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Insolvency and Bankruptcy Reforms: The Way Forward

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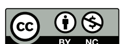
A Concise History of Bankruptcy, Insolvency, and Debt Restructuring Laws in India

Saket Hishikar

Bankruptcy laws are integral to any capitalist system. They form the basis for an orderly dissolution or reorganization of various forms of businesses from proprietorship, partnership to limited liability companies. Thus, from an economic perspective, bankruptcy laws facilitate efficient re-allocation of capital locked in a failed business. Since bankruptcy laws involve balancing competing interests of many parties such as banks, suppliers, employees, operational creditors, bondholders, and government, there are obvious distributional consequences in any bankruptcy proceeding. This makes bankruptcy laws sensitive to both political and economic exigencies.

An accurate history of the evolution of bankruptcy laws over time, therefore, requires factoring both socioeconomic (demand for law) and political (supply of law) contexts in which they were created. With that context, the article discusses the history of bankruptcy and insolvency laws starting from 1993, i.e., the post-reform period of 25 years.



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However, it needs to be mentioned that 1993 is not the real starting point in the long history of such laws in India. Hishikar et al. (2019)[1] have argued that laws on debt recovery or bankruptcy had a history of 2000 years of evolution in India. Their work has tried to correct the perception that India had no bankruptcy laws before British efforts in the late 1800s and early 1900s. They argue that many of modern principles of bankruptcy can be found in *Smriti* traditions of India. However, this long and rich tradition suffered two exogenous shocks: first, during the Muslim period; and second, during the British period. While there were no legal transplants during the Muslim period, the British period was marked by large-scale transplant from common law traditions.

By the time the British left in 1947, the procedures for insolvency and bankruptcy were firmly grounded in common law traditions. After Independence, developments in bankruptcy and insolvency laws were shaped by the debate on the role of the private sector under a system of socially regulated industrialization. Since under socialism, all major means of production and distribution were owned by the State, the concept of bankruptcy was generally disregarded. As planned economy excludes most trading risks, insolvency would not be considered a legal problem.

As a result, personal insolvency laws largely remained unchanged. The bankruptcy/winding-up provisions of company laws were not influenced by economic compulsions of socialism and followed the same path during the colonial period as evident from recommendations of the Bhabha Committee, 1952. However, in practice, the thrust of legislative wisdom was to experiment with debt recovery laws rather than bankruptcy laws.

The legal framework for dealing with corporate insolvency and bankruptcy in India immediately after Independence consisted of only two major laws: Industrial Development and Regulation Act, 1951 and the Companies Act, 1956. Under both the laws, matters concerning insolvency and bankruptcy were assigned to the high courts. The procedures under these laws were plagued by many issues such as lack of time frame for completion of proceedings or to prescribe an insolvency cost, lack of competency in official liquidator, limited information about the organization or its business and technology. Creditor's recourse to the liquidation of an insolvent company was nearly missing.

The Fourth and Fifth Plan phase (i.e., 1965–1975) was a period of acute industrial stagnation. The mounting unpaid loans with banks prompted the passage of Sick Industrial Companies Act, 1985 (SICA). SICA created the Board for Industrial and Financial Reconstruction, and the first-time matters relating to insolvency and bankruptcy were diverted away from the high courts. SICA was preventive legislation with first preference for restructuring rather than winding up. SICA had several shortcomings–notably the abuse of Section 22 which allowed companies to seek a bar on proceedings for execution, arbitration, recovery suits, enforcement of security interest, etc. The recovery rate under SICA as per the Eradi Committee was only 19 per cent.

DEBT RECOVERY LAWS IN THE POST-REFORM PERIOD

The legislative efforts in the post-reform period for the recovery of a debt in failed business was a product of three vectors: baggage of failures as summarized above, the balance of payment crisis of 1993, and the recommendation of broad-based financial sector reforms by Narasimham Committee-I (1991). Furthermore, these efforts can be grouped into two sets: those made by the Government of India and those made by the Reserve Bank of India (RBI).

The government legislated the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI) to speed up the recovery process. Under this Act, Debts Recovery Tribunals (DRTs) were formed. Initially, the system functioned well. However, soon DRTs were to be overburdened with a large number of pending cases. Within a decade, the government introduced another legislation, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act, 2002) to safeguard the interest of secured creditors. The SARFAESI Act provided for the creation of asset reconstruction companies (ARCs) in India. India's experiment with ARC in 2002 without any established bankruptcy laws or developed financial market, notably corporate bonds market, is quite puzzling. Particularly, the factors that led to the emergence of ARCs in the 1990s in the United States were completely absent in the case of India.

[1] Hishikar, S., Kheterpal, D., & Sharma, S. (2019). *A socioeconomic history of bankruptcy & insolvency laws in India*. [Paper presentation]. IIMA-World Bank Research Conference on Financial Distress, Bankruptcy, and Corporate Finance, IIM Ahmedabad.

The RBI, on the other hand, put in place, in August 2001, the Corporate Debt Restructuring (CDR) mechanism for the restructuring of debt without the need for an asset quality downgrade if the restructuring plan met certain conditions. The underlying rationale for CDR was that restructuring schemes were required as the country did not have an effective bankruptcy law in place. The schemes essentially created a framework for a resolution that should normally happen under the aegis of an insolvency and bankruptcy law.

The CDR mechanism worked well initially. In later years, it was used more as a tool for avoiding the recognition of non-performance of stressed assets and less for their effective resolution. Therefore, in May 2013, the RBI withdrew the forbearance on asset classification effective 1 April 2015. However, in the wake of the mounting non-performing assets (NPAs), the RBI allowed asset classification benefits for certain types of restructuring schemes. These included the Strategic Debt Restructuring, flexible structuring of project loans, and the Scheme for Sustainable Structuring of Stressed Assets.

Hence, after 60 years since Independence, there emerged no comprehensive framework or strategy to tackle insolvency and bankruptcy proceedings effectively. All the previous acts/schemes dealt mostly with recovery and/or restructuring of businesses, so to speak the socialist hangover in respect of bankruptcy and debt recovery laws was well entrenched during the reform phase.

INSOLVENCY AND BANKRUPTCY CODE: EXPERIENCE SO FAR

In 2014, the Bankruptcy Legislative Reforms Committee, led by T. K. Viswanathan, proposed the Insolvency and Bankruptcy Code (IBC). The objective of IBC was to consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms, and individuals in a time-bound manner for the maximization of value of assets of such persons, to promote entrepreneurship, availability of credit, and balance the interests of all the stakeholders including alteration in the priority of payment of government dues.[2]

IBC, 2016 was finally enacted and notified in the Gazette of India in May 2016. The law aims at insolvency resolution in a time-bound manner (initially 180 days, extendable by another 90 days under certain circumstances but now extended to 330 days) undertaken by insolvency professionals. The law ensures the separation of judicial and commercial aspects of the resolution process, thereby correcting the mistakes of past legislations. Furthermore, under IBC, the adjudicating body will be the National Company Law Tribunal (NCLT) and not the DRTs.

