RBI Moves to Wind-up CDR System

The Reserve Bank of India (RBI) is considering shutting down the corporate debt restructuring (CDR) system, its very first loan recast mechanism, after its inability to effectively tackle the non-performing assets problem.

- Nearly Rs.1.32 trillion worth of bad loans are presently undergoing restructuring under the CDR mechanism.
- RBI's decision to wind up the cell comes after it issued a circular in February 2018 withdrawing all existing restructuring schemes - the CDR scheme, strategic debt restructuring (SDR) scheme and scheme for sustainable structuring of stressed assets (S4A) and 5/25.

Corporate Debt Restructuring (CDR)

- It is the reorganization of a company's outstanding debts, often achieved by reducing the burden of the debts on the company by decreasing the interest rates and/or increasing the time to repay. This allows a company to increase its ability to meet the obligations.
- The CDR system in India was framed in 2001 to restructure corporate debt outside the purview of debt recovery tribunals (DRT) and the Board for Industrial and Financial Reconstruction.
- Under the CDR rules, at least 75% of creditors (by value) should approve the resolution plan, which would make it binding on the remaining 25%.

Reasons for Failure of CDR

- Banks initially preferred to restructure loans rather than classifying them as non-performing assets. However, in some cases the banks may have been hasty in agreeing to restructure the debt and failed to adequately assess the ability of the borrowers to meet their restructuring commitments. This only delayed them from taking a hit on the loans rather than solving the underlying problems.

- Regulatory changes required that net present value of a loan after restructuring should be retained - this led to ballooning of debt which ultimately led to the collapse of the CDR framework.
- Most cases that have failed are from the infrastructure sector as restructuring packages typically prescribed shorter interest payment moratorium of two years only, even though these cases need long time to develop and pay back – generally more than 10 years.
- In many cases where there is provision for conversion of loan into equity, the companies obstruct the process of increasing authorised capital, getting board approval, etc. This is because the promoters hesitate from taking new investors on board which can reduce their overall stake in the company.
- Monitoring of CDR cases is another big issue. The banks don't have enough resources to oversee the large number of restructuring cases.
- Restructuring schemes also often turn futile because promoters are unable to sell non essential assets to mobilise resources as promised to their creditors.