Corporate Debt Restructuring- Issues and Way Forward[1]

Ms. Soundara Kumar, Deputy Managing Director, State Bank of India, Mr. Siby Anthony, Managing Director & CEO, Edelweiss Asset Reconstruction Co. Ltd., Mr. R. Sundaram, President (Finance) & Company Secretary, Indo Count Industries Limited, Mr. T.R Madhavan, Executive Chairman, Centrum Group, and, seated in front of the dais, Mr. Chandir Gidwani , Promoter, Centrum Group, other distinguished guests, members of the print and electronic media, ladies and gentlemen, I wish all of you a very good morning . I must also remember in absentia, Mr. K. V. Krishnamurthy, ex-Chairman and Managing Director, Bank of India, because of whose request I am here today. It is indeed my pleasure to be here today to discuss this very topical subject of Corporate Debt Restructuring – a subject in which I also have a lot of personal interest.

2. Corporate Debt Restructuring (CDR) or simply restructuring of loans and advances, with all its pros and cons, is an effective financial tool, especially during the times of crisis, for smoothening the adverse effects of economic downturns on the borrowers of credit as well as their lenders. I congratulate the organisers of the Seminar for choosing this very relevant topic at a time when the world economy has completed five years since the sub-prime crisis in the USA in mid-2007, which gave way to the full-fledged global financial crisis of 2008 and the global recession of 2009, the fourth such recession since World War II. The present crisis and the global recession of 2009, like the previous three global recessions of 1975, 1982 and 1991 and the great depression of the 1930s, have necessitated the banks all over the world to deleverage as also to restructure a large number of their household and corporate debt. But, any kind of restructuring has to be accompanied by prudence on the part of the lenders and financial discipline on the part of the borrowers. Absence of these conditions results in dead weight loss to the society in general.

Ethics and the Role of Finance Professionals

[1] Address by Dr. K. C. Chakrabarty, Deputy Governor, Reserve Bank of India at the Corporate Debt Restructuring Conference 2012 organized by Centrum Group at Mumbai on August 11, 2012. Assistance provided by Shri M.P.Baliga, Ms Dimple Bhandia and Shri M. K. Poddar in preparation of this address is gratefully acknowledged.

3. I will also like to quote two statements from the corporate mission of the organiser (Centrum Group) of this Conference , which interconnect the reasons for and solutions to the woes of the financial sector and which is also relevant to the topic of my discussion.

- Challenge the status quo and provide financial consultancy and syndicated products to deliver value beyond expectations.
- Focus on conducting business ethically.

Firstly, challenging the status quo and delivering value beyond expectations require innovation in products and services. However, ethics help in preventing misuse. These facts can be seen in the genesis of the global financial crisis. It was not the innovative financial products but the lack of ethics in their design and sale which led to the crisis. CDR was also a beautiful innovation to protect the values of both the corporates under distress and the credit portfolio of their lenders. However, due to the extraordinary rise in the number and volume of advances being restructured under the scheme in recent times, it has come under media scanner, and engaged the attention of the financial market players, the borrowers, the regulators and the policy makers. However, it appears that the provisions of the CDR mechanism have not been used very ethically and judiciously, giving rise to the unprecedented increase in cases under CDR.

4. Viability criteria, a critical element in any restructuring, and its assessment brings into picture a number of professionals apart from the essential counterparties to a loan agreement, i.e. the borrowers and the lenders. Financial services companies and professionals comprising of investment bankers, Chartered Accountants, Company Secretaries, Surveyors, Chartered Engineers, Financial Analysts, Cost Accountants, Lawyers, etc., play a very important role in assessing the viability of restructuring proposals. Due to constraints of time and skills as also because of statutory requirements, lenders have to rely on the due-diligence done and certificates given by such professionals. However, such decisions are prone to Type I and Type II errors of statistics, i.e. an unscrupulous borrower with an unviable account may avail the benefit of restructuring and at the same time, a bonafide

borrower with a viable account may be denied the opportunity to resurrect his account. Therefore, ethics and professionalism of individuals in such positions go a long way in ensuring that such errors do not occur. Centrum and other professionals, therefore, must ensure that their mission statements and professional codes of conduct do not remain mere fancy statements but become their ***raison d'être***.

