

CORPORATE DEBT RESTRUCTURING MECHANISM – NEED TO REVIEW/ RE-DEFINE THE POLICY

There are few hurdles in the process of effecting Corporate Debt Restructuring Mechanism and a possible threat to the Indian Economy. The objective of this article is to highlight the noble objectives of corporate debt Restructuring Mechanism; to examine the hurdles and to explore the possible solution to remove these deficiencies.

Corporate Debt Restructuring is one of the most commonly adopted corporate strategies by entities facing financial crunch affected by internal or external factors. The corporate Debt Restructuring Scheme was introduced by the Reserve Bank of India vide its Circular No. BP.BC. 15/21/04.114/2000-01 and the Primary objectives of the corporate Debt Restructuring have been mentioned as:

1. *To ensure a timely and **transparent mechanism** for re-structuring of Corporate Debts of **viable corporate entities** affected by internal or external factors, outside the purview of BIFR , DRT and other legal proceedings **for the benefit of all concerned**.*
2. *To minimize the losses to the creditors and other stakeholders through an orderly and coordinated restructuring program.*

The idea to bring CDR scheme by Reserve Bank of India is based on twin consideration- one is to revive such companies whose cases are genuine and there is very good chance in future that these companies will become profit making organisation and other one is to minimize the losses of the creditors. This noble mechanism is being mischievously misused by some companies.

Of late, it is found that unscrupulous borrower companies are diverting, misusing siphoning their funds for the personal benefit of directors/promoters. This is being done with a view to taking undue advantage of CDR Mechanism which has been causing heavy losses not only to public sector Banks , FIs, Private sector Banks but also other creditors and stakeholders.

To elucidate the aforesaid proposition, the following factors are instrumental for not using CDR Forum for which it was formulated by RBI:-

Transparency is missing in whole mechanism:

No detailed information about the factum of CDR proposal and its approval thereof is made available in public domain in the case of unlisted companies and as to the listed companies, a very scanty information for moving of such application is disseminated , without giving full details of CDR proposal. And as a result, the stakeholders in such companies do not get full picture of CDR application & Approval Order.

In this process, the shareholders/Non CDR lenders/suppliers/creditors/ customers and other stakeholders are kept in dark and they don't have any information in public domain and they do not become aware of terms and conditions of CDR Proposal. And as such it is difficult for them to ascertain as to how far this mechanism is going to affect their interest in the company and thus the transparency is missing from the whole CDR Mechanism. There are instances where CDR Cell has denied to give information to Shareholders and Non-CDR Lenders of a Company which CDR Proposal it has finalized.

Re-structuring of Corporate Debts of viable corporate entities:

In the CDR Scheme, the financial viability parameters pertain to project related aspects and it does not deal with the size, capacity of the Borrower Company & skills of Management of the Company. Most of companies who have opted for Corporate Debt Re-structuring are those which have very small paid-up capital and reserves against their heavy loans.

These types of companies usually borrow heavy loans which is normally 10 to 20 times more than their Paid-up capital and Reserves for their ambitious project or otherwise, and many times this loan amount is out of their repaying capacity.

It is noticed that the Management of such companies failed to properly execute their plan and policies and after destroying the financial health of the company, they attempt to escape the liabilities of the company by taking recourse of CDR mechanism.

Thus, the CDR Forum has become a safe platform for those companies whose management has failed to execute policies due to their mis-management and incapability to manage the company and also for stopping the payment of all creditors/lenders and bankers in the name of Corporate Debt Re-structuring. Therefore, there is need to re-define the parameters of viable corporate entities so that only genuine companies can take the advantage of this scheme.

For the benefit of all concerned:

The basic idea for which this CDR scheme was brought, is to benefit all the concerned of a Company. The expression "All Concerned" has very wide meaning and includes Shareholder, Creditors, Suppliers, Secured Lenders, Unsecured Lenders and public at large.

