Corporate Debt Restructuring and Strategic Debt Restructuring: 
Defaulters’ Envy and Banker’s Pride

Sunita Sharma*

ABSTRACT

The world over, Non-Performing Loans (NPLs) have been a matter of concern for depositors, bank employees and management, governments and the public at large. The concept of restructuring and rescheduling loans has existed in India for several decades. Several steps have been taken by Reserve Bank of India (RBI) to reduce the amount of NPLs and one step is Corporate Debt Restructuring (CDR). During the last few years, there has been an extraordinary rise in cases referred and reworked under CDR. RBI has come out with Strategic Debt Restructuring (SDR) mechanism, through which banks have been empowered to recover their long outstanding dues from the restructured stressed companies. This research paper explains progress report of CDR cases and SDR mechanism. It also highlights the risks and challenges attached with the implementation of SDR packages.

Keywords: Joint Lenders Forum, Debtor-Creditor-Agreement, Empowered Group, Inter-Creditor Agreement, Letter of Approval, Working Group.

1.0 Introduction

Guidelines from Reserve Bank of India (RBI) on renegotiation or restructuring of loans and advances date back to the late 1970s, when it was targeted towards people affected by natural calamities. All over the world Non Performing Loans (NPLs) have been a matter of concern for depositors, bank employees management, governments and the public at large. Steps have been taken to reduce the amount of NPLs and one step taken is Corporate Debt Restructuring (CDR). NPLs are like an ice cream cone, if you don’t get rid of them, they melt all over your hands and you don’t have anything left to sell.

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The objectives of this research paper are:

- To sum up the genesis of corporate debt restructuring mechanism in India.
- To find out bank-wise, progress report of CDR cases.
- To explain Strategic Debt Restructuring (SDR) mechanism through which banks have been empowered to recover their long outstanding dues from restructured stresses companies.
- To identify and review major risks relating to lenders, defaulters, pricing of equity and operational issues attached with implementation of SDR mechanism and concludes.

2.0 Reserve Bank of India Scheme on Corporate Debt Restructuring

The RBI felt the need for revolving an appropriate mechanism for CDR in the country on the lines of similar mechanism prevalent in countries like U.K., Thailand, Korea, Malaysia etc. In response to the need, RBI issued a circular No. B.P.B.C.15/21.04.114/2000-01 on August 23, 2001. This circular outlined the CDR scheme which was later on modified to have a wider coverage. Banks are also asked to publish in their annual accounts, the following information in respect of CDR undertaken during the year: (i) total amount of loan assets subjected to restructuring under CDR; (ii) the amount of standard assets subject to CDR; and (iii) the amount of sub-standard assets subject to CDR.

In 2008, comprehensive guidelines for both institutional restructuring, as well as non-institutional restructuring were issued. Master guidelines were issued in 2012. Following the report of the Working Group (W.G.), the RBI revised the CDR guidelines on 30th May, 2013. The objectives of the scheme 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 the creditors and other stakeholders through an orderly and co-ordinated restructuring programme.

2.1 Triggering CDR mechanism

The CDR mechanism is a voluntary non-statutory system based on Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA) and the approvals by super majority of 75 per cent creditors (by value) which makes it binding on the remaining 25
percent to fall in line with the majority decision. The CDR mechanism covers multiple banking accounts, syndication / consortium accounts, where all banks and institution together have an outstanding aggregate exposure of Rs. 200 million and above. It consists of categories of assets in the books of member – creditors classified in terms of RBI’s asset classification standards. Even cases filed in Debt Recovery Tribunals / Bureau of Industrial and Financial Restructuring / and other suit-filed cases are eligible for restructuring under CDR. The cases of restructuring of standard and sub-standard class of assets are category-I, while cases of doubtful assets are covered under category-II Reference of CDR mechanism may be triggered by:
- any or more of credit institutions having a minimum 20 per cent share in either working capital or term finance or
- by the concerned borrower if supported by a bank / financial institution having minimum 20 per cent share as above. Borrower’s consent to be covered by CDR as they have to deal with only one agency and they are free to pursue their operations as going concerns.

2.2 Structure of CDR system
The edifice of the CDR mechanism in India stands on the pillar of a three-tier structure:
- CDR standing forum – is a self-empowered body comprising all the banks and financial institutions participating in the system.
- CDR Empowered Group – decides individual cases of restructuring and is comprised of representatives from banks and financial institutions.

2.3 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 (EG) 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 (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.

