

INSOLVENCY AND BANKRUPTCY
CODE,2016:FEATURES,MECHANISM AND CHALLENGES
IN IMPLEMENTATION

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Abstract

The Insolvency and Bankruptcy Code, 2016 (the Code) is a significant reform in Insolvency laws in India. Until the code was implemented there were a dozen of laws dealing with Insolvency and Bankruptcy proceedings in India. A significant number of legislation and their overlapping provisions had made the recovery process time consuming and costly. Due to this India also appeared low in World Bank Ease of Doing Business Index. The Insolvency and Bankruptcy Code ensures certainty in the process, including what constitutes insolvency, the processes to be followed to resolve the insolvency, and the process to resolve bankruptcy once it has been determined. Present study has touched different dimensions of Insolvency and Bankruptcy Code-2016 and has concluded that unless and until the challenges in the way of Insolvency and Bankruptcy code are removed it will not function successfully. Present study also serves as a reference point for the imminent need to pursue reforms in Insolvency and Bankruptcy practices and processes prevalent in India.

Keywords:

Insolvency and Bankruptcy Code(IBC);
Insolvency and Bankruptcy Board of India(IBBI);
Information Utilities(IU);
Insolvency Professionals(IP);
Insolvency Professional Agency;

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Introduction

A single unified code for solving insolvencies has been provided through Insolvency and Bankruptcy Code-2016 whereby provisions of Insolvency and Bankruptcy Code will have override effect on other existing laws on matters pertaining to Insolvency and Bankruptcy. A consolidated single regulatory platform has been provided for the insolvency of Corporate, Limited Liability Partnerships(LLPs),Individuals and Partnership firms. Presently a number of enactments deal with insolvency and bankruptcy provisions. The Code aims to amend all these existing legislations, regulations and non-statutory guidance.

Key existing legislation, regulations and non-statutory guidance amended:

- Companies Act,1956/2013
- The Recovery of Debts Due to Banks and Financial Institutions Act (RDDBFI Act)1993
- The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI ACT).It allows banks and other financial institution to auction residential or commercial properties to recover loans.
- SICA Act, 1985(The SICA is repealed with effect from 1 December, 2016. The BIFR and AIFR stand dissolved with effect from that date, and all proceedings before them stand abated)
- The Presidency Towns Insolvency Act, 1909
- The Provincial Insolvency Act, 1920
- LLP Act, 2008
- Non-statutory guidelines/out-of-court
 - Bilateral restructuring
 - One-time settlement
 - JLF/CDR/SDR
 - Sale of loan to ARC

Research Method

This study is based on secondary data. Various reports published by renowned corporate agencies in India have been used to study this Code from different angles. An attempt has been made to cover different dimensions of this Code so as to implement this code successfully in India.

Objectives of the study

- ✓ To bring to limelight various issues related to Insolvency and Bankruptcy laws in earlier regime.
- ✓ To highlight major changes initiated by Government of India in Insolvency and Bankruptcy laws till now.
- ✓ To throw light on challenges faced in implementation of Insolvency and Bankruptcy Laws in India.

Literature Background**Table 1: Findings of the Studies**

EY (Jan 2017)	EY in its report titled “Interpreting the Code, Corporate Insolvency in India, “concluded that Insolvency and Bankruptcy Law has high potential to change the way we do business — if implemented with the intent with which it has been drafted. No timely action by lenders is considered appropriate in an Indian environment, which destroys the overall value for most creditors. The law has provisions for such situations, but there are enough and more issues to deal with, including creditors taking quick decisions during the moratorium period, appeals to NCLT being resolved amicably and NCLT relying more on the insolvency professional (IP) to run the process for quicker disposition. The law is more an operational turnaround than a legal battleground. If that is understood by all the participants, it would solve problems than create them.
HSA Advocates (2016)	HSA Advocates in their report titled

