



# The Insolvency and Bankruptcy Code, 2016

## A Step Forward



## Foreword

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Indian Banking scenario is going through unprecedented times with stressed loan portfolio touching all-time high. As per estimates stressed loan portfolio of all banks put together, is around 17%-18% of total advances. There is an apprehension that there could be further significant additions as many stressed loan accounts have been disguised as standard. Realizing the problem, RBI has attempted to force banks to clean up balance sheets and come out with many regulatory steps aimed at improving banks' ability to deal with such stressed accounts. Of them, Strategic Debt Restructuring (SDR), 5:25 and (Scheme for Sustainable Structuring of Stressed Assets (S4A) being the latest to be added to the list. These frameworks, though unable to address all situations, are a step forward towards an intent of resolution. There is an all-round need for identifying the problem well in time, focus on a comprehensive turnaround and all stakeholders, be it creditors or borrowers, should be actively engaged towards the objective.

India currently has multiple laws to deal with insolvency, which leads to significant delays in winding up a company. In this scenario, the Indian Government has introduced the Bankruptcy and Insolvency Code, 2016 which will consolidate the existing frameworks and create a new institutional structure. The Code creates time-bound processes for insolvency resolution of companies and individuals which thereby will help India improve its World Bank insolvency ranking.

The new bankruptcy law isn't a "magic wand". The main challenge will be implementation-adequacy of infrastructure and skilled pool of insolvency professionals, who will help with the fast implementation of the law.

CII-Sumedha Fiscal has come out with this knowledge paper with the objective to touch upon the key aspects of the Code and lay bare the issues and challenges.



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## Introduction

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In a simple dictionary term, insolvency is a situation where liabilities of a person or a firm exceed its assets. In practice, the insolvency situation occurs when a person or a firm cannot pay its financial obligations i.e. cannot pay the debts it owes. Sometimes, a firm's assets may be higher than the liabilities, still it cannot pay debt obligations as assets may be illiquid and cash flows are not sufficient to pay debts. It may also happen that a firm's liabilities are higher than assets, but generating enough cash flow to repay obligations. So for a creditor, it is important to examine the situation before taking any decision. Sometimes, the phrase 'technical insolvency' and 'actual insolvency' are used to explain these two situations (technical insolvency – when liability is higher than the assets and actual insolvency when cash flow is insufficient to pay the debts).

Bankruptcy is little different from insolvency. It occurs when a court recognises the insolvency. It is a legal status of a person or a firm. However, in India, no law have defined bankruptcy (except in the Insolvency and Bankruptcy Code, 2016). Certain acts only define the term 'winding up', which is different from bankruptcy. Bankruptcy is a plan when an insolvent debtor seeks relief. In accordance with new Insolvency and Bankruptcy Code, 2016, a bankrupt entity is a debtor who has been adjudged as bankrupt by an Adjudicating Authority by passing a bankruptcy order. In the bankruptcy proceeding, the court appoints a trustee who is responsible for selling the property and paying obligations to the creditors.

According to the Law Commission of India, the insolvency law has a two-fold purpose<sup>1</sup>, (i) to give relief to the debtor from the harassment of his creditors, whose claims he is unable to meet and, (ii) to provide a machinery by which creditors, who are not secured in the payment of their debts are to be satisfied. It is based on the Roman principal 'cessio bonorum' that is to say, surrender by the debtor of all his goods for the benefit of his creditors, in return for immunity from court process.

Indian economy has expanded at a very rapid pace in the past one decade and crossed the two trillion dollar mark. However, our credit system is not vibrant and the corporate bond market is at the nascent stage. Thus, banks are the main source of corporate credit. Non-performing assets in the banking system have been rising and have reached to a level that is beyond the comfort zone.

We have multiple laws that deal with insolvency and bankruptcy for different entities under different situations. Due to the complexity of multiple laws, the entire resolution procedure is fragmented, expensive and time-consuming with very low recovery rate. All, out of the court, debt restructuring processes like CDR, SDR, S4A and 5:25 are not very successful, rather bad loans have piled up in the system after their implementation.

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<sup>1</sup> Law Commission of India, Report on Insolvency Laws/Objective of Insolvency Law.



In this background, the new code has been formed with the broad objective to consolidate all existing laws relating to insolvency and bankruptcy for companies and individual. The code, on implementation, may enhance credit availability, promote entrepreneurship and balance the interest of all stakeholders. The code will drastically reduce the insolvency resolution time resulting in a low loss in recovery.

The code has proposed to set up a well-regulated institutional framework under a new regulator, the Insolvency and Bankruptcy Board of India. Two Adjudicating Authorities, NCLT and DRT are formed and that will perform the judicial control during the process. Other entities like insolvency professional and information utilities will perform specific role during the process.



## Multiplicity of the existing laws – an issue

In India, there is not a single law that exclusively deals with bankruptcy and insolvency. Rather, we have multiple rules and regulations under different authorities that ultimately delay the entire procedure.

There was no concrete law related to bankruptcy or insolvency before the British came to India. The first evidence of an insolvency legislation can be traced to sections 23 and 24 of the Government of India Act, 1800 (39 and 40 Geo III, c 79, in line with the Lord’s Act 1759, England)<sup>2</sup>.

The law empowered three courts (Fort William, Madras, and Bombay) to make rules for relieving the insolvent debtors. The special insolvency legislation began in 1828 when Statue 9 (Geo IV c 73) was passed and the first insolvency courts were formed in Presidency-towns<sup>3</sup> with the objective to relieve the insolvent debtors. In 1848, a revised insolvency legislation, the Indian Insolvency Act, 1848 (11 and 12 Vict. c. 21) was passed. Later, the act was found insufficient to address the changing business environment and a new Insolvency Bill was proposed for the entire India in line with the Bankruptcy Laws in England.

### Existing legal frameworks

The Presidency Towns Insolvency Act, 1909
The Provincial Insolvency Act, 1920
SARFAESI Act, 2002
Recovery of Debts due to Banks and Financial Institutions Act, 1993
Companies Act, 2013
Sick Industrial Companies (Special Provisions) Act, 1985
LLP Act, 2008

However, the plan was dropped and the Indian Insolvency Act, 1848 was continued in Presidency-towns till the enactment of the Presidency-Towns Insolvency Act, 1909. The Presidency Towns Insolvency Act, 1909 was enacted to resolve the same bankruptcy issues in Presidency-Towns.

The above-mentioned acts were mainly focused towards insolvency legislations in Presidency-Towns and there was no separate law for the mofussil, where the business environment was different. Later, the Provincial Insolvency Act, 1907 was formed and it covered the mofussil. In 1920, a new law ‘Provincial Insolvency Act, 1920’ was formed and replaced the old act.

<sup>2</sup>Law Commission of India, 26th Report – Report on Insolvency Laws, Government of India, Ministry of Law.

<sup>3</sup>Presidency-towns were the administrative divisions of British India. There were three Presidency-towns during the British rule in India (Madras, Bombay and Calcutta).



Till date, both the laws viz. ‘Presidency Town Insolvency Act 1907’ and ‘Provincial Insolvency Act, 1920’ are sound in principle and have worked satisfactorily, in practice. However, these two acts have been brought within the scope of the Insolvency and Bankruptcy Code 2016 (Code).

Earlier, banks and financial institutions used to file civil suit in a court of law to recover dues from the defaulter companies. However, this process was extremely time-consuming and sometimes it took five to fifteen years for getting a judgement<sup>4</sup>. The civil courts were burdened with diverse types of cases and debt recovery related cases were like other cases and did not get any priority<sup>5</sup>. In this background and based on the recommendation of various committees on financial market reform, ‘The Recovery of Debts due to Banks and Financial Institutions Act, 1993 (or DRT Act) was enacted with the objective to provide a platform to banks and financial institutions for smooth and speedy recovery of bad loans. A specialised Adjudicating Authority, Debt Recovery Tribunal or DRT was formed and that has been exclusively taking care of debt recovery related issues of banks and financial institutions. In spite of the involvement of DRT, there has been no speedy recovery of debts. Even debtors have identified several loopholes in the DRT Act and they have misused it.

To address the issues faced by DRT Act and to further strengthen the recovery process, The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), was designed. This act

empowers the banks and financial institution to recover bad loans directly from the debtor without Court’s intervention. The act allows banks and financial institutions to auction mortgaged assets of the defaulting borrowers and sale may take place without the intervention of courts. The act has certain limitations. It does not consider the rights other than secured creditors. The SARFAESI Act is a foreclosure and does not consider a business as going concern.

