Hence, the prepayment risk will have to be borne by the investors. To mitigate this, appropriate treatment of prepayment of loans need to be accommodated in the regulations.	RBI	Short Term

Recommendation	Rationale and Description	Concerned Authority	Implementation Timeline
	<u>Setting up a third-party Servicing Agency</u> As of now, there exists conflict of interest between the originators business and PTC holders. In case of any difficulties in the originators business, the PTC holders do not have an option to shift servicing agents. Hence it is recommended that Public sector banks with strong collection operations may setup a separate third-party servicing agent business	RBI/MoF	Short/Medium Term
	<u>Standardized clause in loan agreement for allowing banks to securitize their share</u> Majority of the infrastructure loans in the country are provided by multiple bankers through a syndicate for the purpose of risk diversification and to comply with regulations on exposure limits. However, a lender has to seek NOC from each of the lenders for securitization of the underlying loan. Sometimes, there are clauses in the loan agreement specifically prohibiting the securitization of loans at a later stage. Hence it is recommended that a standardized clause may be added to loan agreements allowing lenders to securitize their portion of the loan without any prohibitions.	RBI/IBA	Short Term
Rationalisation of provisioning norms for restructured accounts	The existing prudential framework for resolution of stressed asset (Ref: RBI/2018-19/203 DBR.No.BP.BC.45/21.04.048/2018-19)	RBI	Immediate-Short Term

Recommendation	Rationale and Description	Concerned Authority	Implementation Timeline
	accords differential provisioning treatment for the residual debt for resolution plans implemented with or without change in ownership. In case of change in ownership, the residual debt can be immediately classified as standard thus saving on progressive provisioning requirement for lending institutions, which shall not be the case where resolution plan is implemented with the same sponsor/promoter despite the fact that unsustainable debt is fully provided in the books and carved out from the loan book. The fundamental risk profile of cashflows supporting the residual debt is likely to remain the same with or without change in management. Rationalisation/uniform treatment of asset classification, with or without change in management shall help the lending institution in conserving capital by saving on incremental provisioning. Therefore, it is recommended that this dispensation may be made available to large projects which have gone through detailed project appraisal and due diligence at the time of sanction of loan and the reasons of stress are beyond the control of promoters/sponsors.		

(C) Recommendations Agnostic to Asset lifecycle

Recommendation	Rationale and Description	Concerned Authority	Implementation Timeline
Withholding tax exemption on Masala bonds for 12 months	In line with NIP Task Force recommendation for a positive tax-free or low-tax regime for long-term bonds, exemption from with-holding tax for raising funds through issue of masala bonds for a period of 12 months (on the lines as permitted in FY2019) may be permitted. This would enable additional FPI investments in banks, NBFC-IFCs and IDF-NBFCs which would be used to financing/refinance infrastructure projects. A similar dispensation (exemption from withholding tax for masala bonds) was provided by the Govt of India for a short period for part of the year in FY 2019 which resulted in significantly increased fund raising through masala bonds by almost 4x as compared to the period in which this benefit did not exist. Once the masala bonds are issued for the 1st time with the help of the withholding tax exemption window during the first 12 months and the Indian financial institutions establish themselves as a reputed issuer with sufficient liquidity (trading) in its bonds, they will be able to continue to tap this market for more funds in future years as well, even without the withholding tax.	RBI	Immediate-Short Term
Tax Paid Bonds	Government owned banks, NBFC-IFCs and their subsidiaries may be allowed to issue tax paid bonds to tap funding from retail investors. The proposed tax paid bond features would be a combination of both the taxable bond and tax-free bond. Proposed tax-paid bonds will have no tax implications as such on the investors. Tax will be deposited to the government by Issuer. Further, A special tax rate of 10% may be notified to make the	MoF	Immediate-Short Term

Recommendation	Rationale and Description	Concerned Authority	Implementation Timeline
	instrument attractive. The tenor of the bonds would be long term only i.e. 10-20 years. Tax incidence on issuer will ensure that there is no administrative burden on investors or tax authorities. The coupon rate could be equivalent or slightly higher than the prevailing coupon rate / yield on the tax-free bond. This will result in higher yield to the investors and unlike Tax free bonds, government will not lose its entire tax revenues.		

