Report
Of
The Special Group for Formulation of Debt Restructuring Mechanism
For
Medium Enterprises

2004

RESERVE BANK OF INDIA
Central Office
Rural Planning and Credit Department
Mumbai

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Acknowledgement

Small and Medium Enterprises (SMEs) Sector is an important segment of the Indian economy. It contributes 35% of the national exports and provides employment to about 2.74 crore people. 40% of the value addition in the manufacturing sector has been provided by the SME sector. Medium enterprises have come into existence as a process of graduation of several successful SSIs into units, having larger investment level. Medium enterprises assume importance in view of the role they are playing as ancillary to majority of the large corporates. As such, it must be seen as contiguous with SSI.

In an environment of economic reforms and with the opening up of the Indian economy due to liberalization and globalization, this vital sector of the economy is facing huge challenges and competition from of the domestic as well as multi national corporations. Reserve Bank of India has been striving continuously to strengthen the credit delivery system as well as for the healthy growth of the Small and Medium Enterprise (SME) sector. As part of the policy initiatives to extend relief/concessions to the entrepreneurs whose borrowal accounts are in stress due to unavoidable circumstances, a Special Group, as announced by the Governor in the Annual Policy Statement for the year 2004-05, has been constituted in the Rural Planning & Credit Department, Reserve Bank of India to formulate a **mechanism for debt restructuring for medium enterprises on the lines of the Corporate Debt Restructuring (CDR) and also to suggest appropriate operational guidelines in this regard.**

I would like to especially thank the members of the Special Group for their noteworthy and valuable contributions during the deliberations of the Group and in the preparation of the final report:

Shri T.M.N.Singh, Chief General Manager (Credit Management), State Bank of India, Mumbai;

Shri R.K.Garg, General Manager, Bank of Baroda, Mumbai;

Shri K.G.Alai, General Manager, SIDBI, Mumbai;

Shri Manoranjan Mishra, Deputy General Manager, Department of Banking Operations & Development, Reserve Bank of India, Central Office, Mumbai.

The guidance and encouragement of Deputy Governor, Smt. K.J.Udeshi and Executive Director, Shri A.V.Sardesai are acknowledged with grateful thanks.

I wish to put on record the excellent support the Special Group has received from colleagues in the Reserve Bank of India, Shri G. P. Borah, Deputy General Manager, Ms. V.G. Savithri, Assistant General Manager and Smt Minal A.Jain, Assistant General Manager. I also wish to convey my thanks to Shri K.P.Ananth Krishna, Assistant General Manager, Shri P.R.Ruke, Chief Manager and other staff members of State Bank of India, Industrial Finance Branch, Wakdewadi, Pune for extending their support to the Special Group during the field visit to auto ancillary clusters near Pune.

The Special Group had received valuable inputs from several individuals and SSI Associations and wish to acknowledge them with thanks:

Shri A.C.Mahajan, General Manager, Bank of India;
Shri D.N.Rawal , General Manager, Punjab National Bank;
Shri P.Mohanan, Deputy General Manager, Canara Bank;
Shri N.G.Pai, Chief General Manager, Saraswat Co-operative Bank;
Shri.P.Joshipura, General Manager, Gujarat State Financial Corporation;
Shri D.J.Pendse, General Manager, Maharashtra State Financial Corporation;

Shri A.R.Alagappan, General Manager, Tamil Nadu Industrial & Investment Corporation Ltd;

Shri T.A.N.Devalkar, Vice-President, SICOM Ltd;

Shri A.V.Sabhapati, Deputy General Manager, Urban Banks Department, Reserve Bank of India, Central Office, Mumbai;

Shri Anil S.Gupte, Poona Shims Pvt. Ltd;

Shri Anshul Goel , Duro Shox Pvt. Ltd;

Shri R.H.Pahale, Samarth Auto Precision (I) Ltd;

Shri Ambresh Tipnis, Uniklinger;

Shri D.J.Karandikar, Praditi Press Parts Pvt. Ltd;

Shri Shireesh Deshpande, Hansa Diesels & Equipments Pvt. Ltd;

Shri Rajiv Panse, Panse Auto Com;

Shri Anil Kulkarni, Pooja Castings;

Shri Sadashiv Pandit, Fleetguard;

Shri Pritam Singh Randhava, Seven Seas Forgings Pvt. Ltd;

Shri A.S.Kulkarni, Jayashree Die castings Pvt. Ltd;

Shri P.V.Modak, Pimpri-Chindchad Automobile Component Maufacturers' Association;

Shri C.R.Janardhana, President, Karnataka Small Scale Industries Association (KASSIA);

Shri Ashok Poddar, President, Federation of Associations of Small Industries of India (FASSI);

Shri Magan Bhai Patel, President, Gujarat State Small Industries Federation;

Shri K.Gopalakrishnan, Chairman, Labour Laws Committee, Tamil Nadu Small & Tiny Industries Association (TANSTIA);

Shri Satish Girotra and T.G.Keswani, Members, Managing Committee, PHD Chamber of Commerce & Industry;

Dr. S. Rohini, Additional Development Commissioner, Ministry of SSI, Government of India;

Shri Praveen Mahto, Director, Ministry of SSI, Government of India;

Shri B.D.Berwal, Under Secretary, Banking Division, Ministry of Finance, Government of India.

On behalf of the Special Group, I wish to place on record our grateful thanks to Dr. Y. V. Reddy, Governor, Reserve Bank of India, for giving us this unique opportunity to explore the important issue of facilitating flow of credit to the SME sector.

G. Srinivasan
Chairman of the Special Group
Mumbai
5 November 2004

Executive Summary

Small and Medium Enterprises (SMEs) Sector is an important segment of the India economy, contributing 35% of the national exports and providing employment to nearly 2.74 crore people. At the same time, Medium Enterprises have emerged as an important component of manufacturing sector with its role as ancillary to many large corporates.

The Small and Medium Enterprises (SME) sector is under stress due to globalization / competition and since there is no mechanism for debt restructuring for this sector, the Annual Policy Statement for the year 2004-05, announced that a special group be constituted formulate a mechanism for debt restructuring on the lines of the Corporate Debt Restructuring (CDR) for medium enterprises and also to suggest appropriate operational guidelines in this regard**.**

The new debt restructuring mechanism for medium enterprises, termed as **Medium Sector Restructuring (MSR) System,** will have two-tier structure with MSR Standing Forum at the national level and MSR Empowered Group at the state level. A MSR Cell will work as the secretariat for the MSR Empowered Group. An MSR Core Group will be constituted as appellate body at the state level. MSR Standing Forum (at Mumbai), MSR Empowered Group with MSR Cell and MSR Core Group (in each state/group of states) will be housed at SIDBI. All banks and financial institutions may share the administrative and other costs.

The MSR System will be implemented by commercial banks, financial institutions, state financial corporations and urban co-operative banks. It will cover all multiple banking accounts/syndication/consortium i.e. more than one lenders with outstanding exposure of Rs.5 crore or more but less than Rs.20 crore. Initially MSR System will be extended to corporates in the SME sector. However, after review of the system after one year it may be extended to cover partnership/proprietorship firms in the SME sector also. Only standard (under stress) and sub-standard assets will be covered under the MSR system. No case of willful default, fraud or misfeasance as declared by any one of the lenders will be considered for restructuring under MSR system.

The Debtor-Creditor (DCA) and the Inter-Creditor Agreement (ICA) may provide the legal basis for the MSR mechanism.

One of the most important elements of Debtor-Creditor Agreement would be ‘stand still’ clause, binding for 90 days by both sides, which can be extended to 180 days in respect of genuine cases of delay. Under this clause, both the debtor and creditor(s) may agree to a legally binding ‘stand still’ whereby both the parties commit themselves not to take any other legal action during the ‘stand still’ period.

Under the restructuring package of MSR system, existing or new lenders may take additional exposures. Such additional exposures may be exempted from provisioning requirements for certain specified period. SIDBI may consider extending refinance to SFCs providing concession/relief to units restructured under MSR system.

