Corporate Debt Restructuring -- A revival mechanism for companies

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Abstract:
In spite of their best efforts and intentions, sometimes corporates find themselves in financial difficulty because of factors beyond their control and also due to certain internal reasons. For the revival of the corporates as well as for the safety of the money lent by the banks and financial institutions, timely support through restructuring in genuine cases is called for. This paper highlights the fact that there is a need to create awareness about Corporate Debt Restructuring as a revival mechanism.

Keywords:
Corporate debt restructuring, corporates, revival, bankrupt.

Introduction

Corporate Debt Restructuring (“CDR”) mechanism is a voluntary non statutory mechanism under which financial institutions and banks come together to restructure the debt of companies facing financial difficulties due to internal or external factors, in order to provide timely support to such companies.

The intention behind the mechanism is to revive such companies and also safeguard the interests of the lending institutions and other stakeholders. The CDR mechanism is available to companies who enjoy credit facilities from more than one lending institution. The mechanism allows such institutions, to restructure the debt in a speedy and transparent manner for the benefit of all.
The objects of the CDR mechanism, as enunciated by the Reserve Bank of India, the central bank of the country are-

“To ensure timely and transparent mechanism for restructuring of corporate debts of viable entities facing problems, for the benefit of all concerned.”

“To aim at preserving viable corporates that are affected by certain internal and external factors”.

“To minimize the losses to creditors and other stakeholders through an orderly and co-ordinated restructuring programme”.

**Working of Corporate Debt Restructuring (CDR) Mechanism:**

The CDR mechanism has a three tier structure-

[I] CDR standing Forum – The representative general body of banks and financial institutions participating in the CDR system. It is a self empowered body which lays down the policies and guidelines, such as the timeframe within which a unit shall become viable and the minimum level of promoter contribution. It also monitors the progress of corporate debt restructuring. The Forum also provides a platform for borrowers and creditors to amicably evolve policies for working out debt restructuring plans in the interest of everyone. The CDR Standing Forum comprises of Chairman and Managing Director, Industrial Development Bank of India Ltd; Chairman, State Bank of India; Managing Director and CEO, ICICI Bank Limited; Chairman, Indian Banks’ Association as well as Chairmen and Managing Directors of all banks and financial institutions participating as permanent members in the system. Most of the big financial institutions in India that lend money to companies are permanent participating members of the standing forum.

CDR Core Group – A CDR Core Group is carved out of the CDR Standing Forum to assist the Standing Forum in convening the meetings and taking decisions relating to policy, on behalf of the Standing Forum. The Core Group consists of Chief Executives of Industrial Development Bank of India Ltd., State Bank of India, ICICI Bank Ltd, Bank of Baroda, Bank of India, Punjab National Bank, Indian Banks’ Association and Deput Chairman of Indian Banks’ Association representing foreign banks in India. It lays down policies and guidelines to be followed by the CDR Empowered Group and CDR Cell for debt restructuring, including policies regarding the operational difficulties faced by the CDR Empowered Group. It also prescribes time frame, and modalities for the enforcement of time frame for cases that are referred for the CDR mechanism.

[II] CDR Empowered Group- The individual cases of corporate debt restructuring are decided by the CDR Empowered Group. This group consists of Executive director level representatives of Industrial
Development Bank of India Ltd., ICICI Bank Ltd. and State Bank of India as standing members, in addition to ED level representatives of financial institutions and banks who have an exposure to the concerned company. While standing members facilitate the conduct of the group’s meetings, voting is in proportion to the exposure of the creditors only. The CDR Empowered Group considers the preliminary report of all cases of requests of restructuring, submitted to it by the CDR Cell. After the Empowered Group decides that restructuring of the company is prima-facie feasible and the enterprise is potentially viable in terms of the policies and guidelines evolved by the Standing Forum, the detailed restructuring package is worked out by the CDR Cell in conjunction with the Lead Institution, which is the institution which has the highest exposure in the concerned company. The CDR Empowered Group examines the viability and rehabilitation potential of the company and approves the restructuring package within a specified time frame of 90 days, or at best within 180 days from the date on which it received the reference. The decision of the CDR Empowered Group is final and if it finds the restructuring package feasible and approves the scheme then the company is put on the restructuring mode. If restructuring is not found viable, the creditors are then free to take necessary steps for immediate recovery of dues and / or liquidation or winding up of the company, collectively or individually.