As of today, IBC has become the single law that deals with insolvency, bankruptcy, and reorganization of failed business, and has somehow reduced the importance of previous legislations. With the enactment of IBC, a major legislative gap in the resolution of NPAs was removed. The RBI through its 12 February 2018 circular abolished all the then existing CDR guidelines with a harmonized and simplified generic framework for the resolution of stressed assets through IBC. Although the Supreme Court on 2 April 2019 struck down RBI's 12 February circular whereby the central bank had mandated lenders to initiate resolution or restructuring of loans even if the default was recorded for a single day, this circular no doubt marks the first shift in enforcing the sanctity of debt contracts.

CONCLUSION

How should one view the recent history of debt recovery and bankruptcy laws in India? Can IBC be described a grand success given what has been achieved so far?

On the first question, there is no doubt that from the point of view of the recovery of debt, 1993 did not mark a major shift. Thus, even if the economic policy and the fundamental principles of macroeconomic management underwent sea change, they had no impact on debt recovery laws. As noted above, the socialist hangover on debt recovery laws continued in the post-reform period only to be reversed in 2016 with the enactment of IBC. The recovery rates realized under the RDDBFI Act and SARFAESI Act were only tad better than under SICA at around 25 per cent. Yet the gross NPA ratio of scheduled commercial banks (SCBs) declined steadily from 7 per cent in 1996–1997 to low 1.3 per cent in 2007–2008 on the back of a sharp recovery in economic growth following liberalization.

[2] Vishwanathan, N. S. (2018, April 18). *It is not business as usual for lenders and borrowers* [Speech by Deputy Governor, RBI]. NIBM.

However, the NPA cycle reversed in SCB after 2008 and NPAs rose sharply in 2016, 2017, and 2018. This jump in NPAs happened when economic growth was considered to be robust, quite the opposite what was seen in the 1990s. Thus, a large part of the rise in NPAs can be ascribed to factors other than economic such as asset stripping, wilful default, fund diversion, and poor corporate governance.

It was in this context IBC was instituted in 2016. Thus, the purpose of IBC was not just debt recovery but to correct the behaviour of borrower. Promoters, fearing of losing control of the company, do not want to be dragged into IBC. The institution of insolvency professionals is also a major departure from the past and address the deficiencies of official liquidator expertise in the valuation of assets of insolvent companies. Form this point of view, IBC has achieved success, and the positive benefits of this change will accrue in the long run.

But the progress of IBC and the experience of lenders cannot be described as smooth despite its pro-creditor tilt. Since the time the law was put into force, borrowers have a stifled resolution process through numerous petitions and counter-petitions. The net result, hardly any major case under IBC was resolved within the time frame of 270 days. Of the 1497 cases undergoing resolution, 535 have been in the system for over 270 days. Only recently the government has amended this timeline for completion of the resolution process to 330 days.

On the operations side, IBC's strategy to adjudicate bankruptcy cases before NCLT was no different from what was adopted in the 1990s. At the start of the reform process, an overburdened high court had virtually stopped lenders' recourse to the winding-up provisions under the Companies Act. Further, under SICA, the recovery was low due to the misuse of SICA provisions. Thus, to bypass this legacy, DRTs were constituted. Since DRTs today are themselves burdened with cases (around 29,500 under DRTs and 91,300 under SARFAESI), the use of NCLT is just another diversion in the hope that resolution can be achieved in time.

Then as Hishikar et al. (2019) have argued, IBC draws nothing from the history of such laws in India or elsewhere. This is evident from the repeated use of ordinances to amend the law to close loopholes in the original law. The first ordinance which came in 2017 barred promoters and wilful defaulters for bidding in the IBC process. The second ordinance which came in 2018 addressed the issue of home buyers and virtually blurred the distinction between the operation creditor and the financial creditor. Then the interaction of IBC with other regulation such as the Prevention of Money Laundering Act, 2002 and ringfencing of criminal liability for a successful bidder under IBC were highly contested issues till recently.

These examples clearly show that the drafted law had no relationship with ground reality and the dynamics that lead to the problem of NPAs. The following observation of Late Nani Palkhivala in respect of Income Tax laws in the preface to the eighth edition of his income tax book way back in 1990 perhaps drills home the point in respect of experience with IBC quite clearly[3]:

> We legislate first and think afterwards; complexity is heaped upon complexity and confused becomes worse confused …. In United Kingdom there are 29 million income-tax payers but the number of references filed in the High Court is only around thirty in a year. In India there are only seven million income-tax payers but number of references filed in our High Courts is over 6000 a year, in addition to more than 1000 writ petitions. These figures reflect the tremendous public dissatisfaction with quality of the law and of fiscal administration …. G. K. Chesterton, in his brilliant essay 'The Mad Officials' analyse how a society goes mad. The rot begins, he says, when wild actions are received calmly by society. 'These are people that have lost the power of astonishment at their own action. When they give birth to a fantastic passion or foolish law, they do not start or stare at the monster they have brought forth …. These nations are really in danger of going off their head *en mass*, of becoming on vast vision of imbecility'. India is one such country in respect of its budgeting and fiscal law. Today the monster of our direct tax structure has become more monstrous than ever before.

[3] Sorabjee, S. J., & Arvind, P. D. (2012). *Nani Palkhivala the courtroom genius*. LexisNexis Butterworths Wadhwa.

Legal Perspective on Insolvency and Bankruptcy Laws in India

Saakshi Bangar

GENERAL OVERVIEW OF THE INSOLVENCY LAWS IN INDIA

In India, the erstwhile legislations dealing with insolvency and bankruptcy of individuals and corporates were governed by a host of legislation such as the Companies Act, 2013, the Sick Industrial Companies (Special Provisions) Act, 1985, the Recovery of Debt Due to Banks and Financial Institutions Act, 1993, and SARFAESI. The erstwhile legislations were piecemeal, and they fragmented and lacked an efficient mechanism for the closure or restructuring of unviable firms. Various insolvency and recovery procedures led to a multiplicity of proceedings before various adjudicating authorities, erosion in the value of recovery by creditors due to delayed resolutions. To overcome the lacunae under the erstwhile legislations, the government introduced robust and comprehensive legislation, i.e., IBC, 2016 (henceforth referred to as Code) on 28 May 2016. The Code governs insolvency and bankruptcy of corporate persons and individuals in India in a time-bound manner for the maximization of value of such assets of such persons, to promote entrepreneurship, availability of credit, and balance the interests of all the stakeholders.