Though asset classification norms under MSR system will be identical to existing CDR system for large corporates, certain concessions in provisioning norms for the sacrifice component have been recommended.

Banks/Financial Institutions will have to disclose in their annual Balance sheets, under ‘Note on Accounts’, the requisite information on total amount restructured (both standard and sub-standard assets) under MSR system.

Banks/Financial Institutions may issue necessary guidelines on debt restructuring, as approved by their respective Boards, for single lender as well as more than one lenders borrowal accounts for outstanding amount below the Rs.5 crore (floor for MSR system) on the lines of MSR system.

<u>**Chapter 1**</u>

1.1 Governor's announcement in the **Annual Policy Statement for the year 2004-2005** stated as follows**:**

"**A mechanism for debt restructuring on the lines of the Corporate Debt Restructuring (CDR) is proposed to be developed for medium enterprises. A special Group would be constituted by RBI to suggest appropriate operational guidelines in this regard."** (Para.89)

Accordingly, the Reserve Bank of India constituted a Special Group with the following members:

Shri G.Srinivasan, Chief General Manager, Rural Planning & Credit Department, Central Office, Mumbai -**Chairman**

Shri T.M.N.Singh, Chief General Manager (Credit Management), State Bank of India, Corporate Centre, Mumbai -**Member**

Shri R.K.Garg, General Manager, Bank of Baroda, Baroda Corporate Centre, Mumbai -**Member**

Shri.K.G.Alai, General Manager, Small Industries Development Bank of India, Mumbai - **Member**

Shri.Manoranjan Mishra, Deputy General Manager, Department of Banking Operations & Development, Reserve Bank of India, Central Office, Mumbai -**Member**

1.2 The Group held five meetings during July and November, 2004 and also made field visit to auto ancillary clusters near Pune with a view to get a first hand experience regarding difficulties faced by SME entrepreneurs. The suggestions received at the meetings and field visit are furnished at Annexure-I. The Group has also received suggestions from experts/trade bodies/other organization, which are furnished at Annexure-II.

1.3 In the first meeting of the Special Group held on 23 July 2004, the Governor addressed the members of the Special Group and highlighted the following points which acted as roadmap for the Group.

- In view of domestic restructuring and international competition, better prospect lies ahead for growth of the SME sector.
- The focus should be on suggestion for change in regulatory prescription and direction to Boards of banks, which may include a decentralized structure with 2-3 models for the new debt restructuring mechanism. The Group should prescribe principles while the banks may frame the detailed guidelines.
- Definition of medium enterprises may be considered as Rs.10 crore, based on investment limit on plant and machinery.
- Quality of loan assets to be covered under the new debt restructuring mechanism may be prioritized i.e. which can be covered automatically and by exception (public sector undertaking/government agencies). Dues of large corporates to SMEs should be brought on record. Further, reputational risk of large corporates and public sector undertaking/government agencies can play an effective role in timely payment of dues by them to SMEs.
- SFCs should be included under new debt restructuring mechanism.
- While granting concession of time and quantum of sacrifice, the opportunity cost should be considered. Provisioning norms can be relaxed where regular repayments are forthcoming especially in SME segment.
- Inspite of certain lacunae in the existing CDR mechanism, it continues to remain relevant as special measure. This special measure should be followed by standard mechanism.

Chapter 2

Recommendations of the Special Group

The recommendations of the Special Group for Formulation of Debt Restructuring Mechanism for 'Medium' Sector, constituted by the Reserve Bank of India are described below.

Background

1.1 Inspite of their best efforts and intentions, sometimes corporates find themselves in financial difficulty because of factors beyond their control and also due to certain internal reasons. For the revival of the corporates as well as for the safety of the money lent by the banks and Financial institutions, timely support through restructuring in genuine cases is called for. Keeping in view the above objectives, Reserve Bank of India issued detailed guidelines on Corporate Debt Restructuring System vide circular DBOD No. BP.BC. 15/21.04.114/2000-01 dated August 23, 2001 for facilitating timely and transparent mechanism for restructuring 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. A revised system on Corporate Debt Restructuring has been issued vide circular DBOD.No.BP.BC.68 /21.04.132/2002-03 dated February 5, 2003.

1.2 Based on the experience on restructuring of corporate debts for viable entities, as announced by the Governor in the Annual Policy Statement for the year 2004-05, a mechanism for debt restructuring on the lines of the Corporate Debt Restructuring (CDR) for medium enterprises has been formulated which is termed as **Medium Sector Restructuring** (MSR) System throughout the report.

The salient features of the Medium Sector Restructuring (MSR) System are as under:

2. Objective

The objective of the MSR System is to ensure a timely and transparent mechanism for restructuring of the debts of viable entities affected by internal or external factors, outside the purview of BIFR, DRT and other legal proceedings, for the benefit of all concerned. Initially MSR System will be extended to corporates in the SME sector. However, after review of the system (say, after one year), it may be extended to cover partnership/proprietorship firms also.

3. Structure

MSR System in the country will have a two-tier structure:

- MSR Standing Forum at the National Level. It will be based in Mumbai.
- MSR Cell, MSR Empowered Group and MSR Core Group (which is the appellate body for MSR Empowered Group) in each state or group of states, depending on concentration of SMEs. It will be based in state capitals concerned.

3.1 MSR Standing Forum

3.1.1 The MSR Standing Forum would be the representative general body of all financial institutions and banks participating in MSR system. All financial institutions, banks, state financial corporations and urban cooperative banks should participate in the system in their own interest. MSR Standing Forum will be a self-empowered body, which will lay down policies and guidelines and monitor the progress of debt restructuring.

3.1.2 The MSR Standing Forum may comprise the Deputy Managing Director of State Bank of India, the Executive Director of ICICI Bank Limited and Small Industries Development Bank of India as well as the Executive Directors of all banks and financial institutions participating as permanent members in the system. The Forum will elect its Chairman for a period of one year and the principle of rotation will be followed in the subsequent years.

3.1.3 The MSR Standing Forum may meet at least once in every six months and would review and monitor the progress of medium sector debt restructuring system. The Forum would also lay down the policies and guidelines to be followed by the MSR Empowered Group and MSR Core Group for debt restructuring and would ensure their smooth functioning and adherence to the prescribed time schedules for debt restructuring. The MSR Standing Forum will be housed at SIDBI, Mumbai.

3.2 MSR Empowered Group

3.2.1 SIDBI will be a permanent member of the MSR Empowered Group in each State. Other permanent members of the MSR Empowered Group will be SLBC Convenor bank and State Bank of India (where State Bank of India is not the SLBC Convenor) and two dominant lenders to SME segment in the State. In case, where State Bank of India is the SLBC Convenor bank then State Bank of India and three other dominant lenders to SME segment in that State will be permanent members of the MSR Empowered Group. Other lenders, who are members of the Standing Forum, join as members whenever cases where they have exposures, are considered for restructuring. The representation may be at the level of senior management executives not below the level of Assistant General Managers (preferably, General Manager/Deputy General Manager), duly authorized by the Board for making commitment/decision on behalf of their respective bank/FI.

This Group may consider and decide upon the preliminary report of all cases of requests of restructuring, submitted by MSR Cell within 30 days. After the Empowered Group decides that restructuring of the unit is prima-facie feasible and potentially viable, the detailed restructuring package will be worked out by the MSR Cell. The MSR Empowered Group would be mandated to look into each case of debt restructuring, examine the viability and rehabilitation potential of the Company and approve the restructuring package within a specified time frame of 60 days of reference to the Empowered Group. The approved package should be implemented within 45 days. The restructuring package should be within five to seven years. In the exceptional cases, maximum period may be allowed up to ten years on very justifiable grounds.

The Forum will provide an official platform for both the creditors and borrowers (by consultation) to amicably and collectively work out debt restructuring plans in the interests of all concerned.

The creditors may agree that if 75% of secured creditors by value, agree to a debt-restructuring package, the same would be binding on the remaining secured creditors.

