SOUTH INDIAN Bank

STUDENTS' ECONOMIC FORUM

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Revised Guidelines on CDR Mechanism

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Theme No. 252 :REVISED GUIDELINES ON CDR MECHANISM

A well informed customer will make the policy makers as well as organisations which produce goods and services more responsive to the customer needs. This will also result in healthy competition among organisations and improve the quality of goods and services produced.

The "SIB Students' Economic Forum" is designed to kindle interest in economic affairs in the minds of our younger generation. We highlight one theme in every monthly meeting of the "Forum". This month, we discuss on "CDR Mechanism" modified as per recommendations of the high-powered group chaired by the then RBI Deputy Governor Smt. Shyamala Gopinath.

Briefly describe the background of CDR mechanism introduced by RBI?

Corporate Debt Restructuring was initially introduced by RBI as per the VepaKamesam Committee recommendations. The major objective of setting up a CDR system was to help the corporates to come out of financial problems, caused by internal reasons, such as economic slowdown, which are beyond their control. Generally corporate entities look at the member banks in a credit consortium or in a similar arrangement to provide them timely support through restructuring to overcome the financial difficulties. But generally there is an inordinate delay in arriving at a consensus among member banks. CDR mechanism was devised to address such issues and provide timely assistance to the corporates. CDR is a non-statutory system framed as a voluntary mechanism based on debtor – creditor and inter creditor agreements. CDR mechanism has now been included as an integral part of the "Prudential Guidelines for Restructuring of Advances by Banks" and RBI has advised banks to extend special regulatory treatment to applicable cases reported under CDR. Based on the recommendations made by the Special Group, draft guidelines on Corporate Debt Restructuring were prepared and circulated among banks for comments. On the basis of the feedback received the draft guidelines have been reviewed and the revised guidelines on CDR mechanism have been released.

What are the major objectives of the modified CDR mechanism?

The objective of the Corporate Debt Restructuring (CDR) framework is to act as a timely and transparent mechanism for restructuring the corporate debts of viable entities facing problems, and is outside the purview of BIFR, DRT and other legal proceedings. The system has been widely accepted since it helps the creditors and other stakeholders to minimise losses through effective restructuring and preserve viable companies to tide over the unprecedented outcomes due to certain internal and external factors. Initially, all those cases which were pending before the Board for Industrial and Financial Reconstruction (BIFR) and the Debt Recovery Tribunal (DRT) were ineligible for CDR. However, such cases with outstanding exposure in excess of Rs. 25 crore have been made eligible from 2008 onwards. The scheme has also been extended to those NPA accounts which are classified as ‘doubtful’.

What are the major modifications made in the existing CDR mechanism?

The major modifications are

- Extension of the scheme to entities with outstanding exposure of Rs.10 crore or more.
- Requirement of support of 60% of creditors by number in addition to the support of 75% of creditors by value with a view to make the decision making more equitable.
- Discretion to the core group in dealing with wilful defaulters in certain cases other than cases involving frauds or diversion of funds with malafide intentions.
- Linking the restoration of asset classification prevailing on the date of reference to the CDR Cell to implementation of the CDR package within four months from the date of approval of the package.
- Restricting the regulatory concession in asset classification and provisioning to the first restructuring where the package also has to meet norms relating to turn-around period and minimum sacrifice and funds infusion by promoters.
- Convergence in the methodology for computation of economic sacrifice among banks and FIs.
- Limiting RBI’s role to providing broad guidelines for CDR mechanism.
- Enhancing disclosures in the balance sheet for providing greater transparency.
- Pro rata sharing of additional finance requirement by both term lenders and working capital lenders.
- Allowing OTS as a part of the CDR mechanism to make the exit option more flexible.
- Regulatory treatment of non-SLR instruments acquired while funding interest or in lieu of outstanding principal and valuation of such instruments.

What is the structure of CDR system?

The CDR Mechanism has a 4 tier structure.

The first tier consists of a **Standing Forum**. The CDR Standing Forum would be the representative general body of all the financial institutions and banks participating in CDR system. All the financial institutions and banks should participate in the system in their own interest. It primarily deals with the issue of laying down guidelines and is a self empowered general body. It serves as an important platform where creditors and borrowers participate in the formulation of guidelines and also monitor the CDR process. The CDR Standing Forum comprises of Chairman & Managing Director, IDBI Ltd; Chairman, SBI ; Managing Director & CEO, ICICI Bank Limited; Chairman, Indian Banks’ Association as well as Chairmen and Managing Directors of all banks and financial institutions participating as permanent members in the system. Since institutions like Unit Trust of India, General Insurance Corporation, Life Insurance Corporation may have assumed exposures on certain borrowers, these institutions may participate in the

CDR system. The Forum will elect its Chairman for a period of one year and the principle of rotation will be followed in the subsequent years. However, the Forum may decide to have a Working Chairman as a whole-time officer to guide and carry out the decisions of the CDR Standing Forum. The RBI would not be a member of the CDR Standing Forum and Core Group. Its role will be confined to providing broad guidelines. The CDR Standing Forum shall meet at least once in every six months and would review and monitor the progress of corporate debt restructuring system. The Forum would also lay down the policies and guidelines including those relating to the critical parameters for the restructuring to be followed by the CDR Empowered Group and CDR Cell for debt restructuring would ensure their smooth functioning and adherence to the prescribed time schedules for debt restructuring. It can also review any individual decision of the CDR Empowered Group and CDR Cell. The CDR Standing Forum may also formulate guidelines for dispensing special treatment to those cases, which are complicated and are likely to be delayed beyond the time frame prescribed for processing.

Out of the Standing Forum, a **Core Group** is carved out. It is designated with the task of convening meetings and taking policy decisions. The Core Group also ensures that companies which have had fraudulent dealings or which had approached the CDR system with malafide intent are excluded. The Core Group will consist of Chief Executives of IDBI, SBI, ICICI Bank, Bank of Baroda, Bank of India, Punjab National Bank, Indian Banks' Association and Deputy Chairman of Indian Banks' Association representing foreign banks in India. The CDR Core Group would lay down the policies and guidelines to be followed by the CDR Empowered Group and CDR Cell for debt restructuring
The **Empowered Group**, which comprises of Executive Director level representatives from the participatory institutions, considers individual cases for CDR. It decides based on the preliminary reports to ascertain where restructuring is feasible, and hands over the selected cases to the CDR Cell. Therefore, while the Standing Forum issues guidelines, the Empowered Group executes them.

The **CDR Cell** is responsible for assisting the Standing Forum and the Empowered Group with all their tasks and for making the initial scrutiny of proposals. The Cell will make the initial scrutiny of the proposals received from borrowers / creditors, by calling for proposed rehabilitation plan and other information and put up the matter before the CDR Empowered Group, to decide whether rehabilitation is prima facie feasible, within one month. It shall be the responsibility of the lead institution / major stakeholder to the corporate, to work out a preliminary restructuring plan in consultation with other stakeholders and submit to the CDR Cell within one month. The CDR Cell will prepare the restructuring plan in terms of the general policies and guidelines approved by the CDR Standing Forum and place for consideration of the Empowered Group within 30 days for decision. The Empowered Group can approve or suggest modifications but ensure that a final decision is taken within a total period of 90 days, which may be extended upto a maximum period of 180 days. The cost in operating the CDR mechanism including CDR Cell will be met from contribution of the financial institutions and banks in the Core Group at the rate of Rs.50 lakh each and contribution from other institutions and banks at the rate of Rs.5 lakh each.

What are the eligibility norms of the scheme?

1. The CDR mechanism will cover only multiple banking accounts / syndication / consortium accounts of corporate borrowers with outstanding fund-based and non-fund based exposure of Rs.10 crore and above by banks and institutions.
2. The category 1 CDR system will be applicable only to accounts classified as 'standard' and 'sub-standard'. There may be a 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'/ 'substandard' in the books of at least 90% of creditors (by value), the same would be treated as standard / substandard, only for the purpose of judging the account as eligible for CDR, in the books of the remaining 10% of creditors. There would be no requirement of the account or company being sick, NPA or being in default for a specified period before reference to the CDR system. However, potentially viable cases of NPAs will get priority.
3. BIFR cases are not eligible for restructuring under the CDR system. However, large value BIFR cases may be eligible for restructuring under the CDR system if specifically recommended by the CDR Core Group. The Core Group shall recommend exceptional BIFR cases on a case-to-case basis for consideration under the CDR system. It should be ensured that the lending institutions complete all the formalities in seeking the approval from BIFR before implementing the package.

What is Category 2 CDR System?

This category is meant for accounts classified as "doubtful" and a minimum 75% by value and 60% by number of the lenders should satisfy themselves of the viability of the account and consent of such restructuring subject to the following conditions.

1. It will not be binding on the creditors to take up additional financing worked out under the debt restructuring package
2. The decision to lend or not to lend will depend on each bank/FI separately.
3. All other norms under CDR such as the standstill clause, asset classification status will continue to be applicable to this category also.

How can a reference to the CDR system be triggered?

Reference to Corporate Debt Restructuring System could be triggered by any one or more of the creditors who have minimum 20% share in either working capital or term finance, or the concerned corporate, if supported by a bank or financial institution having stake as above.

What is the legal basis of the CDR system?

CDR is a non-statutory mechanism which is a voluntary system based on Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA). The Debtor-Creditor Agreement (DCA) and the Inter-Creditor Agreement (ICA) shall provide the legal basis to the CDR mechanism. The ICA 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. The lenders in foreign currency outside the country are not a part of CDR system. Such creditors and also creditors like GIC, LIC, UTI, etc., who have not joined the CDR system, could join CDR mechanism of a particular corporate by signing transaction to transaction ICA, wherever they have exposure to such corporate. The Inter-Creditor Agreement would be a legally binding agreement amongst the creditors, with necessary enforcement and penal clauses, wherein the creditors would commit themselves to abide by the various elements of CDR system. One of the most important elements of Debtor-Creditor Agreement would be 'stand still' agreement binding for 90 days, or 180 days by both sides. Under this clause, both the debtor and creditor(s) shall agree to a legally binding 'stand-still' whereby both the parties commit themselves not to take recourse to any other legal action during the 'stand-still' period, this would be necessary for enabling the CDR system to undertake the necessary debt restructuring exercise without any outside intervention, judicial or otherwise. However, the stand-still clause will be applicable only to any civil action either by the borrower or any lender against the other party and will not cover any criminal action. During the pendency of the case with the CDR system, the usual asset classification norms would continue to apply. The process of reclassification of an asset should not stop merely because the case is referred to the CDR Cell. However, if a restructuring package under the CDR system is approved by the Empowered Group, and the approved package is implemented within four months from the date of approval, the asset classification status may be restored to the position which existed when the reference to the Cell was made. Additional finance, if any, is to be provided by all creditors of a 'standard' or 'substandard account' irrespective of whether they are working capital or term creditors, on a pro rata basis. A creditor, outside the minimum 75 per cent and 60 per cent, who does not wish to commit additional financing, for any internal reason, will have an exit option. The lenders who wish to exit from the package 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 exiting lender and the taking over lender. Equity acquired by way of conversion of debt / overdue interest under the CDR mechanism is allowed to be taken up without seeking prior approval from RBI, even if by such acquisition the prudential capital market exposure limit prescribed by the RBI is breached, subject to reporting such holdings to RBI, Department of Banking Supervision (DBS), every month along with the regular DSB Return on Asset Quality.

CDR MECHANISM: Functioning:

Step 1 The Proposal (Time Frame: 30 days)

The agreement between the creditors usually states that such plan as is decided by 75% of secured creditors by value or by 60% of creditors by number shall be executed.

Step 2: Preliminary Scrutiny [Time Frame: 30 days)

The CDR Cell undertakes a scrutiny of the proposal submitted before it.

Step 3 : Detailed Review (Time Frame: 90-180 days)

The Cell puts the plan before the Empowered Group for its prima facie consideration on its feasibility and for suggestions for modifications.

Step 4: The Restructuring Model (Time Frame: Variable)

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