But under the existing CDR Mechanism, the interest of other stakeholders is not protected especially those who do not participate in the scheme but their name is inserted without their consent and the outstanding dues of such lenders are not paid under the guise of CDR scheme.

Surprisingly in the whole CDR Scheme, no provision is made regarding re-payment of unsecured lenders & suppliers who are not CDR Members. Hence this scheme is not serving interest of all concerned.

In the case of listed entity where management & promoters have only 20 to 35% shareholding, Management of these companies not take any approval from shareholders for compromise with CDR Lenders and without approval of shareholders they made contract with Banks and in that process they grant options to CDR Member Banks to convert their loan into Equity in upcoming years & resultant shares are so huge in nos. that it may result into takeover of Company into hands of CDR Members Banks. If management of these Companies failed to ratify the terms of allotment of shares in General Meeting that these Contract will be void ab initio.

Possible threat:

In the prevalent scenario of Indian economy, if the CDR Scheme is allowed to continue without putting stringent riders on the companies seeking the benefit of CDR Mechanism, there is a possible threat that the unscrupulous borrower companies, after availing heavy loans from Banks, financial institutions and other lenders, may be induced and encourage to take undue advantage of CDR Scheme which may be detrimental in the long run to the interest of lenders and public at large.

Suggestion for improvement of CDR Mechanism:

1. Improvement of Transparency in the working of CDR Cell:

If any borrower company makes an application to CDR Forum for re-structuring its debts, copy of application of CDR proposal and its approval order thereof is displayed in the public domain by putting at the web-site of RBI and CDR Cell or the highlights of CDR approval order may be displayed at these websites containing information relating to the amount of the loan re-structured and un-structured loans, concessional rate of interest, the estimation of performance of the company in coming years and other terms and conditions to enable other lender to know the status and also the possible impacts on its loans outstanding against the borrowing company it should also contain the condition for the utilization of the CDR package.

RBI should be the final approval authority of CDR Proposals and RBI should provide the detailed information to stakeholders relating to a CDR Proposals.

2. Enlarge the criteria of Viable Corporate Entities:

Following parameters be include in Financial Viability Parameters as defined in clause 3 of CDR Master Circular dated June 3, 2009 so as to define the Viable corporate entities:

- i. Only those companies may be allowed to take the advantage of this scheme which has sufficient Paid-up capital + Reserves against its debts.
- ii. Two years financial accounts of company, preceding the financial year in which the application for corporate debt re-structuring was filed with CDR Cell, be re-audited by any one of the Big Four Chartered Accountant Firms and this Audit Report be displayed on the web site of RBI & CDR Cell so that the present correct picture of the company could be known to stakeholders & irregularities and fraud, if any, could be detected.
- iii. Those listed & unlisted companies in which promoters and directors have disinvested their stake from the company and made personal gain, may prohibited from taking advantage of this scheme.
- iv. Only those companies may be eligible for this scheme which have followed Good corporate Governance and have complied with all the corporate laws, listing agreement, if applicable, and other related laws & their financial viability is assessed to survive to the expectations made in the approval.
- v. There should be a specific provision in the approval of the CDR that if subsequently it is brought to the notice to the CDR cell that the borrower company has willfully diverted and misutilize its funds and has committed misfeasance or fraud the approval is canceled and action against the directors /promoters is launched by the RBI/ CDR Cell so that the other companies could not venture for seeking unjustified relief under the scheme.

3. Benefit should be for all the stakeholders :

To fulfill this basic object of the CDR Scheme, the interest of all stakeholders need to be taken care of and there should be some provisions relating to the payments of unsecured & secured lenders who are not taking part in the CDR Scheme & such stipulation are also incorporated in the order of approval of scheme.

RBI should monitor the whole order of CDR proposal and make specific arrangement for payment of Non CDR lender/ creditors so that their interest will not suffered.

Thus in the light of above there is strong need to rethink the whole CDR Mechanism by RBI as the money involved in the CDR Mechanism largely belongs to public sector banks like SBI, IDBI, ICICI, etc, and all these monies belong to public .

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