The permanent members of Empowered Group may not have voting rights except in cases where they are lenders. SIDBI's voting rights will be based on their direct lending and not based on refinance provided.

In the normal course, the decisions of the MSR Empowered Group may be final. Any appeal against the decision of the Empowered Group can be placed before the MSR Core Group. In that case, the decision of the MSR Core Group would be final. If restructuring of debt is found to be viable and feasible and approved by the Empowered Group, the unit would be put on the restructuring mode. If restructuring is not found viable, the creditors may take necessary steps for immediate recovery of dues and / or liquidation or winding up of the company, collectively or individually.

3.2.2 MSR Cell

MSR Cell will act as the Secretariat to the MSR Empowered Group. It will work out the detailed restructuring package, in conjunction with the lending institutions within 60 days from the date of reference to the Empowered Group.

3.2.3 MSR Core Group

A MSR Core Group will be carved out from the permanent members of the MSR Empowered Group. MSR Core Group, as an appellate body, can review any individual decisions of the MSR Empowered Group on reference made to it by any aggrieved party. The MSR Core Group may also formulate guidelines for dispensing special treatment to those cases, which are complicated and are likely to be delayed beyond the time frame prescribed for processing. The MSR Core Group will consist of General Managers/Deputy General Managers of SIDBI, State Bank of India and any 2/3 major lenders in the state.

MSR Cell, MSR Empowered Group and MSR Core Group will be housed and administered by SIDBI in each State/group of States. All banks and financial institutions may share the administrative and other costs. MSR Cell will have adequate members of staff deputed from banks and financial institutions, particularly from Core Group member banks/financial institutions. The MSR Cell may also take outside professional help where considered necessary. The cost-sharing pattern may be as determined by the Standing Forum. The cost in operating the MSR mechanism including MSR Cell may be met from contribution from the banks and financial institutions in the Core Group at the rate of Rs.15 lakh per annum and contribution from other institutions and banks at the rate of Rs.2.5 lakh per annum initially, to be reviewed at a later stage.

3.2.4 The MSR Empowered Group may decide on the acceptable viability benchmark levels on the following illustrative parameters, which may be applied on a case-by-case basis, based on the merits of each case.

- Return on Capital Employed (ROCE);
- Debt Service Coverage Ratio (DSCR);
- Gap between the Internal Rate of Return (IRR) and the Cost of Fund (COF); and
- Extent of sacrifice.

The illustrative benchmark financial parameters, on the lines of existing CDR for large corporates, could be approved by the MSR Standing Forum, for adoption by the MSR Empowered Group as below.

Sr.	Financial indicator	Benchmark
1	ROCE	Market related rate, say an appropriate G-sec+3%
2	IRR – Cost of funds	At least 1%
3	DSCR	Average of 1.25:1 over the restructuring period with annual DSCR not less than 1:1

4	Operating break-even and cash break-even point	Industry average
5	Gross profit (earning before interest, depreciation, tax)	In line with industry experience
6	Extent of sacrifice	On a case to case basis

Standard and special conditions

Typically the borrowers approaching the MSR mechanism may be classified into the following four categories for designing an appropriate restructuring mechanism. The categories are as under:

- Those affected by external reasons/ environment;
- Those affected by predominantly external reasons with some element of internal problems;
- Borrowers who have diversified into unrelated fields;
- Borrowers facing difficulty, either internal or external, but where there are other large stake holders like share holders, labour, large exposure of lenders and revenue to the exchequer; and

Depending on the type of borrower as above, special conditions may be imposed, such as,

- Personal guarantees;
- Pledge of shares;
- De-rating existing equity;
- Conversion of overdue into equity instead of waivers;
- Escrow account mechanism;
- Appointment of nominee/whole-time director, lenders' engineer and concurrent auditors;
- Right to recompense for sacrifice made by the lenders; and
- Promoter's contribution to the package.

Restructuring models

The Empowered Group may devise appropriate restructuring model best suited to an individual restructuring package. The Standing Forum, while framing broad parameters of restructuring may provide guidelines for consistent and uniform application of the following usual restructuring methodologies:

a) Extension of repayment period;
b) Funding of irregular portion of Working Capital;
c) Funding of past interest dues (overdues) and if necessary future interest for specified period into funded interest term loan (FITL);
d) Waiver of liquidated damages / penal interest in exceptional cases;
e) Aligning the interest rate to sustainable levels based on future cash flows subject to a maximum concession of 2% below the average BPLR of major lenders;
f) If the debt profile is unsustainable but the account is viable, the restructuring model may incorporate induction of additional capital, carving out unsustainable debt into non-interest bearing instruments, servicing of which is decided on the availability of cash flow; and
g) Restructuring models may comprise various buckets to suit different types of lenders, such as, compromise settlement, early exit etc. Lenders who exit early must bear a higher sacrifice than the ones who continue with the company for a longer time.

4.1 Eligibility criteria

4.1.1 Eligible Lenders under MSR mechanism.

- Banks, Financial Institutions including State Financial Corporations (SFCs)/ Small Industrial Development Corporations (SIDCs) and Urban Co-operative Banks.
- NBFCs as lenders may not be included under the system at this stage, as they do not have considerable exposure to SME sector.

4.1.2 Size of the loan to be covered under MSR System.

The MSR system may cover multiple banking accounts/ syndication/ consortium accounts i.e. more than one lender with outstanding exposure of more than Rs.5 crore but less than Rs.20 crore (the current threshold limit of Rs.20 crore under the CDR for large industries) by banks and financial institutions who are members of the Standing Forum.

4.1.3 Other Criteria for coverage of Loan Assets under MSR System.

- Only standard (under stress) and sub-standard assets will be covered.
- Based on outstanding level of loan (both term loan and working capital) as on date of reference including amount devolved and crystallized under non-fund based facilities.
- Only viable units may be considered for restructuring under the MSR system. The Empowered Group based on the benchmark parameters may determine viability. No case of wilful default, fraud or misfeasance with any member of the Standing Forum will be considered for restructuring under MSR system. Where borrower is declared as wilful defaulters by any of the lenders, such account may not be considered for restructuring.
- Borrowers under manufacturing and services sectors may be covered. However, traders and NBFCs as borrowers may be excluded from the MSR system.

4.2 Reference to MSR System

Reference to MSR System could be triggered by (i) any one or more of the eligible lenders who are members of the Standing Forum and who either singly or in aggregate have a minimum 20 % share in the aggregate exposure. or (ii) enterprise supported by a bank or FI having stake as above.

4.3 Legal Basis

The Debtor-Creditor Agreement (DCA) and the Inter-Creditor Agreement (ICA) may provide the legal basis to the MSR system. The debtors may have to accede to the DCA, at the time of reference to MSR Cell. Similarly, all participants in the MSR system through their membership of the MSR Empowered Group may have to enter into a legally binding inter-creditor agreement, with necessary enforcement and penal clauses, to operate the system through laid-down policies and guidelines.

4.4 Stand-Still Clause

One of the most important elements of Debtor-Creditor Agreement would be 'stand still' clause, binding for 90 days by both sides. There may also be a provision for ‘stand still’ clause extendable to 180 days in respect of genuine cases of delay. Under this clause, both the debtor and creditor(s) may agree to a legally binding 'stand-still' whereby both the parties commit themselves not to take recourse to any other legal action during the 'stand-still' period, This would be necessary for enabling the MSR System to undertake the necessary debt restructuring exercise without any outside intervention, judicial or otherwise.

4.5 Additional finance

4.5.1 Need based additional working capital finance may be provided by the lenders in relation to the outstanding or sanctioned limit whichever is higher.

4.5.2 The providers of additional finance, whether existing lenders or new lenders, may have a preferential claim on cash flows out of recoveries as may be worked out under the restructuring package.

4.5.3 The additional finance extended to borrowers in terms of restructuring packages approved under the MSR system may be exempted from provisioning requirement for a period of one year coinciding with the period allowed to upgrade the classification category of the restructured assets.