[III]

CDR Cell - The CDR Cell makes the initial scrutiny about the health of the company and the role of corporate governance and scrutinizes the of the proposals received from borrowers / creditors, by calling for proposed rehabilitation plan and other information and puts up the matter before the CDR Empowered Group within one month to decide if rehabilitation is prima facie feasible. If found feasible, the CDR Cell will proceed to prepare detailed Rehabilitation Plan with the help of creditors and, if necessary with experts to be engaged from outside.

Reference to CDR system
Reference to the CDR Cell may be made by (i) one or more creditor who have minimum 20% share in either the working capital or term finance of the company in respect of which the reference is made, or (ii) by the concerned corporate if such corporate is supported by a bank or financial institution having 20% stake as above.

Hypothetical Case Study
Assume that a company has the following structure of debt on its books;
(a) Domestic bank lending- 45%
(b) External commercial borrowing- 38%
(c) FCCBs (Foreign currency convertible bonds) – 17%

In a CDR mechanism for such company there is an omnipresent spectre of favour towards domestic banks as they may choose not to include the lenders falling under category (b) and (c) in the CDR mechanism. Once the final restructuring package is formulated it will most likely have an effect on lenders falling under category (b) and (c) as well. For example where as per the terms of the package the company decides to sell some of its assets on which the foreign lenders had a charge. CDR Empowered Group has quasi judicial powers and its decision and approved package are final. The only recourse left to the foreign lenders is to petition the court for winding up of the company and not give a no objection certificate which is usually required from the Lenders for sale of an asset by the company.

Eligibility criteria
The scheme will not apply to accounts involving only one financial institution or one bank. The CDR mechanism will cover only multiple banking accounts / syndication / consortium accounts of corporate borrowers with outstanding fund-based and non-fund based exposure of Rs.10 crore and above by banks and institutions.
The Category 1 CDR system will be applicable only to accounts classified as 'standard' and 'sub-standard'. There may be a situation where a small portion of debt by a bank might be classified as doubtful. In that situation, if the account has been classified as ‘standard’/ ‘substandard’ in the books of at least 90% of creditors (by value), the same would be treated as standard/ substandard, only for the purpose of judging the account as eligible for CDR, in the books of the remaining 10% of creditors. There would be no requirement of the account / company being sick, NPA or being in default for a specified period before reference to the CDR system. However, potentially viable cases of NPAs will get priority. This approach would provide the necessary flexibility and facilitate timely intervention for debt restructuring. Prescribing any milestone(s) may not be necessary, since the debt restructuring exercise is being triggered by banks and financial institutions or with their consent.

While corporates indulging in frauds and malfeasance even in a single bank will continue to remain ineligible for restructuring under CDR mechanism as hitherto, the Core group may review the reasons for classification of the borrower as willful defaulter specially in old cases where the manner of classification of a borrower as a willful defaulter was not transparent and satisfy itself that the borrower is in a position to rectify the willful default provided he is granted an opportunity under the CDR mechanism. Such exceptional cases may be admitted for restructuring with the approval of the Core Group only. The Core Group may ensure that cases involving frauds or diversion of funds with malafide intent are not covered.

The accounts where recovery suits have been filed by the creditors against the company, may be eligible for consideration under the CDR system provided, the initiative to resolve the case under the CDR system is taken by at least 75% of the creditors (by value) and 60% of creditors (by number). BIFR cases are not eligible for restructuring under the CDR system. However, large value BIFR cases, may be eligible for restructuring under the CDR system if specifically recommended by the CDR Core Group. The Core Group shall recommend exceptional BIFR cases on a case-to-case basis for consideration under the CDR system. It should be ensured that the lending institutions complete all the formalities in seeking the approval from BIFR before implementing the package.

**Disclosure**

Banks / FIs should also disclose in their published annual Balance Sheets, under "Notes on Accounts", the following information in respect of corporate debt restructuring undertaken during the year:

a. Total number of accounts total amount of loan assets and the amount of sacrifice in the restructuring cases under CDR.

b. The number, amount and sacrifice in standard assets subjected to CDR.

c. The number, amount and sacrifice in sub-standard assets subjected to CDR.

d. The number, amount and sacrifice in doubtful assets subjected to CDR.

**Case Study**

**Details about Gammon India's corporate debt restructuring:**

Loan repayment to be stretched to 10 years, Gammon India to get moratorium of two years on servicing it.