2.4 Promoter’s contribution and sacrifice
Under the 2012 guidelines, RBI has instituted that the promoter’s contribution should be minimum 20 per cent of the diminution of the fair value of the advance or 2 per cent of the restructuring debt, whichever is higher, the banks may insist on a higher sacrifice where larger exposures are concerned.

2.5 Conversion of debt into equity
Lenders were allowed to convert a part of the debt outstanding beyond seven years from the date of restructuring into equity. The 2013 guidelines provide a cap of 10 per cent of the restructured debt. Only listed companies can avail of this provision.

2.6 Right of recompense
The guidelines provide that every restructuring package must have a 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, minimum 75 per cent of the recompense amount, is payable for exit of companies from the system.

2.7 Personal guarantee of promoters
A personal guarantee of promoters is mandatory as per the 2012 guidelines in order to obtain an asset classification. A corporate guarantee will be accepted in cases, the promoters is a corporate body or if individual promoters cannot be identified.

3.0 CDR Trends
The number of restructurings, under CDR have sky-rocketed in the past few years, e.g. in 2010, 220 cases had been approved under CDR amounting to 1.05 trillion rupees. In the financial year ended 2015, a record breaking 530 cases were referred for CDR with an amount 40.9 trillion rupees. (Table 1) 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-corporates. The new CDR guidelines do not address sector-specific concerns, but rather provide for broad-based solutions.
Table 1: Progress Report of CDR Cases

<table>
<thead>
<tr>
<th>Year</th>
<th>Total References Received</th>
<th>Cases Rejected / Closed</th>
<th>Cases under finalization of Restructuring Packages</th>
<th>Total cases Approved (including cases withdrawn / exited / merged after approval)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of Cases</td>
<td>Aggregate Debt</td>
<td>No. of Cases</td>
<td>Aggregate Debt</td>
</tr>
<tr>
<td>September 20, 2010</td>
<td>276</td>
<td>120,864</td>
<td>34</td>
<td>7,220</td>
</tr>
<tr>
<td>June 30, 2013</td>
<td>549</td>
<td>337,511</td>
<td>92</td>
<td>39,045</td>
</tr>
<tr>
<td>June 30, 2014</td>
<td>624</td>
<td>432,843</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>June 30, 2015</td>
<td>655</td>
<td>474,002</td>
<td>125</td>
<td>70,998</td>
</tr>
</tbody>
</table>

Source: http://www.cdrindia.org/addreading.htm

Looking at Table 2, bank-wise position of number of accounts and amount under CDR, shows that SBI group, Punjab National Bank and ICICI Bank account for large amounts under CDR. The Economic Times, 19 May 2016 reported that “There is a surge in gross Non Performing Assets (NPAs) of Punjab National Bank to Rs.55818 crore in March 2016 from Rs.25,695 crore at the end of March 2015. Five other state run banks- Bank of Baroda, UCO Bank, Central Bank of India, Allahabad Bank and Dena Bank has reported increase in NPLs.”

The extraordinary rise in cases referred to and reworked under CDR, led to questions, whether the trend was due to downturn or a gross misuse of the facility by banks and companies. Raghuramrajan, Governor of RBI said “promoters do not have a divine right to stay in charge regardless of how badly they mismanage an enterprise, nor do they have the right to use the banking system to recapitalize their failed ventures” (The Economic Times, 10 September, 2013).

Despite enjoying substantial benefits from lenders under CDR packages, some stressed companies fail to come out of the blue, on account of various visible / invisible / operational / managerial inefficiencies. These have raised concerns both for the lenders and the regulators. Hence, RBI has now come out with ‘Strategic Debt Restructuring’ (SDR) mechanism through which lenders have been empowered to recover their long
outstanding dues from those restructured stressed companies which have failed to achieve the projected milestones those agreed upon in CDR package.

Table 2: Bank-wise Corporate Debt Restructuring (CDR)