The provisions of the Code have been notified in a staggered manner and on a need-based basis. The provisions pertaining to Corporate Insolvency Resolution Process (CIRP) under the Code was brought in force in December 2016. The provisions relating to individual insolvency were proposed to be notified in three phases, i.e., first, being personal guarantors to corporate debtors (in effect from December 2019), followed by partnership firms and proprietorship firms; and then other individuals (yet to come in force). In terms of informal work-out arrangements, the RBI has issued a prudential framework dated 7 June 2019, under which inter-creditor arrangements may be entered into to enable the resolution of stressed assets (7 June Circular)[4] before initiating insolvency under the Code.

[4] https://ibbi.gov.in//webadmin/pdf/legalframwork/2019/Jun/PRUDENTIALB20DA810F3E148B099C113C2457FBF8C_2019-06-07%2019:42:15.pdf

PROGRESS OF THE RESTRUCTURING AND INSOLVENCY ACTIVITY POST INTRODUCTION OF THE CODE

Though IBC was enacted more than three years ago, its effects have been palpable. As of February 2020, approximately 26,250 applications were filed under IBC and of them around 3600 have been admitted. Of the admitted cases, 205 cases have been resolved, and 890 cases have ended with liquidation. The time taken for the resolution of companies has been reduced from about 4.3 years to approximately 364 days under IBC. Further, the realization by financial creditors under resolution plans in comparison to their claims was around 42 per cent.

The gross NPAs in the financial year ending 2019 reduced to around 9.1 per cent from 11.2 per cent in 2018.[5] The average recovery through the Code is significantly better than through other recovery and work out mechanisms.[6]

As per the 'resolving insolvency index' under the World Bank's Doing Business Report, 2020: (a) India's ranking has improved from 136th in 2015 to 52nd in 2019, (b) recovery rate has been from 25.7 per cent in 2015 to 71.6 per cent in 2019, and (c) time is taken in recovery from 4.3 in 2015 to 1.6 years in 2019.[7]

This article provides an overview of the processes under the Code, along with the recent developments and the challenges faced by the stakeholders.

OVERVIEW OF THE PRESENT LEGAL FRAMEWORK UNDER THE CODE

The Code separates commercial aspects of insolvency and bankruptcy proceedings from judicial aspects.

[5] Reserve Bank of India (RBI). (2019). *RBI handbook of statistics on Indian economy 2018–19*. Department of Economic and Policy Research, RBI.

[6] RBI. (2019, December 28). *Report on trend and progress of banking in India, 2017–18*. Department of Economic and Policy Research, RBI.

[7] World Bank Group. (2020). *Economy profile India: Doing Business 2020*. World Bank. https://www.doingbusiness.org/content/dam/doingBusiness/country/i/india/IND.pdf.

The primary focus of the legislation is to ensure revival and continuation of the corporate debtor by protecting the corporate debtor from its management and from a corporate death by liquidation. The Code is thus a beneficial legislation which seeks to revive the distressed company and mere recovery legislation for creditors. The interests of the corporate debtor have, therefore, been bifurcated and separated from that of its promoters and/or those who are in management. Thus, the resolution process is not adversarial to the corporate debtor but, in fact, protective of its interests.[8] The framework under the Code protects the interest of the creditors under the liquidation waterfall by putting the pay-out to secured creditors higher in the ranking against pay-out towards crown debts. However, during the resolution process, it is the commercial wisdom of the majority of creditors which is to determine, through negotiation with the prospective resolution applicant, as to how and in what manner the corporate resolution process is to take place including the distribution of funds.[9]

Some of the key features of the framework under CIRP and liquidation process for corporate debtors are as under:

1. *CIRP*: A financial creditor (either by itself or jointly) or an operational creditor or the corporate debtor itself is eligible to initiate CIRP on a minimum default of ₹1,00,00,000.[10] To prevent insolvency proceedings against medium and small enterprises amidst COVID-19 crisis, the government has recently enhanced the threshold limit for initiating CIRP from ₹1 lakh to ₹1 crore.

   Upon admission, a moratorium on suits, transfer of assets, and enforcement of security commences. Board of directors is suspended, and the interim resolution professional (IRP) is appointed who takes control of the corporate debtor and its assets, etc.

   IRP thereafter constitutes a committee of financial creditors (CoCs). CoC is required to take critical (with 66% voting share) and routine decisions (with 51% voting share) not in the domain of IRP.

   The resolution professional (RP), with the approval of CoC, sets the eligibility criteria for the submission of the resolution plan and publishes an expression of interest. To avoid the tainted person to regain control, certain persons who are subject to disability in or outside India in terms of Section 29A of the Code are barred to submit a resolution plan. A legally compliant, commercially viable, and feasible resolution plan is approved by CoC with 66 per cent majority and then submitted to the relevant bench of NCLT for its approval. If no resolution plan is received or no resolution plan is approved by the CoC till the maximum resolution period, i.e., 270 days or 330 days (including litigation), then the corporate debtor must be liquidated. However, the 330-day timeline is not mandatory and has been interpreted to be directory by the Supreme Court in the case of *Essar Steel India Limited vs. Satish Kumar Gupta & Others*.[11] The resolution plan approved under the Code may include provisions for the restructuring of a corporate debtor by way of merger, amalgamation, and/or demerger.

2. *Liquidation process*: Under the Code, a CIRP may or may not be followed by liquidation. Triggers for liquidation include (a) rejection of a resolution plan by NCLT if it fails to meet certain necessary conditions, (b) the resolution plan not being approved by the CoC by 66 per cent in value or no resolution plan is received, (c) a decision of the CoC to proceed with liquidation during the CIRP period, or (d) failure of the debtor to adhere to the terms of the resolution plan approved by NCLT. A company may also suo motu resolve to voluntarily liquidate the company, in case it has not made any payment defaults.

   Upon liquidation order being passed by NCLT, a liquidator is appointed by NCLT, CoC ceases to exist, and stakeholders' (creditors entitled to distribution) consultation committee is constituted. Liquidator verifies, admits, or rejects claims of creditors, prepares asset memorandum, and takes into custody and controls all the assets of the corporate debtor. The liquidator may sell the assets of the corporate debtor collectively or on a standalone basis or in parcel or in slump sale, or on a going concern basis. Sale is typically through auction.[12] A person who is not eligible under IBC to submit a plan for insolvency resolution of the corporate debtor shall not be a party in any manner to such compromise

8 *Innoventive Industries Ltd. v. ICICI Bank and Anr*. (2018). 1 SCC 407.

9 *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta & Ors*. [Civil Appeal No. 8766-67/2019 and other petitions].

10 https://ibbi.gov.in//uploads/legalframwork/48bf32150f5d6b30477b74f652964edc.pdf.

11 https://ibbi.gov.in//uploads/order/d46a64719856fa6a2805d731a0edaaa7.pdf.

12 Section 5(26) of the Code.

or arrangement. The liquidation process may be completed within a period of one year.