Creditors have approved a Rs.13,500 crore corporate debt restructuring (CDR) package for Gammon India Ltd, offering the engineering and construction company a breather from a crisis brought on by slower economic growth and project delays, but adding to the growing pile of restructured loans at banks.

The CDR cell, a forum of lenders, has cleared the proposal and the process of loan restructuring will start soon, said two bankers familiar with the proposal. They declined to be named because of the sensitive nature of the matter.

Under the terms agreed for the CDR, the loan repayment will be stretched to 10 years and Gammon India will get a moratorium of two years on servicing it. The interest rate on the loan amount will be reduced by 1-2 percentage points to 11-12%.

“The loan recast will definitely aid an improvement in the operations of the company. Banks have approved this case, recognizing that there is a genuine need for the firm to avail this facility,” said a
banker with a state-run bank, one of the creditors of Gammon India, who also did not want to be named.

Gammon India and other infrastructure companies are struggling amid a slump in economic growth, which fell to a decade-low of 5% in the year ended March, as companies put new investments on hold. Infrastructure firms have also been battling a credit crunch amid high borrowing costs that made it difficult for many borrowers to repay debt. Delays in securing mandatory government approvals have stalled project execution and impeded cash flows at several infrastructure firms. In April, according to finance ministry estimates, about 215 infrastructure projects were stalled, involving a collective outlay of over Rs.7 trillion.

Shares of Gammon India surged as much as 9.6% in intra-day trading on investor speculation about the loan recast. They closed up 3.481% at Rs.19.4 on the BSE on a day the benchmark Sensex gained 1.22% to 19,410.84 points.

In Gammon India’s case, out of the total debt amount, banks have a fund-based exposure of aboutRs.3,500 crore Fund exposure is the loan amount given by the bank to the company. Non-fund exposure is mainly in the form of performance guarantees or similar facilities. Leading lenders to the company include ICICI Bank Ltd and Canara Bank Ltd. Banks will restructure the non-fund exposure of the company to the extent at which the facility has been used, said one of the officials cited above.

As of 31 May, 2013 Indian banks had loans outstanding of Rs.7.7 trillion to the infrastructure sector. Under CDR, bankers typically extend the repayment period, cut lending rates and sometimes agree to forego a part of the money that’s owed to them. Banks may also offer a repayment holiday. A CDR is approved if at least 75% of the banks by value of the loan and 60% by number agree to proposal. For the quarter ended 31 March, Gammon India reported a net loss of Rs.124.98 crore, largely because of some one-off items on its overseas operations, which included provisions made by the company in connection with investments and advances.

Gammon joins several companies that have recast loans. Analysts said banks are going ahead with loan recasts despite the higher provision they need to make on such loans, failing which they would need to categorize these loans as non-performing assets (NPAs), which attract even higher provisions. “Gammon restructuring was on expected lines. This is a good move for banks also as otherwise they would be forced to classify this as NPA,” said Hatim Broachwala, an analyst at Karvy Stock Broking Ltd.

On a cumulative basis, total restructured loans under the CDR mechanism have crossed Rs.2.29 trillion, or 4.4% of total loans given by Indian banks, as of March. The aggregate figure for bilateral loan recasts is not available, but bankers said such recasts may nearly equal the CDR figure. That would take the total restructured assets of the Indian banking industry to around Rs.4 trillion.

“IT (Gammon CDR) seems to be in the ordinary course of things,” said Vaibhav Agrawal, vice-president, research at Angel Broking Ltd. “There are going to be more such cases at least in the next 1-2 years. Probably the peak of restructuring is over but things are not getting any better.”

Indian banks began large-scale restructuring in the aftermath of the 2008 global financial crisis that followed the collapse of Lehman Brothers Holdings Inc. Indian banks have recast loans of companies across sectors such as textiles, real estate, power and gems and jewellery. About 10-15% of the restructured advances are estimated to have turned bad in the first cycle of loan recasts, but this time the proportion will be higher at around 15-20%, analysts said.

**Conclusion :**
Debt-ridden infrastructure companies could find it difficult to get back on the road to recovery, even if they're trying to fix finances. That's because companies going through the corporate debt restructuring or CDR process have been barred from applying for contracts floated by some government agencies in states like Gujarat and Andhra Pradesh. The companies going for this revival mechanism can have a bright future but still that a farfetched thought and lots of hurdles have to be cleared. The important thought over here is that “We have to realize that CDR does not mean that the company is bankrupt".
References: