

Bankruptcy Framework in **India**

Knowledge Series on Banking, Pension and Insurance

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Restructuring mechanism in pre-IBC era

- **Multiple Laws enacted at various points in time**
 - **Companies Act 1956: Winding up of companies. No separate provisions for restructuring except M&A and voluntary compromise**
 - **SICA 1985: Restructuring of distressed industrial firms**
 - **Recovery of Debt due to Banks and Financial Institutions Act 1993**
 - **Security and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002**
- **RBI introduced CDR mechanism for restructuring of companies**
- **In view of ineffectiveness of CDRs, RBI introduced SDR and S4A which however proved inept at improving asset quality**

Limitations of restructuring mechanism

- Low power with creditor when faced with default
- Fragmented framework
- Erosion of value in corporate distress
- Lack of accurate and reliable information about indebtedness



Key principles driving design of Code

- **Facilitate viability of business at early stage**
- **Enable smooth flow of information amongst debtors and creditors**
- **Ensure time bound process to preserve economic value**
- **Ensure collective process**
- **Respect rights of creditors equally**
- **When negotiations fail to establish viability; outcome of bankruptcy must be binding**
- **Ensure clarity of process**

Salient features of IBC

- **Consolidate existing laws to provide single framework to all stakeholders**
- **Time bound resolution for maximizing the value of asset**
- **Shift focus from debtors in possession to creditors in control**
- **Test of insolvency from erosion of networth to payment default**
- **NCLT is quasi-judicial body for adjudicating IBC matters**
- **Regulator for IPAs, IPs, IUs**
- **FC/OC/CD can initiate proceedings**
- **Moratorium period for companies under IBC**
- **Seamless dissemination of information through IUs**
- **Liquidation of assets incase resolution plan not submitted to NCLT within timelines**

Corporate Insolvency Resolution Process

Admission into CIRP & appointment of IRP

- Can be initiated by FC/OC/CD
- NCLT admits case into CIRP; IRP is appointed

Filing & validation of claims, formation of CoC

- IRP verifies claims received from creditors
- CoC formed basis claims & 1st meeting convened

Invitation & receipt of Resolution Plans

- RP invites plans from resolution applicants
- Submission of resolution plans for evaluation

Evaluation of resolution plans

- RP evaluates eligibility of applicant under IBC
- Feasibility check & scoring as per evaluation criteria

Approval of resolution plan by CoC & NCLT / liquidation

- RP presents eligible plans to be voted upon by CoC
- CoC approved plan submitted to NCLT

Issues

- Litigations by unsuccessful resolution applicants & Creditors
- Approval from 75%* of financial creditors by value
- Invocation of personal guarantees to CD
- Verification of claim on assets under dispute
- Eligibility criteria for resolution applicant u/s 29A
- Lack of clarity over management of company between approval of plan & handing over of operations to successful RA
- Definition of related party and relative

Amendments (1/2)

- **Nov 23, 2017:**
 - Code to apply to personal guarantors to CDs;
 - Section 29A bars promoters of NPA companies & their related parties from submitting resolution plans;
- **June 03, 2018 :**
 - Reduced voting threshold: 66% for major decisions; 51% for routine decisions
 - Non applicability of moratorium period to enforce guarantee to CD
 - Withdrawal of admitted application allowed with approval of 90% vote of CoC
 - Home buyers recognized as FC
 - 1 year moratorium for successful RA to fulfill various statutory obligations required under different laws

Amendments (2/2)

- **June 03, 2018 (amendments to S29A/30):**
 - **Proving onus of eligibility u/s 29A shifted to resolution applicant**
 - **Promoters of MSMEs not disqualified from bidding under willful defaulter criteria**
 - **NPA disqualification to be tested as on date of submission of plan**
 - **NPA disqualification shall not apply to pureplay financial entities not related to CD**
 - **RA holding NPA a/c of prior approved resolution plan provided 3 year cooling off period from date of acquisition**

IBC so far...

- IBC was introduced for improving asset quality by fast-track resolution of stressed assets
 - Banking system Gross NPA as at Dec 31, 2017 : ₹ 8.41 trillion
- RBI issued 1st list of 12 cases in June 2017, Gross NPA of ₹ 2.00 trillion
 - 11 cases admitted under IBC; one resolved so far
- 2nd list of 28 cases issued by RBI in August 2017, Gross NPA of ₹ 1.15 trillion
 - Less than 50% cases admitted till date
- 525 cases admitted in NCLT up to March 31, 2018; 43% are OCs
 - 310 cases by OCs u/s 9
 - 262 cases by FC u/s 7
 - 129 cases by CD u/s 10
- IBC is further strengthened by RBI's circular dated Feb 12, 2018 on resolution of irregular accounts

Thank You

Limitations of restructuring mechanism: Low power with creditor when faced with default

- Promoters stay in control of company with creditors having no say
- Relief available only to a set of creditors
- Focus more on collateral backed debt, hence important asset light industries/start ups starved of debt
- Lending concentrated to few large Borrowers with low probability of default

Limitations of restructuring mechanism: Fragmented Framework

- **Multiple Laws dealing with insolvency**
 - Individual insolvency: Presidency Towns Insolvency 1909; Provisional Insolvency Act 1920
 - Corporate insolvency: Companies Act 1956; SICA 1985; RDDBFI Act 1993; SARFAESI Act 2002
- **Lack of comprehensive and consistent treatment of bankruptcy and insolvency for individuals, sole proprietorships, partnerships, LLPs, MSMEs**
- **Lack of clarity of jurisdictions**
- **Different fora deciding on rights of debtors and creditors**
- **Forum deciding on insolvency/bankruptcy may not have business/financial expertise/bandwidth to decide such matters**

Limitations of restructuring mechanism

- Value destruction in corporate distress
 - Good realisation of business sold as going concern
 - Realisation value sometimes lower than liquidation value when there are delays
- Lack of accurate and reliable information about indebtedness
 - Lot of time spent on getting data
 - Reliable/accurate undisputed data