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Name of the Bank</th>
<th>2009-10</th>
<th>2011-12</th>
<th>2014-15</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>No. of A/cs</td>
<td>Amount under CDR</td>
<td>No. of A/cs</td>
</tr>
<tr>
<td>SBI and its Associates</td>
<td>State Bank of India</td>
<td>3870</td>
<td>18999.23</td>
<td>33</td>
</tr>
<tr>
<td></td>
<td>State Bank of Bikaner &amp; Jaipur</td>
<td>08</td>
<td>215.65</td>
<td>16</td>
</tr>
<tr>
<td></td>
<td>State Bank of Hyderabad</td>
<td>167</td>
<td>1692.04</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>State Bank of Mysore</td>
<td>12</td>
<td>362.14</td>
<td>34</td>
</tr>
<tr>
<td></td>
<td>State Bank of Patiala</td>
<td>22</td>
<td>677.73</td>
<td>33</td>
</tr>
<tr>
<td></td>
<td>State Bank of Travancore</td>
<td>1</td>
<td>18.78</td>
<td>05</td>
</tr>
<tr>
<td>Nationalized Banks</td>
<td>Allahabad Bank</td>
<td>1</td>
<td>417.22</td>
<td>21</td>
</tr>
<tr>
<td></td>
<td>Andhra Bank</td>
<td>04</td>
<td>81.02</td>
<td>21</td>
</tr>
<tr>
<td></td>
<td>Bank of Baroda</td>
<td>07</td>
<td>355.76</td>
<td>16</td>
</tr>
<tr>
<td></td>
<td>Bank of India</td>
<td>12</td>
<td>819.79</td>
<td>22</td>
</tr>
<tr>
<td></td>
<td>Bank of Maharashtra</td>
<td>03</td>
<td>133.68</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Canara Bank</td>
<td>67</td>
<td>1571.72</td>
<td>13</td>
</tr>
<tr>
<td></td>
<td>Central Bank of India</td>
<td>08</td>
<td>393.41</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>Corporation Bank</td>
<td>05</td>
<td>105.31</td>
<td>09</td>
</tr>
<tr>
<td></td>
<td>Dena Bank</td>
<td>14</td>
<td>630.92</td>
<td>16</td>
</tr>
<tr>
<td></td>
<td>Indian Bank</td>
<td>04</td>
<td>163.87</td>
<td>04</td>
</tr>
<tr>
<td></td>
<td>Indian Overseas Bank</td>
<td>12</td>
<td>335.60</td>
<td>32</td>
</tr>
<tr>
<td></td>
<td>Oriental Bank of Commerce</td>
<td>11</td>
<td>354.30</td>
<td>14</td>
</tr>
<tr>
<td></td>
<td>Punjab and Sind Bank</td>
<td>02</td>
<td>28.44</td>
<td>21</td>
</tr>
<tr>
<td></td>
<td>Punjab National Bank</td>
<td>14</td>
<td>1706.37</td>
<td>19</td>
</tr>
<tr>
<td></td>
<td>Syndicate Bank</td>
<td>11</td>
<td>260.19</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Union Bank of India</td>
<td>06</td>
<td>176.19</td>
<td>18</td>
</tr>
<tr>
<td></td>
<td>United Bank of India</td>
<td>06</td>
<td>167.02</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>United Commercial Bank (UCO Bank)</td>
<td>07</td>
<td>206.57</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Vijaya Bank</td>
<td>09</td>
<td>58.80</td>
<td>17</td>
</tr>
<tr>
<td></td>
<td>IDBI Bank</td>
<td>29</td>
<td>3509.69</td>
<td>49</td>
</tr>
<tr>
<td>Important Private Banks:</td>
<td>Axis Bank (UTI Bank)</td>
<td>04</td>
<td>162.58</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>HDFC Bank</td>
<td>-</td>
<td>34.78</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>ICICI Bank</td>
<td>33</td>
<td>8130.94</td>
<td>14</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>4359</td>
<td>69187.21</td>
<td>494</td>
</tr>
</tbody>
</table>

Source: Annual Reports of the above mentioned banks
4.0 Strategic Debt Restructuring Mechanism

Observing repetition of CDR packages which are growing at fast pace in the last few years (refer Table 1 and 2) the RBI is of the view that instead of lenders, powerful shareholders, especially promoters of chronic defaulting companies, should be the first to bear the losses. The new restructuring mechanism authorizes lending banks to convert their outstanding loans into a majority equity stake. Undertaking of SDR route to change the ownership by the lenders will strike a fear in promoters from defaulting as they might end up losing their companies.

The features of SDR scheme are:

- SDR mechanism is a non-statutory and voluntary, based on Debtor-Creditor and Inter-Creditor Agreements.
- Under the scheme, RBI has allowed banks to take control of a defaulting company, and convert their debts into equity. Banks under Joint Lenders Forum (JLF) can become majority owner in the defaulting company by holding 51 per cent or more stakes. Banks need to insert a suitable clause at the time of restructuring, and convert the debt into equity at a fair value.
- The scheme covers multiple banking accounts / consortium accounts with outstanding exposure of Rs. 10 crores and above by banks and financial institutions. It does not apply to accounts involving single lending institution only.
- The scheme is applicable to standard and sub-standard accounts, but also covers doubtful accounts, BIFR cases, and suit filed accounts subject to specific stipulations.