3. *Other key features*: For the benefit of creditors, the Code provides that the transactions which are preferential, undervalued, or extortionate in nature are required to be evaluated. The review period for evaluation is prescribed as (a) two years where transactions are entered into with related parties and (b) one year in all other cases. Further, the transactions entered with the intent to defraud the creditors also need to be reviewed, but the provisions under the Code do not provide any lookback period.

RECENT LEGAL DEVELOPMENTS

The government has increased the threshold for filing cases under IBC from 1 lakh to 1 crore. Government is further mulling upon putting the IBC filings in abeyance for several months due to the increase in coronavirus cases.

The government recently brought in force the provisions relating to insolvency and bankruptcy of financial service providers (FSPs). Presently, the provisions are applicable to non-banking financial companies (which include housing finance companies) with an asset size of ₹500 crore or more as a category of FSP (with the RBI as the financial sector regulator). First such FSP undergoing CIRP is Dewan Housing Finance Corporation Limited.[13]

Scope of 'Interim finance' expanded to 'any other debt that may be notified'. This gives rise to the scope for certain pre-IBC financing to be included in the category of 'interim finance'.

Minimum thresholds for filing of the application under IBC (a) in case of homebuyers/allottees is lower than at least 100 homebuyers/allottees under the same project or at least 10 per cent of the total number of such allottees; and (b) in case of a class of creditors, is lower than at least 100 creditors of such class or at least 10 per cent of the total number of creditors in such class.

RP has been given the power to identify critical goods and services which may not be terminated during moratorium (provided dues are paid during moratorium). Similarly, there will be no automatic termination/suspension of license, permit, registration, quota, concession, clearances, or a right given by the central government, state government, local authority, sectoral regulator, or any other authority, and they must continue during moratorium subject to dues being paid for the services provided during the moratorium.[14]

In many cases, it was noted that during the liquidation period, the corporate debtor does not have sufficient funds to meet the costs to liquidate the company. In effect, an amendment provided that COC shall identify the liquid assets of the company and compare it with the costs likely to be incurred by the liquidator if the company goes into liquidation (liquidation cost). Where the estimate of liquid assets is less than the liquidation costs, CoC shall contribute towards the difference, if any, between the liquidation costs and the liquid assets available with the company.[15]

Further, where the secured creditors who opt to realize their security interest, shall contribute their share of the insolvency resolution process cost, liquidation process cost, and workmen's dues (relating to a period of 24 months preceding the liquidation commencement date) to the extent of their relinquished security interest. Such amounts should be paid by them within 90 days of the liquidation commencement date. They shall also pay excess amount realized over the amount of their claims admitted, within 180 days of the liquidation commencement date. Where the secured creditor fails to pay such amounts to the liquidator within 90 days or 180 days, as the case may be, the asset shall become part of liquidation estate assets of the Corporate Debtor.[16] Secured creditors cannot sell assets to a person barred from submitting an insolvency resolution plan (Section 29A).

CHALLENGES AND WAY FORWARD

IBC has strengthened creditors' position and has transformed the culture of corporate credit in India. It has also brought behavioural changes in promoters of non-performing companies by instilling credit disci-

[13] https://ibbi.gov.in//uploads/legalframwork/7bcd2585a9f75b9074febe216de5a3c1.pdf.

[14] https://ibbi.gov.in//uploads/legalframwork/d6b171ec9b9ea5c54f7423bc36f92977.pdf.

[15] Regulation 39B of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

[16] https://ibbi.gov.in/uploads/legalframwork/6eda1d32cfc69cf3fbf91feff9116078.pdf.

pline. This, coupled with the notification of provisions related to the initiation of insolvency of personal guarantors to corporate debtors, has further amplified the impact of IBC.

Some of the other challenges to the effective resolution of companies under IBC include issues such as: (a) breach of the resolution plan by the resolution applicant after approval of NCLT, (b) lack of regulations and rules for cross-border insolvency, (c) lack of regulations and rules for group insolvency, (d) post-closure litigation by operational creditors including tax authorities or unsuccessful bidders, and (e) conflicting judgements from different benches of NCLT, etc.

Some of the issues faced in the implementation of IBC can be eased by (a) conducting timely colloquium for judges of NCLT and increasing interaction between practitioners from various jurisdictions; (b) sensitizing various government and statutory authorities about the treatment of government and statutory dues under IBC to reduce the scope for litigation and consequent delay in the resolution of companies under corporate insolvency; (iii) NCLTs according to higher priority to applications filed in respect of avoidable transactions such as extortionate, preferential, undervalued, and fraudulent transactions; and (iv) NCLTs discouraging frequent adjournments and ensuring timeliness of the resolution process.

IBC 2.0 in the Making: A Relook into the Insolvency Regime in India

Sandeep Parekh and Sudarshana Basu

INTRODUCTION

On 15 November 2019, the central government notified specific provisions under IBC, 2016, along with various other rules, which dealt with the insolvency resolution process about a personal guarantor of a corporate debtor. This change, effective from 1 December 2019, not only earmarks the first step towards operationalizing the personal insolvency framework in India,[17] but also provides a huge impetus to the timely resolution of insolvency cases against corporate debtors, which is one of the key objectives behind the enactment of IBC.

IBC was enacted with a view to provide for a single framework for *time-bound* reorganization and insolvency resolution in India, in a process which would ultimately lead to a maximization of the value of assets of the entity undergoing the insolvency resolution process. Prior to IBC, creditors had to opt for debt resolution under the SICA, the Recovery of Debt Due to Banks and Financial Institutions Act, 1993, or the SARFAESI Act, 2002, which were largely ineffective due to the delays in the resolution process.

On the other hand, under IBC, once an application for CIRP is accepted by the adjudicating authority, i.e. NCLT, the entire CIRP is required to be completed within 180 days, subject to a maximum extension of 330 days.[18] Therefore, the introduction of IBC was an important legislative reform that marked a major overhaul of the insolvency regime, which was previously stymied by multiple legislation and a constant piling up of NPAs.

KEY DEVELOPMENTS IN THE FRAMEWORK

While the enactment of IBC in itself is viewed as a watershed moment in the resolution of stressed assets in India, it has undergone several amendments, and the judiciary has also played a significant role in fine-tuning the various loopholes in the framework. Some of the major changes to IBC have been discussed below.

Primacy of the Committee of Creditors

One of the primary objectives of IBC is to ensure the revival of an insolvent entity through resolution plans which may involve a restructuring of business operations, so as to allow such an entity to repay its debts to the creditors without necessarily going into liquidation. The success of the entire resolution process lies in minimum interference from courts and regulatory authorities. For instance, any resolution plan requires the approval of CoCs, which is tasked with the responsibility of overseeing the resolution process, and as observed by the Supreme Court,[19] NCLT or NCLAT cannot call into question the 'commercial wisdom' of CoC.