5. Against this backdrop, I will structure my discussions in various segments. First, I will elaborate on what constitutes debt restructuring and the genesis of restructuring, including that of corporate debt restructuring, in the country. I will then discuss why restructuring is important and also what is the role of regulators in debt restructuring. Debt restructuring, in particular corporate debt restructuring, has become a subject of discussion of late. I will touch upon the reasons why this is so, going on to talk about why the Reserve Bank is concerned in this regard. Finally, I will outline what I feel is the way forward if restructuring is to continue as an instrument for ensuring the well being of lenders, borrowers and the society at large.

What is Restructuring and its Genesis

6. As I briefly mentioned a little while ago, any change in the Terms and Conditions of the loan or credit, especially in respect of its servicing, is called restructuring of loan/ debt. Corporate debt restructuring is a specialised institutional mechanism for restructuring large exposures involving more than one lender under consortium/multiple banking arrangements.

7. Stijn Claessens of the World Bank has defined and explained in detail the term ‘restructuring’ in his seminal paper “Policy Approaches to Corporate Restructuring around the World: What Worked, What Failed?” I quote “Restructuring refers to several related processes: recognizing and allocating financial losses, restructuring the financial claims of financial institutions and corporations, and restructuring the operations of financial institutions and corporations. Recognition or resolution involves the allocation of existing losses and associated redistribution of wealth and control. Losses—that is, differences between financial institutions’ and corporations’ market value of assets and nominal values of liabilities—can be allocated to shareholders by dilution, to depositors and external creditors by reduction (of the

present value) of their claims, to employees and suppliers by payment of lower wages and prices, and to the government—that is, the public at large—through higher taxes, expenditure cuts, or inflation. Financial restructuring for corporations can take many forms: rescheduling (extension of maturities), lower interest rates, debt for equity swaps, debt forgiveness, indexing of interest payments to earnings, and so on. The main aims of financial restructuring are separating and treating appropriately viable and nonviable firms and creating the right incentives for operational restructuring. Operational restructuring, an on-going process, includes improvements in efficiency and management, reductions in staff and wages, sales of assets (for example, reduction in subsidiaries), enhanced marketing efforts, and so on, with the expectation of higher profitability and cash flow". Unquote.

8. Before I go into the details of the issues involving CDR in India, I will like to elucidate, in brief, the evolution of restructuring. Restructuring of loans and advances is not a new phenomenon in India and terms such as rescheduling / renegotiation / rehabilitation / restructuring have been used interchangeably by the Reserve Bank of India (RBI) and banks since long. Reserve Bank's prudential guidelines on restructuring of advances have evolved over a period of time from simple instructions to reschedule the loans of people affected by natural calamities in the late 1970s to comprehensive guidelines on restructuring of loans to large corporates under consortium/multiple banking arrangement. The guidelines gradually evolved in tune with the changing dynamics of the financial and real markets by taking into account the international best practices, recommendations of various committees and feedback from the stakeholders. CDR is a specialised institutional arrangement for restructuring of large credit exposures of multiple banks to corporates.

9. The need for such a specialised institutional mechanism arose in the background of difficulties faced by banks while restructuring their large exposures involving more than one lender, under consortium/multiple banking arrangement. While it was easier for banks to negotiate the terms of restructuring of their own exposure with their customers, they found it difficult to co-ordinate their negotiation and monitoring efforts where restructuring involved multiple lenders. Therefore, a need was felt to devise a system where restructuring of large corporate exposures from multiple

banks under consortium/multiple banking arrangements could be carried out. The Reserve Bank was seized of the matter and it put in place the scheme of CDR in August 2001 based on the mechanism prevalent in countries like the U.K., Thailand, Korea, Malaysia, etc. These guidelines were finalised after extensive discussion between Government of India, Reserve Bank, Banks and FIs.