Companies Act 1956, has the legal provision for insolvency. According to chapter V of Companies Act 1956, there can be arbitration, compromises, arrangements or reconstructions between companies and creditors and shareholders. The act also deals with winding up of companies. The companies Act 2013 has provisions for rescue and rehabilitation and liquidation of all registered entities (Chapter XIX and XX). The Companies Act 2013 also has provision to merge domestic companies with foreign companies.

The Sick Industrial Companies (Special Provision) Act 1985 (SICA) was designed to rescue the sick companies, whose accumulated loss is higher than the net worth at the end of any financial year. Under this act, BIFR (Board for Industrial and Financial Reconstruction) reviews the viability of a sick business. The act was also proved inefficient.

The current insolvency procedures that are governed either by Companies Act or SICA, will be replaced by the procedure under the Insolvency and Bankruptcy Code.

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<sup>4</sup>An Introduction to the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 – A Study by G. S. Dubey, Chartered Accountant Practice Journal.

<sup>5</sup>Tiwari Committee Report.



## Current stress in the banking sector

The RBI Published Financial Stability Report highlights the increased stress in the Indian Banking system arising out of deteriorating asset quality and low profitability.

The previous RBI governor Dr. Raghuram Rajan had opined that “Our intent is to have clean and fully provisioned banks’ balance sheets by March 2017”.

Risks to India’s banking sector have increased mainly on account of deterioration in asset quality and low profitability. The burden of NPAs continued to increase sharply;

79.7% y-o-y growth in gross non-performing assets (GNPA) as of March 31, 2016;

14.5% gross non-performing assets for public sector banks;

4.5% private sector banks and foreign banks, each reported GNPA of 4.5%;

### Stressed assets in the banking system

Mar	FY13	FY14	FY15	FY16	FY13	FY14	FY15	FY16	FY13	FY14	FY15	FY16
	Total				Public Sector Banks				Private Sector Banks			
Gross NPA Ratio (%)	3.27	3.86	4.37	7.61	3.59	4.34	4.94	9.6	1.86	1.82	2.14	2.7
Net NPA Ratio (%)	1.72	2.17	2.48	4.63	1.99	2.53	2.9	6.1	0.52	0.63	0.87	1.3
Stressed Assets/advances (%)	NA	9.75	11.01	11.5	NA	11.04	12.68	14.5	NA	4.29	4.59	4.5

Source: RBI

The framework for Corporate Debt Restructuring was widely used till regulatory forbearance towards asset classification benefit stands

withdrawn effective from 1st April 2015. The current statistics as on 30th September 2016 for CDR cases are:-

Rs. in crore

Particulars	No. of cases	Aggregate Debt
Total References received by CDR Cell	655	474002
Cases rejected before admission or approval	125	70998
Total cases approved	530	403004
Cases withdrawn on account of package failure	248	110772
Cases exited successfully	97	70660
Live Cases in CDR	185	221572

Source: www.CDRIndia.org



## Summary analysis of currently used options

Option	Feature	Concern
CDR	<ul style="list-style-type: none"> <li>🌐 Has been widely used earlier and helped many companies in coming out of stress</li> <li>🌐 Majority decision making</li> </ul>	<ul style="list-style-type: none"> <li>🌐 Lost charm after withdrawal of forbearance benefit by RBI from 1st April, 2015</li> <li>🌐 Not helped much. Too many failures post CDR implies it was deferment of inevitable</li> </ul>
Bilateral	<ul style="list-style-type: none"> <li>🌐 Mostly used for individual cases</li> <li>🌐 Had worked well earlier</li> </ul>	<ul style="list-style-type: none"> <li>🌐 Very few cases considered by lenders now post withdrawal of forbearance benefits.</li> </ul>
JLF	<ul style="list-style-type: none"> <li>🌐 Majority decision making</li> <li>🌐 Early decision making through Corrective Action Plan</li> </ul>	<ul style="list-style-type: none"> <li>🌐 Guidelines have come too late. Damage is already done Timelines are not maintained resulting in slow progress. As account becomes NPA upon restructuring most lenders prefer rectification or recovery route</li> </ul>
5:25	<ul style="list-style-type: none"> <li>🌐 Helps realign debt without restructuring tag through longer amortisation period</li> </ul>	<ul style="list-style-type: none"> <li>🌐 Available for large cases and a few select industries only – Infrastructure and Core Industries</li> </ul>
SDR	<ul style="list-style-type: none"> <li>🌐 Helps realign debt without restructuring tag</li> <li>🌐 Weed out inefficient management</li> <li>🌐 Provides standstill clause for 18 months.</li> </ul>	<ul style="list-style-type: none"> <li>🌐 For old cases cannot be forced upon</li> <li>🌐 Existing management may continue in disguise</li> <li>🌐 Finding new promoter is always a challenge</li> <li>🌐 Banks not comfortable towards steep discount to debt and need for refinancing</li> </ul>
ARC	<ul style="list-style-type: none"> <li>🌐 Help in Realign/settle debt at a realistic level</li> <li>🌐 Faster decision making as question of accountability doesn't arise</li> </ul>	<ul style="list-style-type: none"> <li>🌐 Banks are not able to realize significant portion of their dues</li> <li>🌐 Increase in cost as ARC charge management fee</li> <li>🌐 ARC's capital base too limited compared to overall magnitude of stressed assets</li> </ul>
S4A	<ul style="list-style-type: none"> <li>🌐 Advantage of getting to run the business with a more manageable debt i.e. 50%</li> </ul>	<ul style="list-style-type: none"> <li>🌐 Current cash flows of company taken as basis to ascertain sustainable debt, so there are not enough companies which can come under its purview</li> <li>🌐 Terms and conditions of the loan cannot be changed</li> </ul>

## Resolving insolvency – time and cost matter

An efficient insolvency regime is a topmost priority for a vibrant business environment. The law should be such that it should restrict the liquidation of a potential business at a very early stage and at the same time, it will discourage creditors to put money into a relatively risky business. The law should also restrict debtors to take improper business

and financial decision. Various studies have shown that an efficient bankruptcy law can reduce the cost of funds, increase wider access to credit as well as timely recovery of loans<sup>6</sup>. If banks or financial institutions can recover a major portion of its blocked money, it can again reinvest them into more efficient business.

Region/Country	Recovery Rate <sup>a</sup>	Time <sup>b</sup>	Cost <sup>c</sup>	Outcome <sup>d</sup>	Strength <sup>e</sup>
OECD high income	73	1.7	9.1	0.8	12.1
East Asia & Pacific	33.9	2.6	20.6	0.3	7.1
Europe & Central Asia	38.2	2.2	13.1	0	9.9
Brazil	15.8	4	12		13
Canada	87.4	0.8	7	1	11
China	36.9	1.7	22		11.5
Denmark	88	1	4	1	12
Finland	90.3	0.9	3.5	1	14.5
France	78.5	1.9	9	1	11
Germany	84.4	1.2	8	1	15
Hong Kong SAR, China	87.2	0.8	5	1	9
<b>India</b>	<b>26</b>	<b>4.3</b>	<b>9</b>		<b>6</b>
Japan	92.1	0.6	4.2		14
Slovenia	89.2	0.8	4	1	11.5
Singapore	88.7	0.8	4	1	8.5
South Africa	35.1	2	18	0	12.5
United States	78.6	1.5	10		15

Source: The World Bank/Doing Business Framework

<sup>a</sup>**Recovery Rate:** The recovery rate is recorded as cents on the dollar recovered by secured creditors through judicial reorganization, liquidation or debt enforcement (foreclosure or receivership) proceedings.

<sup>b</sup>**Time:** Time for creditors to recover their credit is recorded in years.

<sup>c</sup>**Cost:** The cost of the proceedings is recorded as a percentage of the value of the debtor's estate.

<sup>d</sup>**Outcome:** Whether the business continues operating as a going concern or whether its assets are sold in piecemeal.

<sup>e</sup>**Strength of Insolvency Framework Index:** The strength of insolvency framework index is the sum of the scores on the commencement of proceedings index, management of debtor's assets index, reorganization proceedings index and creditor participation index. The index ranges from 0 to 16, with higher values indicating insolvency legislation that is better designed for rehabilitating viable firms and liquidating nonviable ones.