Annexure V

Analysis of Kelkar Committee Recommendations

Introduction

The note summarizes major structural recommendations of Kelkar Committee Report[12](‘Report’), their rationale and their current status of implementation. A holistic implementation of such recommendations shall foster confidence and reinvigorate private sector investment in infrastructure PPP’s in the country. For ease of reference, the recommendations are grouped under following three pillars:

i. Recommendations that shall facilitate development of a strong foundation for implementation of PPP’s in India.
ii. Recommendations that shall facilitate development of enabling ecosystem for reinvigorating investor confidence.
iii. Recommendations that shall facilitate capacity building and prepare ground for mature PPP’s.

Although Kelkar committee recommendations are specific to PPP projects, a preferred mode of implementation of infrastructure projects, not all projects are suitable to be implemented under this route. Determining suitability of project towards PPP framework should be the first step towards project implementation. It’s suggested to incorporate a ‘PPP Primacy Test’, that shall examine whether the project is capable of being funded by private capital in PPP format. Only if test of PPP primacy fails (e.g. in social sector, agricultural infrastructure or projects having superior economic returns but lower financial returns) should such projects be put up for public funding. Conducting PPP primacy test may be entrusted to specialized institution such as 3P-India.

Given the context, role of new DFI becomes extremely critical in catalyzing private sector investment in infrastructure. The new DFI can foster PPP closures through innovative support, guarantees and credit enhancement measures attracting private sector investments.

A. Developing strong foundation for facilitating implementation of PPP’s

Amendment of Prevention of Corruption Act, 1988

Background and Rationale: The Prevention of Corruption Act, 1988 does not distinguish between genuine ‘errors in decision-making’ and ‘acts of corruption’.

Every wrong decision does not have a malafide intent and decisions are often judged ‘wrong’ only with the benefit of hindsight. Only malafide action by public servants and not errors, or decisions taken with bonafide intention should be punishable. A clear path to distinguish between error and malafide action will safeguard and facilitate bonafide decision making by bureaucrats and public servants. This shall help in avoiding policy paralysis and ensure quick and objective decision making for the benefit of all stakeholders.

[12] Report of the Committee on Revisiting and Revitalising the PPP Model of Infrastructure

Current Status: The Prevention of Corruption Act was amended in 2018 to bring it in line with United Nations Convention against Corruption 2005. The amendment is a positive development in respect of anti-graft regime; however, it falls short in protecting public servants for actions taken with bonafide intentions.

Subgroup's View: *A clear and objective definition of 'error' and 'malafide intent' to ensure that decisions taken with bonafide intent are protected by a statute shall go long way in expediting decision-making process in government bodies and public financial institutions.*

<u>*Quick and Efficient Dispute Resolution Structures*</u>

Background and Rationale: The Report recommends PPP contacts to have clearly articulated dispute resolution structures that demonstrate commitment of all stakeholders and provide flexibility to restructure within the commercial and financial boundaries of the project. The recommendation includes setting up sector specific monitoring and regulatory committees, independent of involvement of public sector, to periodically revisit contractual and commercial relationships between parties for balanced risk sharing.

Current status: The Public Contracts (Resolution of Disputes) bill is yet to be tabled in the Parliament. Amendments in Arbitration and Conciliation Act streamlining the arbitration process for commercial contracts were notified in 2019.

