CHAPTER 3

OBJECTIVES OF

CORPORATE DEBT RESTRUCTURING (CDR)
3.1 THE OBJECTIVES OF DEBT RESTRUCTURING

Debt restructuring should be carried out to maximize the creditor's chances of getting repayment subject to the debtor's ability to repay the loan, or in some other way improve on the conditions set out in the original contract to both parties. In particular, debt restructuring should be carried out to help debtors who have difficulties in loan repayment due to the effects of an economic crisis but are expected to recover in future. Financial institutions should ensure that restructuring is not carried out with the objective of postponing or avoiding debt classification or provisioning requirements, or the avoidance of stopping interest accruals.

CORPORATE DEBT RESTRUCTURING (CDR SYSTEM) –

The objective of the Corporate Debt Restructuring (CDR) framework is to ensure timely and transparent mechanism for restructuring the corporate debts of viable entities facing problems, outside the purview of BIFR, DRT and other legal proceedings, for the benefit of all concerned. CDR will be a non statutory mechanism which will be a voluntary system based on Debtor Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA)
Chapter - 3

Objective Of Corporate Debt Restructuring (CDR)

CDR system consists of a three tier structure: (1) CDR Standing Forum and its Core Group (2) CDR Empowered Group and CDR Cell. The CDR Standing Forum would be the representative general body of all financial institutions and banks participating in CDR system. All financial institutions and banks should participate in the system in their own interest. The Forum would also lay down the policies and guidelines to be followed by the CDR Empowered Group and CDR Cell for debt restructuring and would ensure their smooth functioning and adherence to the prescribed time schedules for debt restructuring. These guidelines shall also suitably address the operational difficulties experienced in the functioning of the CDR Empowered Group. The individual cases of corporate debt restructuring shall be decided by the CDR Empowered Group. The CDR Standing Forum and the CDR Empowered Group is assisted by a CDR Cell in all their functions. The CDR Cell makes the initial scrutiny of the proposals received from borrowers/lenders, by calling for proposed rehabilitation plan and other information and put up the matter before the CDR Empowered Group, within one month to decide whether rehabilitation is *prima facie* feasible. If found feasible, the CDR Cell proceeds to prepare detailed Rehabilitation Plan with the help of lenders and, if necessary, experts to be engaged from outside. If not found *prima facie* feasible, the lenders may start action for recovery of their dues.

One of the main features of the CDR system as per
the revised Reserve Bank of India guideline is that accounts, which are classified as 'standard' and 'substandard' in the books of the lenders, are restructured under the first category (Category 1). Accounts which are classified as 'doubtful' in the books of the lenders would be restructured under the second category (Category 2).

The sick enterprises will became technologically viable and start production, and will start profile. Ultimately and financial institutions NPAs will substantially be reduced and Banks will become more healthy. More job opportunity will be created GDP will be increased and the thus there will be Country’s Economics Growth and National Goal will be achieved.

The Bank and Financial Institutions should ensure that Corporate Debt Restructuring is not used as deferment of NPAs in the books, there should be physically reduction of NPAs.

At present Corporate Debt Restructuring is being misused for reduction of NPAs, this is not the intention of the policy is following cases Corporate Debt Restructuring should not be considered.

i. In cases there is inherent non feasibility of the project

ii. In cases there is no demand of end product.

iii. In cases where the management reputation is not good.
Chapter - 3

Objective Of Corporate Debt Restructuring (CDR)

The Bank and Financial Institutions should ensure that Corporate Debt Restructuring is not used as deferment of NPAs in the books

At present Corporate Debt Restructuring is being misused for reduction of NPAs

1. In cases there is inherent non feasibility of the project
2. In cases there is no demand of end product.
3. In cases where the management reputation is not good.

To make the Corporate Debt Restructuring more effective

1. The promoters must bring the Share of Funds before the Banks and financial institutions being their share.
2. The product should be changed if there is no demand for it, for example if there is no demand for Scooter then it should be changed to motorbike to composite textile changed to yarn.
3. The management is changed and Concurrent Auditors from the financial institutions be appointed.
4. In cases there is inherent non feasibility of the project
5. In cases there is no demand of end product.
6. In cases where the management reputation is not good.
Objective Of Corporate Debt Restructuring (CDR)

Genesis of CDR Mechanism in India

The objective of the Corporate Debt Restructuring (CDR) framework is to ensure timely and transparent mechanism for restructuring the corporate debt of viable entities facing problems, outside the purview of BIFR, DRT and other legal proceedings, for the benefit of all concerned.