Experts believe that the fear of takeover of the company might compel them to initiate suitable steps to keep their companies from slipping away. Conversion of debt of stressed companies into equities will move their lending portfolio from loan segment to investment segment in the balance sheets of the banks. But there are some major risks attached with implementation of SDR mechanism.

5.0 Implementation of SDR Mechanism: Risk Attached

5.1 Lenders point of view
a) *CDR mechanism is non-statutory:* It is based on Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA). The principle of approvals by super-majority of 75 per cent creditors (by value) makes it binding on the remaining 25 per cent to
fall in line with the majority decision makers. As it is voluntary, borrowers do not pay serious need to CDR structure.

b) Involvement of all the lenders: For successful implementation of the package, it is required to involve all the lenders, but at times, promoters create charge on few assets of the company, in favor of other lending institutions who when requested avoid participation.

c) Approvals from respective Boards: Sometimes member banks are unable to obtain approval from their respective boards, for various restructuring packages, which create unnecessary delay in the implementation of the process.

d) Reluctance by participating private and foreign banks: At time the consortium members from private and foreign banks express their reluctance in joining the mechanism, thus creating problems in extending benefits to the stressed companies.

5.2 Risk attached with defaulters

a) Genuine Defaulters: Industry experts know that most of the borrowers try genuinely to service their debt obligations in time. However when a particular sector gets into trouble, the borrowers of this sectors find themselves trapped into liquidity crunch. Nothing can be done unless the economy picks up and sector revives. Lenders have to identify these genuine defaulters and protect them.

b) Willful defaulters: They are the defaulters who know the rules of the game and can bypass the system effortlessly. The lenders know that extracting change of ownership from such defaulters is not easy, as they have blessing from political and financial world. They may get the lenders, involved in the legal tangle and get the entire process delayed.

5.3 Challenges in obtaining approval from the Board of Restructured Companies

In terms of SDR guidelines lenders have to incorporate a clause in the CDR mandates for which the promoters of the restructured company will have to get approval from their shareholders. This often becomes a challenge, as in absence of these approvals they cannot extend the SDR package to the company.

5.4 Risk attached with pricing of equity

a) Challenges in recovering the debt outstanding properly and adequately: In terms of SDR guidelines, conversion of debt to equity of such companies has to be done at a fair value. The share price should not exceed the lowest of ‘market value’ or ‘break-up’ value. Generally share price of stressed and defaulting companies are beaten
down, and their break-up value is low. Thus the interested buyers may buy the company’s shares, its assets at a very low cost.

b) **Conversion of Debt**-Approval required from all participating Lenders: As per guidelines on SDR, to convert debt to equity requires approval from 75 per cent of lenders in value and 60 per cent in number. Many lenders may not convey their approval and conversion of debt into equity may not take place.

c) **Reaping Benefits from calculation of Capital Market exposure**: Effective from 1st April, 2015, banks are required to provide 15 per cent of outstanding in any CDR in their profit and loss account. In order to reap benefits from such stipulations-incorporating the clause for conversion of debt into equity at the time of restructuring, and secondly, the conversion of debt into equity is done at fair value.

5.5 **Risk attached with lenders/bankers running a company and finding buyers**

a) **Challenges involved in running a company**: As per SDR the lenders (bankers), acquire equity and after taking ownership run the stressed company to recover their money. Running a bank and running a company, both are all together a completely different game, and two opposite ends of risk spectrum.

b) **Finding Buyers**: SDR guidelines stipulate that banks will take control of stressed companies only to cede ownership to the new promoters. But selling the stake of a company with uninspired past record to the new promoters is easier said than done. Bankers are going to have a hard time in finding solutions to this herculean task.

c) **Ensuring no links with the old promoters**: Bankers have also to ensure that new promoters do not have any link to old promoters. In India, micro-management from the backstage is a common feature. Big guns, push their decisions, behind the curtain. Under such circumstances how the lender will ensure adherences to this stipulation remains a big question.

5.6 **Operational risk issues-monitoring aspects: Opening Pandora Box**

RBI has stipulated that Joint Lenders Forum (JLF) should closely monitor the restructured companies’ performance so as to ensure, compliance with the various terms of SDR package. Lending institutions job is to lend (money) for the process, and not to get lent (themselves) into the process. Implementation of the SDR scheme is not an easy task and carries complexities. The ultimate goal of the bank is to divest the equity holdings of the company to new promoters as soon as possible.