10. The objective of the CDR framework was 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. In particular, the framework aimed at preserving viable corporates affected by certain internal and external factors, thereby minimizing the losses to the creditors and other stakeholders through an orderly and coordinated restructuring programme. Viability of the account was an important condition for restructuring with malfeasance/fraud and cases of wilful default being barred from the CDR mechanism. These guidelines also adopted the existing asset classification benefit available to fully secured standard accounts, on restructuring, which was previously permitted vide a March 2001 circular. These guidelines on CDR were subsequently reviewed and revised on the basis of recommendations of a High Level Group under the Chairmanship of Shri Vepa Kamesam, in February 2003 and a Special Group under the Chairmanship of Smt. S. Gopinath, in November 2005. Subsequent to these reviews, guidelines on CDR mechanism allowed restructuring of exposures of Rs.10 crore and above and restructuring of accounts even classified as Doubtful, subject to their viability, under category 2 CDR System. Through these guidelines, RBI also delegated the authority to approve the corporate debt restructuring packages to CDR Standing Forum and CDR Empowered Group and retained with itself only the authority to issue the broad guidelines. The current comprehensive guidelines on CDR as well as non-CDR restructuring were issued in August 2008.

Why is Restructuring Required?

11. Let me now turn to the question of why restructuring is required. You would agree that it is a societal convention to attempt to assist anyone in distress. Similarly, restructuring is a tool to lend a hand of assistance to borrowers who are temporarily

in distress, in particular, where the distress is caused by circumstances beyond the control of the borrower. Thus, debt restructuring may be required under certain circumstances viz. a general downturn in the economy or in any particular sector, which result in the deterioration in the financial health of borrowers. It may also be warranted in case of emergence of legal or other issues that cause delays, particularly in cases of project implementation. External developments, such as global factors may also result in widespread impact on the financial health of borrowers and may necessitate use of restructuring as a tool to help the borrower tide over difficult circumstances.

Restructuring of Accounts – Role of the Regulator

12. Let me now turn to the role of the regulator in restructuring of accounts. But first let me explore some myths which are commonly accepted about restructuring in the country. First, it is a prevalent misconception among the industry and borrowers that restructuring can be carried out only in cases of standard accounts. The Reserve Bank has clarified time and again that even the accounts classified as substandard and doubtful can be restructured, if found viable. However, the asset classification benefit of retention of standard account classification after restructuring, although it being an event of impairment, is a regulatory forbearance. Such regulatory forbearance is available on certain conditions laid down by the Reserve Bank's guidelines. But accounts can always be restructured outside the regulatory forbearance, if found viable.

13. Even the accounts which are compulsorily downgraded on restructuring due to absence of regulatory forbearance can be upgraded after satisfactory performance during the specified period. Industry, borrowers as well as banks approach the Reserve Bank for granting them the permission to restructure their accounts on account of some hardship. As the RBI guidelines on restructuring are comprehensive and applicable to all borrowers and they already provide some regulatory forbearance, such requests imply a request for further relaxations in our guidelines.
Such frequent tweaking with regulatory guidelines is not an ideal practice and therefore, the Reserve Bank generally does not agree to such requests. At times an impression is created that such refusals imply that these accounts cannot be

restructured. However, the fact remains that restructuring of viable accounts is always in the domain of the banks and it is the duty of the banks to nurture a viable account even in the absence of asset classification benefit.

14. Having presented some of these common misconceptions about the regulatory approach to restructuring; let me know turn to why regulators are interested in what is, after all, a bilateral commercial decision between the borrower and the bank. The regulator's interest in restructuring emerges from the close linkages between restructured accounts and non-performing advances (NPAs). Let me elucidate. If the terms and conditions of loans, especially in relation to repayment are not adhered to, especially for a specified period of time, account is classified as an NPA. If accounts are restructured, then too, the terms and conditions of the loans are not fulfilled. But such accounts are not always classified as NPAs. From an operational perspective, there can be two types of restructured accounts: the first type of accounts are those which are restructured and classified as NPAs; the second type are those which are restructured but asset classification is retained as standard.