That being said, CoC must take into account certain factors such as the asset value of the corporate debtor will be maximized, the corporate debtor must keep going as a 'going concern' and that the interests of all stakeholders, including that of operational creditors, have been adequately considered.[20] Therefore, in effect, IBC envisages a shift in control of the corporate debtor to the creditors who are represented by CoC, and the scope of judicial review over the merits of any decision taken by such CoC is limited.

Section 29A: Eligibility for Resolution Applicant

One of the most contentious provisions, Section 29A of IBC, was introduced with a view to restrict the backdoor entry of defaulting promoters by submitting a resolution plan and acquiring the assets of the corpo-

[17] The personal insolvency provisions under Part III of the IBC were enacted in 2016; however, provisions related to insolvency resolution of personal guarantors to corporate debtors were enforced w.e.f. 1 December 2019.

[18] Section 12 of IBC.

[19] *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and Ors.* [Civil Appeal Nos. 8766-67 of 2019], decided on 15 November 2019 [Supreme Court]. See also *K. Sashidhar v. Indian Overseas Bank and Ors.* [Civil Appeal No. 10673 of 2018], decided on 5 February 2019 [Supreme Court].

[20] *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and Ors.* [Civil Appeal Nos. 8766-67 of 2019], decided on 15 November 2019 [Supreme Court].

rate debtor at discounted prices.[21] Before this, there was no specific eligibility criteria or qualification assigned to a resolution applicant under IBC. However, the enactment of Section 29A rendered certain categories of persons ineligible to submit resolution plans, including persons who had contributed to the defaults of the corporate debtor along with their connected persons and related parties.

The wide prohibition under Section 29A, under the garb of 'connected persons' and 'related parties', effectively rendered many genuine applicants also ineligible until 2019 when the Supreme Court clarified the scope of the provision by limiting the interpretation of the term 'related party' to include only those who had a connection with the business activity of the resolution applicant.[22] The Supreme Court not only upheld the constitutional validity of the said provision but also clarified that erstwhile promoters of corporate debtors have no vested right to apply for being considered as a resolution applicant.

Operational Creditors vis-à-vis Financial Creditors

The Supreme Court on 15 November 2019 finally settled the question of parity between financial creditors and operational creditors in the *Essar Steel* case,[23] by overruling the July 2019 decision of NCLAT,[24] which held that financial creditors and operational creditors cannot be treated in a discriminatory manner by CoC. NCLAT, in its decision, had modified the resolution plan initially approved by CoC and had ordered for the 'equal distribution' of funds among all classes of creditors, wherein both financial creditors and operational creditors with claims over ₹1 crore could recover around 60.7 per cent of their total dues.

While reversing the decision, the Supreme Court not only recognized that an 'equitable', and not 'equal', the approach is required to be adopted for different classes of creditors but also highlighted the dangers of stretching the 'equality for all' principle to the extent of treating unequal classes of creditors as equals. Also, as discussed earlier, the Supreme Court reinstated the primacy of CoC and their 'commercial wisdom' as far as resolution plans are concerned, as long as the interests of all classes of creditors have been looked into. The above decision is particularly significant to determine and account for the haircuts allowed to operational creditors in such cases, considering that operational creditors nearly account for an equal number of insolvency and bankruptcy cases filed before NCLT as the financial creditors.

Homebuyers as 'Financial Creditors'

In the original enactment, homebuyers were not recognized as operational creditors or financial creditors, which meant that real estate allottees seeking the delivery of their properties were left in a lurch. This loophole was plugged in the matter of *Jaypee Infratech*,[25] where insolvency proceedings against Jaypee Infratech Limited were initiated, ignoring the rights of other stakeholders such as the homebuyers. The Supreme Court allowed the appeal and ordered for the fresh constitution of CoC, which would enforce the status of the allottees as financial creditors.

Closely following the above development, an amendment was made to IBC, wherein with effect from 6 June 2018, the amounts raised from 'allottees' of real estate projects registered under the Real Estate Regulation Act, 2016 were brought within the purview of 'financial debt'.[26] This means that homebuyers can not only initiate CIRP against real estate developers, but they are also entitled to represented by CoC wherein they can vote for the approval or rejection of a resolution plan.

When the constitutionality of the aforesaid amendment was challenged before the Supreme Court through a batch of petitions led by real estate developers,[27] the Supreme Court upheld the validity of the amendment by stating that amounts raised from the homebuyers under a contract are akin to raising finance and, therefore, would constitute 'financial debt' within the meaning of Section 5(8) of IBC.

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21 Section 29A was initially introduced vide the IBC (Amendment) Ordinance, 2017, and subsequently brought into effect through the IBC (Amendment) Act, 2018.

22 *Swiss Ribbons Pvt. Ltd. v. Union of India, Writ Petition* (Civil) [No. 99 of 2018], decided on 25 January 2019 [Supreme Court]. In this judgement, the Supreme Court also upheld the constitutional validity of IBC.

23 *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and Ors.*, 2019.

24 *Standard Chartered Bank v. Satish Kumar Gupta, Company Appeal* [(AT) (Ins.) No. 242 of 2019], decided on 4 July 2019 [NCLAT, Delhi].

25 *Chitra Sharma v. Union of India*, Writ Petition (Civil) [No. 744 of 2017], decided on 9 August 2018 [Supreme Court].

26 The IBC (Second Amendment) Act, 2018.

27 *Pioneer Urban Land and Infrastructure Limited v. Union of India*, Writ Petition (Civil) [No. 43 of 2019], decided on 9 August 2019 [Supreme Court].

Withdrawal of CIRP

When IBC was originally enacted, there was no provision for an application for withdrawal of insolvency proceedings, although the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 permitted such withdrawal requests to be made before NCLT prior to the admission of the application for insolvency proceedings.

In 2018, Section 12A was inserted in IBC which permitted withdrawal of application for insolvency made by operational or financial creditors or the corporate debtor, provided such an application for withdrawal was made by with the approval of 90 per cent of the voting share of CoC.[28] Also, such an application for withdrawal could be made only prior to the stage of issuance of an invitation for expression of interest by RP for the submission of resolution plans under Regulation 36A.[29] However, the Supreme Court has construed this requirement of making withdrawal application prior to the issuance of an invitation for the expression of interest, as directory and not mandatory.[30] Therefore, NCLT may allow an application for withdrawal even after the issuance of expression of interest, depending upon the facts and circumstances of the case.

Insolvency of Financial Service Providers

In November 2019, the central government notified the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 (FSP Rules). Under the FSP Rules, FSPs (other than banks) and non-banking financial companies, including housing finance companies, with an asset size of more than ₹500 crore, would be subjected to insolvency and liquidation proceedings under the IBC and the FSP Rules. CIRP of FSPs can be initiated at the instance of the appropriate regulator, i.e., the RBI, on the occurrence of a 'financial default'. However, the provision of the moratorium, in the case of FSPs, is not applicable to third-party assets held in trust by FSP for the benefit of such third parties.

