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‘Insolvency law’s aim is biz rejig, not recovery’

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Amid concerns over poor realisation from insolvency resolution, M S Sahoo, chairman of Insolvency & Bankruptcy Board of India (IBBI), tells TOI that how much money is realised depends on a variety of factors and the law is not for recovery, but resolution. Excerpts from an interview:

There is fear that many of the ousted promoters are trying to get entry through the backdoor through people they know. Are the fears justified?

Let me make it clear that there is no prohibition on promoters to retain their company through a competitive resolution plan. The prohibition is on a person, whether a promoter or not, who does not have credible antecedents. Any person, which is connected or related to the prohibited person, is also prohibited. He is also prohibited from buying assets in liquidation or participating in compromise or arrangement of the company. Therefore, backdoor entry is not possible. However, in their endeavour to cling on to the company, some promoters may genuinely believe that either they are not prohibited, or the law prohibiting them is not just, or there is a way to get around the law. They try their luck up to the highest court. There has, however, not been a single instance, where a prohibited person has gained control of the company through a resolution plan.

They may not be promoters or their family members but those who have been associated with the promoters. Are more steps required?

Some of it may be hearsay. The law prohibits every person, natural as well as artificial, who is connected with the business activity of the prohibited person. Further, a basic premise of any law is that what cannot be done directly cannot be done indirectly. I think, the extant provisions are adequate.

One of the major concerns is about a haircut, which in one case was described as a tonsure. Is that a concern?

The question to ask is why does IBC (Insolvency and Bankruptcy Code) process yield zero haircut in one case and 100% haircut in another for creditors? It depends on the nature of business, health of the economy, marketing efforts, etc. It critically depends on at what stage of stress, the company enters IBC process, as much as at what stage a patient arrives at the hospital. If the company has been sick for years, and the assets have depleted significantly, the IBC process may yield huge haircut or even liquidation. The IBC maximises the value of the existing assets, not of the assets which do not exist. It has been realising, on average, 190% of the liquidation value of the existing assets, for creditors.

Tinbergen Rule, named after the first Noble laureate in Economics Sciences, Jan Tinbergen, stipulates that a policy must not have more than one objective. The IBC has only one objective, that is, reorganisation. It reorganises the affairs of a company to rescue it if its business is viable or to close it if its business is unviable. Such reorganisation has several intended benefits, namely, promoting entrepreneurship, improving credit availability, maximising the value of assets of the company, balancing interests, etc. Recovery is neither an objective of the IBC nor even one of the intended benefits, as evident from its long title. It may be appropriate to talk about haircut in case of a law/ policy, which has recovery as a target.

Will the Supreme Court order on guarantors help banks in recovery?

The haircut, as quoted in case of IBC, is deceptive. It is typically amount of realisation/ amount of claim. The amount of realisation often does not include the amount realisable through avoidance transactions and insolvency resolution of guarantors. The amount of claim often includes loan amount as well as its related guarantee amount, interest on interest, and penal interest. These understate the numerator and overstate the denominator, projecting a higher haircut. The Supreme Court order paves the way for resolution of personal guarantors which will help to reduce or eliminate haircut.

Are you seeing banks approach much more quickly compared to earlier?

In the initial days, banks were a bit hesitant to initiate the process. That is why probably the banking law was amended to authorise the RBI to direct banks to initiate IBC proceedings in case of default. In the first instance, the RBI directed banks in June 2017 to file applications for insolvency proceedings in respect of 12 accounts having very large NPAs. With attractive outcomes, IBC is now attracting bankers as a possible option to resolve stressed assets. They may not be exercising this option, at the first instance of default, but only when they are sure of better outcomes keeping in view the prevailing economic and sectoral performance.

How many cases of MSME resolution have come under the alternate prepack framework?

It takes three-six months for the stakeholders to understand a new framework, compare it with other available options and prepare themselves to use it. Prepack requires prior understanding between debtor and creditors before initiating the formal process. It is too early to witness inflow of applications.

It's been three months since the IBC freeze was lifted. Have you seen a spurt in cases being filed?

Since expiry of suspension on filing, applications for initiation of insolvency proceedings against 200 companies have been filed. This is on expected lines and has been the experience internationally. The higher threshold of default of Rs1 crore coupled with support and forbearances has limited the flow of applications. More importantly, the stakeholders like to use the Code when the likelihood of resolution is high. They may be waiting for the appropriate time to invoke the Code.

One of the idea was to fast-track resolution process and therefore 180 days time limit was set with possible extension of another 90 days. But it is taking longer. Are you satisfied with it?

Yes and no. Yes, as compared to pre-IBC days. Earlier it took more than four years. Now it takes around 400 days. No, as compared to our intention. It must be appreciated that we are doing something for the first time. We must allow some more time for the new law and ecosystem to mature and settle down.

Do you think there is a need to focus on certain sectors, such as real estate, where resolutions are lower than average?

This law is optional. It is not the only law for reorganisation. The stakeholders use it only when they consider it as a better option as compared to other options available to them. They will not invoke IBC if they are apprehensive of outcomes. Further, this law is sector neutral. If one sector gets a preferential treatment as compared to another, it would distort the level playing field and consequently misallocate resources impinging on economic growth. The laws relating to resource allocation, namely, insolvency, competition, securities are always sector neutral.

What are the next set of measures that should be taken?

Constantly bettering the insolvency ecosystem and enhancing the legislation with value adding features is the endeavour of the Government and the regulator. In keep with this, some work has been done in group insolvency and cross-border insolvency for corporate insolvency, and fresh start process for individuals. These will require amendment to the law. After successful implementation of corporate insolvency, individual insolvency could be the next frontier.