15. In the first case, regulatory concerns are few and limited to the issue of upgrading the account to the standard category. In general, a NPA account, can be upgraded when the terms and conditions of the loan are fulfilled by the borrower. In the case of restructured accounts, however, the original terms and conditions are changed. Hence, the issue of the conditions under which the account can be considered as standard or upgraded to the standard category become pertinent. Regulatory guidelines attempt to lay down the broad parameters under which restructured accounts can be treated as standard. The second type of restructured accounts, however, attract greater regulatory attention, due to the associated moral hazard problems – that of the potential of an account being restructured, at times repeatedly, to avoid classification as an NPA. This give rise to the need for regulatory and/or prudential guidance. Hence, the role of the regulator in case of restructuring of accounts arises with regard to the issue of prudential guidelines for determining the asset classification of account at the time of restructuring and the time frame for upgradation of restructured NPA accounts. The regulator also comes

into the picture for the purpose of granting regulatory forbearance with respect to asset classification under exceptional circumstances.

Trends in Restructuring

16. As I mentioned at the outset, CDR, has come under the attention because of the extraordinary rise in the number and volume of advances being restructured under the scheme in recent times. The guidelines on restructuring have generally been used to the advantage of both the borrowers and the banks in situations of economic downturns and temporary cash flow problems. However, due to extraordinary rise in the cases referred to and restructured under CDR mechanism during the current and previous fiscal years, questions are being raised as to whether this indicates a general downturn or gross misuse of the CDR Mechanism by banks and corporate borrowers.

17. Slowdown in the country amidst overall global slowdown is generally being cited as the reason for the recent increase in restructured accounts. In fact, an analysis of the data and trends in restructured accounts, especially standard restructured accounts, seem to suggest differently. The reason for choosing the data on standard restructured accounts is that possibilities of unviable accounts getting restructured is greater when some kind of regulatory forbearance is available on asset quality and provisioning.

18. The increase in resorting to restructuring can be partially attributed to excessive leveraging by some borrowers during boom period. An analysis of the trends in leverage of the larger borrowers in the country during the first decade of this century certainly seems to suggest this. Again, there are deficiencies in the manner in which project appraisal is conducted especially with regard to cash flow analysis and determination of the date of completion of projects. When commercial operations are delayed, a host of factors including the uncertainties surrounding the project are cited as the reason. But, when there are uncertainties, these have to be accounted for during the appraisal of the project and a proper cushion needs to be built to take care of these uncertainties. Instead, the effort is to appraise a project keeping in view an aggressive repayment schedule resulting in a very short term focus of

borrowers, banks and financial analysts who appraise the project. This short term focus, in many cases, is the reason for the need for successive restructuring.

19. Let us look at some of statistical trends in restructured advances in the last few years. From the data available with RBI (Table 1), it is observed that between March 2009 and March 2012, while total gross advances of the banking system grew at a compound annual growth rate of less than 20 per cent, restructured standard advances grew by over 40 per cent. Resultantly, the proportion of Restructured Standard Advances to Gross Total Advances increased from 3.45 per cent in March 2011 to 4.68 per cent in March 2012.

Table 1: Trends in Restructuring

Particulars		March 2009	March 2010	March 2011	March 2012
Gross Advances	Gross Advances (Rs. Crore)	27,53,365	32,27,287	39,82,954	46,55,271
	Growth Rate (%)		17.21	23.41	16.88
	Compound annual growth rate (2009-2012) (%)				19.13
Restructured Standard Advances	Restructured Standard Advances (Rs. Crore)	75,304	1,36,426	1,37,602	2,18,068
	Growth Rate (%)		81.17	0.86	58.48
	Compound annual growth rate (2009-2012) (%)				42.54
Restructured Standard to Gross Advances	Ratio (%)	2.73	4.23	3.45	4.68