Subgroup's View: *The latest amendment of Arbitration and Conciliation Act 2019 falls short of interventions required for streamlining the dispute resolution process for PPP's. Due to their unique characteristics, the dispute resolution framework of PPP's must be distinct from that of other commercial contracts. An objective framework mandating timebound resolution of disputes shall foster confidence of both investors and lenders in financing PPP projects.*

<u>*Independent Sector Regulator*</u>

Background and Rationale: Setting up independent regulators is critical for sectors going in for PPPs. Independent regulators with a unified mandate that encompasses activities in different infrastructure sub sectors shall ensure harmonized performance, faster and smoother implementation of the projects. Independent sector regulators are also essential for quick and expeditious decision making.

Current Status: Regulatory Reforms Bill is yet to be tabled in parliament.

Subgroup's View: *An independent regulator, technical and/or commercial, avoids potential conflict of interest and fosters stakeholder confidence on just and equitable resolution. A multisectoral regulator shall prevent multiple interpretations of similar disputes across sectors, thus providing guidance and a clear path of implementation to stakeholders in other sectors. With the current push for privatization of strategic sectors such as Railways, an independent sector regulator shall go a long way in encouraging private sector participation in such initiatives.*

B. Developing enabling ecosystem for reinvigorating investor confidence

Objective Renegotiation Framework

Background and Rationale: Typically, infrastructure PPP projects span 20-30 years and it is difficult to accurately estimate project cash flows at the time of award of contract. Further, the developer, who invests money in a project over a 4-5 year construction period, often loses bargaining power related to tariffs and other matters in case there are abrupt changes in the economic or policy environment, which are beyond his control, giving the government authority and an upper hand over the private developer after project completion.

In certain cases, the government may have a different interpretation of reasons for a particular delay, while a private developer might want to attribute a delay to reasons beyond his control. The absence of independent regulators in infrastructure sub-sectors further weakens the private sector's capacity to appeal against unwarranted delays.

An objective renegotiation framework under concession agreement shall ensure an equitable and balanced outcome for stakeholders.

Current status: DEA has issued guidance note for developing a framework for renegotiation of PPP contracts ('Renegotiation Framework') with focus on the National Highway and Major Port concessions[13]. The model clauses based on established thresholds for renegotiation are being drafted.

Subgroup's View: *An objective renegotiation framework shall not only address 'Obsolescing Bargain' but shall also protect investor returns and avoid misuse of renegotiation option by the authority. It is essential that model clauses incorporating objective Renegotiation Framework developed by DEA is notified on priority.*

Resolution of Legacy Issues

Background and Rationale: The deteriorating asset quality of the Indian banking system undermines the viability of the banking system. Situation-specific efforts made to address insolvency issues in past have not succeeded in addressing the problem. Thus, there is a need to evolve a suitable, time bound mechanism to expeditiously evaluate and address the circumstances that pose imminent threats to the economic foundation of any PPP project.

Considering the pervasive nature of the problem, only a statutorily established, credible, empowered, multi-disciplinary expert institutional mechanism should deal with the complex issues involved.

The Report suggests a two-tier mechanism comprising of Infrastructure PPP Project Review Committee ('IPRC') and Infrastructure PPP Adjudication Tribunal ('IPAT') for resolution of legacy

[13] http://pppinindia.com/NPBCP_images/PDFs/DEVELOPING%20A%20FRAMEWORK%20FOR%20RENEGOTIATION%20OF%20PPP%20CONTRACTS.pdf.

issues. It’s further recommended that such a statute be enacted under Article 323B of constitution for its seamless implementation.

The Report suggests that learnings from highway sector may be utilized for developing sector specific institutional framework with necessary customization. Simultaneously, umbrella guidelines may be developed for such stressed projects to provide an overall framework for development and functioning of sector specific frameworks

Current status: The Committee recommendations in respect to constitution of IPRC, IPAT and development of umbrella guidelines for resolution of stress are yet to be implemented.

Subgroup’s View: *Timebound resolution of stress shall free up capital of banks and FI’s to support incremental lending. DEA in consultation with Niti Aayog may develop umbrella guidelines that can be used as a framework for sector specific resolution of stressed projects. The Kelkar committee recommendation on constitution of IPRC and IPAT along with associated framework may be implemented on priority.*

Streamlining project implementation

Background and Rationale: Report recommends setting up an institutionalized mechanism like the National Facilitation Committee (‘NFC’) to ensure time bound resolution of inter-ministerial issues and issues such as getting timely clearances and approvals during implementation of projects for their smooth running.