4.5.4 In cases where SFCs are unable to provide for sacrifice as well as additional finance under the restructuring package, SIDBI may at its discretion extend refinance for this purpose.

4.5.5 The units may not be debarred from the benefits under TUFS, Credit Linked Capital Subsidy System merely because they are restructured under the MSR mechanism.

4.5.6 As part of restructuring measures, different government agencies may consider proposals for rephasing their statutory dues favourably.

4.6 Conversion option

4.6.1 The MSR Empowered Group, while deciding the restructuring package, may decide on the issue regarding convertibility (into equity and preference shares) option as a part of restructuring exercise whereby the banks / financial institutions may have the right to convert a portion of the restructured amount into equity, keeping in view the statutory requirement under Section 19 of the Banking Regulation Act, 1949, (in the case of banks) and relevant SEBI regulations. Reserve Bank of India may consider providing relaxation to banks in respect of non-SLR investment in unrated / unlisted instruments to accommodate the needs of conversion of debt into other instruments.

4.6.2 Exemptions from the capital market exposure ceilings prescribed by RBI in respect of such equity acquisitions should be obtained from the respective regulatory authorities on a case-to-case basis by the concerned lenders.

5. Accounting treatment for restructured accounts

The prudential norms applicable to the MSR system may be as under:

5.1 Asset Classification:

During the pendency of the case with the MSR system, the usual asset classification norms would continue to apply. The process of down gradation of an asset should not stop merely because the case is referred to the MSR Cell. However, if restructuring under the MSR system takes place, the asset classification status should be restored to the category, which existed when the reference to the Cell was made. Consequently, any additional provisions made by banks towards deterioration in the asset classification status during the pendency of the case with the MSR system may be reversed. For MSR System, the date of reference may be defined as the date on which the Preliminary Report is first presented in the MSR forum.

5.2 Sacrifice

Under the existing CDR for large corporates, sacrifice is arrived at in respect of re-schedulement of interest. For the purpose, the future interest due as per the original loan agreement in respect of an account is discounted to the present value at a rate appropriate to the risk category of the borrower (i.e. current BPLR + the appropriate credit risk premium for the borrower-category) and compared with the present value of the dues expected to be received under the restructuring package, discounted on the same basis. The provision held towards sacrifice in respect of restructured account is retained till all monies are received.

Restructured account would be eligible to be upgraded in asset category only after the specified period, i.e. a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms, subject to satisfactory performance during the period. The amount of provision made earlier, net of the amount provided for the sacrifice in the interest amount in present value terms as aforesaid, may be reversed after the one-year period. In case satisfactory performance is not evidenced during the one-year period, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule

The method prescribed for arriving at the sacrifice as above for existing CDR is a true representation of economic cost of re-schedulement/ reduction of interest rate. The same method may be continued for debt restructuring under the MSR system.

Following concessions are proposed under MSR System:

i) Concessions in provisioning to the extent of 50% instead of 100% may be given for cases with aggregate exposures up to Rs.10 crore so that the concession is made available to the SMEs while it is not entirely discriminatory against the extant CDR system.

ii) Where the original payment terms prescribed a fixed rate of interest, the interest flow for calculation of sacrifice may be calculated with respect to BPLR + risk premium as on the date of restructuring.

5.3 Method to arrive at the level of sacrifice:

The economic cost or sacrifice involved in restructuring packages can be best estimated in terms of present value of the future interest flows. The method of calculation of sacrifice is not difficult as banks can arrive at the sacrifice levels by using any simple computer software.

6. Disclosure

Banks / Financial Institutions may also disclose in their published annual Balance Sheets, under "Notes on Accounts", the following information in respect of debt restructuring undertaken under MSR system during the year:

a. Total amount of loan assets subjected to restructuring under MSR.

[(a) = (b)+(c)]

b. The amount of standard assets (under stress) subjected to MSR.

c. The amount of sub-standard assets subjected to MSR.

d. Level of provision made towards sacrifice involved in the MSR.

7. Others.

Banks/Financial Institutions may consider issuing necessary guidelines on debt restructuring, as approved by their respective Boards, for single-lender as well as multiple lender borrowal accounts for outstanding amount below the Rs.5 crore (floor for MSR system) on the lines of MSR system.

Sd/-

(G. Srinivasan)
Chairman

Sd/-
(T.M.N.Singh)
Member

Sd/-
(K.G.Alai)
Member

Sd/
(R.K.Garg)
Member

Sd/
(Manoranjan Mishra)
Member

Annexure I

Details of meetings held

1. 1st meeting on July 23, 2004 at Reserve Bank of India, Central Office, Mumbai.
2. 2nd meeting on August 2, 2004 at Reserve Bank of India, Central Office, Mumbai.
3. 3rd meeting on August 14, 2004 at Reserve Bank of India, Central Office, Mumbai.
4. Field Visit to auto ancillary clusters near Pune on August 23, 2004.
5. 4th meeting on September 10, 2004 at Reserve Bank of India, New Delhi.
6. 5th (& final) meeting was held on November 5, 2004 in Mumbai.

N.B. Suggestions/views received during the deliberations of above meetings/visit are annexed.

First Meeting of the Special Group for Formulation of Debt Restructuring Mechanism

The first meeting of the above Working Group was held on July 23, 2004 at 11.00 A.M. in the Central Office Building of RBI, Mumbai under the chairmanship of Shri G. Srinivasan. A list of the participants is enclosed. The views/suggestions received during the deliberations of the above meeting are summarized below. The Governor of Reserve Bank addressed the Working Group.

Views/suggestions of Governor

- In view of domestic restructuring and international competition, better prospect lies ahead for growth of the SME sector.
- The focus should be on suggestion for change in regulatory prescription and direction to Boards of banks, which may include a decentralized structure for the new debt restructuring mechanism with 2 to 3 models. The Group should give principles while the banks may frame the detailed guidelines.
- Definition of medium enterprises may be considered as Rs.10 crore, based on investment limit on plant and machinery.
- Quality of loan assets to be covered under the new debt restructuring mechanism may be prioritized i.e. which can be covered automatically and which can be covered by exception (public sector undertaking/government agencies). Dues of large corporates to SMEs should be brought in record. Further, reputational risk of large corporates and public sector undertaking/government agencies can play an effective role in timely payment of dues by them to SMEs.
- SFCs should be included under new debt restructuring mechanism.
- While granting concession of time and quantum of sacrifice, the opportunity cost should be considered. Provisioning norms can be relaxed where regular repayments are forthcoming especially in SME segment.

- Inspite of certain lacunae in the existing CDR mechanism, it continues to remain relevant as special measure. This special measure should be followed by standard mechanism.

Views/suggestions of Deputy Governor

- Problems/lacunae in the existing CDR mechanism such as elongated cash flow and time granted may be revisited under the new dispensation.
- Large corporates having substantial dues to SMEs, reputational risk can help bring financial discipline among these large corporates.
- She suggested that whether loan agreement can include a clause to furnish information to CIBIL.

Views/suggestions of Executive Director

- He highlighted salient features of CDR mechanism for large industries as well as guidelines for rehabilitation of sick SSI units based on Kohli Working Group recommendations.
- Ancillary unit/medium enterprises can play an important role as a supplier to large industries.
- He suggested that the group may interact with SSI Associations, Trade and Commerce Associations (CII, FICCI), select SFCs, NBFCs and also visit industrial clusters to get valuable inputs.

Views/suggestions of Shri K.G.Alai

- Size of the loan to be covered under the new debt restructuring mechanism-the limit may be banks' exposure upto Rs.10 crore (this was suggested in the context of likely downward review of the current threshold limit of Rs.20 crore under CDR for large industries).
- Quality of loan assets to be covered under the new debt restructuring mechanism-initially only standard and stressed assets may be covered. Further, in the initial stage loan assets of SMEs in corporate sector may be included (other may be included by exception).

