Debt restructure in India: learning from experience

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To save and revive viable corporate entities and for the benefit of all stakeholders including the lenders, the Reserve Bank of India (RBI) in 2001 put in place the corporate debt restructuring (CDR) mechanism. The mechanism is regulated under comprehensive RBI guidelines based on international practices.

CDR was conceived as a timely and transparent mechanism for restructuring of corporate debts of viable entities that face problems due to certain internal and external factors, and to minimize losses to creditors and other stakeholders. It is a voluntary non-statutory system for companies having a minimum outstanding exposure of ₹100 million (US$1.85 million), based on legally binding debtor-creditor and inter-creditor agreements and the principle that decisions of 75% of creditors (by value) are binding on all creditors.

Three tiers

The CDR mechanism is a three-tier structure comprising: (a) CDR Standing Forum; CDR Empowered Group (EG); and (c) CDR Cell. The mechanism may be triggered by one or more of the creditors having minimum 20% share in either working capital or term finance, or by a borrower company if supported by a bank or other financial institution having a minimum 20% share as above.

For the stipulation of CDR conditions, borrower companies are classified in four categories: class A, companies affected by external factors only; class B, companies additionally affected by weak resources, lack of vision etc.; class C, overambitious companies that have diversified; and class D: financially undisciplined borrowers.

Once the restructuring plan is approved and confirmed by the CDR EG, the CDR Cell issues a letter of approval for the restructuring package to all the lenders sanctioning within 45 days and full implementation within a further 45 days. The restructuring plan under a CDR package involves a variety of measures including rescheduling (extension of maturities), lower interest rates, debt-equity swaps, debt forgiveness and indexing of interest payments to earnings.

For successful implementation of the CDR package, a monitoring mechanism comprising a monitoring institution, monitoring committee and external agencies to carry out audit, valuation, etc., is put in place.

Growing popularity

Use of the CDR route has increased in the wake of the global economic downturn. Of 491 references received by the CDR Cell since its inception in 2001, 186 were received between March 2011 and December 2012. Creditor approval was obtained in 362 of the 491 references.

CDR should not to be seen as a stigma and sufficient time should be devoted to assessing its viability. The list of successful cases of CDR in India includes Essar Steel, Essar Oil, Jindal Steel, JSW, Ispat Industries, India Cements, Saurastra Cements, Arvind Mills, Dhampur Sugars, Mawana Sugar and Wockhardt.

The advantages which CDR offers to lenders as well as borrowers, over and above the legal procedures for recovery, have led to a sharp rise in the number and volume of advances being restructured under CDR. Banks and other lenders now more liberally opt for CDR with borrower companies, granting them another opportunity for revival and turnaround.

From its inception to 31 March 2013, CDR Cell will have successfully negotiated the exits of over 80 cases worth over ₹600 billion. There were 57 exits valued at ₹430 billion to 30 September 2012 and 25 cases valued around ₹180-200 billion are in the exit pipeline for the last two quarters of 2012-13.

The way forward

In the view of some critics, India's CDR mechanism shows a skewed trend towards big companies and that too in some specific sectors only. Any such discrimination as to size and nature of business of the borrower should be avoided.

Recently, to further facilitate easier restructuring, the upper house of parliament cleared the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Bill, 2011, which allows asset reconstruction companies, in addition to banks, to undertake CDR and to partly convert debt into equities.

While working for one of our clients, a listed public limited company with a global presence for which CDR EG approved a package for revival, we found that despite all scheduled banks and other financial institutions having consented to the CDR package, a single private lender that refused to be the part of the CDR package created obstructions that delayed the finalization and implementation of the package. To avoid such eventualities, the guidelines ought to be suitably amended to bring even private lenders under the CDR mechanism.

To ensure that CDR works for the larger benefit of the fast growing economy, it is imperative that it be available in a timely and non-discriminate manner to all classes of borrowers including small and medium-sized enterprises in priority sectors.

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