20. A further analysis of data suggests distinct trends in restructured accounts in public sector banks and in private sector and foreign banks. Restructured accounts have growth at a compound annual growth rate of 47.86 per cent in public sector banks as against a growth rate of credit of 19.57 per cent. The corresponding figures for private sector and foreign banks are 8.12 per cent (restructured advances) and 19.88 per cent (credit growth) and (-) 25.48 per cent (restructured advances) and

10.96 per cent (credit growth) respectively. Further, as on March 2012, the ratio of Restructured Standard Advances to Total Gross Advances is highest for PSBs at 5.73 per cent, while the ratio is significantly lower for private and foreign banks at 1.61 per cent and 0.22 per cent, respectively (Tables 2 and 3).

Table 2: Trends in Restructuring across Bank Groups - Growth Rates in %

Particulars	2009-10		2010-11		2011-12	
	Gross Advances	Restructured Standard Advances	Gross Advances	Restructured Standard Advances	Gross Advances	Restructured Standard Advances (*)
All Banks	**17.21**	**81.17**	**23.41**	**0.86**	**16.88**	**58.48 (42.54)**
Public Sector Banks	19.81	96.59	22.98	3.86	16.02	58.33 (47.86)
Private Sector Banks	12.80	5.60	26.60	(-)28.48	20.65	67.35 (8.12)
Foreign Banks	(-)1.38	(-)25.06	19.06	(-)27.56	16.35	(-)23.76 ((-)25.48)

(*) Figures in brackets are the compound annual growth rates between 2009 and 2012

Table 3: Ratio of Restructured Standard Advances to Gross Advances (%) across Bank Groups

Particulars	March 2009	March 2010	March 2011	March 2012
All Banks	**2.73**	**4.23**	**3.45**	**4.68**
Public Sector Banks	3.03	4.97	4.20	5.73
Private Sector Banks	2.19	2.05	1.16	1.61
Foreign Banks	0.73	0.55	0.34	0.22

21. A further granular breakup of the data on restructuring over the last few years indicates that the ratio of restructured accounts to gross advances is the highest for the Industries sector at 8.24 per cent (with medium and large industries sector being at 9.34 per cent). The ratio for agriculture stood at 1.45 per cent, while that for services stood at 3.99 per cent (with micro and small services being 0.94 per cent). While the ratio stood at 2.24 per cent for priority sector advances, it stood at 5.83 per cent for non-priority sector loans. The data clearly highlights the fact that restructuring is resorted to liberally in case of industrial sector (particularly large

industries), while smaller borrower accounts such as agriculture and micro and small enterprises see less of restructuring (Tables 4 and 5).

Table 4: Trends in Restructuring across Sectors - Growth Rates in %

Particulars	2009-10		2010-11		2011-12	
Segments	Gross Advances	Restructured Standard Advances	Gross Advances	Restructured Standard Advances	Gross Advances	Restructured Standard Advances
Agriculture	25.74	64.91	15.65	11.16	15.09	20.74
Industries	24.14	93.87	26.96	(-)0.23	19.52	64.70
Industries - Micro and Small	13.06	52.79	12.84	(-)3.61	20.32	(-)17.51
Industries - Med and Large	26.79	99.21	29.96	0.11	19.38	72.59
Services	29.02	79.91	31.99	35.67	20.74	134.34
Services - Micro and Small	53.87	49.44	42.19	1.50	14.74	1.02
Services - Med and Large	22.03	89.36	28.37	44.04	23.10	157.35
Others	1.08	49.37	16.78	(-)14.80	11.20	(-)16.04
Total	**17.21**	**81.17**	**23.41**	**0.86**	**16.88**	**58.48**

Table 5: Ratio of Restructured Standard Advances to Gross Advances (%) across Sectors

Particulars	March 2009	March 2010	March 2011	March 2012
Agriculture	1.10	1.44	1.38	1.45
Industries	4.87	7.60	5.98	8.24
Micro and Small	2.91	3.93	3.36	2.30
Medium & Large	5.34	8.39	6.46	9.34
Services	1.43	2.00	2.05	3.99
Micro and Small	1.54	1.50	1.07	0.94
Medium and Large	1.40	2.17	2.44	5.10
Others	1.78	2.62	1.91	1.45
Total	**2.73**	**4.23**	**3.45**	**4.68**