	<p>“Challenges in Insolvency and Bankruptcy Code, 2016” found that The current Bankruptcy resolution mechanism in India is highly fragmented. Lack of clarity and certainty due to large number of legislations and non statutory guidelines have made recovery of debt a complex and time consuming process. The Insolvency and Bankruptcy Code, 2016 seeks to consolidate the existing framework by creating a single law for bankruptcy and insolvency.</p>
<p>Divanshu Mittal(2017)</p>	<p>The author concluded that the Code would take India from among relatively weak insolvency regimes to becoming one of the world’s best insolvency regimes. It will lay foundation for the development of the corporate bond market, which would finance the infrastructural projects of the future.</p>

Need for Insolvency and Bankruptcy Code

1. Existing Mechanism – Inadequate & Ineffective :

- a. No single Law dealing with IB in India;
- b. overlapping jurisdiction
- c. Multilayered Adjudicating Mechanism

There are thousands of pending litigations for recovery of money, squarely due to overlapping jurisdictions of various laws governing insolvency resolution and courts. Hitherto, there were about 12 laws concerning insolvency.

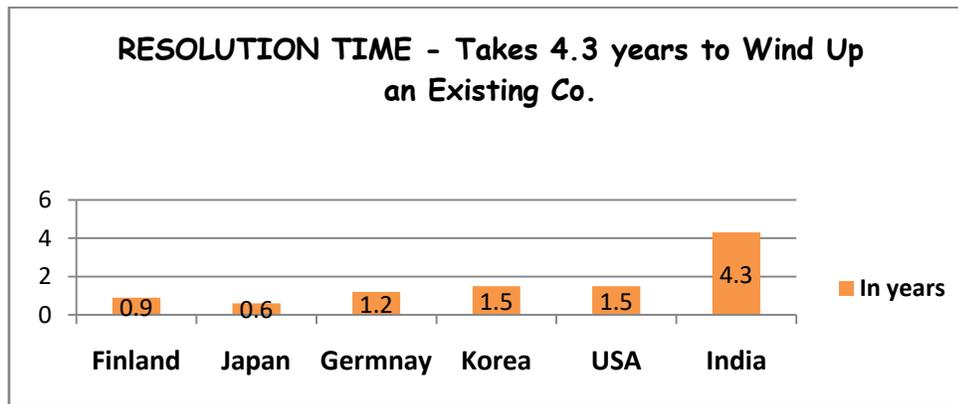
2. To reduce the time and cost involved in resolving insolvencies.

India appears very low on the list of 190 countries with ease of doing business and resolving insolvencies as per World Bank.

Table 2:Ease of Doing Business Rankings-2017(Resolving Insolvency)

	Rank	Recovery rate	Time required to recover debt(in Years)	cost required to recover debt(% of debtor's estate)	Strength of Insolvency framework index(0-16)
Finland	1	90.3	0.9	3.5	14.5
Japan	2	92.1	0.6	4.2	14
Germany	3	84.4	1.2	8.0	15
Korea	4	84.5	1.5	3.5	14
USA	5	78.6	1.5	10.0	15.0
India	136	26.0	4.3	9.0	6.0

- India is at rank number 136 so far as resolving insolvencies are concerned.
- In India, the time taken for resolving insolvency is much more compared to other progressive economies. In India on an average 4.3 years are taken to recover a debt.

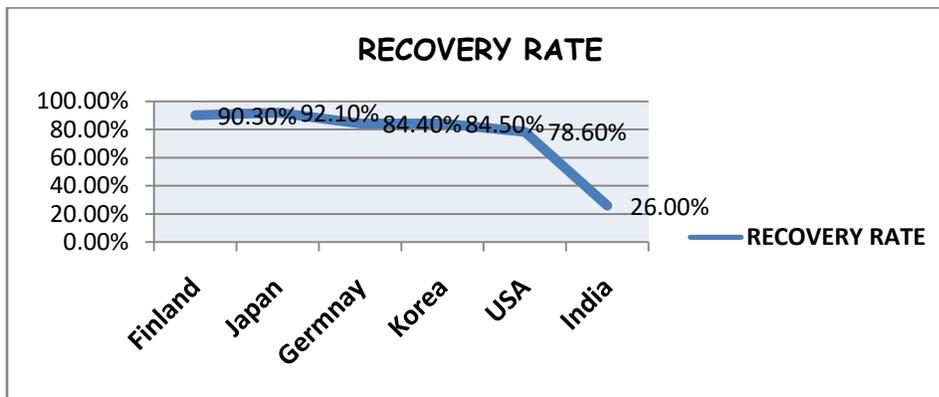
Figure 1: Resolution Time to wind up an existing company