- New debt restructuring mechanism may include service sector (such as hospital, nursing, etc.) in addition to manufacturing sector.
- Due to large number of accounts under SME sector, a decentralized structure will be preferable. SIDBI may take over the responsibility however in many instances SIDBI may not be any stakeholder. This option needs detailed examination and needs to be debated.
- The issue of inclusion of SFCs under new debt restructuring mechanism may be debated, as they will not be in apposition to infuse fresh capital due to their precarious financial position.
- Role of SLIIC needs to be redefined after the new debt restructuring mechanism put in place.

Views/suggestions of Shri R.K.Garg

- Medium sector needs to defined clearly.
- Due to not so happy instances of undue concession taken by some of the promoters under CDR, there should be some system of 'check' under the new dispensation.
- Time granted for rehabilitation/restructuring to corporates under existing CDR is too long (15-20 years). The same needs to be reduced to shorter duration (may be 5 years).
- Provisioning norms needs to be revisited where regular repayments are forthcoming especially in SME segment.

Views/suggestions of Shri T.M.N.Singh

- Early decision regarding definition of medium enterprises.
- Size of the loan to be covered under the new debt restructuring mechanism-floor may be either Rs.1 crore or Rs.5 crore and ceiling can be Rs.15 crore or Rs.20 crore.
- SFCs/State level financial institutions under the new debt restructuring mechanism may be considered.

- A decentralized structure for the secretariat under the new dispensation is preferable-SIDBI or Lead Bank in the state may be considered.
- Issue of willful defaulter-in certain instances minority stakeholder do not agree for restructuring/rephasement under CDR.
- Under CDR whether any government dues can also be rephrased?

Views/suggestions of Shri M. Mishra

- Eligibility criteria under the new debt restructuring mechanism-a limit of less than Rs.20 crore may be considered.
- Whether a mechanism like CDR should be available as a permanent mechanism or should the mechanism have a life of its own?

Summing up by the Chairman (Shri. G.Srinivasan)

- Group may interact with SSI Associations, Trade and Commerce Associations (CII, FICCI), select SFCs, NBFCs and also visit industrial clusters to get valuable inputs.
- Members may please list out issues on the basis of broad parameters indicated by the Governor for discussion in the next meeting.

Invitees

Dr.Y.V.Reddy, Governor.

Smt.K.J.Udeshi, Deputy Governor.

Shri A.V.Sardesai, Executive Director.

Chairman & Members of the Group

Shri G.Srinivasan, CGM, RPCD, RBI, Central Office- Chairman

Sheri T.M.N.Singh, CGM (Credit Management), SBI - Member

Shri R.K.Garg, General Manager, BOB -Member

Shri.K.G.Alai, General Manager, SIDBI -Member

Shri Manoranjan Mishra, Deputy General Manager, -Member
DBOD, RBI, CO.

Members of the Secretariat

Shri G.P.Borah, DGM, RPCD, CO, Mumbai;

Ms.V.G.Savithri, AGM, RPCD, CO, Mumbai;

Smt. Minal A. Jain, AGM, DBOD, CO, Mumbai.

Second Meeting of the Special Group for Formulation of Debt Restructuring Mechanism

The second meeting of the above Working Group was held on August 2, 2004 at 11.00 A.M. in the Central Office Building of RBI, Mumbai under the chairmanship of Shri G. Srinivasan. A list of the participants is enclosed. The views/suggestions received and deliberated in the above meeting are summarized below.

Issues on which general consensus have been arrived.

1. **Inclusion of entities under new debt restructuring mechanism.**

    - Banks, Financial Institutions, SFCs, Urban Co-operative Banks.
    - NBFCs may not be included under the system at this stage as their exposure to SME sector is very minimal [They are mostly active in the Small Road Transport Operator (SRTO) segment].
    - The units will continue to be eligible for benefits under TUFS, Credit Linked Subsidy System even after the rehabilitation programme under the new debt restructuring mechanism.

2. **Size of the loan to be covered under the new debt restructuring mechanism.**

    - The floor may be Rs.5 crore where as the ceiling can be upto Rs.20 crore (the current threshold limit of Rs.20 crore under CDR for large industries). In the event of lowering of the current threshold limit of Rs.20 crore to Rs.15 crore under CDR for large industries, the ceiling for new debt restructuring will be also lowered to Rs.15 crore.
    - Generally, public and private limited companies in SME sector may be covered. Loan Account of large units with IDBI, with marginally lower outstanding amount than the ceiling amount under the new debt restructuring mechanism (say 19.50 crore as on reference date) may not be covered under the new dispensation as the new system is broadly targeted at SME segment only.

- Borrowers under manufacturing and services sectors should be covered. However, traders may be excluded from the new debt restructuring mechanism.

3. Quality of loan assets to be covered under the new debt restructuring mechanism.

- Only standard and stressed standard assets should be covered.
- Based on outstanding level of loan with more than one lender.

Under Fund Based Limits:

For Working Capital: Outstanding or limit as on reference date.
For Term Loan : Outstanding as on reference date.

Under Non-Fund Based Limits:

Already committed amount.

- Only viable units should be considered for restructuring under the new dispensation.
- Where borrower is declared as willful defaulters by majority of the lenders, such account may not be considered for restructuring.
- Under the rehabilitation package, Working Capital and Term Loan component should be treated separately. 75% of the Working Capital and Term Loan Lenders should agree separately to the rehabilitation package for wider acceptability.
- The restructuring package should be implemented within five years. In the exceptional cases, maximum period may be allowed is seven years.

4. Secretariat to New Debt Restructuring Mechanism Group (say MSR Group).

- SIDBI will be permanent member of the Group. The SLBC Convenor bank and bank(s) having majority stake will be other members of the Group.
- The Group may be housed at either at SIDBI office in a particular state or at SLBC Convenor bank. Staff will be deputed from the member banks/lenders. Expenditure will be shared by the banks coming under the new debt restructuring mechanism.
- In the initial stage, the Group may start functioning in a state or group of states (e.g. all states in the North Eastern Region) depending on SME concentration with a threshold limit (say one lakh units).
- The MSR Group should take final decision on restructuring package within 60 days from the date reference to the Group but in no case this time frame should exceed 90 days.

Above issues may be debated further before drawing up detailed operational guidelines in this regard.

Other issues, which require further debate/discussion.

- For the specific purpose of restructuring under the new debt restructuring mechanism, SFCs will be eligible for refinance from SIDBI (which are, otherwise, not eligible due to their poor financial condition). This issue may be discussed with the representatives of SFCs before taking a final view in this regard.
- Due to prevalence of partnership firms in the SME sector, their inclusion may be considered under the new debt restructuring mechanism with proper safeguards. This issue may be discussed with the representatives of SSI Associations before taking a final view in this regard.
- No direct reference may be permitted to the MSR Group. At least one of the lenders should agree to restructuring proposal. To avoid non-serious references to MSR Group, borrowers may be asked to deposit 5 to 10% of their principal + interest to all

lenders as the start up money for kicking off the restructuring process. These issues may be discussed with the representatives of SSI Associations before taking a final view in this regard.

- The issue of granting relaxation in prudential norms, simplification of calculation of sacrifice component, etc. may be discussed in DBOD before taking a final view in this regard.
- Detailed parameters to be worked out regarding rehabilitation/restructuring package in the lines of CDR, Kohli Working Group recommendations for SSIs and extent rehabilitation guidelines issued by DBOD/IECD.

Chairman & Members of the Group

Shri G.Srinivasan, CGM, RPCD, RBI, Central Office- Chairman

Shri T.M.N.Singh, CGM (Credit Management), SBI - Member

Shri R.K.Garg, General Manager, BOB -Member

Shri.K.G.Alai, General Manager, SIDBI -Member

Shri Manoranjan Mishra, Deputy General Manager, -Member
DBOD, RBI, CO.

Members of the Secretariat

Shri G.P.Borah, DGM, RPCD, CO, Mumbai;

Ms.V.G.Savithri, AGM, RPCD, CO, Mumbai;

Smt. Minal A. Jain, AGM, DBOD, CO, Mumbai.