In India, due to the presence of multiple laws, the present insolvency resolution process is complex, time-consuming and expensive. In India, it takes an average of 4.3 years to resolve bankruptcy, which is extremely high compared to countries like Japan, Singapore, and Finland. In Japan, it takes only 6 months' time to resolve bankruptcy. The same run rate is 8 months, 10 months and 1.5 years in Singapore, Finland, and the United States respectively. A complex judicial system in India has restricted the use of formal legal bankruptcy procedure to resolve financial distress. The usage of legal bankruptcy procedure is only 0.04% in India compared to 4% in the USA in 1990s<sup>7</sup>.

The recovery rate, in terms of cents recovered per dollar debt, is very low as it takes prolonged

resolution time. The figure is 26 cents/dollar in India, much lower than many developed countries. In countries like Finland, Japan, Germany and the United States the recovery rate is extremely high at 90.3 cents, 92.1 cents, 84.4 cents and 78.6 cents per dollar respectively. Many developing countries like China, Brazil, and Russia have poor recovery rate but better than India. The cost in terms of the percentage of the value of the debtor's estate is also very high in India. It is 9% in our country against 3.5%-4.2% in Finland, Japan and Singapore.

As per the World Bank Report, India fares poorly on the Ease of Doing Business Index and Resolving Insolvency.

Economy	Resolving Insolvency Rank	Ease of Doing Business Rank	Starting a Business Rank	Getting Credit Rank	Protecting Minority Investors Rank
Finland	1	13	28	44	70
Japan	2	34	89	82	53
Germany	3	17	114	32	53
United States	5	8	51	2	41
United Kingdom	13	7	16	20	6
Hong Kong	28	4	3	20	3
Singapore	29	2	6	20	1
New Zealand	34	1	1	1	1
South Africa	50	74	131	62	22
Russian	51	40	26	44	53
China	53	78	127	62	123
Brazil	67	123	175	101	32
<b>India</b>	<b>136</b>	<b>130</b>	<b>155</b>	<b>44</b>	<b>13</b>
Bangladesh	151	176	122	157	70

Source: The World Bank/Doing Business Framework

So the current practice in India is time-consuming, expensive with very low recovery rate. But the situation can be improved like in many countries where the system has become efficient after the implementation of new laws or modification of the existing laws. For example, Slovenia

improved the recovery rates and reduced the resolving time substantially between 2013 and 2015 by way of adopting two amendments to the Financial Operations, Insolvency Proceedings and Compulsory Dissolution Act.

<sup>6</sup>Ease of doing business, The World Bank

<sup>7</sup>Claessens and Klapper 2005).

# Demystifying the Insolvency & Bankruptcy Code, 2016

## Key Highlights

- ☞ The Code brings a paradigm shift from “Debtors” in possession to “Creditors in Control”
- ☞ Insolvency test moved from “erosion of net worth” to “payment default”
- ☞ Single insolvency and bankruptcy framework. It replaces/modifies/amends certain existing laws.
- ☞ Time bound resolution process at each stage
- ☞ Establishment of Insolvency and Bankruptcy Board-a regulator as an independent body
- ☞ A clearly defined distribution of recovery proceeds
- ☞ Insolvency Professional to take over management and control of the Corporate Debtor
- ☞ Government dues would rank below the claims of other creditors
- ☞ Have provisions to deal with concealment, fraud and /or manipulation leading to fine and/or imprisonment
- ☞ Provide confidence to Lenders and Investors in the debt market



## The Insolvency and Bankruptcy Code, 2016

### Objective

The Insolvency and Bankruptcy Code, 2016 has been formed with the following objectives<sup>8</sup>:

- ☞ To promote entrepreneurship;
- ☞ To make credit available;
- ☞ To balance the interest of all stakeholders by consolidating and amending the existing laws relating to insolvency and bankruptcy;
- ☞ To reduce the time of resolution for maximizing the value of assets.

The key theme of the Code is to consolidate all laws relating to insolvency of companies, limited liability entities, unlimited liability partnership and individuals, presently governed by multiple laws, into a single legislation. The SICA Repeal Act came into force in December, 2016, and the AAIFR and BIFR stands dissolved. Several provisions of the Code have been notified during last few weeks to streamline its operations effectively.

### New ecosystem of institutional infrastructure

The Insolvency and Bankruptcy Code, 2016 has introduced the following entities for successful implementation and smooth function.

- ☞ Insolvency and Bankruptcy Board of India
- ☞ Adjudicating Authority
- ☞ Insolvency Professionals Agencies
- ☞ Insolvency Professionals
- ☞ Information Utilities

<sup>8</sup>Ministry of Finance, Government of India



## **Insolvency and Bankruptcy Board of India (IBBI)**

The IBBI was established on 1st October 2016. The Board has been given wide powers to regulate the Insolvency Professional Agencies, Insolvency Professionals and Information Utilities. The Code also gives powers to the Board to make regulations in respect of all the processes, appointments, procedures, investigation, monitoring, etc. The Board shall be a body corporate with perpetual succession. The Board shall consist of 10 members headed by Chairperson and at least three whole-time members.

### **Adjudicating Authority**

The Code prescribes that in case of corporates, limited liability partnerships and other limited liability entities as may be notified, NCLT shall be the Adjudicating Authority. In case of individuals and partnerships, DRT shall be the Adjudicating Authority. All appeals from NCLT and DRT

shall lie with NCLAT and DRAT respectively. The Supreme Court of India shall have Appellate jurisdiction over NCLAT and DRAT. The NCLT benches are already functional all over the country.

Further, the Code bans the jurisdiction of Civil Courts over the related matter and this Code shall have an overriding effect over all other laws.

### **Insolvency Professional Agencies**

Insolvency Professional Agencies are those specialized bodies/agencies that will be entrusted with the task of registration and governance of Insolvency Professionals.

### **Registration as an Insolvency Professional Agency (Section 206 and 207 of the code)**

In order to function as an Insolvency Professional Agency, one has to be registered and obtain a license from the Board.

#### **Functions of an Insolvency Professional Agency (Section 204 of the Code)**

- Grant membership to persons who fulfil all requirements set out in its bye laws on payment of membership fee
- Lay down standards of professional conduct for its members
- Monitor the performance of its members
- Safeguard the rights, privileges and interests of insolvency professionals who are its members
- Suspend or cancel the membership of insolvency professionals who are its members on the grounds set out in its bye-laws
- Redress the grievances of consumers against insolvency professionals who are its members
- Publish information about its functions, list of its members, performance of its members and such other information as may be specified by regulations

## Insolvency Professionals

Insolvency Professionals are those licensed professionals who are appointed by Insolvency Professional Agencies who would take on the roles of Resolution Professional/Liquidator/bankruptcy Trustee in the Insolvency Resolution Process of different entities.

## Enrolment and Registration of Insolvency Professionals (Section 207 of the Code)

The Insolvency Professional has to be registered with the following:

- ☞ Insolvency Professional Agency
- ☞ Insolvency and Bankruptcy Board of India

## Functions and Obligations of Insolvency Professionals (Section 208 of the Code)

- ☞ Manage the affairs of the corporate debtors as a going concern
- ☞ Constitute the Code of Conduct, convene its meetings and conduct such meetings
- ☞ Conduct the corporate insolvency resolution process
- ☞ Prepare the information memorandum
- ☞ Submit a resolution plan to the adjudicating authority as approved by the Code of Conduct
- ☞ Conduct the liquidation process if the resolution plan is rejected or fails after approval

## Code of Conduct to be followed by Insolvency Professional (Section 208 of the code)

- ☞ Taking reasonable care and diligence while performing his duties
- ☞ Complying with all requirements and terms and conditions specified under the bye-laws of the insolvency professional agency of which he is a member.
- ☞ Allowing the insolvency professional agency to inspect his records
- ☞ Submitting a copy of the records of every proceeding before the Adjudicating Authority to the Board as well as to the insolvency professional agency of which he is a member
- ☞ Performing such functions in such manner and subject to such conditions as may be specified.





## Information Utility

An information utility is an agency that is in charge of collecting, collating and disseminating financial information. The business of the information utility is primarily concerning financial information.