Source: World Bank

- Data on pending cases(Based on Eradi Committee Report and the Report of the Joint Committee on Insolvency and Bankruptcy Code,2016)shows that in 1999 there were 473 winding up cases which were pending for more than 25 years. In 2015, there were 5141 winding up cases pending, out of which 1479 were pending for more than 20 years. As per Data Live Mint dated 5th November, 2016. 2016 there were 95,537 cases pending in 32 DRTs (amount involved ₹4 lakh crore)
- The costs associated with the case amount to approximately 9% of the value of the debtor's estate. According to World Bank, costs incurred during the entire foreclosure process mainly include

- court or government agency fees (INR 300,000, according to Mumbai Court fees Act, 1959),
 - attorney fees (INR 100,000),
 - costs of notification and publication (INR 25,000),
 - fees of accountants, assessors, inspectors and other professionals (INR 100,000),
 - fees of auctioneers (INR 50,000),
 - fees of service providers and/or government levies (INR 100,000-200,000), and other fees (INR 100,000).
- Recovery rate is 26% which is very less as compared to first five rankers i.e. Finland, Japan, Germany, Korea and USA.

Figure 2: Recovery Rate



Source: World Bank

3. To address the NPA situation:

NPA problem with Indian Nationalised banks has become grave and it is shocked to see that Corporate bad loans constitute 56% of the total bad debts of nationalised banks. (Bansal, 2017)

Salient Features of Insolvency And Bankruptcy Code-2016

1. There is shift from “Debtors in possession” regime to “Creditors in control” regime.
2. All existing insolvency laws are consolidated into one single unified Insolvency and Bankruptcy Code.
3. Insolvency and Bankruptcy Code would have overriding effect on all prevalent existing insolvency laws in India.

4. Insolvencies will be resolved in a fixed time-bound manner i.e. 180 days extendable upto 270 days.

5. Insolvency professionals will take over the management of the company.

6. Moratorium period will be of 180 days:

The effect of moratorium period will be to prohibit Institution/continuation/proceedings of suits including execution of any judgment, decree or order in any Court, Transferring, encumbering, alienating or disposing of assets/legal right/beneficial interest, any action to Foreclosure, Recover or enforce any security interest created including any action under SARFAESI Act, 2002, Recovery of any property by owner or lessor where such property is occupied by Adjudicating Authority. It will help the Entity to Continue Operation with no additional stress on Business. Supply of essential goods or services to the Corporate Debtor as may be specified shall not be terminated or suspended or interrupted.

7. Qualified Insolvency Professionals will oversee the whole CIRP and liquidation process.

8. IBBI will administer and govern whole Insolvency & Bankruptcy Law.

9. There will be shift from balance sheet to cash flow test. Under the Code an application for CIRP can be filed even on default of payment of ₹ 1 lakh (or higher amount as prescribed by a NCLT).so it becomes imperative on part of company to focus on its cash flows as any default on repayment of debt can have serious consequences.

10. Any person to whom a financial debt or operational debt is owed or a corporate person who owes a debt to any person can invoke corporate insolvency resolution.