Third Meeting of the Special Group for Formulation of Debt Restructuring Mechanism

The third meeting of the above Working Group was held on August 14, 2004 at 11.00 A.M. in the Central Office Building of RBI, Mumbai under the Chairmanship of Shri G. Srinivasan. The representatives of certain select banks (Bank of India, Canara Bank and Punjab National Bank), Urban Co-operative Bank (Saraswat Co-operative Bank), State Financial Corporations (TIIC Ltd., GSFC, MSFC and SICOM Ltd.) and Urban Banks Department, RBI participated in the discussion as “Invitee”. A list of the participants is enclosed. Besides the issues discussed in 1st and 2nd meetings (where broad consensus have been arrived) such as inclusion of entities under new debt restructuring mechanism, size of the loan to be covered, quality of loan assets to be covered, Secretariat to the new debt restructuring mechanism group (say MSR Group), following new suggestions have been received and deliberated in the above meeting.

Views/ suggestions of Shri A.C.Mahajan, General Manager, Bank of India.

- The Financial institutions have an overriding power in deciding the restructuring proposals due to 75% majority in most of the cases, which affects the banks with smaller stakes.
- As the New Capital Accord defies retail trade as Euro 1 million, i.e. approx. Rs.5.5 crore, the lower limit for the system may be fixed at Rs.5 crore.
- Accounting norms for calculation of sacrifice component, net present value under the existing CDR are complicated which require revisit/simplification. Further, provisioning and disclosure norms for sacrifice component are very strict. Provisioning norms should be relaxed in respect of the sacrifice component considerably.
- For the purpose of calculation of sacrifice component, Bank Rate (B.R.) should be taken as benchmark rate as it is the only secular benchmark available.

- Benchmark or range parameters should be provided for concession/sacrifice under the new debt restructuring mechanism (under the existing CDR these parameters are fixed by the 'Core' group).
- Under the existing CDR, the restructured debts are partially converted to debentures/equities such as optionally convertible cumulative participating preference shares. At present RBI allows exemption from capital market exposure ceiling for such acquisition of equity, on a case to case to basis. Under the new debt restructuring mechanism banks may be granted exemption from capital market exposure norms for acquisition of such equity, in order to encourage banks to take up more restructuring proposals.

Views/suggestions of Shri D.L.Rawal, General Manager, Punjab National Bank.

- Inclusion of NSIC may be considered in the National level forum as they are playing an important role for the development of SME sector.
- Suitable training programme may be conducted (preferably by SIDBI) to educate the SME entrepreneurs in order to enable them to complete the procedures/formalities under the new debt restructuring mechanism.
- Setting up of venture fund to provide seed money for the units put under restructuring. Fund from SME Fund set up with SIDBI may be considered for utilization for the units put under restructuring.
- Individual Boards of banks may delegate adequate powers for the officials participating discussion under the new debt restructuring mechanism.
- Prescription of common/uniform documentation under the new debt restructuring mechanism. IBA may be entrusted the task of formulating uniform documentation.

Views/suggestions of Shri P. Mohanan, Deputy General Manager, Canara Bank.

- All SMEs having investment limit in plant and machinery upto Rs.10 crore and turnover upto Rs.100 crore may be covered under the new debt restructuring mechanism. The system should not be restricted to corporates, as they constitute a very small contingent of the SMEs.
- Suggestion for decentralized structure-National and State level forum. In the State level there will be a Working Group to study cases, evaluate viability and submit package to the State level forum. The SLBC Convenor will provide the secretariat for the Working Group.
- The Standstill clause i.e. 90 days from the reference or implementation of the restructuring package should have provision for no coercive action including from state level enterprises.
- Concessions similar to those available under CDR mechanism may be considered under the new debt restructuring mechanism.
- SSI Associations can provide guarantee on behalf of the entrepreneurs whose accounts have been restructured. CGTSI can also offer guarantee for this purpose for which the scope of CGTSI needs to be expanded.

Views/suggestions of Shri. N. G. Pai, Chief General Manager, Saraswat Co-operative Bank.

- Though Urban Co-operative Banks (UCBs) are not covered under the existing CDR they may be covered under the new debt restructuring mechanism. However, the maximum tenure of 7 years for sanction of loans under the bye-laws of most of the UCBs may act as hindrance for restructuring under the new debt restructuring mechanism. This aspect needs to be looked into before taking a view in this regard.
- There is not much consortium financing by co-operative banks.
- Incentives/relaxation in provisioning norms may be provided for the restructured accounts under SME sector.

- New debt restructuring mechanism may be implemented as “Pilot Project” in one or two centers in the initial stage and the structure for implementing the debt restructuring mechanism may be kept simple.

Views/suggestions of Shri. A.R.Alagappan, General Manager, Tamil Nadu Industrial & Investment Corporation Ltd.

- New debt restructuring mechanism is going to be helpful for SFCs.
- Provisioning norms for restructured accounts should be made simple.
- The promoters would not be able to infuse further capital.
- For fresh capital infused in the restructured accounts under SME sector, the extant asset classification norms of keeping in standard asset category for one year may be extended to three years.

Views/suggestions of Shri. J.P. Joshipura,General Manager, Gujarat State Financial Corporation.

- New debt restructuring mechanism is going to be helpful for SFCs.
- Due to poor financial condition of SFCs as well as their high cost of fund, sacrifice under the restructuring as well as additional funding become difficult for them. SIDBI should provide back to back refinance for this purpose.
- Training programme may be arranged for the officers of SFCs on accounting norms.
- Salient features of Gujarat BIFR model may be considered while formulating guidelines for the new debt restructuring mechanism.

Views/suggestions of Shri D.J.Pendse, General Manager, Maharashtra State Financial Corporation.

- New debt restructuring mechanism should be security based. Recovery of overdues should be the prime concern.
- Due to predominance of partnership/HUF firms under SME sector they may be included under the new debt restructuring mechanism.
- The debt restructuring mechanism should be non-discriminatory, non-discretionary.

- Simple accounting procedures with concessions in prudential norms may be provided under the new debt restructuring mechanism.
- For those closed units where promoters are willing to restart the units may also be considered under the new debt restructuring mechanism.

Views/suggestions of Shri.T.A.N.Devalkar, Vice-President, SICOM Ltd.

- Partnership firms may not be covered under the new debt restructuring mechanism.
- Under the existing CDR the repayment period is of very long. Further, the restructured debts are converted to debentures/equities (such as pref. shares/optional shares/zero coupon bonds). But this may not be feasible in case of SME sector.

Views/suggestions of Shri A.V.Sabhapati, DGM, UBD, RBI, CO, Mumbai.

- Irrespective of the exposure limit to SME sector, all urban co-operative banks should be brought under the new debt restructuring mechanism.

Issues discussed in the 2nd meeting on which general consensus have been arrived after deliberations in the current meeting.

- Loan Account of large units with IDBI, with marginally lower outstanding amount than the ceiling amount under the new debt restructuring mechanism (say 19.50 crore as on reference date) may also be covered as a special case under the new dispensation.
- All standard, stressed standard and substandard assets should be covered. Only viable units may be considered.
- For working capital, outstanding or limit as on reference date whichever is higher may be taken.
- Upfront deposit of 5 to 10% of the principal + interest to all lenders by the borrower may not be insisted upon. However, he may be asked to deposit certain amount during the consideration period of the restructuring process.

- As a part of Inter Creditor Agreement (ICA), ‘No Objection Certificate’ (NOC) should automatically be issued and pari-passu charges stand created.
- The method prescribed for arriving at the sacrifice is a true representation of economic cost of re-schedulement/ reduction of interest rate. The same method may be continued for debt restructuring under the proposed mechanism.

- **Concessions proposed for sacrifice component**:

i) Provisioning to the extent of 50% instead of 100% of the sacrifice may allow the asset to be retained in the same asset category without the asset category slipping to the lower rung. This concession may be given to exposures up to Rs.10 crore so that the concession is made available to the SMEs while it is not entirely discriminatory against the extant CDR system.

ii) Where the original payment terms prescribed a fixed rate of interest, the interest flow may be calculated with respect to BPLR + risk premium as on the date of restructuring instead of contracted rate of interest.