## Registration of the Information Utility (Section 210 of the Code)

An information utility shall be registered with the Board

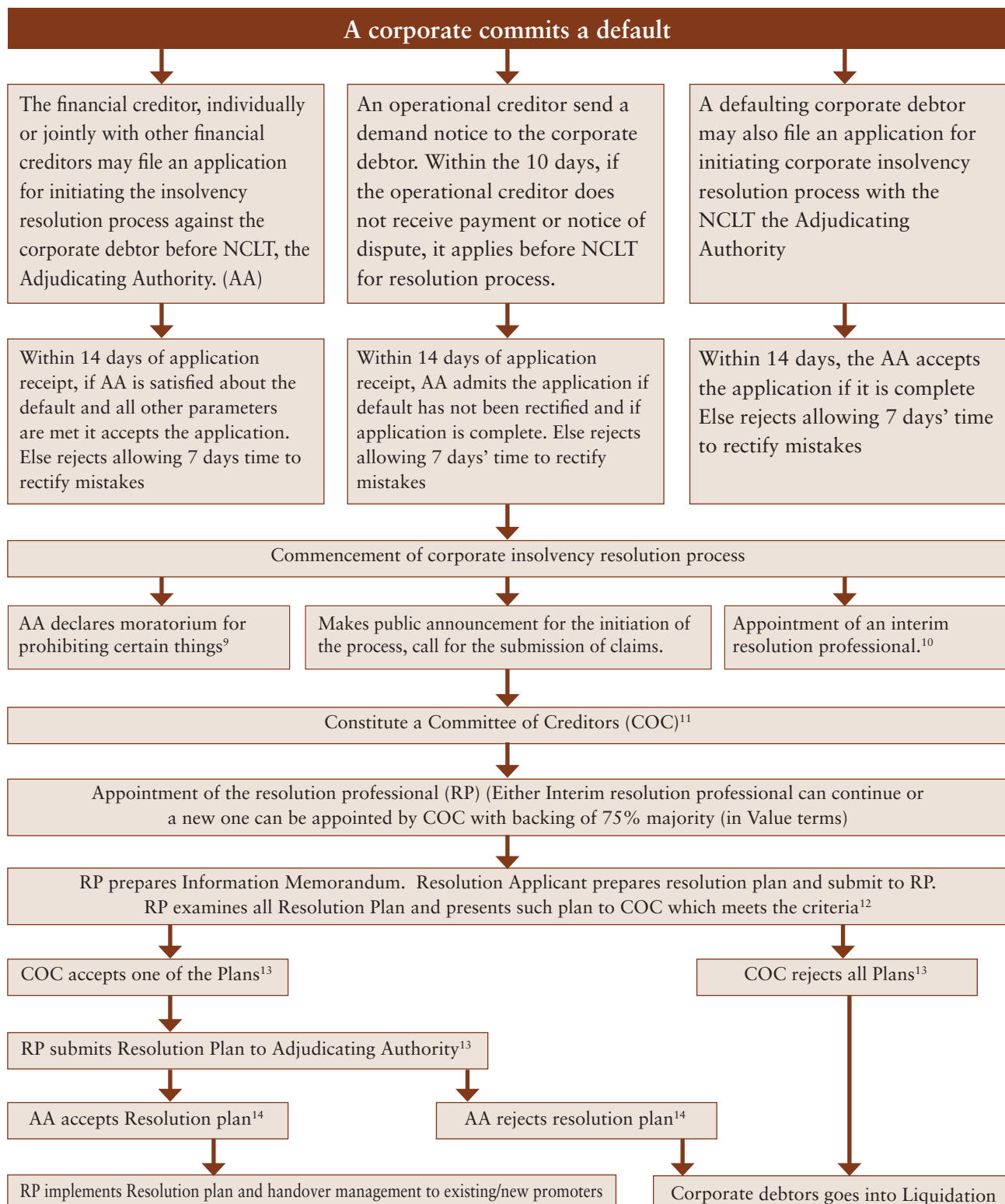
### Obligations and Functions of Information Utility (Section 214 of the code)

- Create and store financial information in a universally accessible format.
- Accept electronic submissions of financial information from persons who are under obligations to submit financial information under sub-section (1) of section 215 in such form and manner, as may be specified by regulations.
- Accept, in specified form and manner, electronic submissions of financial information from persons who intend to submit such information.
- Meet such minimum service quality standards as may be specified by regulations.
- Get the information received from various persons, authenticated by all concerned parties before storing such information
- Provide access to the financial information stored by it to any person who intends to access such information in such manner, as may be specified by regulations
- Publish such statistical information as may be specified by regulations
- Have inter-operability with other information utilities



# Insolvency resolution process for corporate

The insolvency resolution process provides a transparent and speedy procedure to resolve insolvency.





## The trigger

When a corporate debtor makes a payment default of the debt it owes, then either financial creditor(s) or operational creditor(s) or the corporate debtor himself can initiate the process. The minimum loan default amount to initiate the procedure is Rs. 1 Lakh.

## Entities not entitled to make application (section 11 of the Code)

- ☞ For a corporate debtor
  - 🌐 who is already undergoing insolvency process; or
  - 🌐 having completed insolvency resolution process twelve months preceding the date of making application; or
  - 🌐 in respect to whom a liquidation order has been made.



- ☞ For a corporate debtor or a financial creditor
  - 🌐 Who has violated any of the terms of the resolution plan, which was approved twelve months before the date of making an application.

## 9Moratorium

The Adjudicating Authority declare moratorium for prohibiting the following (section 13 of the Code)–

- ☞ All legal issues, judgment, court orders, tribunals, arbitration etc. against the corporate debtor.
- ☞ Transferring, encumbering, alienating or disposing of any assets or any legal right or beneficial interest therein.
- ☞ Any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property.
- ☞ The recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.
- ☞ Exclusion:
  - 🌐 There should not be any termination of supply of the essential goods or services to the corporate debtor during the moratorium period.
  - 🌐 The moratorium shall not apply to any transaction as notified by the Central Government in consultation with any financial sector regulator.
- ☞ The order of moratorium shall be continued until the completion of corporate insolvency resolution process.

## **<sup>10</sup>Appointment of an interim resolution professional; to manage the business initially (section 16 and 17 of the code)**

- ☞ As soon as the interim resolution professional gets appointed, the management of affairs of the corporate debtor shall vest on him and the power of the board of directors shall stand suspended.
- ☞ Financial institutions maintaining accounts of the corporate debtor shall act on the instruction of the interim resolution professional.
- ☞ The interim resolution profession has the authority to access the books of accounts, records and other relevant documents of corporate debtor available with the government authorities, statutory auditors, accountants and such other persons as may be specified.
- ☞ The interim resolution professional shall collect all information relating to the assets, finance and operations of the corporate debtor for determining the financial position of the corporate debtor, including information relating to –
  - 🌐 Business operation for the previous two years;
  - 🌐 Financial and operational payments for the previous two years;
  - 🌐 List of assets and liabilities as on initiation date; and
  - 🌐 Such other matters as may be specified;



- ☞ The interim resolution professional shall constitute a committee of creditors. It shall monitor all the assets of the corporate debtor and manage its operations until a resolution professional is appointed by the committee of creditors.
- ☞ It shall take control and custody of any asset over which the corporate debtor has ownership right as recorded in the balance sheet, or with information utility or the depository of securities or any other registry that records the ownership of assets. However, assets owned by a third party and assets of any Indian and foreign subsidiary of the corporate debtor shall not be included.
- ☞ The interim resolution professional shall collect all claims received against the corporate debtor and determine the financial position of the corporate debtor.

## **11 Committee of creditors (section 21 of the Code)**

- Committee of creditors shall comprise of all financial creditors except related parties to whom a corporate debtor owes a financial debt. If there is more than one financial creditor, each of them shall be the part of the committee and their voting shall be determined on the basis of financial debts owed to them.
- An entity who is both a financial creditor, as well as an operational creditor shall be included in the committee of creditors with voting share proportionate to the extent of financial debts owed to them. It shall also be considered as operational creditor to the extent of the operational debt owed by the corporate debtor to them.
- When the debt is extended as a part of consortium, syndicate or issued as securities provided for a single trustee or agent to act

for all financial creditors, each financial creditor may -

- Authorise the trustee or agent to act on his behalf in the committee of creditors to the extent of his voting share;
- Each financial creditor may represent himself in the committee of creditors to the extent of his voting share;
- Appoint an insolvency professional (other than the resolution professional) at its own cost to represent itself in the committee of creditors
- Exercise his right to vote to the extent of his voting share with one or more financial creditors jointly or severally.
- All decision of the committee of creditors shall be taken by a vote of not less than 75% of the voting share of the financial creditors.
- The first meeting of the committee of creditors shall be held within seven days of the constitution of the committee.