Different risks relating to day to day performance of the company are:

a) **Performance Related**: These include the following:
• **Day to day operations:** Normally higher prices, lower sales, unsold inventory, high interest burden etc. are major contributing factors behind poor performance of stressed companies.

• **Non-execution of orders:** One of the major factor responsible for downfall of the stressed company is delayed / non-execution of orders.

• **Delay in disposal of unproductive and slow moving assets:** One of the solutions to revive company quickly is disposal of unproductive and slow moving assets. This will generate cash flow.

b) **End-use of funds**

• **Liquidity problems:** Often companies use working capital funds for unplanned capital expenditure and face liquidity problem. Lenders need to analyse such investments, so as to improve liquidity position.

• **Investments in Associates:** Few companies make huge investments in associates or group concerns, form where the return is shown almost nil. Such investments place the companies, in a situation, where they bear unnecessary losses.

• **Cash flow issue:** Poor generation of cash flows leads to liquidity problems and companies find it difficult in servicing their debts.

• **Issues relating to timely realization of debtors:** Often companies undertake a business strategy, stretching receivables beyond a normal period, this results in mismatch of cash flows.

c) **Deviation from terms of sanction**

• **Risks attached with companies taking funds from non-consortium banks:** Often stressed companies obtain funds from non-consortium banks / financial institutions (F.Is) / and diversify the funds there from.

• **Infusion of equity funds by promoters:** Promoters of stressed companies borrow funds from banks and F.Is to infuse their share of equity contribution, thus resulting in depletion of net working capital.

d) **Non-achievement of targets**

• **Unplanned expansion:** Ambitious unplanned expansion by the companies put them into financial crisis.

• **Long gestation period:** A company might find it challenging, if the gestation period gets extended by a few months on account of unforeseen circumstance.

• **Capacity utilization:** Poor capacity utilization, on account of late erection of plant, inadequate working capital plays an important role in revival of a stressed company.
e) Competitive advantage and changing consumer habit

- Competitive from established and new market players: Companies may face constraints, and also experience delay in revival due to competition from already established and or new players.
- One man show: If most of the key functions are dealt with by one person, his withdrawal from the system may create a vacuum.
- Issues related with third party transactions: It may happen that there are ties between the company and flagship subsidiaries. Lack of transparency in the transactions may create problems for the lending institutions.
- Concealment of facts: Some companies convert the accounting norms to conceal their weakness e.g not charge expenditure to the balance sheet, instead show it as off balance-sheet item.

f) Identify early warning singles

- Demand and supply of products: sluggish demand for the products, poor inflow of fresh orders etc. plays an important role in revival of a company.
- Extending repeated restructuring package: a company may continue to suffer losses due to inherent weakness of the project, in such cases, repeated restructuring process cannot help revival of the company.

g) Meeting rating requirements

- The enterprises are required to obtain credit rating from authorized rating agencies, for obtaining finance from banking institution. But when stressed companies fail to furnish the required information, to these agencies, they suspend rating of such companies.

6.0 The Road Ahead

SDR, in times to come, may prove to be a valuable tool in the banker’s kit to facilitate recovery of bad debts. Experts believe that this new arrow in the lender’s quiver will help them sell-off the businesses which have an unviable debt structure. Nonetheless, it cannot be seen as the end game because the problem of “ability of debtors to litigate” will persist till formal strong and robust bankruptcy legislation is in place. Any borrower, who is expected to lose control of his company, will explore legal loopholes and try to get the issues lend up in the court of law. To the extend, if the clauses enabling banks to become majority equity holders in the event of failed restructuring efforts are incorporated in the initial loan documents, the new mechanism may prove to be a significant different, especially for those who tend to take bank’s recovery process ‘lightly’.
For effective SDR, a strong bankruptcy law is required and for obtaining benefits of bankruptcy law, effective implementation of SDR mechanism is essential. “Insolvency and Bankruptcy Code, 2015 had been passed by the Lok Sabha. The Bill seeks to bring a host of regulatory changes to build a robust and faster insolvency resolution mechanism beside setting up of an insolvency and bankruptcy board of India. The new law will provide an overarching framework for dealing with bankruptcy, replacing multiple laws dealing with the issue. The key feature of the code includes hasten debt recovery and restructuring by setting a dealing of 180 days, to decide fate of a company that defaults” (The Economic Times, 12th May, 2016, p.3).

References