Chairman & Members of the Group

Shri G.Srinivasan, CGM, RPCD, RBI, Central Office- Chairman

Shri T.M.N.Singh, CGM (Credit Management), SBI - Member

Shri R.K.Garg, General Manager, BOB -Member
(Leave of absence)

Shri.K.G.Alai, General Manager, SIDBI -Member

Shri Manoranjan Mishra, Deputy General Manager, -Member
DBOD, RBI, CO.

List of Invitees

Shri A.C.Mahajan, GM, BOI

Shri D.N.Rawal , GM, PNB

Shri P.Mohanan, DGM, Canara Bank

Shri. N.G.Pai, CGM, Saraswat Co-operative Bank

Shri J.P.Joshipura, GM, GSFC

Shri D.J.Pendse, DGM, MSFC

Shri. A.R.Alagappan, GM, TIIC

Shri.T.A.N.Devalkar, Vice-President, SICOM Ltd.

Shri A.V.Sabhapati, DGM, UBD,RBI, CO, Mumbai.

Members of the Secretariat

Shri G.P.Borah, DGM, RPCD, CO, Mumbai;

Ms.V.G.Savithri, AGM, RPCD, CO, Mumbai;

Smt. Minal A. Jain, AGM, DBOD, CO, Mumbai.

Visit to auto ancillary industries clusters near Pune by the Special Group for Formulation of Debt Restructuring Mechanism -

As decided in the 3rd meeting of the Special Group for Formulation of Debt Restructuring Mechanism (held on August 14, 2004), the members of the Group along with the secretariat members have visited auto ancillary industries clusters near Pune on August 23, 2004. A list of the participants is enclosed. The views/suggestions received during the above visit are summarized below.

- There is no clear definition of 'medium' enterprises. 'Medium' enterprises should be defined at the earliest.
- The gestation period for certain SMEs is quite long. Further, most of the SMEs get their payments from large industries after 90 days. As such, the NPA norm of 90 days needs to relaxed for SME sector, at least for working capital limits.
- There should be special cell/wing for SSI sector in every branch.
- Rating mechanism for SME sector should be developed at the earliest.

- The interest rate charged by banks (say SBI) and FI (SIDBI) varies. This may be looked into.
- Efforts should be made to reduce paper work in respect of loan proposal.
- Branch level officials of banks should be sensitized adequately to realize the need for restructuring of particular units. Besides finance background they should have certain level of technical knowledge to assess a particular proposal properly. They may be allowed to participate in different fair/expos in order to acquaint themselves with latest technology.
- Margin and collateral norms for SME sector need to be relaxed.
- In those cases where turn over is going up but profit margin is remaining stagnant, the banks should extend need based additional fund limits without insisting on additional collateral.
- Banks policy should be purpose-oriented and not security-oriented.
- New loan products launched by banks should be user friendly.
- Restructuring mechanism should be extended to all SMEs, both corporates as well as partnership firms.
- Time frame should be prescribed to implement restructuring proposal.
- During the period of consideration of restructuring process, additional advance in the form of short-term loan may be provided to meet statutory dues such as electricity bill, taxes and other dues.
- Strict measures/mechanism should be put in place to ensure timely payments by large corporates to SME suppliers.
- “Project Uptech” (earlier launched by SBI for technology upgradation) may be revived/relaunched on account of the immense benefit derived from it by SSI entrepreneurs.
- The phenomenon of placing orders for supplying components by large manufacturer/corporate to one large supplier, instead of a few small suppliers may result in squeeze in profit margin leading to their closure.

Other Issue(s)

- Some of the large corporates are insisting their suppliers to open current accounts with particular bank to make their payments (inspite of SSI supplier already having current account with their banker). The SSI suppliers requested RBI to look into the issue and initiate remedial measures in this regard.

The group visited three units viz. Hansa Diesels & Equipments Pvt. Ltd. (manufacturing brake disk for diesel vehicle); Seven Seas Forgings Pvt. Ltd. (manufacturing industrial die) and Poona Shims Pvt. Ltd. (manufacturing oil cooler for diesel engine).

Chairman & Members of the Group

Shri G.Srinivasan, CGM, RPCD, RBI, Central Office- Chairman

Shri T.M.N.Singh, CGM (Credit Management), SBI - Member

Shri R.K.Garg, General Manager, BOB -Member
(Leave of absence)

Shri.K.G.Alai, General Manager, SIDBI -Member

Shri Manoranjan Mishra, Deputy General Manager, -Member
DBOD, RBI, CO.

List of Invitees

Shri Anil S.Gupte, Poona Shims Pvt.Ltd.

Shri Anshul Goel, Duro Shox Pvt.Ltd.

Shri R.H.Pahale, Samarth Auto Precision (I) Ltd.

Shri. Ambresh Tipnis, Uniklinger

Shri D.J.Karandikar, Praditi Press Parts Pvt. Ltd.

Shri Shireesh Deshpande, Hansa Diesels & Equipments Pvt. Ltd.

Shri. Rajiv Panse, Panse Auto Com.

Shri.Anil Kulkarni, Pooja Castings.

Shri Sadashiv Pandit, Fleetguard.

Shri Pritam Singh Randhava, Seven Seas Forgings Pvt. Ltd.

Shri A.S.Kulkarni, Jayashree Die castings Pvt. Ltd.

Shri P.V.Modak, Pimpri-Chindchad Automobile Component Manufacturers' Association.

Members of the Secretariat

Shri G.P.Borah, DGM, RPCD, CO, Mumbai;

Ms.V.G.Savithri, AGM, RPCD, CO, Mumbai.

Fourth Meeting of the Special Group for Formulation of Debt Restructuring Mechanism

The fourth meeting of the above Working Group was held on September 10, 2004 at 10.30 A.M. in the Reserve Bank of India Building, New Delhi under the Chairmanship of Shri G. Srinivasan. In the forenoon session, detailed discussion was held with the representatives of select SSI Associations (Tamil Nadu Small & Tiny Industries Association, Karnataka Small Scale Industries Association, Gujarat State Small Industries Federation, Federation of Associations of Small Industries of India and PHD Chamber of Commerce & Industry). In the afternoon session, discussion was held with the senior officials from the Ministry of SSI, Government of India (Additional Development Commissioner and Director) and Banking Division, Ministry of Finance, Government of India (Under Secretary). A list of the participants is enclosed. The views/suggestions received and deliberated in the above meeting are summarized below.

Views/suggestions of Shri C.R.Janardhana, President, Karnataka Small Scale Industries Association (KASSIA).

- Prudential norms for SSI sector should be relaxed and permitted up to 2008. The subsidy amount and receivables should be excluded to arrive at the NPA norms. This will reduce NPA level and burden on restructuring.
- Sickness is a continuous phenomenon in the SSI sector. As such, OTS extended by banks should be made an on-going process (instead of making available for limited period).
- Package of concessions may include subsidy for term loan, waiver of penalty, reduction in interest rate, partial exemption in electricity tariff, sales tax, etc. Sharing of debt burden by the different stakeholders including Government, local bodies, suppliers, vendors may be explored.
- Periodic Adalat presided over by High/District Court Judge and with a member from the State Industry Department may be constituted to dispose of cases expeditiously.
- Rehabilitation proposal may be vetted by an independent consultancy/Chartered Accountant firm. A monitoring mechanism may be put in place comprising members from SSI Association and consultancy firm.

- Acquisition and mergers may be adopted as a strategy for reconstruction of debt. Securitization Act should be used as the last resort.
- The Central, State Governments and SSI Associations may set up a "Sick Unit Revival Fund" for facilitating debt-restructuring process.

Views/suggestions of Shri.Ashok Poddar, President, Federation of Associations of Small Industries of India (FASSI).