## **<sup>12</sup>Appointment of resolution professional (section 22 of the code)**

- ☞ In the first meeting of the committee of creditors, it decides by voting to appoint the interim resolution professional as resolution professional or to replace by another resolution professional. In the case of replacement, it has to apply before NCLT for the appointment of the proposed resolution professional.
- ☞ Ultimately, the matter will go the Board for final confirmation. In case, the Board delays in confirming beyond ten days, the NCLT should direct the existing interim resolution professional to continue to function until Board confirms the appointment.

## **Resolution professional to manage the business**

- ☞ The resolution professional shall perform the role and responsibilities vested on the interim resolution profession (12appointment and role of interim resolution professional)
- ☞ In addition, the resolution professional will conduct all meetings of the committee of creditors and will submit the notice of the same to members of the committee of creditors, members of the suspended Board of Directors and operational creditors (if the amount of their aggregate dues is not less than ten percent of the debt).
- ☞ The committee of creditors may replace the existing resolution professional by a vote of 75%, at any point of time under the process (to follow the same appointment process).

- ☞ Another important role of the resolution professional is to prepare the information memorandum specified by the Board for formulating a resolution plan.
- ☞ Limitation/restriction of the resolution professional
  - 🌐 During the corporate insolvency resolution process, the resolution professional cannot raise any additional interim finance without prior approval of the committee of creditors. It cannot create any security interest over the asset of the company also.
  - 🌐 Without prior permission of the Committee of Creditors, it cannot change the capital and ownership structure.
  - 🌐 In addition, it cannot undertake any related party transaction, amend any constitutional documents, make any change in the management, transfer right of the financial debts, or change the appointment terms of auditors without the prior permission of the Committee of Creditors.

## **<sup>13</sup>Preparation and submission of resolution plan**

The resolution applicant shall prepare and submit the resolution plan to resolution professional for examination. Post examination, the resolution professional shall submit the plan to the committee of creditors for their reference. The committee of creditors may approve the plan by a vote (not less than 75% of the voting share of financial creditors). Once it is approved, the resolution professional submits it to the Adjudicating Authority.



## 14 Approval or rejection of the plan by the Adjudicating Authority (Section 31 of the code)

If the Adjudicating Authority is satisfied with the resolution plan approved by the committee of creditors, it shall by order, approve the plan.

If the Adjudicating Authority finds that the plan does not conform to some requirements, it may by order reject the plan. After the approval by the Adjudicating Authority, the moratorium orders passed under section 14 shall cease to have an effect.

### Timelines

Particulars	Timeline (in days)
Filing an application with the NCLT for initiating corporate insolvency resolution process.	X
NCLT admits the application (commencement of corporate insolvency resolution process) or rejects the application.	X+14
Insolvency resolution professional appointment	(X+14)+14
Constitution of Committee of Creditors	(X+14)+14+10
Submission of Resolution plan	(X+14)+180
- On approval – moratorium ceases to have effect	
- On reject – initiation of liquidation	
Completion of Insolvency Resolution Process	(X+14)+180+90
Extension of the resolution Process	



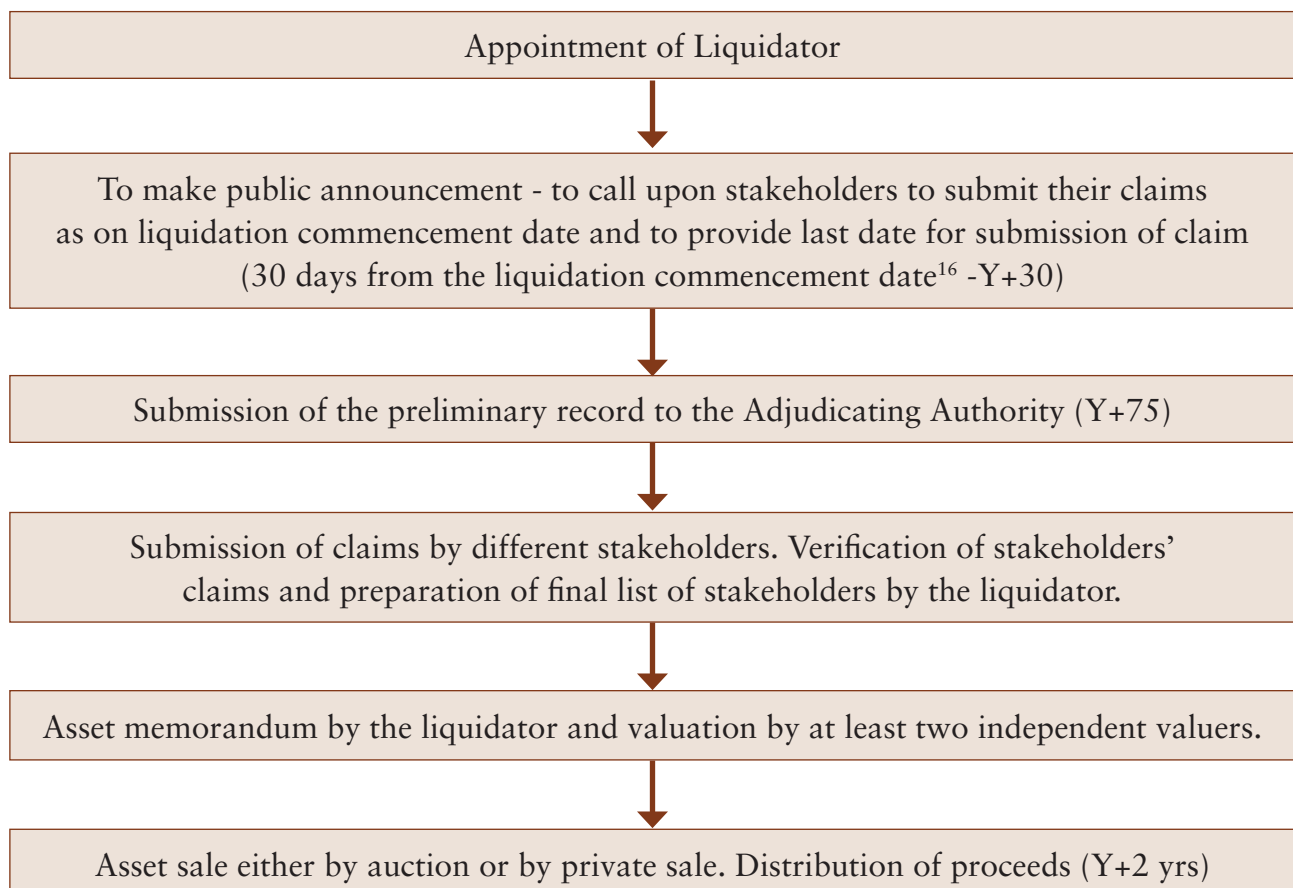
# Liquidation & distribution of recovery proceeds

## Liquidation

The Insolvency and Bankruptcy Board of India has framed new regulations under ‘Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations 2016 [the regulation]’ to deal with liquidation process (covers section 5, 33, 34, 35, 37, 38, 39, 40, 41, 43, 45, 49, 50, 51, 52, 54, 196 and 208 read with 240 of the Insolvency and Bankruptcy Code, 2016).

Before the expiry of the insolvency resolution process period or the maximum period permitted for resolving insolvency process or the fast track insolvency resolution process, if the Adjudicating Authority does not receive any resolution plan or the Adjudicating Authority rejects the resolution plan, it will pass an order requiring the corporate debtor to be liquidated (section 33).

## Liquidation



<sup>16</sup> Liquidation commencement date: means the date on which proceedings for liquidation commence in accordance with section 33 or section 59 of the Code (Y)



## Liquidator

- ☞ In the process of liquidation, a liquidator needs to be appointed. An insolvency professional shall be eligible to become a liquidator provided it/he is independent of the corporate debtor.
- ☞ A liquidator shall disclose the existence of any pecuniary personal relationship with the corporate debtor or any of its stakeholder as soon as he becomes aware of it, the Board and the Adjudicating Authority.