The CDR empowered group will consider 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 Standing Forum, the details restructuring package will be worked out by the CDR Cell in conjunction with the Lead Institution. However, if the lead institution faces difficulties in working out the detailed restructuring package, the participating banks / financial institutions should decide upon the alternate institution / bank which would work out the detailed restructuring package at the first meeting of the Empowered Group when the preliminary report of the CDR Cell comes up for consideration.

The sick enterprises will become techno and economically viable and start production, and will start profit. Ultimately the banks and financial institutions’ NPAs will substantially be reduced and Banks will become more healthy. More job opportunity will be created GDP
will be increased and the thus there will be Country’s Economics Growth and National Goal will be achieved.

The Banks & Financial institutions should ensure that CDR is not used as deferment of NPAs in the books, there should be physical reduction of NPAs.

At present CDR is being misused for reduction of NPAs, this is not the intention of the policy – in following cases CDR should not be considered.
   i) In cases there is inherent non feasibility of the project.
   ii) In cases, there is no demand of end product.
   iii) In cases where the management reputation is not good.

3.2 RESULT OF BENEFICIARIES

WHAT ARE THE ADVANTAGE OF TRIGGERING CORPORATE DEBT RESTRUCTURING?

A. A "Stand Still" clause becomes operational, by virtue of that, the borrower is not under any onus to pay to any Inter-Creditor Agreement -signatory lender and all suits filed by any Inter-Creditor Agreement -signatory lender comes to stand still.

B. All accounts, subjected to CDR process, would continue to be eligible for fresh financing of funding requirements
by the lenders as per their respective normal policy-parameters and eligibility criteria.

C. The rescheduling of principal alone (i.e. if due interest is recovered in full) will facilitate the account to remain under the existing Asset Classification provided the rescheduled loan/advance is fully secured;

D. Similarly, the rescheduling of interest alone or together with rescheduling of principal (as said above) will facilitate the account to remain under the existing Asset Classification provided the amount of sacrifice, if any, in the interest-element, measured in present value terms, is either written-off or provision is made to the extent of the sacrifice involved.

E. The asset classification under Corporate Debt Restructuring shall continue to be the bank-specific based on record of recovery of each bank as per the existing prudential norms.

The Sub-standard accounts, subjected to Corporate Debt Restructuring process, will be eligible to be up-graded after the specified period, i.e., a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due, subject to satisfactory performance during the period. And, then, the amount of provision, made earlier net of the amount provided for the sacrifice in the interest amount in present value terms as aforesaid, may also be reversed.
TYPES OF DEBT RESTRUCTURING

With reference to these guidelines, the term debt restructuring refers to general debt restructuring cases as well as troubled debt restructuring defined here as follows:

1. General debt restructuring refers to debt restructuring whereby the financial institutions has incurred no losses from restructuring of debt - for example, where creditors have granted concessions by reducing the interest rate to reflect changes in market fundamentals or to maintain the relationship with the debtor, or by extending the repayment period or granting a grace period whereby the debtor continues to pay interest at the original contractual interest rate where creditors’ analyses have shown that the debtor is able to repay the full amount of the loan (principal and interest) as agreed in the original loan contract.

2. Troubled debt restructuring refers to debt restructuring cases where financial institutions incur losses from the restructuring due to one or a combination of the following -
   a. A reduction of the principal or accrued interest; or
   b. Loss from restructuring through acceptance of a transfer of assets in debt repayment where fair value of assets is lower than credit written off; or
   c. Concessions in the terms of loan repayment resulting in a fall in the present value of cash flows such that this value is lower than the sum of book value of the
credits outstanding and the accrued interest there on; or

d. Loss from the debt restructuring calculations based on the market value of the debtor’s business, the fair value of the collateral asset, or loss from other techniques in debt restructuring such as from debt-to-equity conversions.