- Adequate timely finance at an affordable price can prevent many of the incidences of sickness.
- For wilful defaulters, banks should initiate stringent action. However, in those instances of genuine defaults (due to unavoidable circumstances) banks should extend all possible support.
- For viable/potentially viable cases, banks should freeze all outstanding dues with minimal interest.
- Rate of interest for restructuring cases should be at PLR.

Views/suggestions of Shri. Magan Bhai Patel, President, Gujarat State Small Industries Federation.

- SFCs/SIDCs and banks should ensure timely sanction and disburse of working capital and term loan.
- Awareness programme should be initiated for bank officials as well as entrepreneurs.
- SIDBI bill discounting system may be promoted.
- SIDBI, NSIC and SISI should extend guidance for restructuring process.
- Margin money may be reduced at the time of up gradation of a unit.

Views/suggestions of Shri K.Gopalakrishnan, Chairman, Labour Laws Committee, Tamil Nadu Small & Tiny Industries Association (TANSTIA).

- Time frame of 90 days may be prescribed for disposal of the proposal for restructuring under the new debt restructuring mechanism.

- Even when none of the lenders are willing to refer the restructuring proposal before the new debt restructuring mechanism, the entrepreneur may be permitted to present his case as a special case. The precondition of agreeing to the restructuring proposal by 70% outstanding by the lenders may be removed.
- New debt restructuring mechanism should have state level set up due to peculiar problems prevailing in different states.
- SIDBI may be nodal agency for even single lender account.
- Concessions granted during restructuring process should not be withdrawn immediately after the account becomes regular.

Views/suggestions of Shri Satish Girotra and T.G.Keswani, Members, Managing Committee, PHD Chamber of Commerce & Industry, New Delhi.

- All partnership/proprietorship firms (besides corporates) having loan size of Rs. 2 crore and up to Rs. 20 crore should be covered under the new debt restructuring mechanism. The system may be optional and not mandatory. The guidelines should be transparent and exhaustive.
- Non-banking issues such as excise duty, raw material, etc. should be looked into by this forum at the time consideration of restructuring proposal.
- The amount written off in the books of accounts of banks/financial institutions due to restructuring of debt should be allowed as deductible expenditure under Income Tax Act.
- The restructured amount outstanding as loan may be considered as priority sector lending. This will incentivise banks to come forward more liberally for debt restructuring.

Views/suggestions of Dr. S. Rohini, Additional Development Commissioner, Ministry of SSI, Government of India.

- The problem of sickness in SSI sector is serious which needs to addressed urgently.

- OTS was not very successful. Further, there is a degree of stigma for those who had settled their dues to banks through OTS. This needs to addressed.
- 90 days an NPA norms for SSI sector are very harsh. This may be relaxed for SSI sector.
- All SSIs, irrespective of sectors may be covered under the new debt restructuring mechanism. Since majority of the SSIs are under tiny sector (almost 90%), the floor for new debt restructuring mechanism may be brought down to Rs.25 lakh.
- For single lender having lower than the proposed floor amount (of Rs. 5 crore), banks may be advised to formulate a similar debt-restructuring system.
- Legislative measures may be initiated to disclose dues by large corporates to SSIs in their balance sheet.
- Rephasement of statutory dues (on the lines of Gujarat BIFR model) at the time of consideration of rehabilitation proposal under the new debt restructuring mechanism may be looked into.

Views/suggestions of Shri B.D. Berwal, Under Secretary, Banking Division, Ministry of Finance, Government of India.

- The floor for new debt restructuring mechanism may be Rs.2 crore.
- For single lender having lower than the proposed floor amount (of Rs.5 crore), banks may be advised to formulate a similar debt-restructuring system.

Chairman & Members of the Group

Shri G.Srinivasan, CGM, RPCD, RBI, Central Office- Chairman

Shri T.M.N.Singh, CGM (Credit Management), SBI - Member

Shri R.K.Garg, General Manager, BOB -Member

Shri.K.G.Alai, General Manager,SIDBI -Member

Shri Manoranjan Mishra, Deputy General Manager, -Member
DBOD, RBI, CO.

Members of the Secretariat

Shri G.P.Borah, DGM, RPCD, CO, Mumbai;

Ms.V.G.Savithri, AGM, RPCD, CO, Mumbai;

Representatives of SSI Associations

1. Shri C.R.Janardhana,
   President,
   Karnataka Small Scale Industries Association (KASSIA), Bangalore.
2. Shri.Ashok Poddar,
   President,
   Federation of Associations of Small Industries of India (FASSI),
   Kolkata.
3. Shri. Magan Bhai Patel,
   President,
   Gujarat State Small Industries Federation,
   Ahmedabad.
4. Shri.K.Gopalakrishnan,
   Chairman, Labour Laws Committee
   Tamil Nadu Small & Tiny Industries Association (TANSTIA),
   Chennai.
5. Shri.Satish Girotra and T.G.Keswani,
   Members, Managing Committee
   PHD Chamber of Commerce & Industry,
   New Delhi

Government of India Officials

1. Dr. S. Rohini, Additional Development Commissioner, Ministry of SSI, Government of India.
2. Shri Praveen Mahto, Director, Ministry of SSI, Government of India.

3. Shri B.D.Berwal, Under Secretary, Banking Division, Ministry of Finance, Government of India.

Fifth (&final) Meeting of the Special Group for Formulation of Debt Restructuring Mechanism

The fifth meeting of the above Working Group was held on November 5, 2004 at 4.00 P.M. in the Reserve Bank of India Central office, Mumbai, under the Chairmanship of Shri G. Srinivasan. The members discussed the draft report with the Chairman and after firming up the feedback and suggestions from them, the report was signed.

Chairman & Members of the Group

Shri G.Srinivasan, CGM, RPCD, RBI, Central Office- Chairman

Shri T.M.N.Singh, CGM (Credit Management), SBI - Member

Shri R.K.Garg, General Manager, BOB -Member

Shri.K.G.Alai, General Manager, SIDBI -Member

Shri Manoranjan Mishra, Deputy General Manager, -Member
DBOD, RBI, CO. (leave of absence granted)

Members of the Secretariat

Ms.V.G.Savithri, AGM, RPCD, CO, Mumbai;

Ms. Minal A. Jain AGM, DBOD, CO, Mumbai

Annexure II

Suggestions from individuals and Organizations.

1. **Suggestions from Shri Gurpal Singh, Deputy Director General, Confederation of Indian Industry, New Delhi.**

    - Creation of a Special Purpose Vehicle (SPV) for SME sector, which will purchase identified pool of debt at a rate depending on the risk level of the debt. The SPV will raise fund by floating bonds against this pool of debt;
    - Setting up of factoring companies dedicated to SMEs which will buy debts of SMEs at a discounted rate and undertake the risk of collecting dues from the debtors; and
    - The banks should come out with different bill discounting systems.

2. **Suggestions from Shri Mahesh Thakkar, Director General, Finance Industry Development Council (Self Regulatory Organization for Registered NBFCs), Mumbai.**

    - NBFCs should be brought under the MSR system;
    - The ideal size would be Rs.10 lakh of loan/Lease/Hire-Purchase per account; and
    - The restructuring mechanism under MSR should include, inter-alia interest rate relaxation/interest waiver, reshedulement, moratorium and restructuring of the principal amount.

3. **Suggestions from Shri K.N.Nagaraju, President, Association of Borrowers of Karnataka, Bangalore.**

    - Restructuring by converting overdue interest to equity so that bank can sell them at appropriate time and bring improvement in debt-equity ratio;

- The decision on restructuring proposal should be completed within 3 months from the date of receipt of the proposal. Other members of the consortium should convey their decisions within 2 months. There should be a nodal monitoring agency for monitoring restructuring process;
- Low cost funds may be made available for the units put under restructuring mechanism.

4. Suggestions from Shri C.M. Saxena, Secretary General, Bihar Industries Association.

- A separate debt restructuring mechanism for SME sector is essential.
- The period of repayment for restructured debt should be between 5 to 7 years.