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CORPORATE DEBT RESTRUCTURING MECHANISM IN INDIA: A TOOL IN FINANCIAL CRISIS

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Abstract:-CDR is a necessity especially in this era where economic changes in the form of upturn and downturn are a way of life and a part of business cycles for individual companies. Taking into consideration the need, the Reserve Bank of India, for that purpose, put in place the scheme of CDR in August 2001 based on the mechanism prevalent in other countries . CDR has received attention because of the extraordinary rise in the number and volume of advances being restructured under the scheme recently, especially in Banks. The guidelines on restructuring have generally been used to the advantage of both the borrowers and the lenders , mostly banks, in situations of economic downturns and liquidity problems. Due to the extraordinary rise in the cases referred to and restructured under CDR mechanism during the current and previous fiscal years, questions are being raised as to whether this indicates a general downturn or gross misuse of the CDR Mechanism by banks and corporate borrowers. Any kind of restructuring has to be accompanied by prudence on the part of the lenders and financial discipline on the part of the borrowers.

Keywords: Advances , Economic downturns, Financial discipline, Restructuring,

1.INTRODUCTION :-

Debt restructuring is a process that allows any sovereign entity , facing cash flow problems and financial distress, to reduce and renegotiate its delinquent debts in order to improve or restore liquidity and revive the entity to normal conditions. Restructuring of loans and advances includes terms such as rescheduling / renegotiation / rehabilitation / restructuring used interchangeably by the Reserve Bank of India (RBI) and banks. Debt restructuring is an effective tool to offer aid to borrowers in distress, owing to circumstances beyond the borrower's control, due to reasons such as a general downturn in the economy ,legal or other issues causing delays, in project implementation. CDR is a necessity especially when economic upturn and downturn are a part and parcel of life cycles and business cycles for individual companies. The existing guidelines on CDR Mechanism in India have been evolved in the context of international experience.

2.CORPORATE DEBT RESTRUCTURING MECHANISM -A TOOL IN FINANCIAL CRISIS :

Corporate Debt Restructuring (CDR) or simply restructuring of loans and advances is an effective financial tool, during the times of crisis, for facing the adverse effects of economic downturns on the borrowers as well as lenders. But, any kind of restructuring has to be accompanied by prudence on the part of the lenders and financial discipline on the part of the borrowers. Restructuring of loans and debts calls for change in the terms and conditions of the loan or credit, especially in respect of its servicing. Corporate debt restructuring is a specialized institutional mechanism for restructuring large loans involving more than one lender under consortium banking arrangements. The need for such a specialized institutional mechanisms arose primarily due to the difficulties faced by banks while restructuring their large loans involving more than one lender, under consortium/multiple banking arrangement. Whereas, it was easier for banks to negotiate the terms of restructuring of their own exposure with their customers, it was difficult to co-ordinate their negotiation and monitoring efforts where restructuring involved multiple lenders. Therefore, a need was felt to bring a system where restructuring of large corporate exposures from multiple banks under consortium/multiple banking arrangements could be carried out. The Reserve Bank for that purpose, to put in place the scheme of CDR in August 2001 based on the mechanism prevalent in other countries. These guidelines were finalized after extensive discussion between Government of India, Reserve Bank, Banks and Financial Institutions in India. The debt restructuring mechanism is usually less expensive and a preferable alternative to bankruptcy. The main costs associated with a debt restructuring are the time and effort to negotiate with bankers, creditors, vendors and tax authorities. Debt restructurings typically involve a reduction of debt and an extension of payment terms. Recently there has been a rise in Out-of court restructurings, known as "workouts", the world over. The aims and objectives of Corporate Debt Restructuring (CDR) Mechanism as enunciated in the Scheme evolved by the Reserve Bank of India are to ensure timely and transparent mechanism for restructuring of Corporate debts of financially viable entities and preserving viable corporates and also to minimize the losses to the creditors and other stakeholders through an orderly and planned programme.

3. IMPLEMENTATION AND MONITORING OF CDR SCHEME :

The Monitoring Institution appointed by CDR Empowered Group to monitor the implementation of the scheme and submit report every month in prescribed format. The Monitoring Committee constituted by CDR Empowered Group and comprises representatives of the referring bank/institution, one or two other CDR lenders having major exposure in the case, one lender with minor exposure and the CDR Cell. The promoters/representatives of the company besides representatives of the concurrent auditor, lenders' engineer, if considered necessary, are invited for the meetings as special invitees. Whenever larger issues such as relating to sharing of charge, matters relating to working capital tie-up, permission for expansion/modernization are to be discussed then other lenders including consortium members are invited for the meetings. The concerned companies are required to refer all proposals for expansion, diversification, mergers/demergers, equity raising, one time settlements, partial prepayment to CDR members/non-CDR lenders to the Monitoring Committee for due scrutiny.

4.TRENDS OF RESTRUCTURING IN INDIAN BANKS:

CDR has come under the attention because of the extraordinary rise in the number and volume of advances being restructured under the scheme recently ,especially in Banks. There has been an extraordinary rise in the number of cases referred to and restructured under CDR mechanism during the current and previous fiscal years, and hence questions are being raised as to whether this indicates a general downturn or gross misuse of the CDR Mechanism by banks and corporate borrowers. The growth rates of gross advances, restructured advances and the ratio of gross advances to restructures advances can be studied with the help of the following table.