Trends in Restructuring – Regulatory Concerns

22. The above trends clearly underscore the reasons for the regulatory discomfort with the manner in which the extant restructuring guidelines and the associated regulatory forbearance are being used. While clearly there is cause for concern given the pace and quantum of restructuring over the last few years, the concerns are aggravated by the fact that the restructuring is neither being permitted in a transparent and objective manner by banks nor is it being resorted to in a non-discriminatory manner.

23. It is clearly observed that public sector banks share a disproportionate burden of such accounts. If the reason for the recent increase in restructured accounts is indeed the economic downturn, then it should have been reflected across all bank groups and not just public sector banks. The trends are arguably a reflection of the fact that public sector banks have not been as judicious in the use of restructuring as a credit management tool as the private sector and foreign banks. Recently announced Q1 results for 2012-13 also indicate that private sector banks have managed their credit portfolio in a better way than the PSBs.

24. The data on restructuring also throws up an important question as to whether the small and marginal borrowers are discriminated against by the banks for restructuring of their accounts, even if found viable. Again, if the economic downturn were the sole reason for the increase in restructured accounts of late, then the downturn should logically have affected the weaker segments of the economy more, leading to a higher share of restructured accounts in the SME and priority sectors, which is not the case. The data on restructuring, on the contrary, seems to suggest that, when it comes to restructuring, our banks have a substantial bias towards more privileged borrowers vis-à-vis small borrowers. It seems to suggest that restructuring of accounts is being resorted to avoid classification of accounts as NPA.

CDR – An Instrument of Misuse / Abuse?

25. This brings me to the issue of misuse/abuse of CDR Mechanism by banks as well as corporates. We may note that even the best of intentions gets defeated when a system is not used judiciously. The CDR Mechanism was devised as there was a

need for an institutional mechanism to support the large, viable accounts facing temporary problems as also to preserve the values of large exposures of banks. As previously stated, restructuring has been a prominent central banking tool in the times of crisis across most jurisdictions despite its moral hazard aspects. It is also accompanied by the regulatory forbearance on asset classification, provisioning and capital adequacy in order to provide the banks and corporates the much needed leeway to rejuvenate their productive assets during times of crisis.

26. Regulatory forbearance on asset classification in India, however, has become a standing feature irrespective of the presence or absence of a financial crisis/economic downturn. Rather, it has been observed lately that even at the slightest sign of slowing down of the economy or any particular sector of the economy, banks as well as corporates start demanding even further relaxations in the regulatory forbearance on restructuring. It may be recalled here that CDR Mechanism has been given some special dispensation regarding asset classification on repeated restructuring which is not available to non-CDR restructuring.

27. In view of the foregoing observations, I am compelled to infer that, perhaps, the availability of standing regulatory forbearance to CDR Mechanism has prompted banks to avoid using other means of credit management judiciously, i.e., proper due-diligence before sanctioning a credit facility, regular and proper monitoring of accounts after disbursal and taking prompt corrective action on the first signs of weakness in the accounts. While establishing viability of the account before restructuring the same is a mandatory condition, it seems that proper due-diligence is not carried out on this front in a number of cases. In order to ensure the highest levels of integrity and diligence, the Reserve Bank's guidelines on CDR Mechanism have delegated the authority to evolve policies and guidelines on corporate debt restructuring to CDR Standing Forum, consisting of Chairman level representation from banks; and the authority to approve individual cases of corporate debt restructuring to CDR Empowered Group, consisting of ED level representation from banks. Despite these safeguards, it appears that, in the recent past, many unviable accounts were restructured by establishing viability only with some kind of financial engineering.