[28] The IBC (Second Amendment) Act, 2018.

[29] Regulation 30A of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

[30] *Brilliant Alloys Private Limited v. S. Rajagopal and Ors*., Special Leave Petition (Civil) [No. 31557 of 2019], decided on 14 December 2018 [Supreme Court].

THE ROADMAP FOR THE FUTURE

Although several amendments and reforms have streamlined the implementation of IBC, it suffers from major oversight in certain areas even after more than three years of its enactment. IBC was primarily brought into effect to carve out a recovery roadmap for the lenders and help resolve the issue of increasing NPAs in the country. However, till December 2019, total 3312 CIRPs were initiated, out of which only 190 led to the approval of resolution plans, 780 ended in liquidation, and other 381 cases were either closed on appeal or review, settled, or withdrawn.[31] Many cases were either pending or stuck at various stages of litigation, which was far from the objectives of 'timely' resolution and 'asset value maximization' of IBC. For instance, the *Essar Steel* case alone took almost 2.5 years for ArcelorMittal to complete the acquisition of Essar Steel Limited, which was way beyond the 330 days' timeline envisaged under IBC.

In this backdrop, it is important to revisit the challenges in the implementation of the existing insolvency framework and various other aspects yet to be covered under IBC. Some of these have been elucidated hereunder.

Cross-Border Insolvency

Presently, cross-border insolvency proceedings are governed by Sections 234 and 235 of IBC, which provide for reciprocal arrangements such as bilateral treaties that India can have with a particular country for initiating insolvency proceedings under IBC. However, this framework is unequipped to deal with the various dimensions of cross-border insolvency which may arise, particularly where there is an absence of a bilateral treaty. Cross-border insolvency entails the protection of rights of foreign creditors who have rights on the assets of the debtor which may or may not be located in different jurisdictions, rights of creditors to attach assets of debtor in various jurisdictions and the right to initiate proceedings against the same debtor in multiple jurisdictions.

In January 2020, the Ministry of Corporate Affairs constituted a committee to suggest a framework for the smooth implementation of cross-border insolvency

[31] Insolvency and Bankruptcy Board of India. (2019). *Quarterly newsletter: October–December, 2019* (Vol. 13). https://www.ibbi.gov.in/uploads/publication/62a9cc46d6a96690e4c8a3c9ee3ab862.pdf.

provisions under IBC.[32] The committee will not only propose a draft bill to make the amendments but will also look into the recommendations of the Insolvency Law Committee which had recommended the adoption of the United Nations Commission on International Trade Law in India in its report in October 2018. The proposed chapter on cross-border insolvency is a major step, which, if implemented, will not only ensure the better administration of assets outside India but also put India globally at par with other jurisdictions.

Pre-packaged Insolvency Resolutions

A pre-packaged insolvency or a 'pre-pack' insolvency process involves a pre-defined arrangement wherein the sale of all or party of the entity's business is negotiated with a buyer, prior to the initiation of the insolvency proceedings. Unlike in other jurisdictions such as the United States and the United Kingdom, which already allow such pre-pack insolvency resolutions, India follow a 'bidding' process amongst resolution applicants to get their resolution plan approved. The pre-pack insolvency process offers a much faster resolution process to ordinary insolvency proceedings, which in turn leads to the value maximization of assets.

However, introducing the pre-pack resolution process in India would require a customized approach and implementation of necessary safeguards such as the approval of such pre-packs by NCLT, the balance between interests of creditors and debtors, etc. Nonetheless, pre-pack insolvency is a much-needed reform which will be highly beneficial for the Indian economy, which is presently grappling with NPAs.

Group Insolvency/Substantive Consolidation

The Insolvency Law Committee in its 2018 report had inter alia recommended the inclusion of group insolvency provisions under IBC. The group insolvency resolution process allows the consolidation of the resolution process if multiple entities of a single group become insolvent and ensures that the group is restructured as a whole and is treated as a single economic entity. While the group insolvency process marks a clear departure from the concept of 'separate legal entity', such substantive consolidation offers clubbing of assets and liabilities of all group entities subject to insolvency proceedings, which results in a better utilization of such assets for the benefit of both the corporate debtor and the creditor.

In India, while the recommendations for the adoption of group insolvency are yet to be implemented, NCLT has allowed for the consolidation of 13 group companies, including foreign subsidiaries of Videocon Industries Limited (Videocon), and permitted attachment foreign oil and gas assets held by the Videocon Group through the overseas subsidiaries.[33] However, the consolidation was allowed subject to certain conditions such as the existence of common control, common directors, common assets, common liabilities, inter-dependence between the group companies, pooling of resources, common financial creditors, etc.

Sectoral Impediments to Insolvency

IBC had been promulgated to alleviate the financial distress faced by entities. However, certain sectors such as infrastructure and power suffer from systemic inefficiencies that are directly traceable to government control or unattractive tariffs, etc. For instance, power distribution companies (Discoms) across the country owe significant amounts to power generation companies, and the power sector has been plagued with a stark increase in the number of stressed assets. However, the application of insolvency provisions under IBC to such Discoms would require a fresh approach, considering that the rise in stressed assets is largely attributable to sector-specific factors, and in this regard, some of the provisions of IBC may need to be streamlined to enable smooth insolvency resolution in such sectors.

Timeline Under IBC: Not Mandatory?

As stated earlier, the primary objective of IBC is to ensure the timely resolution of insolvency cases, which was not attainable through other legislations such as SICA. Through the IBC (Amendment) Act of 2019, a provision was inserted under Section 12 of IBC which 'mandatorily' required the completion of CIRP within a maximum period of 330 days, including the time taken

[32] Ministry of Corporate Affairs. (2020, January 23). Insolvency Section (Notification No. 30/27/2018). http://www.mca.gov.in/Ministry/pdf/constitutionOrder_30012020.pdf.

[33] *State Bank of India and Anr. v. Videocon Industries Limited and Ors.* [M.A. No. 1306 of 2018 in C.P. No. 01 of 2018 and Ors.], decided on 8 August 2019 [NCLAT, Mumbai]. See also Venugopal Dhoot (applicant) in the matter between *State Bank of India v. Videocon Industries Limited and Ors.* [M.A. No. 2385 of 2019 in C.P. (IB) 02/MB/2018], decided on 12 February 2020 [NCLAT, Mumbai].

for legal proceedings in relation to such processes. The Supreme Court in the *Essar Steel* case[34] not only struck down the term 'mandatorily' from the said provision but also held that NCLT or the NCLAT can extend the timeline beyond 330 days if certain conditions are met. The above ruling effectively renders the prescribed timeline under IBC for the completion of CIRP as merely a directory, which may not be the best solution for the existing backlog of insolvency cases pending before NCLT/NCLAT.

