40 Years of Leadership

Evolution of Debt Restructuring Mechanisms in India
(December, 2016)

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Abbreviations

ALM	Asset Liability Management
AE	Aggregate Exposure
BIFR	Board for Industrial and Financial Reconstruction
CAP	Corrective Action Plan
CRILC	Central Repository Information on Large Credits
CDR	Corporate Debt Restructuring
CoD	Commercial operations Date
DRT	Debt Recovery Tribunal
INR	Indian Rupee
JLF	Joint Lending Forum
NPA	Non-Performing Assets
OC	Overseeing Committee
RBI	Reserve Bank of India
SDR	Strategic Debt Restructuring
S4A	Scheme for Sustainable Structuring of Stressed Assets
SMA	Special Mention Accounts
TEV	Techno Economic Viability
T and C	Terms and Conditions

Synopsis

Debt restructuring?

- It is a process that allows an entity facing cash flow problems and financial distress to reduce and/or renegotiate/reorganize its delinquent debts in order to improve or restore liquidity so that it can continue its operations.

When can a Cash Flow problems and Financial Distress be confirmed ?

- Default in paying principle outstanding debt obligation when due; or
- Default in timely servicing of interest cost.

Debt can be restructured is several ways including some of the combinations listed below. The list below is not exhaustive:

- Increasing the tenure of the loan repayment period.
- Reducing the Rate of Interest.
- One time Settlement with the borrower.
- Conversion of Debt into Equity (including convertible instruments with form similar to equity) .
- Converting un-serviced interest cost /working capital loans into Term loan.

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Objectives of Debt Restructuring

- Objective is to preserve & sustain Viable Corporates that are affected by certain internal and/or external uncertainties
- Principle of restructuring should be that the equity shareholders bear the first loss arising out of business uncertainties; rather than the debt holders
- Debt restructuring aims at minimizing the losses to creditors & other stakeholders through an orderly plan

Evolution of Restructuring in India

First formal restructuring mechanism was introduced in India in 2001 through formation of Corporate Debt Restructuring (CDR) Scheme.

Prior to CDR Scheme, there were no formal guidelines on restructuring. However prior to CDR; debt revival and safeguarding of stakeholder interest was addressed through:

- Board for Industrial & Financial Reconstruction (BIFR): For considering revival and rehabilitation of the companies.
- Debt Recovery Tribunal (DRT): To enable Bank and Financial Institutions to initiate recovery proceedings.
- SARFESI Act, 2002: Enforcement of Security Interest by secured creditors without intervention of court.

CDR was introduced to **Safeguard interest of Creditors and lenders in particular** and other stakeholders in general. Since then there has been introduction & evolution of various other Restructuring Tools namely SDR, S4A, JLF & CAP and 5/25.

New mechanisms were developed by Reserve Bank of India (RBI) for providing formal procedure and general guidelines for companies facing financial difficulty because of factors beyond their control and also due to certain internal reasons.

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Restructuring Mechanisms- Timelines

- CDR mechanism: 2001.
- Joint Lending Forum (JLF) and Corrective Action Plan (CAP) mechanism: January, 2014.
- Flexible Structuring of Long Term Project Loans to Infrastructure and Core Industries (5 : 25 Scheme) : July, 2014.
- Strategic Debt Restructuring Scheme (SDR): June, 2015.
- Scheme for Sustainable Structuring of Stressed Assets (S4A) :June, 2016.

