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# Revoke IBC suspension to resolve stressed assets

The enactment of the Insolvency and Bankruptcy Code, 2016 ('Code'), is considered the biggest economic reform next only to the GST.

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For representational purpose. (File Photo | PTI)

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The enactment of the Insolvency and Bankruptcy Code, 2016 ('Code'), is considered the biggest economic reform next only to the GST. Prior to its enactment, the legal and institutional mechanisms for dealing with debt default were not very effective and out of alignment with global best practices. The recovery actions initiated by the creditors, utilising available statutes, were time consuming and did not yield the desired outcomes.

Adequate and timely availability of credit is important for the growth of any economy. Secured credit extended by banks is the largest component of credit markets in India, specifically in the absence of a mature capital debt market. The Code promotes entrepreneurship and availability of adequate credit, balances the interests of all stakeholders in a time-bound manner and maximises the value of the assets of debtors.

The paradigm shift brought in by the Code ensures that when a firm defaults on its debt-servicing obligations, its control shifts from the promoters to a Committee of Creditors (CoC), i.e. transformation from the 'debtor in control' model to 'creditor in possession' one. Further, the process being time-bound, the CoC has to either evaluate resolution proposals for resuscitating the company or take it to liquidation. Taking decisions at an early stage of financial stress in a time-bound manner gives a better chance to save a stressed firm as a going concern and the scarce resources of the economy can be put to best use.

The Code is a comprehensive and systemic reform that has catapulted India from amongst the relatively weak insolvency regimes to becoming one of the world's better ones. Accordingly, India's position in the 'resolving insolvency' parameter of the World Bank's Ease of Doing Business Survey has improved 56 places to 52 in 2019 from 108 in 2018, among 190 countries. This in turn pushed India's overall ranking to 63 out of 190 countries in 2019.

Measures initiated to tackle Covid-19 impact: A rare black swan event like the Covid-19 pandemic needed a swift response to save lives, livelihoods and the lives of firms. The Central government adopted an accommodative stance and acted swiftly to prevent corporates and individuals from being forced into insolvency and bankruptcy. Among others, it suspended select provisions of the Code for filing applications, for initiation of Corporate Insolvency Resolution Process (CIRP) for any default arising on or after 25 March 2020, for an initial period of six months and later extended it by another six, in two tranches of three months each.

Further, the threshold of default for initiating the insolvency process was raised from Rs 1 lakh to Rs 1 crore. Measurable impact of Covid-19 measures: The provisions relating to CIRP came into force on 1 December 2016. Since then, the number of CIRPs admitted were registering a gradual up trend, till end March 2020. Pursuant to Covid-19 measures, as above, the number of CIRPs admitted, resolved and withdrawn have registered a sharp decline.

For example, 1,152 CIRPs were admitted in 2018-19, increasing to 1,953 in 2019-20, but declining to a meagre 161 during the first six months of the current financial year. Similarly, the number of cases resolved increased from 80 in 2018-19 to 135 in 2019-20 and thereafter declined to 42 after Covid measures came into force, up to September 2020. Numbers for CIRPs leading to liquidation stood at 306, 536 and 93, respectively.

Prior to implementation of measures to tackle the Covid-19 impact, resolution of stressed assets under the IBC had registered commendable performance. Since inception, till March 2020, 221 CIRPs had yielded resolution, with financial creditors realising `1.77 lakh crore, 45.96% of their admitted claims. Likewise, 1,025 CIRPs resulted in liquidations, releasing precious locked resources that could be channelised for improving economic growth.

Further, on account of behavioural change and transformation of credit culture pursuant to IBC implementation, resolution of stressed assets was happening much before default or in the early days of default. The same is corroborated by the fact that a total of 14,884 CIRP applications, aggregating over Rs 5.15 lakh crore, were withdrawn prior to admission, up to 30 September 2020. The positive transformation in credit culture may revert to pre-IBC days, if this suspension is prolonged any longer.

The RBI in its latest report, Trend and Progress of Banking in India: 2019-20 released on 29 December 2020, while noting the improved asset quality of scheduled commercial banks, has acknowledged the dominant mode of recovery being the Insolvency and Bankruptcy Code. The RBI has also raised concerns about sharp deterioration in asset quality going forward, given the uncertainty induced by Covid-19 and its real economic impact after gradual rollback of the pandemic policy measures.

The way forward: The gradual build-up of momentum for the resolution of stressed assets pursuant to implementation of the IBC over the past four years has led to a positive transformation in credit culture. Speedy resolutions with higher recoveries for financial creditors and closure by way of liquidation have slowed down during the past nine months in the wake of measures initiated to tackle Covid-19. The weakening performance of the IBC framework is visible from the decline in the number of CIRPs admitted/resolved.

Moreover, the RBI has also indicated that it expects a sharp deterioration in asset quality in the near future, after the rollback of Covid-19 measures. In order to continue to enjoy the benefits of the Code and effectively address the expected sharp deterioration in asset quality, it may be imperative to revoke the suspension of sections 7, 9 and 10 of the Code at an early date.

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