### ☞ Liquidator's fees

- 🌐 Liquidator's fees is a part of liquidation cost and the committee of creditors decides it before a liquidation order is passed under section 33(1)(a) or 33(2).
- 🌐 In all cases other than above, the liquidator shall be entitled to a fee as a percentage of the amount realized net of other liquidation costs, and the amount distributed as under:

Amount of Realisation / Distribution (In rupees)	Percentage of fee on the amount realized / distributed			
	in the first six months	in the next six months	in the next one year	Thereafter
	<b>Amount of Realisation (exclusive of liquidation costs)</b>			
On the first 1 crore	5	3.75	2.5	1.88
On the next 9 crore	3.75	2.8	1.88	1.41
On the next 40 crore	2.5	1.88	1.25	0.94
On the next 50 crore	1.25	0.94	0.68	0.51
On further sums realized	0.25	0.19	0.13	0.1
	<b>Amount Distributed to Stakeholders</b>			
On the first 1 crore	2.5	1.88	1.25	0.94
On the next 9 crore	1.88	1.4	0.94	0.71
On the next 40 crore	1.25	0.94	0.63	0.47
On the next 50 crore	0.63	0.48	0.34	0.25
On further sums distributed	0.13	0.1	0.06	0.05

Source: Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016

### ☞ Power and function of liquidator:

- 🌐 Preparation and submission of various reports like a preliminary report, an asset memorandum, progress report(s), sale report(s), minutes of consultation with stakeholders and the final report prior to dissolution of the Adjudicating

### Authority.

- 🌐 Record keeping, maintaining registers and books of account, etc.
- 🌐 A liquidator may appoint professionals to assist him.
- 🌐 Disclaimer of onerous property.



- ☞ The liquidator shall make a public announcement within five days from his appointment to call upon stakeholders to submit their claims as on liquidation commencement date and to provide the last date for submission of claim (30 days from the liquidation commencement date).
- ☞ The liquidator will submit a preliminary report to the Adjudicating Authority within 75 days from the liquidation commencement date. The report shall contain the capital structure of the corporate debtor and the estimation of its assets and liabilities as on liquidation commencement date. The report shall be based on books of the corporate debtor. However, if the liquidator believes that book is not reliable, he shall provide a separate estimate based on reliable record. The preliminary report shall also contain the proposed plan of action for carrying out the liquidation including timeline and costs involved. Time to time, the liquidator shall furnish progress report to the Adjudicating Authority.

## Claims

- ☞ Financial creditors, to whom money is owed, shall prove their claim including interest as on liquidation date to the liquidator. The workmen and employees shall also submit proof of claim to the liquidator. Other stakeholders shall also submit the proof of claim to the liquidator. For the secured creditors, the existence of the security interest has to be proved based on certain records. Any debts denominated in foreign currency shall be valued in the Indian currency.
- ☞ Once the liquidator records all claims, the liquidator shall verify all claims within thirty days from the last date for receipt of claim (section 30 of the regulation).
- ☞ As per section 31 of the regulation, the liquidator prepares the list of stakeholders and file it with the Adjudicating Authority within 45 days from the last date for receipt of the claim and announce the same to the public.

## Asset Realization and liquidation

- ☞ The section 32 and 33 of the Regulations direct about the manner and mode of sale. The liquidator can sell assets through auction or by private sale (in case it is perishable or realization is higher than the auction reserve prices). However, in the second case to happen, a prior permission from the Adjudicating Authority has to be obtained.
- ☞ The section 34 and 35 of the Regulations, deal with asset memorandum and valuation. Section 36 of the Insolvency and Bankruptcy Code, 2016 requires the liquidator to form an estate of the assets and for that purpose, it shall prepare an asset memorandum within 75 days from the liquidation commencement date. The asset memorandum shall contain information like value of the asset, manner, and mode of sale, expected amount of realization etc. The memorandum report has to be submitted along with a preliminary report to the Adjudicating Authority. The liquidator shall appoint at least two registered valuers to value the assets.



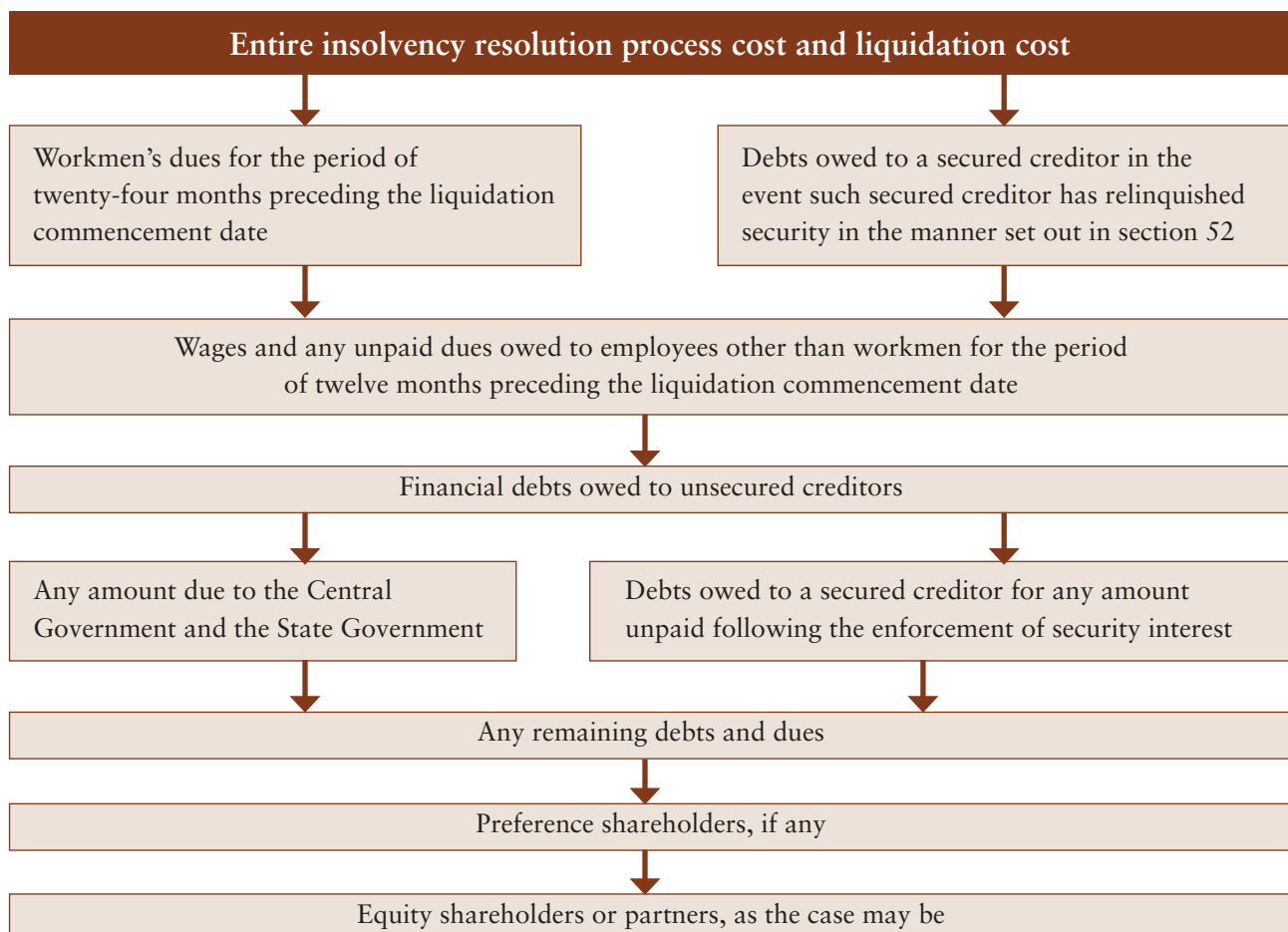
- ☞ When a secured creditor wants to realize its security interest, it shall intimate the liquidator of the price at which he proposes to realize (section 37 of the Regulation). Accordingly, it shall be decided whether the liquidator or the secure creditor shall sell the asset.
- ☞ If an asset remains unsold due to special circumstances, the liquidator shall distribute that unsold asset among stakeholders.

## Distribution of proceeds

As per section 41 of the Regulations, the liquidator shall open a bank account in the name of corporate debtor, followed by the words ‘in liquidation’. The liquidator shall deposit all considerations. The liquidator then shall distribute the proceeds from realization to the stakeholders within six months from the receipt of the amount (section 42 of the regulation). Ultimately, the liquidator shall liquidate the corporate debtor within a period of two years (44 of the Regulations).

## Liquidation waterfall

Section 53 of the Code deals with distribution of assets sale proceeds along with liquidation waterfall.