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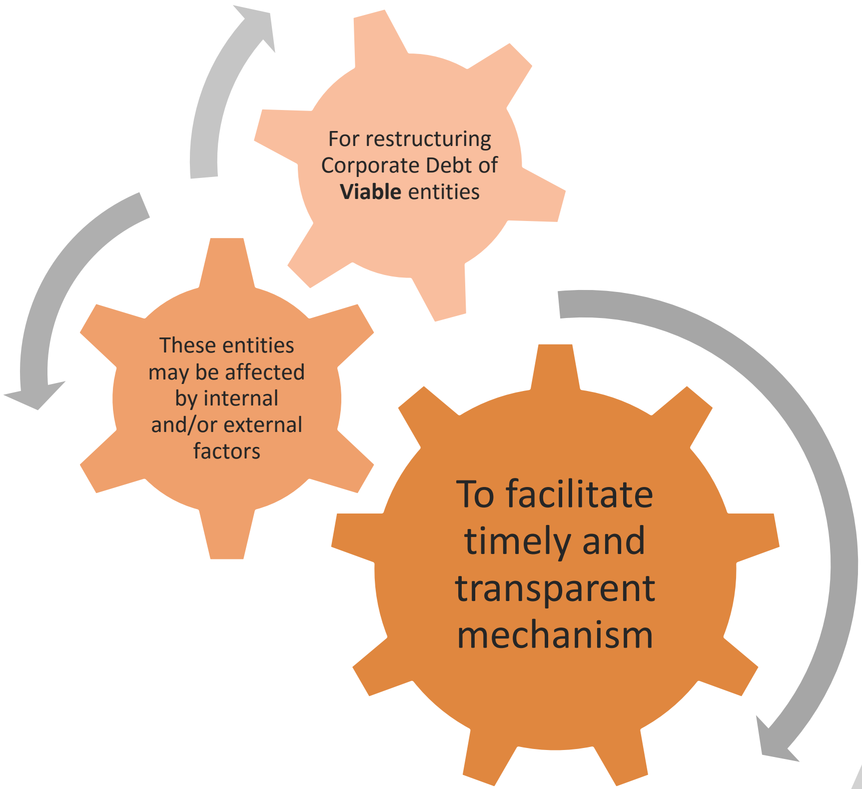
CDR



Hierarchy under CDR

CDR Standing Committee:

It is Representative general body of all financial institutions and participants. It formulates guidelines through CDR Core group.

CDR Empowered Group:

It considers , evaluates and decide on all cases of requests of restructuring, submitted to it by CDR Cell.

CDR Cell:

CDR Cell, in conjunction with lead banks, works out on the detailed restructuring package. The package is submitted to CDR Empowered Group for review

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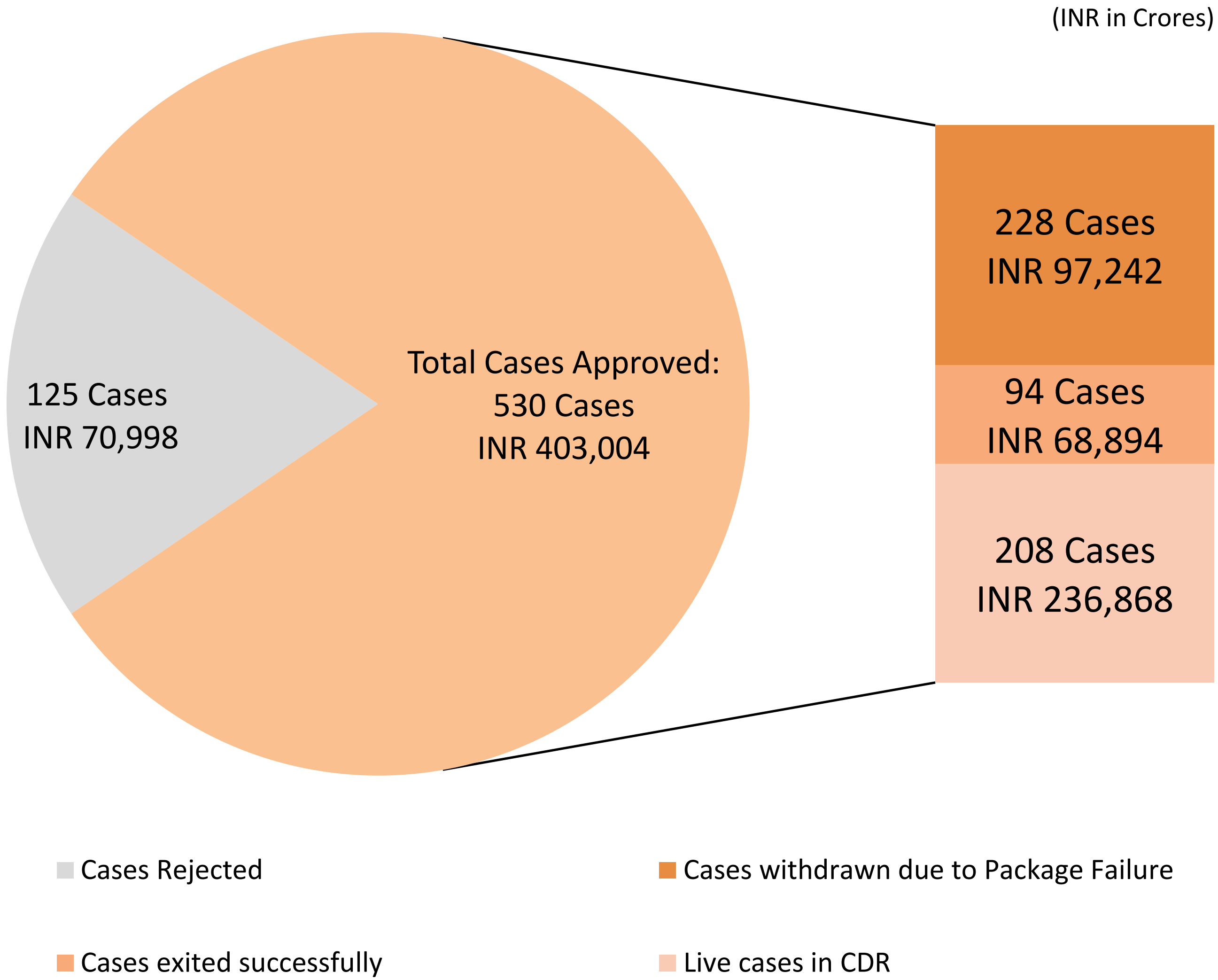
CDR Performance Report



