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Corporate Debt Restructuring, The Current Scenario And Evaluation Of Times Ahead

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Abstract: The concept of restructuring or rescheduling loans has existed in India for several decades. Instructions and guidelines from the RBI on the renegotiation or restructuring of loans and advances date back to the late 1970s, when it was targeted towards people affected by natural calamities. Since then, the instructions have moulded into full-fledged guidelines to address the needs of companies, banks and the economic environment. Restructuring is meant to be a tool for companies facing distress due to certain external circumstances such as a general economic downturn or deterioration in a particular sector. It is not part of the ordinary insolvency law procedure since the whole idea of debt restructuring is to restore the financial health of the company and stabilise it in the long term in a sustainable manner. This article attempts to examine corporate debt restructuring in India: its history, the key aspects surrounding it, the promoters' role in the restructuring and an assessment of the times ahead. In 2001, the RBI set up the corporate debt restructuring (CDR) mechanism as a voluntary mechanism to facilitate restructuring debts of viable corporate outside the normal insolvency law process. The Indian CDR mechanism is largely based on the London Approach, formulated in the early nineties wherein creditors are encouraged to opt for out-of-court agreements following certain principles to "minimise losses to creditors, avoid unnecessary liquidation of viable debtors and offer continued financial support to viable borrowers." The approach grew from the idea that in a multi-creditor restructuring, the lenders would probably achieve better returns through collective and coordinated efforts to rescue a firm in distress, rather than force it into formal insolvency. In 2008, comprehensive guidelines for both institutional restructuring (CDR) as well as non-institutional restructuring (non-CDR) were issued; Master guidelines were issued in 2012. Following the report of the working group, the RBI revised the CDR Guidelines on 30 May 2013, bringing in several new and important changes. The CDR regime is briefly described below.
Keywords: - Corporate, Debt, Restructuring.

I. INTRODUCTION

The concept of restructuring or rescheduling loans has existed in India for several decades. Instructions and guidelines from the RBI on the renegotiation or restructuring of loans and advances date back to the late 1970s, when it was targeted towards people affected by natural calamities. Since then, the instructions have moulded into full-fledged guidelines to address the needs of companies, banks and the economic environment.

Restructuring is meant to be a tool for companies facing distress due to certain external circumstances such as a general economic downturn or deterioration in a particular sector. It is not part of the ordinary insolvency law procedure since the whole idea of debt restructuring is to restore the financial health of the company and stabilise it in the long term in a sustainable manner. This article attempts to examine corporate debt restructuring in India: its history, the key aspects surrounding it, the promoters' role in the restructuring and an assessment of the times ahead.

II. BACKGROUND OF CDR IN INDIA

In 2001, the RBI set up the corporate debt restructuring (CDR) mechanism as a voluntary mechanism to facilitate restructuring debts of viable corporate outside the normal insolvency law process. The Indian CDR mechanism is largely based on the London Approach, formulated in the early nineties wherein creditors are encouraged to opt for out-of-court agreements following certain principles to "minimise losses to creditors, avoid unnecessary liquidation of viable debtors and offer continued financial support to viable borrowers." The approach grew from the idea that in a multi-creditor restructuring, the lenders would probably achieve better returns through collective and coordinated efforts to rescue a firm in distress, rather than force it into formal insolvency.

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Guidelines on 30 May 2013, bringing in several new and important changes. The CDR regime is briefly described below.

III. KEY TERMS OF THE CDR MECHANISM

A. Structure of the CDR

The CDR system is implemented through a three-tier structure comprising the CDR standing forum and its core group; the CDR empowered group; and the CDR cell. The standing forum is a self-empowered body comprising all the banks and financial institutions participating in the system and is responsible for laying down guidelines and monitoring the process of corporate debt restructuring. The empowered group decides individual cases of restructuring and is comprised of representatives from banks and financial institutions at the executive director level. The CDR cell assists the standing forum and empowered group in all their functions.

B. Eligibility for restructuring under CDR

The CDR mechanism is a voluntary, non-statutory system based on contracts signed by the borrowers and lenders (debtor-creditor agreements) and inter se agreements between the lenders (inter-creditor agreements). Restructuring would generally involve the alteration of the repayment period, amounts repayable, amount of instalments or the interest rate.

Only corporate with an outstanding debt of over 100 million rupees are eligible for restructuring. Anyone, or more than one creditor having a minimum 20 per cent share in either the working capital or term finance, or a corporate supported by such a creditor, may make a reference for CDR. The CDR mechanism is also available in cases where recovery suits or BIFR cases are filed.