## Fast track corporate resolution process



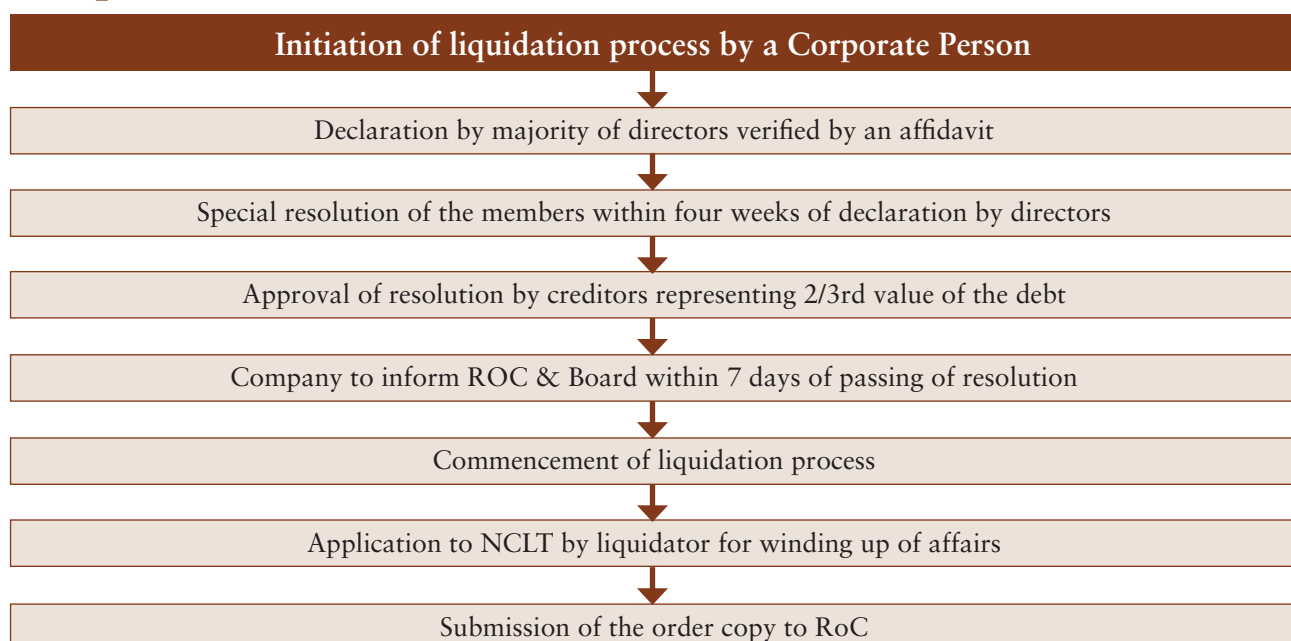
There is provision for a fast track resolution process for smaller companies. Here, the resolution process shall be completed within 90 days from the date of initiation. However, it can be extended further by a maximum of 45 days if more than 75% of the financial creditors agree. As per section 55 of the Code, the process is applicable to small debtors only.

## Voluntary liquidation of corporate person

Companies Act, 2013 has the provision of voluntary liquidation or winding up of companies and accordingly, both members of a company or the creditors should initiate the voluntary winding up process. However, there is a new amendment in Companies Act, 2013, which

shall remove the voluntary winding up provision from the Companies Act, 2013 and shall put the same provision in the Insolvency and Bankruptcy Code, 2016. According to the Code, a corporate person, who has not committed any default, can go for voluntary liquidation process.

### The process





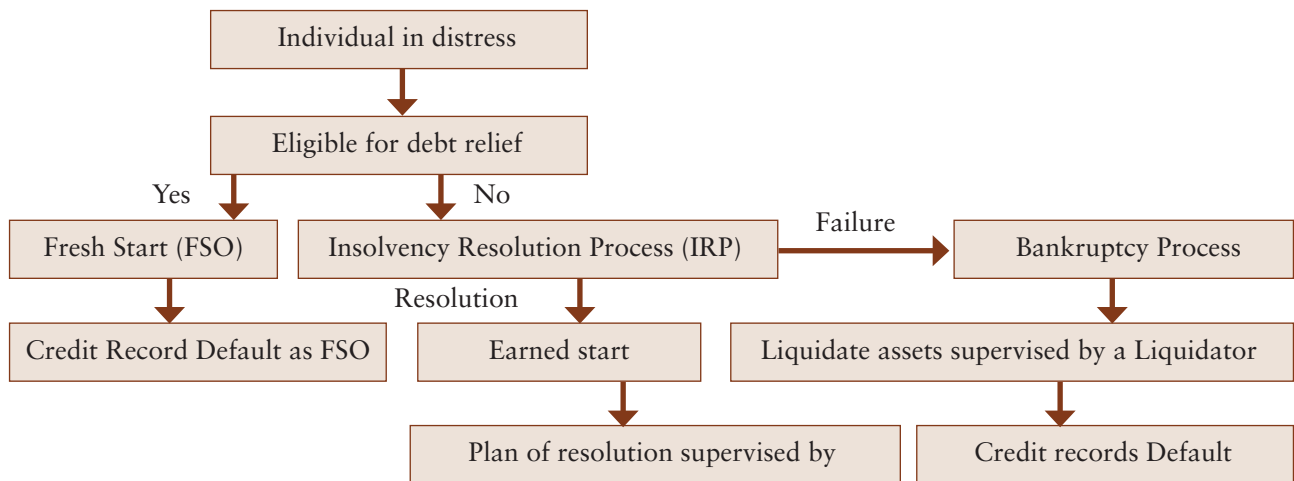
# Insolvency resolution and bankruptcy for individuals and partnership firms

There are two distinct resolution processes namely the Fresh Start and Insolvency Resolution for individual and partnership firms.

## Fresh Start

The Code allows individual debtors, who are unable to pay the debt, to start afresh. As per section 80 of the Code, a debtor, who is unable to pay his debt and fulfils the following conditions, shall be eligible to make application for a fresh start for discharge of his qualifying debt.

- ☞ The gross annual income of the debtor does not exceed sixty thousand rupees;
- ☞ The aggregate value of the assets of the debtor does not exceed twenty thousand rupees;
- ☞ The aggregate value of the qualifying debts does not exceed thirty-five thousand rupees;
- ☞ He is not an undischarged bankrupt;
- ☞ He does not own a dwelling unit, irrespective of whether it is encumbered or not;



There are certain debts like secure debts, court fines, child support payments, student loan, money owed under a criminal charge and debts resulting from certain injury claims against the debtor for which FSO application cannot be made. An indicative list of debts for which FSO

is applicable are credit card loan, unsecured bank overdrafts, and loans, unsecured loans from finance companies, credit from money-lenders, employers, friends and family and debts to customers who have paid for goods or services that debtor did not supply.





# Analysis and implication of the Code

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## Fast track process

The code proposes to initiate the insolvency process at an early stage and the corporate creditor takes indirect control of the business. The resolution process takes 180 days (additional 90 days if required) and the liquidation process requires a maximum two years' time. So, the entire procedure shall be completed in less than three years' time. At present the average time required for creditors to recover their credit is 4.3 years.

## Moratorium to restrict asset strapping and siphoning off assets

To deal with instances of assets strapping and siphon off assets, the Adjudicating Authority shall declare a moratorium to prohibit transferring of any assets or legal rights by the corporate debtor (Section 14 of the Code). The violation of provision 14 shall be punishable with a minimum three years imprisonment term (Section 74 of the Code).

## Management control by insolvency professional

On commencement of the resolution process, the management of affairs of the corporate debtor shall vest on resolution professional (Section 16, 17 and 25 of the Code). The resolution professional can bring expertise in his team to revamp the business, which can save the business from being liquidated.

## Right of unsecured creditor

The code protects the interest of all creditors, be it secure or unsecured and allows them to vote as per their voting share. The code allows unsecured creditor to trigger insolvency resolution process. While distributing asset sale proceeds, unsecured creditors get priority and their order comes after workmen, secure creditors and employees' dues. Earlier, certain unsecured creditor like vendors used to get the least priority and the new law shall take care of their interest.

## Protecting workers and employees

The new code shall protect the interest of the workmen ahead of secured creditors. First, the workmen will get the share from assets sale proceeds and then the secured creditors and employees respectively.