28. Our guidelines on CDR Mechanism have evolved in the context of international experience. Most of the countries have based their framework for corporate debt restructuring on the UK's London Approach, wherein, under the leadership of the Bank of England, UK banks developed a set of informal guidelines on a collective process for voluntary workouts to restructure debts of corporates in distress, while maximizing their value as going concerns. They also took into account the international federation of insolvency practitioners (INSOL International)'s 'Statement of Principles for a Global Approach to Multi-Creditor Workouts'.

29. An informal out of court system like CDR Mechanism is always a preferable way for loan resolution, if used prudently and ethically. In this regard, I would like to quote from the 'World Bank Principles and Guidelines for Effective Insolvency and Creditor Rights Systems' which states that "A country's financial sector (possibly with the informal endorsement and assistance of the central bank or finance ministry) should promote the development of a code of conduct or an informal out-of-court process for dealing with cases of corporate financial difficulty in which banks and other financial institutions have a significant exposure, especially in markets where enterprise insolvency has reached systemic levels. An informal process is far more likely to be sustained where there are adequate creditor remedy and insolvency laws. The informal process may produce a formal rescue, which should be able to quickly process a packaged plan produced by the informal process. The formal process may work better if it enables creditors and debtors to use informal techniques."

30. However, issues of moral hazard are also likely to emerge from such informal out of court systems. Internationally, corporate debt restructurings can also be viewed in the continuum between an excessive creditor oriented approach and an excessive debtor oriented approach. An excessive debtor oriented approach gives rise to the aspect of *moral hazard* as it may encourage the debtor to take excessive risks in the knowledge that the burden of any losses will fall disproportionally on creditors.

31. RBI's CDR guidelines attempt to strike a balance between these two approaches by requiring both the debtors and creditors to make sacrifices and by requiring the

promoters to increase their stake in the form of guarantee or equity. However, these norms have been circumvented to some extent. While the debtors and creditors avail the benefits of asset classification, provisioning and capital adequacy on restructuring, they have tried to avoid the painful sacrifices in terms of provisioning on diminution in fair value and promoters' sacrifice. Such circumvention of norms not only camouflage the weakness of credit portfolio of banks but also weaken their defence against expected losses. The inherent credit weaknesses of such accounts are further aggravated due to lower stake of the promoters in the restructured business. Taken together, both these aspects decrease the efficiency of the financial system and increase its vulnerability to external shocks.

Working Group to Review the Existing Guidelines on Restructuring of Advances

32. The need for one more review of our guidelines on restructuring arose in the light of the above discussed issues. Accordingly, the Reserve Bank constituted a Working Group (WG) to review the existing guidelines on restructuring of advances. The WG has examined the issues confronting the restructuring of advances by banks both under CDR and non-CDR mechanisms. Its recommendations are in the right direction and forward looking. It has recommended the withdrawal of regulatory forbearance on asset classification on restructuring; but considering the current domestic macroeconomic situation as also global situation, this step is suggested, say, after a period of two years. During the interregnum, it has recommended increasing the provision on accounts which get the asset classification benefit on restructuring. These are right steps towards discouraging the banks from taking up the cases of unviable accounts as they will be compelled to use their resources judiciously and only for viable accounts. In remaining cases, deleveraging should be the correct option.

33. The Working Group has also made its recommendations for putting a cap on conversion of debt into preference shares; increasing the promoters' stake in restructured accounts; making the 'right of recompense' mandatory, bringing more clarity in calculation of diminution in fair value, disclosure of only 'material' information, etc. These recommendations, once accepted, will remove the incentives

for ‘adverse selection and moral hazard’. Regulatory forbearance and Government incentives will not be available on ‘tap’ but only in cases of a severe economic crisis.

The Way Forward

34. Let me now turn to what I believe is the way forward with respect to restructured accounts. I have, over the last few minutes, outlined a series of trends in restructured accounts, which are from a public policy standpoint and from a broader economic and societal perspective, disquieting. Does this mean that restructuring should not be allowed ? The answer to that is “no” and as I have mentioned earlier restructuring can play a valuable role for both the borrowers and the banks in situations of economic downturns and temporary cash flow problems.