- Only 15% cases (INR 68,894 crores) have successfully exited from CDR since its inception.
- Certain institutions may have used CDR as a ever-greening tool.
- RBI has since introduced several tools for early identification & addressing the week links in the CDR mechanism.
- These tools include JLF&CAP, SDR, S4A & 5:25.

Source: www.cdrindia.org. Figures as on June 30, 2016.

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JLF and CAP

Lenders are required to identify the stress in the account and implement a revival plan before the account turns into NPA.

To facilitate early warning signs, RBI created platform of CRILC where all lenders are mandated to provide status of all such accounts where Aggregate Exposure (AE) is more than INR 50 Million.

Accordingly, banks are required to identify incipient stress in the account, before it turns into NPA, by creating three sub categories under Special Mention Account (SMA) category as mentioned below:

Bankers are mandated to form JLF as soon as any of the lender has classified the account as SMA – 2 and AE is more than INR 1000 Million. But, they can also form JLF even if above two conditions are not met.

CAP is formulated by JLF to arrive at an early and feasible solution to preserve the economic value of the underlying assets as well as the lender's loans.

CRILC Classification

SMA Sub Categories	Basis of Classification
SMA – 0	Principal or Interest payment not overdue for more than 30 days but account shows signs of incipient stress.
SMA – 1	Principal or interest payment overdue between 31-60 days.
SMA – 2	Principal or interest payment overdue between 61-90 days.

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Options under CAP

3 Options available under CAP

Rectification:

Commitment from the Borrower to regularize the accounts without any change in T & C of the loans. Also possibility of getting some other equity/strategic investors may be explored.

Restructuring:

Will be undertaken only if it is prima facie viable. JLF can undertake restructuring without referring it to CDR Cell, however, it is required to carry out detailed Techno-Economic Viability (TEV) study to conform viability of the restructuring package.

Recovery:

If above 2 options can not be worked out then due process of recovery may be resorted.

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S D R

SDR Briefing

It has been observed that in many cases of restructuring of accounts, borrowers companies are not able to come out of stress **due to operational/managerial inefficiencies** despite substantial hair cut taken by lenders.

With as view to ensuring more stake of promoters in reviving stressed accounts and provide banks with enhanced capabilities to initiate change of ownership in accounts which fails to achieve the projected viability milestones, which were specified in restructuring package under JLF mechanism, banks may, at their discretion, undertake a **Strategic Debt Restructuring (SDR)** by converting loan dues to equity shares.

(a) All lenders under the JLF must collectively hold 51% or more of the equity shares capital of the borrower.