11. Change in the order of priority in the liquidation process:

Earlier Regime	Insolvency and Bankruptcy Code
➤ Secured Creditors	➤ Insolvency related costs;
➤ Liquidation Costs	➤ Secured Creditors & Workmens' dues upto 24 months;
➤ Preferential Creditors(including Government dues and employees dues)	➤ Other employees salaries/dues upto 12 months);
➤ Debentureholders	➤ Financial Debts to Unsecured Creditors;
➤ Unsecured Creditors	

➤ Preference Share holders	➤ Government dues upto 2 years;
➤ Equity Shareholders	➤ Remaining Debts;
	➤ Preference Share holders
	➤ Equity Shareholders

Here Government dues have been made junior to most others. Financial unsecured creditors have got priority over trade creditors.

12. Four Pillars of Insolvency and Bankruptcy Code:

a. Insolvency Professionals:

- i. will conduct the insolvency resolution process,
- ii. take over the management of a company,
- iii. assist creditors in the collection of relevant information, and
- iv. manage the liquidation process.

b. Insolvency Professional Agency:

Will accept registration, examine and certify the insolvency professionals.

c. Insolvency and Bankruptcy Board of India

d. Insolvency Information Utilities:

Would collect, collate, authenticate and disseminate financial information from listed companies and financial and operational creditors of companies.

13. Adjudicating Authority

NCLT: Deal with insolvency matters of Co. & LLP

NCLAT : Appellant Authority

Debt Recovery Tribunal: Deal with insolvency matters of individual & Partnership firm

DRAT : Appellant Authority

Mechanism of Insolvency and Bankruptcy Code:

- A. Corporate Insolvency Resolution Process(CIRP)
- B. Liquidation Process

A. Corporate Insolvency Resolution Process (CIRP)

Following are the stages in CIRP:

1. **Default:** Default in payment of debt(Principal and/or interest). Minimum default is ₹1 lakh.

2. Filing of Application :

- a. Financial Creditor
- b. Operational Creditor
- c. Corporate Debtor

3. Appointment of Resolution Professional:

- a. Name proposed by either Financial Creditor or Corporate Debtor
- b. All powers of Board of Directors vest with Interim Resolution Professional(IRP)/ Resolution Professional(RP)
- c. Resolution Professional will run the company as a going concern.

4. Declaration of Moratorium Period

NCLT will declare 180 days moratorium period from the date of commencement of insolvency proceedings till the completion of insolvency.

5. Committee of creditors:

- a. It consists of financial creditors only. There should not be any related party.
- b. Only the financial creditors are given voting power in ratio of debt owed.
- c. Has the power to confirm or replace IRP as RP
- d. Approve several actions of RP

6. Formation and Approval of Resolution Plan

- a. COC approve resolution plan framed by RP with 75% majority.
- b. Resolution Plan provides for payment of insolvency costs, debts of Financial Creditors and operational creditors.
- c. Resolution Plan provides for management of affairs of the company

