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New insolvency & bankruptcy framework behind attempts to improve ease of doing business in India *By Sumant Batra*

In May 2014, the National Democratic Alliance formed government in India under the leadership of Prime Minister Narendra Modi after a landslide victory in the general elections.

The first task of the Modi Government was to rejuvenate the economy after a low period under the previous government. Non-performing assets ("NPA") had acquired an alarming proportion impacting availability of credit needed to inject energy in the economy. A fragmented and fractured insolvency framework operating at that time was of little help in resolving NPAs. Poor rankings on the World Bank's Ease of Doing Business made things worse.

Prime Minister Modi announced that India would strive to be among the top 50 countries in terms of ease of doing business within three years. A massive exercise was started to address the causes responsible for India's low ranking. An overhaul of the insolvency framework was an immediate beneficiary of this exercise and a new law in the form of the Insolvency and Bankruptcy Code, 2016 ("IBC") was passed by the Parliament on 11 May 2016 to provide the framework of corporate insolvency and bankruptcy of natural persons.

The IBC consolidates and amends the laws relating to the reorganisation and liquidation of corporations, and bankruptcy of natural persons. It seeks to achieve insolvency resolution of a corporate entity in financial distress and, failing that, its liquidation, in a time bound manner. The IBC contains many new principles and concepts that are a fundamental change from the repealed reorganisation and winding up law, substantially as well as procedurally. It introduces a shift from the "debtor in possession" regime under the Sick Industrial Companies (Special Provisions) Act, 1985 (since repealed) to a "creditor in control" regime, making it a creditor-friendly legislation. IBC is based on the United Kingdom's administration procedure although a few provisions have been customised for India.

The role of court has been reduced. A special bankruptcy tribunal has been set up. Strict time lines have been provided for resolution and liquidation, shorter even than what is provided in the English law. An understanding of the experiences under the UK law, where similar provisions have been in practice, will help in development of best practices for the Indian market.

Various new institutions have been established by IBC – the regulator (Insolvency and Bankruptcy Board of India), insolvency professionals, information utilities and the adjudicating authority (National Company Law Tribunal) – which will play a crucial in the insolvency process. An insolvency professional is appointed as resolution professional on commencement of insolvency proceedings, displacing the debtor from the management and control of assets, and becomes responsible for management of the debtor's enterprise as a going concern. Creditors have been provided with greater powers through creditors' committee to approve decisions of insolvency professional appointed as office-holder in corporate insolvency resolution process.

IBC is a shift from balance sheet to cash flow test. Unlike the subjective and often contentious entry test of erosion of net worth under SICA, IBC prescribes an objective test, that of payment default in respect of a debt. An application for commencement of corporate insolvency resolution process can be filed upon the occurrence of a payment default in respect of a debt of at least INR1 lakh before the bankruptcy tribunal.

Effective implementation is key to success of IBC

The government moved at an unprecedented pace to operationalise IBC. In less than six months after the enactment of IBC, most of the subordinate legislation had been finalised and the corporate insolvency law made majorly operational before the end of the year 2016. It became fully operational by the end of March 2017. Most institutions, part of the new ecosystem, became functional and filing of insolvency applications started. Over 100 insolvency applications were filed in the first few weeks of law becoming effective.

In all law-making, a gap opens up between law on the books and law in action. There are several key policy choices that influence the probability of effective implementation, both substantive and institutional.

Insolvency and Bankruptcy Code 2016 contains many new concepts and principles as a result of shift in past policies and new policy choices. The wisdom behind these choices will be tested in the implementation of law. As IBC was being operationalised, NPAs of 39 listed banks surged to 4.38 rupees trillion for the quarter ended 31 December 2016, from 3.4 trillion rupees at the end of September 2016. The aggregate net profit of the 39 listed banks fell 98% to 307 crore rupees in the 2016 December quarter from 16,806 crore rupees in the year earlier. The 24 public sector banks were the worst performers, having reported an aggregate loss of 10,911 crore rupees in the 2016 December quarter compared to a profit of 6,970.8 crore rupees in the year-ago quarter.

> *IBC is an important reform for India and its implementation has to be planned carefully. The total time frame of 180 days provided for corporate rescue sets high expectation for the market.*

Such was the surge in bad loans that provisions towards these wiped out the profits of 12 out of the 39 listed banks. Out of the 27 banks that reported a quarterly profit, six saw profits plummet more than 70% from a year-ago period. Aggregate stressed assets in the banking system comprising NPAs and restructured loans have reached alarming level of 14-15% of total advances as on 31 March 2017. The effectiveness of IBC will be tested in bringing the scale of NPAs down.

Collective stakeholders' responsibility

IBC is an important reform for India and its implementation has to be planned carefully. The total time frame of 180 days provided for corporate rescue sets high expectation for the market. The favourable outcomes of IBC will not only result in unlocking of the flow of capital but also lead to the development of a robust corporate debt market. Access to finance is the biggest constraint to growth and has to be considered in the context of the overwhelming need for macro-financial stability. The new insolvency system will need to mature quickly, commensurately with economic development in the country.

It will be unjust to load the government with the entire responsibility for making IBC successful. While the government must charter the course of its implementation, the onus to make IBC successful rests with all the key stakeholders, including its consumers and beneficiaries. Each stakeholder will need to play an enthusiastic and constructive role in implementation of IBC to ensure its success. To make the new insolvency system robust and at par with global standards, the new institutions established under IBC will have to function guided by the statement of objectives outlined in IBC. The policymakers will need to quickly plug the gaps in law and regulations on an on-going basis. Stakeholders will need to adopt the global best practices with speed. The bar must be set high right at the start.

The discipline of insolvency professionals is a new phenomenon and the market does not have a sufficient number of qualified and experienced insolvency professionals. Completing the process in such a short time will be immensely challenging for resolution professional. They will have to manage the affairs and assets of the company while gathering information, settle claims and invite resolution plans from potential investors and other interested persons. The government, NCLT and the private sector must work in close coordination to ensure that timelines are observed and the IBC is successful. India aspires to compete with the best insolvency system on the strength of its unique characteristics. Its success can propel India is an attractive choice of jurisdiction for resolving insolvency.

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