ESTABLISHING A FORMAL STRATEGY FOR DEBT RESTRUCTURING

a. Financial institutions must establish a formal strategy for debt restructuring whereby the highest level of management should participate directly in formulating this strategy. The strategy must form part of the institution’s written business policy.

b. The strategy should cover every stage of the restructuring process from start to finish including clear time-bound objectives, the approach and methodology for evaluating and granting loans, measures for monitoring and reporting on performance against those objectives to ensure that the restructuring has been carried out correctly in terms of its objectives and its accounting principles.

c. From the onset, financial institutions must clearly set out written procedures regarding the role and responsibility of officials in restructuring approval,
reporting, and monitoring of the restructuring case, including the formation of an action plan for every stage of the restructuring process.

d. The financial institution must set up a division or a group of officials experienced in debt restructuring independent of the loan officer(s) in charge of the debtor to direct and implement the restructuring process. Alternatively, the financial institution may contract out another financial institution or an independent party such as a specialised group of experienced debt restructuring officers to undertake this duty. As a concession to financial institutions with limited personnel, where the institution has insufficient officials to undertake the task, loan officers may undertake the responsibility of following up on debt restructuring cases on condition that the officers strictly follow the regulations set out in 3.3.

WHEN CORPORATE DEBT RESTRUCTURING IS NON-STATUTORY MECHANISM, THEN WHAT IS THE LEGALITY IN RESPECT OF "LENDERS PARTICIPATING IN THE CORPORATE DEBT RESTRUCTURING PROCESS" AND THE LENDERS NOT PARTICIPATING IN THE CORPORATE DEBT RESTRUCTURING PROCESS?
a. The Debtor -Creditor Agreement (DCA) and the Inter-Creditor Agreement (ICA) provide the legal basis to CDR mechanism.

b. The Debtors shall have to accede to the DCA, either at the time of original loan documentation (for future cases) or at the time of reference to Corporate Debt Restructuring Cell.

c. Similarly, all participants in the CDR mechanism through their membership of the Standing Forum shall have to enter into a legally binding agreement, with necessary enforcement and penal clauses, to operate the system through laid-down policies and guidelines.

d. The Inter-Creditor Agreement signed by the Creditors will be initially valid for a period of 3 years and subject to renewal for further periods of 3 years thereafter.

e. The lenders in foreign currency outside the country are not a part of Corporate Debt Restructuring system. Such lenders and also lenders like GIC, LIC, UTI and other third parties who have not joined the Corporate Debt Restructuring system, could join CDR mechanism for a particular corporate by signing transaction - to - transaction Inter-Creditor Agreement, wherever they have exposure to such corporate.
f. The Inter-Creditor Agreement would be legally binding agreement amongst the Creditors with necessary enforcement and penal clause, wherein the Creditors would commit them to abide by the various element of Corporate Debt Restructuring system. Further the Creditors shall agree that if 75% of Creditors by value, agree to be restructuring package of an existing debt (i.e. debt outstanding), the same would be binding on the remaining Creditors.

g. Since Category - 1 Corporate Debt Restructuring scheme covers only Standard or Sub-standard accounts, which in the opinion of 75% of the Creditors, are likely to become performing after introduction of the Corporate Debt Restructuring package, it is expected that all other Creditors (i.e. those outside the minimum 75 percent) would be willing to participate in the entire Corporate Debt Restructuring package, including the agreed additional financing.

h. However, in case for any internal reason, any Creditors (outside the minimum 75 percent) does not wish to commit additional financing, that Creditors will have the option. At the same time in order to avoid the “free rider” problem, it is necessary to provide some disincentive to the Creditors who

\[1\text{ vide Question No. 8 infra}\]
wishes to exercise this option. Such Creditors can either –

- Arrange for his share of additional financing to be provided by a new or existing Creditors, or
- Agree to deferment of the first year's interest due to him after the Corporate Debt Restructuring package become effective. The first year's deferred interest is mentioned above, without compounding, will be payable along with the last installment of the principal due to the Creditors.

i. The dissenting institutional lenders, having exposure of or less than 25% to the borrower and not opting to abide by the decision of CDR process, would have the option to sell their existing share to either the existing lenders or fresh lenders, at an appropriate price, which would be decided mutually between the existing lender and the taking over lender. The new lenders shall rank on par with the existing lenders for repayment and servicing of the dues since they have taken over the existing dues to the existing lender.

j. In addition, the “exit option” will also be available to all other lenders within the minimum 75 percent, provided the purchaser agrees to abide by the restructuring package approved by the Empowered Group.
k. When one or more institutional lenders / banks is not a signatory to Inter-Creditor Agreement:
In such a case, CDR process / decision cannot be enforced upon that Bank/ Financial Institutions and that Bank / Financial Institutions is free to adopt any course of action including filing of suit against the borrower.