## Abolition of the official liquidator

The code abolishes the existing official liquidator structure and the insolvency professional shall perform the role of the liquidator in the liquidation process. The official liquidators are appointed by the Central Government and they are attached to the High Courts of the respective

states. So far, the liquidation procedure managed by the official liquidators is not very successful and most of the time they are overburdened with multiple assignment<sup>17</sup>. Under the code, the liquidation procedure will be completed in a time-bound manner by a professional agency.

## Opens up bond market

The Corporate Bond market activity has relatively been low in India compared to other countries in the world. The code brings in much needed transformation towards rights of other creditors and bond holders. Similarly, the provision towards ranking down Government Dues over other creditors in liquidation, shall give desired confidence to all Investors.



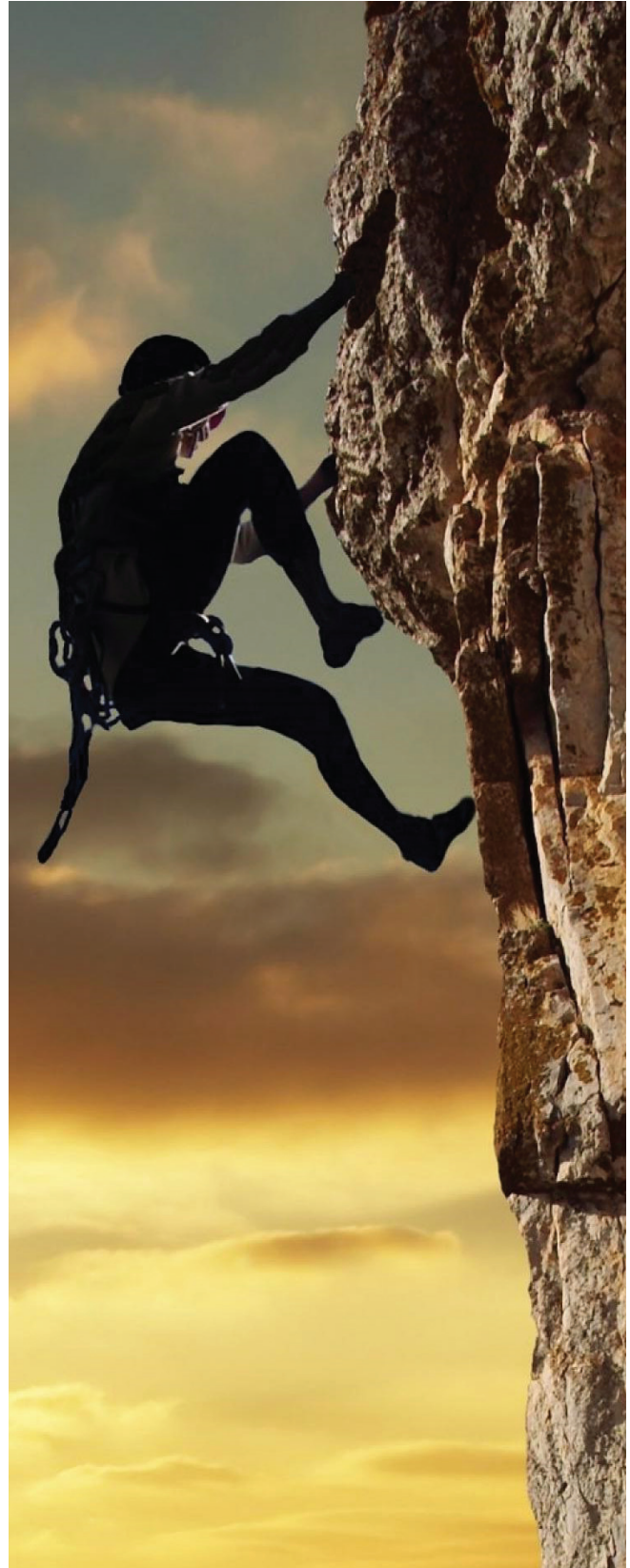
<sup>17</sup> Gujarat High Court; State Bank of India vs Pro. O.L. Of Volvo Steel Ltd, [www.indiankanoon.org](http://www.indiankanoon.org)



## Issues & challenges

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1. Consequent to the dissolution of company law Board and repealing of SICA Act, all the matters pending with CLB shall stand transferred to NCLT whereas all existing registered BIFR cases stands abated and such companies may file with NCLT afresh within 180 days. This shall lead to NCLT dealing with backlogs of CLB/SICA cases. NCLT should possess adequate manpower and infrastructure to deal their cases apart from the responsibility of being Adjudicating Authority under this Code.
2. The current 33 DRTs set up across the country have huge pendency of recovery proceedings and are currently beset with inadequate infrastructure and manpower. With more than 58,000 pending cases, need to beef up its logistics is imminent.
3. Operationalisation of Information Utilities so as to ensure that the data and the information are complete and accurate.
4. SARFAESI may still be a preferred choice for lenders having sufficiency of mortgaged assets.
5. Secured creditors need to exercise professional judgement towards resolution process as liquidation itself may not be the best choice.
6. Overall development of ecosystem may take time for having adequately skilled insolvency professionals, requisite infrastructure with Adjudicating Authority, proactive training of all intermediaries, development of corporate Bond market, well capitalized ARCs, investment in distressed securities etc.





## Glossary

The Sick Industrial Companies Act,1985	SICA
Recovery of Debts due to Banks and Financial Institutions Act,1993	RDDBI
Securitisation and Reconstruction of Financial Assets & Enforcement of Security Interest Act,2002	SARFAESI
National Company Law Tribunal	NCLT
National Company Law Appellate Tribunal	NCLAT
Debt Recovery Tribunal	DRT
Debt Recovery Appellate Tribunal	DRAT
Limited Liability Partnership Act,2008	LLP
Insolvency and Bankruptcy Board of India	IBBI
Insolvency Professional	IP
Non-Performing Asset	NPA
Corporate Debt Restructuring	CDR
Joint Lenders Forum	JLF
Strategic Debt Restructuring	SDR
Asset Reconstruction Company	ARC
Reserve Bank of India	RBI
The Insolvency and Bankruptcy Code,2016	CODE
Scheme for Sustainable Structuring of Stressed Assets	S4A



## About CII

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The Confederation of Indian Industry (CII) works to create and sustain an environment conducive to the development of India, partnering industry, Government, and civil society, through advisory and consultative processes.

CII is a non-government, not-for-profit, industry-led and industry-managed organization, playing a proactive role in India's development process. Founded in 1895, India's premier business association has over 8000 members, from the private as well as public sectors, including SMEs and MNCs, and an indirect membership of over 200,000 enterprises from around 240 national and regional sectoral industry bodies.

CII charts change by working closely with Government on policy issues, interfacing with thought leaders, and enhancing efficiency, competitiveness and business opportunities for industry through a range of specialized services and strategic global linkages. It also provides a platform for consensus-building and networking on key issues.

Extending its agenda beyond business, CII assists industry to identify and execute corporate citizenship programmes. Partnerships with

civil society organizations carry forward corporate initiatives for integrated and inclusive development across diverse domains including affirmative action, healthcare, education, livelihood, diversity management, skill development, empowerment of women, and water, to name a few.

The CII theme for 2016-17, **Building National Competitiveness**, emphasizes Industry's role in partnering Government to accelerate competitiveness across sectors, with sustained global competitiveness as the goal. The focus is on six key enablers: Human Development; Corporate Integrity and Good Citizenship; Ease of Doing Business; Innovation and Technical Capability; Sustainability; and Integration with the World.

With 66 offices, including 9 Centres of Excellence, in India, and 9 overseas offices in Australia, Bahrain, China, Egypt, France, Germany, Singapore, UK, and USA, as well as institutional partnerships with 320 counterpart organizations in 106 countries, CII serves as a reference point for Indian industry and the international business community.

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## Sumedha Fiscal Services Ltd

Sumedha Fiscal Services Limited is a boutique investment banking company with pan India presence and corporate office at Kolkata. The Company offers a wide bouquet of services ranging from Corporate Finance, Turnaround Solution, Equities, Commodities, Wealth Advisory, Portfolio Management, Personal Finance, Currency Futures, Investment Banking and Institutional Broking Services.

The services are broadly clubbed across three key business verticals:

-  Investment Banking
-  Wealth Management
-  Broking Services

Sumedha Fiscal focuses on creating viable solutions for its clients as a trusted partner backed by an experienced team of professionals. Sumedha Fiscal is a listed company and further details can be assessed at [www.sumedhafiscal.com](http://www.sumedhafiscal.com)

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