The Report further recommends that state support agreements should be enforced, and states asked to face punitive costs for not completing their obligations as part of centre-state initiatives.

Current Status: An Infrastructure Group chaired by the Minister, MoRTH has been set up for addressing inter-ministerial clearances and other related issues for overseeing implementation of road projects.

Subgroup’s View: *A clear mechanism to deal with extraneous issues in timebound manner shall facilitate channelizing funds towards greenfield projects. Positive enforcement of state support agreement shall ensure rebalancing of risk leading to lower cost of delivery of the project. It’s recommended that structure like Infrastructure Group for addressing inter-ministerial concern in roads may be implemented in other sectors. Operationalizing of NFC shall help in streamlining coordination and facilitate expeditious project implementation.*

C. Capacity Building and preparing ground for mature PPP’s

Setting up 3P-India

Background and Rationale: The Hon’ble Finance Minister in the Union Budget 2014-15 speech had proposed setting up an institution to provide support to mainstreaming of PPPs, the 3P-India ('3P-I'). 3P-I shall serve as a center of excellence in PPPs, enabling research, activities to build capacity and develop more nuanced and sophisticated contracting and dispute redressal mechanisms.

Current Status: The institution is yet to be set up.

Subgroup's View: *3 P-I shall facilitate in adoption of international best practices and bring cultural and attitudinal change and encourage long term partnership between public and private sector investor. Such institution may be setup either independently or a separate cell within the new DFI proposed under NIP.*

Asset Recycling

Background and Rationale: Equity in completed infrastructure projects may be divested by offering it to long term investors, including overseas investors. This would enable channelization of both equity and long-term debt funds from overseas investors. Asset monetization may require improving PPP project's risk profile so that it is more suitable for overseas and domestic long-term investors.

Viable infrastructure projects that have stable revenue flows after EPC delivery may be considered for monetization by providing O&M PPP opportunities. The authority will be able to free up budgetary funds for fresh EPC and start a virtuous cycle of fresh investment fed by additional revenues.

Current Status: Asset Recycling has been implemented successfully by NHAI for operating road assets.

Subgroup's View: *The NIP envisages around INR 2-3 Lac crores to be raised through asset recycling of completed infrastructure project. The successful asset recycling experience in Road sector may be leveraged for other asset classes having similar characteristics (e.g. Power Transmission). Further, Niti Aayog in consultation with DEA may develop model documents for asset recycling (both equity divestment and OMT) that can be used to expedite implementation.*

Flexibility in Financial Structuring

Background and Rationale: The Report suggests constitution of Bond Guarantee fund for credit enhancement of PPP projects. The Report recommends regulators of domestic pension, insurance and long-term funds may be encouraged to allow investment in PPP SPVs with a lower than AA rating that are appropriately credit enhanced. Further, active investment in take-out financing vehicles, including infrastructure debt funds (IDFs) and infrastructure investment trusts (InvITs), which de-risk returns, may also be encouraged.

Banks and NBFC's should be encouraged to issue zero coupon bonds. The concession agreement should facilitate financial structuring such as automatic refinancing to attract broad pool of investors.

Current status: Recommendations related to ZCB, INVIT and IDF are being implemented. Certain policy tweaks are pending. Proposal for setting up a dedicated credit enhancement institution is under active consideration.

Subgroup's View: *Policy tweaks are required to optimizing the time required for issuance of ZCB and allowing IDF to participate in financing of asset recycling (ToT) and Airport assets. Changes in PPP contracts reflecting provision of automatic refinancing may be incorporated. Further the institution for providing credit enhanced product to infrastructure projects may be operationalized on priority to attract alternate pool of investors.*

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