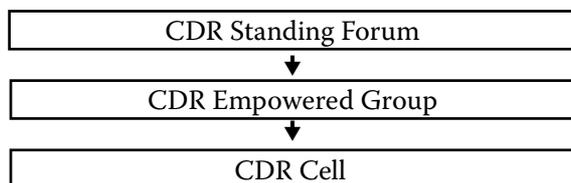




### The CDR Mechanism in India

The genesis of the CDR mechanism in India is an aftermath of the need for the revival of the corporates facing financial hardship and to ensure safety of the money lent by the banks. The CDR system in India is a three-tier structure.



The CDR was given legal recognition by the RBI *vide* circular dated 23<sup>rd</sup> August, 2001.

### Objectives of the CDR mechanism

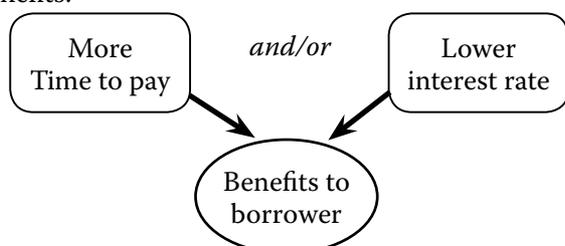
The objectives of the CDR mechanism as enunciated in the scheme evolved by RBI are as follows:

- 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 minimise the losses to the creditors and other stakeholders through an orderly and co-ordinated restructuring programme. (Source: [www.cdrindia.org](http://www.cdrindia.org))

The principle of the CDR mechanism is, preservation of the economic value.

### What Happens under the CDR?

The CDR would normally involve modification of terms of the advances/securities, which would generally include, among others, alteration of repayment period/repayable amount/the amount of installments and rate of interest. It is a mechanism to nurture an otherwise viable unit, which has been adversely impacted, back to health. To put it simply, under the CDR, the borrower gets the following benefits:



### Other Benefits of the CDR

- The CDR can be considered as an out-of-court

restructuring, thus, it avoids litigation which is generally expensive and cumbersome

- The CDR prevents bankruptcy of the company in financial distress by taking necessary steps at the right time to revive the company

### Status of the CDR cases

(as on 30<sup>th</sup> September, 2013)

Particulars	No. of cases	Aggregate debt (₹ in crore)
Total references received by the CDR cell	580	3,62,370
Cases rejected before admission or approval	96	45,256
Cases under consideration of the CDR EG	53	44,828
Total cases approved	431	2,72,286
Cases withdrawn on account of failure	103	24,915
Cases exited successfully	67	51,104
Live cases in the CDR	261	1,96,267

(Source: [www.cdrindia.org](http://www.cdrindia.org))

Based on the above information, the following conclusions can be reached:

- Only 17% of the number of CDR cases (or 12% CDR cases in terms of aggregate debt) were rejected upfront.
- Large number of CDR cases were approved, *i.e.*, 74% of the number of CDR cases (or 75% CDR cases in terms of aggregate debt).
- ***It will be worthwhile to note that out of the cases approved, only 16% of the number of CDR cases (or 19% CDR cases in terms of aggregate debt) were successful.***
- 24% of the number of CDR cases (or 9% CDR cases in terms of aggregate debt) were withdrawn on account of failure; however, this percentage will increase as and when the result of live cases in CDR is out.

Out of the live cases in the CDR, iron & steel, infrastructure, textiles and power industries account for nearly 58% of the aggregate debt of ₹1,96,267 crore with iron and steel having a maximum share of nearly 21% and with infrastructure having nearly 18%.

# Banking and Finance

## Factors contributing to increase in the cases of CDR

- Over-leveraging by companies
- High interest rates due to macroeconomic factors

The fall in India's economic growth made the already over-leveraged Indian companies reluctant to make investments in new projects. However, if the economic downturn was the sole reason for increase in the cases of restructuring, then the impact of the fall in economic growth should have been the same on the public sector and private sector banks, which is not the case. Cases of bad loans are much higher in the public sector banks when compared to private banks. It may be attributed to:

- Interventions by the government to bail out the defaulters.
- Lending to infrastructure projects (building power plants, road, etc.) where the projects are not able to commence operations on account of straining cash flows and delay in clearances to projects by the Government.

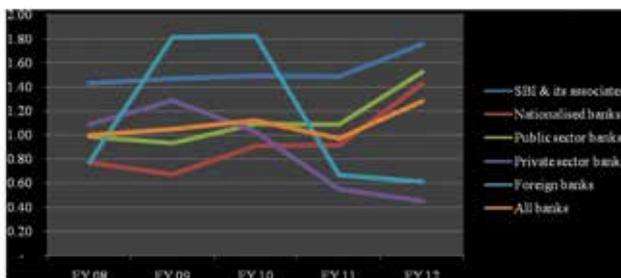
## Loopholes Exploited under the CDR

- Less sacrifice by promoters
- Allowing conversion of debt into equity
- Long extensions being given by the banks
- Lack of proper monitoring on implementation of the CDR package.

Frivolous promoters are exploiting the intent of the CDR mechanism to get undue concession.

## Impact on the banking sector: Due to bad loans & misuse of the CDR mechanism

Let us analyse the net NPA ratio (31<sup>st</sup> March, 2008 to 31<sup>st</sup> March, 2012) of various banks groups based on the information available at the RBI website.

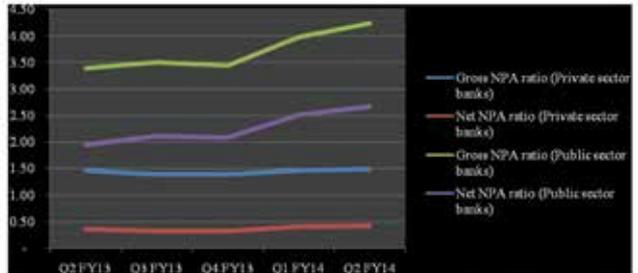


Although foreign banks have underperformed during the FY 9 – FY 10, but their NPAs were

reduced considerably by the end of FY 12. However, nationalised and public sector banks kept performing badly.

## Trend of the NPAs

The trend of the NPAs (based on the above financial information) can be clearly understood with the help of the following chart:



Thus, it can be seen that the ratio of NPA to advances (whether gross or net) is substantially higher in the public sector banks as compared to private sector banks and it is also increasing at a much higher pace.

## The RBI's action plan for increased cases of CDR

The RBI's plan is to expedite the process of debt restructuring and speed up the recovery mechanism so as to ensure that the Indian economy recovers as fast as the US economy recovered after the credit crisis in 2008. Among others, the RBI's plan includes the following:

- Banks should write off bad loans from their books
- The working of debt recovering tribunals should be accelerated
- The working of asset reconstruction companies should be accelerated

In an interview with the Economic Times, Dr. Raghuram Rajan (Governor, RBI) said, "The public does pay a price for restructuring. The public has the right to know that their money is being used in a fair way." The owners should be made accountable and their commitments and obligations should be established towards the CDRs. The lender's right over the ownership of defaulter's assets have to be established to control the misuse of the CDR mechanism. Here, it may be important to note that the banks may not find it feasible to take control of the management of the defaulting company because it may lead to banks concentrating on the business of the defaulting company instead of the banking

business. Also, conversion of debt into equity should be a measure of last resort. In this regard, a preferable option may be that of the change in the management, i.e., banks may find a deserving promoter who can help the company to bring it back to life, or sale of the assets- lock, stock and barrel. Below is an extract of the statement by Dr. Raghuram Rajan on taking office on 4 September, 2013:

*“Finance is not just about lending, it is about recovering loans also. We have to improve the efficiency of the recovery system, especially at a time of economic uncertainty like the present. Recovery should be focused on efficiency and fairness – preserving the value of underlying valuable assets and jobs where possible, even while redeploying unviable assets to new uses and compensating employees fairly. All this should be done while ensuring that contractual priorities are met. The system has to be tolerant of genuine difficulty while coming down hard on mismanagement or fraud.*

*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 recapitalise their failed ventures.*

*Most immediately, we need to accelerate the working of Debt Recovery Tribunals and Asset Reconstruction Companies. Deputy Governor Anand Sinha and I will be examining the necessary steps.*

*I have asked Deputy Governor Dr. Chakrabarty to take a close look at rising NPAs and the restructuring/recovery process, and we too will be taking next steps shortly. RBI proposes to collect credit data and examine large common exposures across banks. This will enable the creation of a central repository on large credits, which we will share with the banks. This will enable banks themselves to be aware of building leverage and common exposures.*

*While the resumption of stalled projects and stronger growth will alleviate some of the banking system difficulties, we will encourage banks to clean up their balance sheets, and commit to a capital raising programme where necessary. The bad loan problem is not alarming yet, but it will only fester and grow if left unaddressed.”*

After his first message, banks are more cautious in offering restructuring of loans and looking closely at the cases where it seems that the funds are being diverted to some other projects. The government has made its intention very clear regarding the CDR, i.e., they will support genuine cases; however, they

will take action against the willful defaulters who commit fraud, e.g., auctioning their collateralised assets, selling NPAs to ARCs, etc. The government is also proposing new rules for the CDR which are under discussion. The new rules recommend the requirement for promoters to pledge 40% of their shareholding and they have to deliver specific results failing which they may lose control.

## Consequences of the new Companies Act, 2013 on CDR

- Under the provisions relating to the national company law tribunal under the Companies Act, 2013, a professional (which includes a Chartered Accountant) can be appointed as a liquidator of the company, thus, easing the existing provisions under the Companies Act, 1956.
- The requirement to approach the Board for Industrial and Financial Reconstruction (BIFR) has been dispensed with.
- Widening of the definition of ‘sick company’ will help the regulator correct the situation before it turns worse.

## What should be the responsibilities of the lenders?

### During the tenure of loan

- Banks should have a system of good governance, e.g., banks should regularly monitor the status of loans
- In suitable cases, banks should issue early warnings to the borrower to avoid a situation of default in repayment of the loan by the borrower in future

### At the time of restructuring of loan

- Banks should not be prompt in approving CDR packages as it will only postpone something which is inevitable
- Banks should ascertain the viability of the project before approving any CDR package
- Banks should ensure that the promoters have not diverted the funds to some other project(s)
- Banks should ensure that no CDR should be allowed in case of suspicious companies, e.g., where the business collapsed on account of mismanagement and not due to the prevailing economic conditions, company having dishonest promoter(s), etc.
- Banks should monitor the cash flows of the company before approving CDR . ■