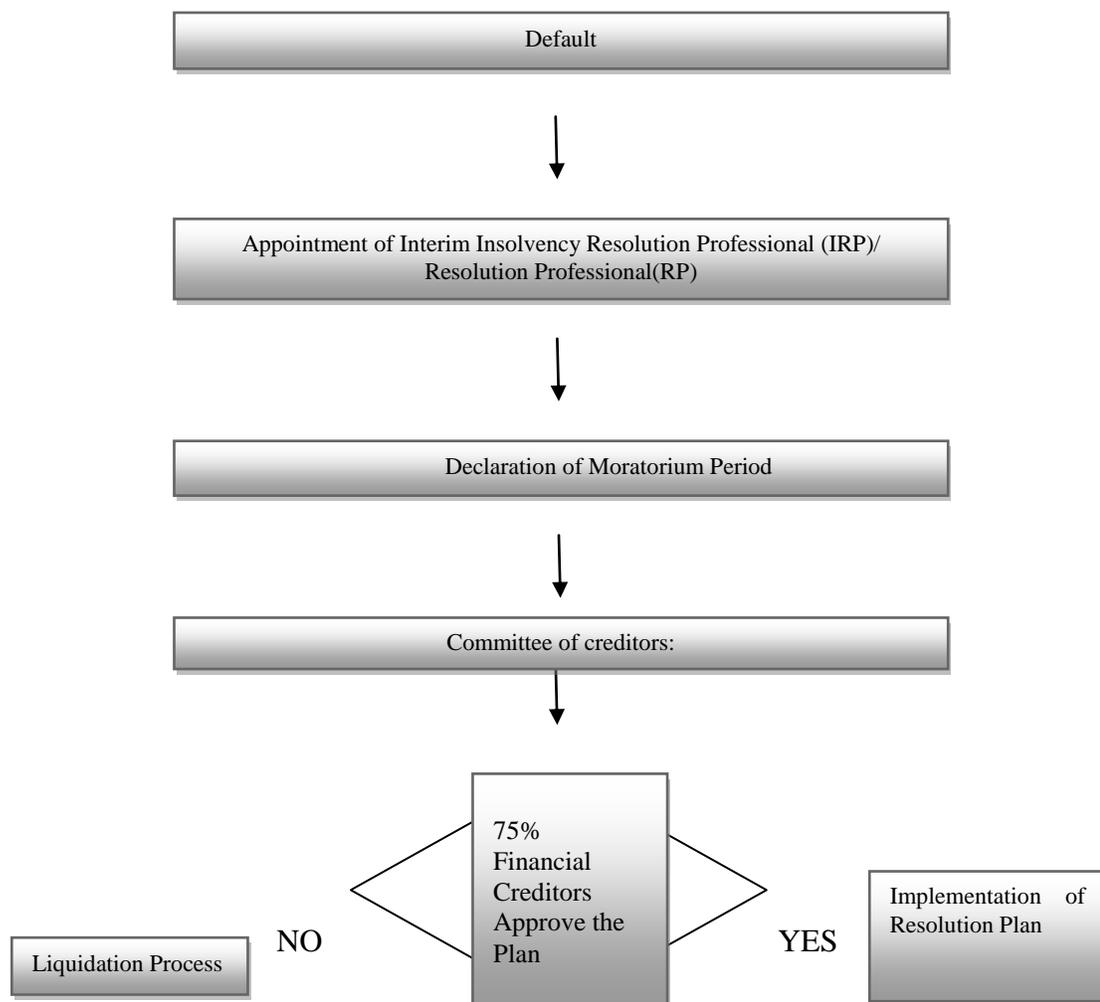
B. Liquidation Process:**1. Initiation of Liquidation Process:**

- a. COC does not approve Resolution Plan
- b. Debtor opts for voluntary Resolution by passing Special Resolution in General Meeting.

2. Appointment and role of Liquidator:

- a. IP acts as a Liquidator.
- b. Main responsibilities of the Liquidator are:
 - a. Verification of claims of creditors
 - b. Control all assets of debtor company
 - c. Valuation of assets of debtor company
 - d. Carry out business of corporate debtor
 - e. Preservation and protection of assets of debtor company
 - f. Sale of assets of corporate debtor
 - g. institute or defend any suit, prosecution or other legal proceedings, civil or criminal, in the name of or on behalf of the corporate debtor

Figure3:Corporate Insolvency Resolution Process (CIRP)



Challenges:**1. Time bound process**

Timeframe of 180-days (plus 90 days) may not be adequate to complete the resolution process.

Speedier actions are required in following fields:

- Collection of credit information about debtors
- Preparation of information memorandum by resolution professional
- Set up of information utilities that can provide authenticated credit information
- Handling the workload of pending cases before NCLT benches.
- Availability of insolvency professionals and taking over of management by insolvency professionals.
- Evaluation of resolution plans by adjudicating authority.

2. Absence of Information Utilities

Authenticated and timely information is required by NCLT if it gets involved in evaluating whether a default has indeed taken place. If information utilities are not available, there can be inordinate delays.