Table showing the growth in Gross Advances, Restructured Advances and ratio of Restructured Advances to Gross Advances of all Banks in India from March 2009 to March 2012:

Growth Rates / Ratio(%)	March 2009 - March 2010	March 2010 - March 2011	March 2011 - March 2012
Gross Advances	17.21 %	23.41%	16.88%
Restructured Standard Advances	81.17%	0.86%	58.48%
Gross Advances to Restructured Advances	4.23%	3.45%	4.68%

The table above showing the growth rates in Gross advance of all banks in India covering Public Sector Banks, Private Sector Banks and Foreign Banks depicts a growth of 17.21 percent from March 2009 to March 2010, whereas the same grew at 23.41 percent for the succeeding period from March 2010 to March 2011 indicating a positive growth of approx 6 percent as compared to the previous period. However for the subsequent period from March 2011 to March 2012 there was a decline in growth of Gross Advances of banks by approximately 7 percent as the growth rate was recorded at 16.88 percent.

The Restructured Standard advances of all Banks in India recorded a high growth rate of 81.17 percent from March 2009 to March 2010, however surprisingly this indicator witnessed an unexceptionally low growth rate of only 0.86 percent during the next period from March 2010 to March 2011. For the subsequent period 2011 to 2012, the growth was moderately at 58.48 percent, showing much improvement as compared to the previous period.

The ratio of gross advances to Restructured advances which was at 4.23 percent from March 2009 to March 2010, declined to 3.45 percent in the subsequent period 2010 to 2011.However again it rose to 4.68 percent, higher than before. The growth in restructured accounts may be basically due to the global slowdown and recession, which is also a cause of concern due to the growing restructured accounts of banks and depicts liberty in resorting to the Restructuring process frequently, which is a sign if misuse of the CDR mechanism.

5.CDR MECHANISM - A NEED FOR REVIEW:

The need for a review of our guidelines on restructuring arose in the light of the existing issues. Accordingly, the Reserve Bank constituted a Working Group (WG) to review the existing guidelines on restructuring of advances. This group has examined the issues confronting the restructuring of advances by banks both under CDR and non-CDR mechanisms. It has recommended the withdrawal of regulatory forbearance on asset classification on restructuring; but considering the current domestic macroeconomic situation as also global situation, this step is suggested, say, after a period of two years. During the interval , it has recommended increasing the provision on accounts which get the asset classification benefit on restructuring. These are right steps towards discouraging the banks from taking up the cases of unviable accounts as they will be compelled to use their resources judiciously and that too , only for viable accounts. Whereas, in the remaining cases, deleveraging should be the correct option.

The Working Group has also made its recommendations for putting a cap on conversion of debt into preference shares; increasing the promoters' stake in restructured accounts; making the 'right of recompense' mandatory, bringing more clarity with respect to calculation of diminution in fair value, disclosure of only 'material' information, etc.

The CDR Mechanism was devised as there was a need for an institutional mechanism to support the large, viable accounts facing temporary problems so as also to preserve the values of large exposures of banks. Restructuring being a prominent central banking tool in the times of crisis despite its moral hazard aspects, is also accompanied by the regulatory forbearance on asset classification, provisioning and capital adequacy in order to provide the banks and corporates, the much needed way to rejuvenate their productive assets during crisis. However, a most significant aspect which needs attention is the issue of misuse and abuse of CDR Mechanism by banks as well as corporates. For this purpose, the government has initiated process of performance review of companies that have opted for corporate debt restructuring (CDR). There has been a concern on the growing number of companies opting for a debt restructuring. The Reserve Bank of India (RBI) had implemented strict norms to ensure only genuine units took this route. However, the performances and operations of companies in the CDR cell are often ignored and many of these have been under CDR protection for years, without any incentive to move out. It goes without saying that its future success and failure will depend upon the ethics and integrity of its members and the professionals involved in the restructuring process. Rather, it has been observed that even at the slightest sign of slowing down of the economy or any particular sector of the economy, banks as well as corporates start demanding even further relaxations in the regulatory forbearance . It may be noted that CDR Mechanism has been given some special dispensation regarding asset classification on repeated restructuring which is not available to non-CDR restructuring.

6 .CONCLUSION:

Corporate debt restructuring is a complicated procedure which can be difficult to implement, especially considering the repercussions of the global financial crisis that has presented some unprecedented debt pressures in corporate, household and financial sectors. Such process of restructuring of debt as is being implemented in clearly in favor of the debtor at the expense of the creditor. The obvious intent is to help the company recover. But often that intent is not realized and the only benefit is that in return for the losses the creditor institution suffers, it is in a position to treat the asset, after providing for any write-down, as a standard asset. Moral hazard issues are also likely to emerge from such informal out of court systems. Internationally, corporate debt restructurings can also be viewed as a mid-way between an excessive creditor- oriented approach and an excessive debtor- oriented approach. An excessive debtor oriented approach gives rise to the aspect of moral hazard as it may encourage the debtor to take excessive risks in the knowledge that the burden of any losses will fall disproportionally on creditors.

The restructuring process is a tool for assisting distressed sections of the economy to tide over difficulties which are temporary in nature and due to circumstances beyond their control. For us to justify that restructuring is for the larger benefit of the economy and the society, it is imperative that it is available to all classes of borrowers and is made available in a timely and non-discriminate manner. This will be possible only if we develop the necessary structures, systems and processes to adhere to the above objectives and a viable time bound action plan for implementing all this.

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