

## Where Next For IBC<sup>1</sup>

Prior to the enactment of the Insolvency and Bankruptcy Code, 2016 (Code /IBC), we did not have any experience of a proactive, incentive-compliant, market-led, and time-bound insolvency law. The Code and the underlying reform, in many ways, was a journey into an uncharted territory - a leap into the unknown, and a leap of faith. Many institutions required for implementation of a state-of-the-art insolvency law did not exist.

We, however, did not have the luxury to wait till we have the institutions. We preferred to implement the Code on *as-is-where-is-basis*, while *learning-on-the-go*. Paradoxically, we commenced with the most complex, 12 largest distressed assets, as we developed the ecosystem, built its capacity, streamlined processes, evolved best practices, promoted markets, and so on. We, in fact, repaired the aircraft, while continuing to fly. The experiment returned huge dividends by any standard. International recognitions came in. In just about three years since the Code came into force, our ranking in World Bank's Ease of Doing Business in terms of resolving insolvency improved from 136<sup>th</sup> to 52<sup>nd</sup> position.

The obvious question for the organisers of this programme is: 'What next for IBC'? I am no astrologer to talk about it. However, if I observe the ongoing efforts correctly, and such efforts ultimately pass the muster of the concerned stakeholder, I see three sets of developments in the IBC space in the near future.

**A. Building institutions:** First is strengthening of institutions of insolvency and bankruptcy. Insolvency is an outcome of market. The Code provides a framework for the market to find out a resolution. Market, however, heavily relies on institutions for efficient and sustainable delivery. In fact, a key differentiator among nations is institutions. There is an increasing focus on strengthening insolvency institutions.

**a. Insolvency Profession:** Insolvency proceedings require high-end, sophisticated professional services. The Code casts, unlike many advanced jurisdictions, strenuous responsibilities on an insolvency professional (IP) to run the affairs of the firm in distress as a going concern, protect and preserve the value of its the property, comply with all applicable laws on its behalf, conduct the entire resolution process with fairness and equity, retrieve value lost through fraudulent and preferential transactions, etc. The promising professionals from disciplines of law, management, accountancy, etc., with ten years of experience have joined the insolvency profession after undergoing certain training and passing the Limited Insolvency Examination. They have performed admirably well.

To take the insolvency profession to the next level, the IBBI has launched a two-year Graduate Insolvency Programme (GIP) for young and bright minds having a professional qualification or a degree in a relevant discipline but without experience. GIP aims to groom tailor-made IPs and inculcate all that an IP needs, including the soft skills such as people management, entrepreneurship, emotional IQ, and deep-rooted ethics and integrity. On completion of GIP, one would be eligible for registration as an IP. GIP is the first of its kind in the world and is an endeavour to create insolvency as a discipline of knowledge.

**b. Valuation:** A key objective of the Code is maximisation of the value of assets of the persons in distress. One needs transparent and credible determination of value of the assets to facilitate

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comparison and informed decision making. The valuations serve as reference for evaluation of choices, including liquidation, and selection of the choices that decides the fate of the firm. If valuation is not right, a viable firm could be liquidated and an unviable firm could be rehabilitated, which could be unfortunate for an economy. An interim framework has been put in place under the Companies Act, 2013. Work has begun to put in place an institutional framework that develops and regulates tailor-made valuation professionals. Here also, the endeavour is novel and aims to create the valuation as independent disciplines of knowledge.

**c. Information Utility:** The resolution process is information intensive. Value depends on availability of quality of information with the stakeholders. The Code provides for a competitive industry of interoperable Information Utilities (IUs) to store financial information that helps to establish defaults, verify claims, and constitute committee of creditors (CoC) expeditiously and thereby facilitate completion of processes in a time bound manner. An IU has already come up and has gathered a critical mass of information and is ready to share information with the concerned stakeholders. This is also first of its kind in the world to address information asymmetry seamlessly.