C. Time frame and procedure under CDR Mechanism

After a reference to the CDR is made, and the 20 per cent vote of the lenders is secured, the CDR cell will conduct the initial scrutiny of the proposals by calling for a flash report from the lenders to be submitted within one month. The standing forum will approve the report before the cell places it for consideration before the empowered group within 30 days to decide its feasibility. Once the flash report has received a super-majority vote, the final restructuring proposal will be submitted to the EG for approval within 90 days (this may be extended to 180 days) of the admission of the flash report and upon receipt of a super majority vote to the final restructuring package, a letter of approval (LOA) shall be issued to the lenders. Within 90 days from the date of issue of the LOA, the creation of security must be completed and the master restructuring agreement is required to be executed for the package to be implemented before 120 days from the date of the LOA.

D. Borrower classification

The CDR Guidelines classify borrowers into four categories in order to determine the standard terms and conditions applicable under the CDR mechanism. These categories are based on the causes of the distress faced by the borrower-corporate and the actions of its promoters and directors. The determination of which category a borrower-corporate will fall into lies with the CDR empowered group at the time when the final restructuring proposal is approved.

E. Standstill clause

Every inter-creditor agreement and debtor creditor agreement under the CDR mechanism, will include a standard standstill clause wherein the participating lenders agree to not take any legal action against the borrower, in respect of recovery of dues, from the date of the first meeting by the CDR EG to consider the reference (Commencement Date) up to 90 days in order to allow for the debt restructuring process to be finalised (this may be extended to 180 days). However, this does not cover any criminal action.

F. Measuring the viability of an account

Unless financial viability is established and there is reasonable certainty of repayment from the borrower within the terms of the restructuring package, no account should be taken up for restructuring. The RBI has provided that the benchmarks for viability applicable to CDR cases shall also apply to non-CDR cases and the banks may make appropriate adjustments, if any, for specific sectors. Banks must also ensure viability is achieved in eight years for infrastructure activities and five years for other cases from the date of restructuring.

G. Asset classification norms

In 2012, accounts classified as "standard assets" would retain their asset classification on restructuring and non-performing assets, on restructuring, were not allowed to slip into lower categories. However, according to international best practices, accounts are to be immediately downgraded on restructuring. Therefore, the WG recommended that regulatory forbearance be withdrawn, to take effect after a period of two years. Consequently the RBI provided that from 1 April 2015, standard accounts will be downgraded to substandard immediately upon restructuring and NPAs will slip into lower asset classification categories.

H. Promoter's contribution and sacrifice

Under the 2012 Guidelines, one of the criteria for regulatory forbearance was that the promoters' sacrifice and promoters' contribution should at amount to at least 15 per cent of the bank's sacrifice. The WG felt however, that this proportion was not sufficient and the promoters needed to show that they had "skin-in-the-game". The RBI has now instituted that the promoters' sacrifice and promoters' contribution should be a minimum of 20 per cent of the diminution of the fair value of the advance or 2 per cent of the restructured debt, whichever is higher. This is a minimum stipulation and banks may insist on a higher sacrifice where larger exposures are concerned. Further, the promoters' sacrifice should be brought upfront while extending the restructuring benefits to the borrowers.

I. Right of recompense

The Guidelines provide that every restructuring package must have a standard recompense clause for the benefit of the lenders to recoup, whether fully or partially, the sacrifice made by the lenders pursuant to the approved CDR package. 100 per cent of the recompense amount, as calculated, is payable for exit of companies from the system. Pursuant to the recommendation of the WG, the recompense amount to be paid to the CDR lenders at the time of exit has been relaxed to a minimum of 75 per cent. It was also recommended that the 'recompense' clause be mandatory for non-CDR restructurings as well.

J. Conversion of debt into equity

As per the earlier norms, lenders were allowed to convert a part of the debt outstanding beyond seven years from the date of restructuring into equity. However, no regulatory cap on the amount of debt which could be converted was specified. This led to cases where a large proportion of debt would be converted into preference shares having no market value and adversely affecting the lenders. Following the WG recommendations, the 2013 Guidelines provide a cap of 10 per cent of the restructured debt which can be converted into preference or equity shares. Further, only listed companies can avail of this provision.

K. Regulatory forbearance in asset classification

One of the conditions for availing of regulatory forbearance in asset classification is that the account should not be "repeatedly restructured". However, the RBI has advised the CDR cell that restructurings done a second time will not fall within "repeated restructuring" if there is no negative NPV on the discounting of cash flows. The WG has recommended that this advice be withdrawn since it could lead to the restructuring of unviable accounts.

L. Personal guarantee of promoters

A personal guarantee of promoters is mandatory as per the 2012 Guidelines in order to obtain an asset classification benefit, except for cases where the unit is affected by external factors pertaining to the economy or industry. However, the limits of "economy and industry" are hard to formulate, and the common refusal by promoters to provide a personal guarantee prompted the WG to recommend that the provision be made mandatory in all cases of restructuring. In addition, a corporate guarantee is no substitute for a personal guarantee. It was felt that such a change was necessary to balance the commitment of the promoters to the restructuring process to that of the lenders. The RBI has implemented the recommendation with the proviso that a corporate guarantee will be accepted in cases where the promoter is a corporate body or if individual promoters cannot be clearly identified.