(b) Consent of at least 75% of lenders by value and 60% of lenders by number need to accent, in order to initiate SDR.

(c)A decision whether to invoke SDR to be taken within 30 days of the account review.

Outside SDR

It is a change in ownership of borrowing entities without banks subscribing to fresh issue of equity shares by the borrowing entity is referred to as Outside SRD restructuring.

Change in ownership could be effected by way of (a) direct sale of shares to new promoters, (b) lenders invocation of pledge shares, (c) acquisition of the borrowing entity by another entity.

S4A

Purpose of S4A:

1. Debt servicing capacity not determined based on future projected cash flows; rather based on existing operating cash flow levels.
2. That level of debt, which can be serviced by existing cash flows levels are allowed to continue as debt and remaining portion of the loan is converted into equity/quasi-equity instruments.
3. Upside to lenders will be through future increase in the market value of converted equity/quasi equity instruments, if the borrower sees a turn around.

Eligible Accounts:

1. Applicable in case of project finance
2. The AE is more than INR 500 Crs.
3. The Project has commenced commercial operations
4. Should meet the Debt Sustainability criteria; as explain below

Debt Sustainability Criteria:

1. Through independent TEV, Sustainable Debt is determined, which is that level of Debt of principal value amongst funded/non-funded liabilities, which can be serviced over the same tenor as that of the existing facilities even if the future cash flows remain at current level.
2. Sustainable Debt should not be less than 50% of current funded Debt.

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S4A

Sustainable Debt:

1. JLF/Consortium Bank/Bank Shall, after an independent TEV, bifurcate current dues of the borrower in Part A and Part B.
2. Part A is that level of debt that can be serviced within respective residual maturities of existing debt based on the cash flows available from the current level of operations.
3. Part B is the difference between aggregate current outstanding debt and Part A.

The Resolution Plan:

1. There shall be no fresh moratorium granted on interest or principal repayment for servicing of Part A.
2. There shall be no modification in T & C for servicing Part A, as envisaged during initial funding.
3. Part B shall be converted into Equity/redeemable cumulative optionally convertible preference shares. In case there is no change in promoters, then bank can convert into Optionally Convertible Debentures also.

Post Resolution Ownership:

Following are the probable scenarios:

1. The current promoters continues to hold majority shares or manage the company.
2. The current promoter is replaced by the new promoters either through SDR Mechanism or Outside SDR Mechanism.
3. Lenders acquire majority shareholding and (a) allow the current management to continue or (b) hand over management to professionals under an Operate and Manage Contract.

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S 4 A

Other Important guidelines

The JLF/Consortium/Bank shall engage the services of credible professional agencies to conduct the TEV and prepare resolution plan.

The resolution plan shall be agreed upon by minimum of 75% of lenders by value and 50% by numbers.

The resolution plan and control rights should be structured in such a way that when there is no change in promoters the promoters are not in position to sell the company/firm without the prior approval of lenders and without sharing the upside, if any , with lenders towards losses in Part B.

The resolution plan shall be submitted by the JLF/Consortium/Bank to the OC. OC comprises of eminent persons appointed by Indian Bank Association in consultation with RBI.

OC will review the processes involved in preparation of resolution plan for reasonableness and adherence to the provisions of these guidelines and opine on it. It will act as an advisory body.

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Flexible Restructuring Scheme (5:25 Scheme)

Introduction:

- Was introduced to assist banks manage their ALM mismatch – in financing projects with long amortization periods (says 15 to 30 years)
- Earlier, banks were unable to finance beyond 12 years; even for projects which may be monetized over longer periods
- Under 5:25, lenders are allowed to fix longer amortization period for project loans, with periodic refinancing after establishing fundamental viability of the project especially through interest coverage ratios
- The repayment at the end of each refinancing period would be structured as a bullet repayment

Conditions:

- Applicable to new project loans in all sectors without any cap on AE.
- In case of existing projects, AE should exceed INR 2500 Million.
- Lenders may fix a Fresh Amortization schedule once during life time of the project, after the Commercial Operations Date (CoD).
- Flexible structuring of funded exposures to construction companies is possible only if such exposure are specifically identifiable against each independent project.

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