3. Non availability of skilled professionals

The insolvency process will be managed by licensed professionals. At present individuals enrolled with three agencies i.e. chartered accountants, cost accountants and company secretaries have been licensed and are able to take on appointments as insolvency professionals. These professionals will also control the assets of the debtor during the insolvency process as the management of the debtors entity will be transferred to their hands. So the task of these Insolvency Professionals will be quite challenging. These professionals might not have knowledge and expertise in running the businesses of debtors independently as the promoters will be forced to step back). They might not be successful in assessing the financial viability of the company in a short span of time and also they may not be efficient enough to prepare or evaluate the resolution plan. Until we have efficient insolvency professionals who are also efficient managers, this code cannot be implemented effectively. The design of this code would seriously be prejudiced.

4. Shortage of NCLT benches

With limited Judicial and Technical benches ,NCLT has inadequate capacity to handle pending cases which have been transferred from Company Law Board,BIFR and DRT to it, what to talk about fresh cases. Unless the number of well equipped benches are increased,effective and expeditious disposal of insolvency cases remains a distant dream.

5. Development and Monitoring of IP's :

It is an onerous task to develop integral and skilled professionals . IPs are the backbone of the IBC. Their role is challenging.They are given the charge of debtor **company.they are accountable to the committee of creditors** and the **adjudicating authority** for their actions. In order to ensure that the IPs perform their role **without any misfeasance,there is need to regularly monitor their actions. For this well-defined entry barriers** to the profession must be designed and the IPs must be **closely regulated by the IBBI**. There is a qualification examination to get registered as IPs.

- **No Cooperation from Management**

In order to formulate resolution plan, information memorandum is required and this information memorandum can be framed only if sufficient and right information is provided by management. However management of debtor entity does not cooperate. Although IP can go to adjudicating authority in case management does not cooperate but this again is a time consuming process.

- **No Consensus among Lenders:**

75% of financial creditors need to approve resolution plan. If resolution plan is not approved and submitted to NCLT within 180(270) days, liquidation process is to be initiated. Lot of power has been granted to financial creditors (banks, financial institutions etc.)who generally do not cooperate. The code can be implemented timely only if lenders reach consensus timely.

- **Cost of Bankruptcy Resolution Process is quite high:**

As Indian IBC is based on UK insolvency regime, it has been seen in UK that with insolvency code although realisations have improved but cost of bankruptcy resolution process has also increased due to which net recoveries have not improved much.

- **Disadvantageous order of priority to trade creditors**

Unsecured financial creditors have priority over trade creditors in the liquidation process. That means they will be paid after the dues of unsecured financial creditors are met.

- **Lack of infrastructure at the offices of adjudicating authorities**

In order to handle corporate insolvency and resolution process and liquidation process ,the adjudicating offices need to strengthen their IT and infrastructure.

- **Cross border insolvency**

This IBC does not explicitly deal with cross border insolvency issues. Now a days businesses are involved in cross border transactions. In order to have a comprehensive insolvency law in India this issue need to be addressed at the earliest. This involves cross court recognitions and agreements which is a challenging process.

Conclusion:

The Insolvency and Bankruptcy Code is a comprehensive and systematic reform in insolvency laws in India. It would help India get rid of multiple overlapping laws relating to Insolvency and Bankruptcy. It will give a boost to Ease of Doing Business in India and also ease of resolving insolvencies in India. But successful implementation of this code is dependent on four pillars of institutional infrastructure. The first pillar of insolvency professionals plays a key role in the efficient working of bankruptcy process. The second pillar “Information Utilities” would eliminate delays about facts whenever default on part of debtor takes place. Third pillar of adjudicating authorities need to strengthen their infrastructure so as to avoid pendency of cases not disposed off timely. The fourth pillar of Insolvency and Bankruptcy Board of India will have regulatory oversight over the other three pillars. There are certain challenges in the implementation of the code which need to be surmounted before the code prove to be successful.

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