M. The Companies Act 2013 and other relevant laws

Section 230 of the Companies Act 2013 includes a new provision for companies proposing a merger or arrangement, to disclose to the National Companies Law Tribunal in an affidavit, a past or present scheme of debt restructuring and particulars thereof, which scheme must have the consent of not less than 75 per cent of the secured creditors by value. The details to be submitted to the Tribunal include a creditor's responsibility statement; safeguards for the protection of other secured and unsecured creditors; an auditor's report that the fund requirements of the company after restructuring shall conform to the liquidity test; a statement where the company proposes to adopt the CDR guidelines; and a valuation report of the company assets.

The guideline issued by the Securities and Exchange Board of India on issue of shares by a listed company provides flexibility on the lock-in of a fresh issue of shares that have been issued pursuant to a CDR process. These guidelines also provide flexibility for pricing the securities that are issues under the CDR process. The Indian Takeover Code also exempts an acquirer of shares of a listed CDR company from making an open offer where the shares are acquired under the CDR process approved by the requisite number of shareholders by way of postal ballot.

IV. CDR TRENDS TODAY

The number of restructurings, both CDR and non-CDR have sky-rocketed in the past year. As per the latest figures, 415 cases have been approved under CDR amounting to about 2.5 trillion rupees. As compared to a year earlier, the amount of debt approved has increased by almost 50 per cent. In 2012 alone, 126 cases of banks being approached for debt restructuring were recorded, amounting to 840 billion rupees. In the financial year 2012–2013, a record-breaking 99 cases were referred as compared to 87 in 2011-12.

Table 1: *Overall status of CDR references as of June 2013. Monetary figures in crores (one crore is 10 million rupees)*

Total References Received		**Cases Rejected/Closed**		**Cases under finalisation of Restructuring Packages**		**Total Cases Approved (including cases withdrawn/exited)**	
No. of cases	Aggregate debt	No. of cases	Aggregate debt	No. of cases	Aggregate debt	No. of cases	Aggregate debt
549	337,511	92	39,045	42	48,187	415	250,279

The figures plainly show the state of the debt recast in India today. The primary industries lining up for restructurings in terms of debt value are iron and steel, infrastructure, textiles, power and construction. The RBI has asserted that the problem today is a result of unethical and indiscriminate use of the CDR mechanism by banks and the borrower-corporate. While this may be a factor, the figures indicate a sector-wide crisis in priority sector lending, real estate and infrastructure, rather than a case of individual companies over-leveraging their accounts. The new CDR guidelines do not address sector-specific concerns but rather provide for broad-based solutions which may not help in the long-term revival of these sectors.

V. PRACTICAL CONCERNS UNDER THE CDR REGIME

During the negotiation process between the lenders, inter se, and with the borrower-corporate, there are several issues that may arise that are worth taking a look at. Invariably, promoters are hesitant to provide an unlimited and irrevocable ‘Guarantee’, which is important to note in cases where the promoter is not in control of, or responsible for the events causing the company to default. Imposing such a strict liability on promoters who no longer hold a stake in the company is not only unfair but superfluous. Moreover, a refusal by a promoter to provide a personal guarantee will only ensure that the CDR is denied and the corporate becomes a non-performing asset. The restructuring of overseas debts, or the restructuring of loans provided by non-CDR lenders, is generally restructured simultaneously or around the same time as the accounts eligible under the CDR mechanism. Once the LOA is issued, the consent of the CDR lenders is required for the restructuring of such debts. Non-conformity of the terms of the non-CDR package with the terms of the CDR package may give rise to a time consuming approval process and delay the restructuring of the other debts. Certain terms such as “moratorium”, “interest payment” and “default events” stated the original lending agreements, may be altered in the master restructuring agreement, which is considered to be sacrosanct. However, the lenders would insist that the original documents coexist with the master restructuring agreement, to the extent that the same are not inconsistent which each other. These may cause practical difficulties as many of the provisions of the master restructuring agreement may indirectly override some of the terms of the original agreements.

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Restructuring requires a security to be created in favour of the CDR lenders. This can be challenging in cases where both CDR and non-CDR lenders are part of a consortium and the non-CDR lenders have not agreed to the terms offered to the CDR lenders.

VI. CONCLUSION

If the CDR process is to be judged from an independent perspective, it could be said that it is a beneficial process and mechanism which endeavours to help viable corporate to come out of financial crisis which may be faced by them due to several external factors. This mechanism is a step prior to liquidation and insolvency, which may not benefit a company or its lenders. Having said this, the reason for the restructuring often arises on account of borrowers' indiscipline and lack of prudence of the banks at the time of sanctioning of the loan. Thus, although CDR is an essential mechanism, the root causes for the loans going bad need to be identified and removed in order to prevent more CDRs from taking place in the times ahead.

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