CONCLUSION

During the initial days, post-implementation of the IBC challenges to the resolution process at every stage led to myriad litigation, which resulted in delays and hindered the completion of such processes in a time-bound manner. However, several amendments and judicial discourse since the inception of the Securities and Exchange Board of India (SEBI) have helped plugged the loopholes in the framework and ring-fence both lenders and borrowers. In the near future, however, structural changes which would strengthen the banking system are necessary. Moreover, there is a need to shift our focus to balance the interests of various stakeholders and reduce friction due to regulatory overlaps, if any. A fragmented approach towards the insolvency regime may not be in the best interests for the Indian economy, especially in the present times, which are marked by uncertainty and scepticism.

[34] *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and Ors.*, 15 November 2019.

Impact of the Indian Insolvency Framework on Corporate Governance, Business Practices, and Capital Markets

U. K. Sinha

Three years is a short period to assess the impact of legislation on an economy. Besides the cases resolved or the money realized by the creditors, the larger impact of the Indian IBC can be gauged from the substantive changes in the behaviour and practices followed by corporates and lenders and its impact on corporate governance and on the capital markets. When compared with the different measures taken in the past to revive stressed companies, IBC truly stands out for its wide-ranging influence on the lending and borrowing practices in India. It is also proving to be a huge step forward in ensuring the confidence of investors in the Indian capital markets. Further, IBC has also significantly transformed the corporate governance landscape by enhancing the role of 'creditors' as a stakeholder and challenging notions of 'promoter' control in the Indian corporate governance regime. Within this context, this article analyses the impact of IBC on corporate governance, business practices, and capital markets in India.

IMPACT ON CORPORATE GOVERNANCE

The concept of a company being an entity separate from the promoter and having different stakeholders has largely been absent in the minds of Indian entrepreneurs. The Companies Act, 2013 (the Companies Act) and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (the Listing Regulations) have laid down several important checks and introduced mandatory provisions for independent directors, committees of the boards, disclosures, preparation of financial accounts, related party transactions, shareholder democracy, etc. Directors are duty-bound to act in the best interest of the company, its employees, shareholders, community, and the environment.[35] Further, a director must exercise independent judgement and discharge his/her duties with due care, skill, and diligence, and not be involved in any situation which has a direct or indirect conflict of interest or attempt to achieve any undue gain or advantage for him/herself or his/her relatives, partners, or associates.[36]

Directors are also required to provide strategic guidance to the management of the company.[37] They have to ensure that the financial reporting is correct and fair and that appropriate systems of control are in place.[38] They are required to monitor the effectiveness of the listed entity's governance practices and make changes as needed. However, often that has not been the case.

IBC has significantly transformed the corporate governance landscape by emphasizing the role of creditors as that of a stakeholder. By virtue of being an officer in charge of the company, directors are the first ones to see incipient signs of stress in a company which often result in self-serving practices such as taking loans recklessly, alienation of assets or profitable business divisions of the company—often to related privately owned entities. Fudging of accounts or making unjust enrichments to promotors through fraudulent means have also not been uncommon. Lax monitoring of loans by banks also encouraged the practice. IBC has put in place strong deterrence measures to prevent directors and promoters from indulging in such practices. IBC incorporates the concept of twilight period, i.e., a look back of two years preceding the commencement of CIRP. Section 66(2) of IBC states that on an application made by the RP, NCLT may make a director of the corporate debtor liable to make contribution to the assets of the corporate debtor if

> [B]efore the insolvency commencement date, such director or partner knew or ought to have known that there was no reasonable prospect of avoiding the

[35] Section 166(2), Companies Act, 2013.

[36] Section 166(3), Companies Act, 2013.

[37] Principle 4(f), Chapter 2, SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

[38] SEBI 2015.

> commencement of a corporate insolvency resolution process in respect of such corporate debtor; and such director did not exercise due diligence in minimising the potential loss to the creditors of the corporate debtor.[39]

Further, Section 45(1) empowers the RP or liquidator to approach NCLT for taking corrective actions if he or she is of the opinion that a transaction has been undervalued or for defrauding creditors.[40] Where NCLT is satisfied that an undervalued transaction has been entered into by the corporate debtor with mala fide intention, it may make orders to impose a penalty, as provided under IBC.[41]

Moreover, IBC also imposes civil and criminal liabilities for the erring directors of the company. Civil liability extends to the disgorgement of personal assets of directors, whereas in cases of actual fraud, falsification of books of account and siphoning off of funds, IBC imposes fines and imprisonment.

For the first time in India, a promoter may lose control over the affairs of his or her company under IBC. Besides, promoters are practically barred from bidding for their own companies or any other company undergoing insolvency, if their companies have turned into NPAs.

It is also important to highlight that the IBC provisions are also in line with the thinking in other parts of the world. The Italian Insolvency Code not only places a responsibility on directors to identify signs of stress when they first appear so as to *avert* or *prevent* a situation of insolvency, it also seeks to hold them responsible for actions that they took in applying their business judgement to save the crisis, but which actually drove the company to insolvency. The Italian code defines 'distress' and has introduced a system of crisis alert measures to identify and address distress situations at a stage when insolvency can still be avoided. Further, in 2018, the Government of UK announced a number of significant reforms which focus specifically on reducing the risk of major company failures occurring through poor governance or stewardship and improving the insolvency framework in such situations. The consultation also sought to tighten the government's ability to hold directors to account for their company being in, or approaching, insolvency.[42]

IMPACT ON BUSINESS PRACTICES

The restrictions on the promoters have also shifted the balance of power from the borrower, i.e., the promoters to the creditors. There are initial indications that there is more discipline in borrowing practices. It has brought about some sense of responsibility and urgency among the promoters and management of the company because they have a threat of losing their company.[43]

Lenders have started exercising stricter loan evaluation criteria. The leverage level is being monitored stringently. Corporates are being asked to bring in more equity and to show its source. It was quite common for promoters to borrow money and place a portion of it in a step-down subsidiary or in a special purpose vehicle as their equity contribution. Now, bankers are asking more difficult questions about the sources of equity. End use of bank loans is being monitored more seriously, and borrowers are under an enhanced threat of action if the purpose of the loan is not strictly followed. The RBI has also introduced heightened obligations on bankers to ensure that funds are not diverted. Diversion of funds can be treated as a step towards wilful default. This has serious consequences for the ability of the promoter to access future loans. In the same vein, SEBI has issued strict guidelines debarring wilful defaulters from raising future money from the capital markets or even being eligible from holding directorship in companies. Even audit committees and the boards of companies now have an onerous responsibility to monitor the end use of funds out of the issue of securities.