35. However, restructuring should be considered only under certain specific conditions. First, the need for restructuring should arise only due to circumstances beyond the control of the borrowers and not generally for errors / mismanagement by them. In any case, the restructuring proposals should be considered from a purely commercial angle albeit with bias towards giving benefit of doubt to customer. Also, a uniform approach needs to be adopted for both Standard and NPA accounts while examining the restructuring proposals. Further, the viability of the project should be established and only after that should any restructuring proposal be considered. For this, it is important that project appraisal standards are significantly enhanced. Finance professionals such as those working in Centrum have an important role to play in this regard.

36. Important in the context of evaluation the project is the need to examine the effective levels of leveraging in the project. Higher leveraging raises the risks of a project especially in an uncertain environment. There have been many instances of even the promoter’s equity component being financed out of debt. There have also been instances of debt flows being structured as equity and of the “private” component of Public Private Partnership projects being debt finance. Borrowing from another bank is not equity and adds to the burden of debt servicing. It is thus important to ensure, at the time of restructuring that projects are not over leveraged.

It would also be important to establish that the borrowers are sincere about the project, in particular, that the borrowers, or at least the senior management of the borrowing companies, are willing to tighten their belt and share the burden of restructuring.

37. Also, lenders must ascertain the amount of the sacrifice required to be made on their part. Restructuring proposals could be considered much more favourably if there is no sacrifice on the part of the lender except postponement of the repayment date of the principal. Banks would do well to adopt the money lender principle of greater concern in the interest income in such situations if the borrower is servicing the loan regularly. Even where the banks has to make some sacrifice by sanctioning the restructuring proposal, there must be some provision for re-compensation when the borrower/ borrowing unit comes out of trouble. Of course, there are prudential provisions which have to be built up to protect the lender in case of the failure of the restructured unit.

38. Further, our entire approach to restructuring has to be reoriented to show more compassion to the small customers. SMEs and priority sector advances are an important segment of the economy and viable accounts facing temporary problems in such sectors must not be discriminated against when they request for restructuring. Nurturing of viable accounts is in the long term interest of both the lenders and the borrowers. This will not happen automatically. There is a need for a structured mechanism for considering restructuring of retail, SME and agricultural loans just as there is the CDR for considering restructuring proposals for larger accounts. This structure will need to be built in at various levels –at the state, the district, the region and the bank level. The functionaries at various levels will need to be empowered to assess and approve viable restructuring proposals. Without such delegation, it would be extremely difficult for the benefits of restructuring to percolate to the smaller accounts.

39. Again, for restructuring proposals to be successful in assisting the borrower to tide over temporary difficulties, it is critical that the assessment of the proposal and its approval are completed within a specific time frame, say 90 days. Time is very often the very essence in ensuring the turnaround of projects and an elongated

process of assessment of the restructuring proposal could itself erode the viability of the project.

Conclusion

40. Before concluding, I would like to emphasise that resources of the banking sector are precious and limited and they cannot be allowed to be used in an imprudent way. CDR is a necessity especially when economic upturn and downturn are a way of life and part and parcel of business cycles for individual companies. Corporate Debt Restructuring has been in existence for more than a decade in India, and this system has fulfilled its objectives to a large extent. It is a mechanism evolved for preserving the economic values of banks' assets should not be used against its noble objectives. Similarly, regulatory forbearances are discretionary tools which should be used only in the most demanding times. It goes without saying that its future success and failure will depend upon the ethics and integrity of its members and the professionals involved in the restructuring process.

41. The restructuring process is a tool for assisting distressed sections of the economy to tide over difficulties which are temporary in nature and due to circumstances beyond their control. For us to justify that restructuring is for the larger benefit of the economy and the society, it is imperative that it is available to all classes of borrowers and is made available in a timely and non-discriminate manner. This will be possible only if we develop the necessary structures, systems and processes to adhere to the above objectives. A viable time bound action plan for implementing all of this is critical and I hope the finance professionals will play a major role in doing this.

I wish the deliberations in the Seminar all success. Thank you.