WHETHER CORPORATE DEBT RESTRUCTURING CONTEMPLATES CONVERSION OF DEBT INTO EQUITY BY THE LENDERS IN DESERVING CASES?

The Corporate Debt Restructuring Empowered Group, while deciding the restructuring package, should decide on the issue regarding convertibility (into equity) option as a part of restructuring exercise whereby the Bank / Financial Institutions shall have the right to convert a portion of the restructured the Banks / Financial Institutions shall have the right to convert a portion of the restructured amount into equity, keeping in view in the statutory requirement Under Section 19 of the Banking Regulation Act, 1949, (in the case of Banks) and relevant SEBI regulation. Exemptions from the capital market exposure ceiling prescribed by Reserve Bank of India in respect of such equity acquisitions should be obtained from Reserve Bank of India on a case – to – case basis by the concerned lenders.

WHAT TYPES OF ACCOUNTS DOES CORPORATE DEBT RESTRUCTURING COVER?
Chapter - 3

Objective Of Corporate Debt Restructuring (CDR)

1. All Standard or Sub-standard and "Doubtful" advance accounts in which:
   - More than one Bank; or,
   - One Bank and one Financial Institutions; or
   - More than one Financial Institutions have exposure (outstanding) aggregating to Rs. 20 crore or more.

2. All advance accounts classified as "Standard" and "Sub-Standard" in the books of the lenders, will be categorized as Category - 1.

3. All advance accounts, classified as "Doubtful" in the books of all the majority of the lenders, will be categorized as Category - 2.: in such a situation Corporate Debt Restructuring may be implemented if a minimum of 75 percent (by value) of the lenders satisfy themselves of the viability of the account and consent for such restructuring, subject to the following conditions:
   - It will not be binding on the Creditors to take up additional financing worked out under the debt restructuring package and the decision to lend or not to lend will depend on each Creditors Bank / Financial Institutions separately. In other words under the proposed second categorized of the CDR mechanism, the existing loans will only be restructured and it would be up to the promoter to firm up additional financing arrangement with new of existing lenders individually.
All other norms under the CDR mechanism (such as the "stand-still" clause) during the pendency of restructuring under Corporate Debt Restructuring etc. will continue to be applicable to this category also.

4. There may be 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 or Sub-standard" in the books of at least 90% of lenders (by value), the same would be treated as Standard or Sub-standard only for the purpose of judging, the account as eligible for Corporate Debt Restructuring, in the books of the remaining 10% of lenders as category - 1.

5. There would be no requirement of the account / Company being sick, NPA or being in default for a specified period before reference to the Corporate Debt Restructuring system.

6. However, potentially viable cases of NPAs will get priority.

7. In no case, the request of any corporate indulging in willful default, fraud or misfeasance, even in a single Bank, will be considered for restructuring under Corporate Debt Restructuring system.
Chapter - 3

Objective Of Corporate Debt Restructuring (CDR)

8. The accounts where recovery suits have been filed by the lenders against the Company, may be eligible for consideration under the Corporate Debt Restructuring system provided, initiative to resolve the cases under the Corporate Debt Restructuring system is taken by at least 75 percent of the lenders (by value). However, for restructuring for such accounts under the Corporate Debt Restructuring system, it should be ensured that the account meets the basic criteria for becoming eligible under the Corporate Debt Restructuring mechanism.

9. BIFR cases are generally not eligible for restructuring under the Corporate Debt Restructuring system. However, large value BIFR cases may be eligible for restructuring under the Corporate Debt Restructuring system if specifically recommended by the Corporate Debt Restructuring Core Group. The Core Group recommended exceptional BIFR cases on a case to case basis for consideration under the Corporate Debt Restructuring system. It should be ensured that the lending institutions complete all the formalities in seeking the approval from BIFR before implementing the package.