**d. CoC:** It is a committee of financial creditors (FCs) which has responsibility to decide the fate of the firm in distress. It is supreme in commercial matters. All stakeholders, including Government, are bound by the resolution plan, which is a commercial decision of the CoC. A wrong decision can destroy an otherwise viable firm or place the firm in the hands of wrong people. The CoC deciphers whether the firm is in economic distress or financial distress. If it is in economic distress, that is, it is failing and unviable, the CoC may release the resources of the firm to other competing uses and the entrepreneur to pursue emerging opportunities. If it is in financial distress, that is, it is failing, but viable, the CoC may rescue the firm from the clutches of current management and put it in the hands of a credible and capable management to avoid liquidation. The CoC also assesses feasibility and viability of resolution plans and capability and credibility of resolution applicants. All round efforts are being made to strengthen the institution of the CoC matching its responsibilities.

Further, the creditors have right to initiate an insolvency proceeding in the event of the threshold amount of default. A default entitles a creditor but does not oblige him to initiate the proceeding if he does not consider it necessary under the facts and circumstances. It requires application of mind and building capacity of creditors.

Thus, the endeavor is to build the insolvency profession, valuation profession, IU, and CoC as institutions. Further, attempt is to graduate organisations such as the IBBI, Adjudicating Authority (AA), Insolvency Professional Agencies, Registered Valuers Organisations, etc. to the level of Institutions. We should see considerable institutionalisation and professionalisation in the next year or two.

**B. Process Improvements:** The second set of developments relates to process improvements for certainty, efficiency, and efficacy.

**a. Responsive Regulation:** As a regulator, IBBI has no parallel elsewhere in the World. It makes, among others, regulations for corporate and individual insolvency, liquidation and bankruptcy processes. Regulation, however, is not an unmixed blessing. Nor is there a regulation for every market failure. A responsive regulator designs and modifies regulations, proactively with changing needs of the market, without unduly restricting freedom of the participants and with the least unintended consequences. IBBI has standardised the regulation

making process to ensure that the regulations are effective as well as responsive, and not excessive. The IBBI (Mechanism for Issuing Regulations) Regulations, 2018 govern the process of making regulations, which includes cost benefit analysis and consulting the public.

**b. Resolvability:** The Code shifted the focus of creditors, in case of default, from the possibility of recovery to the possibility of resolution. The market now prefers to deal with a firm which is resolvable. A resolvable firm obtains a competitive advantage vis-a-vis non-resolvable firms through reduced cost of debt. Where the value of a firm lies in informal, off-the record arrangements or personal relationships among promoters or their family members, prospective resolution applicants may find it hard to trace and harness the value, making resolution of the firm remote. A firm would focus on creating and maintaining value, which is visible and readily transferable to resolution applicants. Similarly, a firm would keep an updated information memorandum ready to enable expeditious conclusion of resolution process, if initiated. It is endeavor of a firm to keep itself resolvable all the time, should a need arise. In a sense, they are preparing a sort of '*living will*' for the benefit of the firm as well as the society at large

**c. Market for distressed assets:** India is the fastest-growing, trillion-dollar economy and the fifth largest in the world. The average growth rate over the last three decades has been about seven percent. Its ranking in ease of doing business improved from 142<sup>nd</sup> to 63<sup>rd</sup> position in the last five years. All vital statistics such as index for competitiveness, index for innovation have been improving over the years. In the face of competition and innovation, it is natural that some firms will have distress. Given the size of the economy and its growth potential, there will be a continuous flow of distressed assets to market. They would need to be resolved, not necessarily through an IBC process. They could be bought even in very early days of distress. An RBI Task Force recently argued for a regulatory push to facilitate development of secondary market for corporate loans. Several platforms provide the details of distress assets. IBBI is coming with a market platform which will show the entire pipeline and enable competitive participation of resolution applicants. In addition to a liquid, transparent market for distressed assets, there would be several entry points for investment in the life cycle of a distressed asset.