The fear of losing control over their companies is prompting promoters to sell off their assets or shares to settle or resolve their dues. This presents an opportu-

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39 Section 66(2), Insolvency and Bankruptcy Code, 2016.

40 Under section 45(2) of the Insolvency and Bankruptcy Code, 2016, a transaction shall be considered undervalued where the corporate debtor: (a) makes a gift to a person; (b) enters into a transaction with a person which involves the transfer of one or more assets by the corporate debtor for a consideration the value of which is significantly less than the value of the consideration provided by the corporate debtor; and such transactions have not taken place in the ordinary course of business of the corporate debtor.

41 Section 49(1), Insolvency and Bankruptcy Code, 2016.

42 Department of Business, Energy & Industrial Strategy, UK. (2018, August 26). *Insolvency and corporate governance: Government response*. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736163/ICG_-_Government_response_doc_-_24_Aug_clean_version__with_Minister_s_photo_and_signature__AC.pdf.

43 CRISIL. (2019). *Three years of IBC, more hits than misses*. https://www.crisil.com/en/home/newsroom/press-releases/2019/05/in-three-years-of-ibc-more-hits-than-misses.html.

nity for investors in stressed assets. Companies are also paying up their debts in advance to avoid defaulting under Section 29A of IBC.[44] Many debtors are also paying debts at the pre-admission stage before NCLT to avoid a declaration of insolvency. As per data provided by the Insolvency and Bankruptcy Board of India in January 2019, total 4452 cases were disposed of at the pre-admission stage, leading to a recovery of around ₹2.02 lakh crores.[45]

IBC has been successful in bringing about a behavioural change in not only the borrowers but also in the creditors. The circular dated 7 June 2019 by the RBI on the Prudential Framework for Resolution of Stressed Assets (Stressed Assets Circular) makes it mandatory for lenders to recognize incipient signs of stress in loan accounts, immediately on default by classifying such assets as special mention accounts (SMAs).[46] Further, the credit information, including the classification of an account as SMA, has to be reported to the Central Repository of Information on Large Credits on all borrowers having credit exposure over ₹50 million and above.[47] Once a borrower is reported to be in default by any lender, lenders have to undertake a prima facie review of the borrower account within 30 days from such default. In respect of accounts with aggregate exposure above a defined threshold with the lenders, the resolution plan has to be implemented within 180 days from the end of the review period. Because of the increased scrutiny and responsibility, borrowers are now evaluating loan proposals and monitoring the company during the tenure of the loan (including pre- and post-insolvency proceeding periods). This has also led to an increased cooperation amongst consortium banks.

With provisions in place that prompt both the lenders and borrowers to act swiftly and an effective insolvency regime setting up strict timelines, IBC has also reduced the overall time taken for winding up companies in India from over four years to less than a year.

IBC AND CAPITAL MARKETS

As per the World Bank Doing Business 2020 report, the recovery rate under IBC has increased to 72 per cent from 26 per cent under the previous mechanisms.[48] This significantly enhances investor confidence in the capital markets. In the past few years, the outstanding bonds increased a lot more than the outstanding bank credit. Consequently, the share of bank loans has declined from 2011 to 2017, while non-bank sources of credit have increased. This is also because the government and regulators have taken many steps to foster the growth of the corporate-bond market. This includes mandating enhanced standards for credit rating agencies for timely monitoring of credit quality of bonds, reducing the time taken for the listing of public issue of bonds from 12 to 6 days, among others.

A recent study using the World Bank's Doing Business data showed that lack of insolvency resolution is one of the main drivers behind 'missing' corporate bond markets in many economies.[49] In the case of Brazil, Russia, and China, three of five BRICS nations (Brazil, Russia, India, China, and South Africa), the five-year average of outstanding corporate-bonds-to-GDP ratio after the implementation of bankruptcy reforms has nearly doubled compared with the ratio prior to the implementation of the reforms.[50] There is a positive correlation between the recovery rate, recovery timeline, and corporate-bonds-to-GDP ratio. However, it is estimated that it takes 5–10 years for the effect of bankruptcy laws to reflect on the bond market. The World Bank estimates that India's pre-IBC of the corporate-debt-to-GDP ratio in 2016 was 17.9 per cent.[51] The impact of IBC on the bond market in India over a five-year period is yet to be seen.

The rise in investor confidence in the Indian market because of IBC is witnessed also by the increasing investments in stressed assets since its enactment. The Canadian Pension Plan Investment Board (CPPIB) has made a statement that CPPIB will allocate capital to

[44] Insolvency and Bankruptcy Board of India. (2019). *Two years of Insolvency and Bankruptcy Code (IBC)*. https://ibbi.gov.in/Two_years_of_insolvency_and_Bankruptcy_Code_IBC_Facebook.pdf.

[45] Insolvency and Bankruptcy Board of India. (2019).

[46] RBI. (2019). *Prudential framework for resolution of stressed assets* (RBI circular RBI/2018-19/203 DBR.No.BP.BC.45/21.04.048/2018-19). https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11580&Mode=0.

[47] RBI 2019.

[48] https://openknowledge.worldbank.org/bitstream/handle/10986/32436/9781464814402.pdf.

[49] Becker, B., & Josephson, J. (2016). Insolvency resolution and the missing high-yield bond markets. *The Review of Financial Studies*, *29*(10), 2814–2849.

[50] Becker, B., & Josephson, J. (2016).

[51] Crisil-Assocham Report. (2018). Also see IMF Private Debt Database.

the private debt market in India.[52] The year 2018 saw a spurt in the number of M&A deals in India and this has been attributed to the enactment of IBC.[53]

CONCLUSION

While the primary outcome of IBC is measured by the number of resolutions made or the amount of lenders' dues realized, the larger impact on the governance culture of corporations is more fundamental. The combination of corporate governance reforms and a well laid-out insolvency process in the last few years has laid the foundation of a corporate practice where interests of all stakeholders, including creditors, are recognized and protected. The twin reforms have also led to the empowerment of independent directors, who are now conscious of their liabilities and have started raising uncomfortable questions in their boards. The working culture in banks has also been showing remarkable improvement. This is resulting in fundamental changes in the way business is conducted in India. International examples of countries which have undertaken insolvency reforms point out that these reforms take a few years to effect the larger corporate and financial system. Developments of the last few years point out that India is well on course to maximizing the impact of these reforms on governance, business practices, and on the markets.

52 Saxena, R. (2019, December 9). Canadian pension funds eye private debt space in India. *LiveMint*. https://www.livemint.com/companies/start-ups/canadian-pension-funds-eye-private-debt-space-in-india-11575825087674.html.

53 PwC. (2018, December). *Deals in India: Annual review and outlook for 2019*. https://www.pwc.in/assets/pdfs/publications/2018/deals-in-india.pdf.

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