**d. Automation of Contracts:** Automation of contracts comprising three elements, namely, standardisation of contracts, dematerialisation of contracts and online execution of contracts, have done wonders to securities market. Automation of loan contracts can do similar wonders to insolvency proceedings. An RBI Task Force has recently recommended setting up of a Central Loan Contract Registry/Repository (CLCR) to serve as a 'one stop shop' for all the information about the loans.

**e. Best practices:** The law does not and cannot provide solutions to every problem. The solutions need to evolve from market. The best practices would emerge. For example, regulations require an information memorandum, in respect of a distressed firm, to provide details of assets and liabilities with such description, as on the insolvency commencement date, as are generally necessary for ascertaining their values. 'Description' includes the details such as date of acquisition, cost of acquisition, remaining useful life, identification number, depreciation charged, book value, and any other relevant details. The relevant details in respect of different kinds of assets should get standardised soon.

**C. Remaining elements:** The third set is implementation of the remaining elements of the Code.

**a. Individual insolvency:** After having passed several milestones in corporate insolvency, it is time now to focus on the next big thing, the individual insolvency. The Code classifies individuals into three classes, namely, personal guarantors to corporate debtors, partnership firms and proprietorship firms and other individuals, to enable implementation of individual insolvency in a phased manner considering the wider impact of these provisions. The learning from the implementation of the earlier phases would help facilitate a smoother roll out of the later phases. It has been decided to commence individual insolvency resolution in respect personal guarantors to corporate debtors from 1<sup>st</sup> December, 2019. Work has begun for operationalising other elements of individual insolvency.

**b. Fresh Start Process:** Part III of the Code provides a fresh start process that allows debtors, who have an annual income  $\leq$  Rs.60,000, assets  $\leq$  Rs.20,000, debts  $\leq$  Rs.35,000 and do not have a dwelling unit, to seek discharge debt. It is being considered to provide a low-cost, simplified and easy-to-access, preferably technology-based process for such debtors to seek relief. An administrative body as the supervising authority in the fresh start process, instead of tribunals / courts, is also being considered.

**c. Financial Service Providers (FSP):** The Code enables application of the processes with appropriate modification for resolution of FSPs. Since India is yet to have a specialized framework for resolution of FSPs, Government notified Rules providing for a slightly different process under the Code for resolution of FSPs. This currently applies to NBFC and HFCs having assets of Rs.5 billion. If need arises, these Rules can be applied to other FSPs.

**d. Cross border:** The Code enables the Government to enter into bilateral agreements with foreign countries for applying the provisions of the Code. There are obvious limitations of bilateral approach. However, a few resolutions having cross border elements have come up. The AA has worked out a protocol between insolvency practitioners of two jurisdictions, pending a comprehensive framework. The Insolvency Law Committee (ILC) has proposed to add a chapter in the Code to introduce a globally accepted and well recognised cross border insolvency framework. Implementation of the framework will create an internationally aligned and comprehensive insolvency framework for corporate debtors, which is essential in a globalised environment. A committee is currently developing rules and regulations required for implementation of this framework.

**e. Group insolvency:** Under the guidance of the AA, a protocol has been worked out for resolution of firms in a group. A committee has done further work. The first phase may facilitate procedural co-ordination of only firms in domestic groups. Cross-border group insolvency and substantive consolidation could be considered at a later stage, depending on the experience of implementing the earlier phases of the framework, and the felt need at the relevant time. While it would be voluntary for the stakeholders of the firm in distress to use the framework, the provisions relating to communication, cooperation and information sharing between IPs, CoC and AAs is proposed to be made mandatory for the firms which belong to a group and have been admitted into corporate insolvency resolution process.

### **Commitment**

While these three sets of developments will dominate the insolvency space, the Government remains committed to address deficiencies arising from implementation of the Code, in sync with the emerging market realities, to further its objectives. The ILC continuously reviews the implementation of the Code to identify issues impacting the processes under the Code and make recommendations to address them. The road to success always remains under construction.