Re-calibrating the Insolvency and Bankruptcy Code

The Insolvency and Bankruptcy Code (IBC) enshrined in the Act of 2016 was seen as the answer to the long-standing woes of banks in recovering their dues, especially from corporates. By correcting the skewed relationship between corporate borrowers and banks and ensuring a more balanced relationship, IBC was meant to actualise capitalism's famed promise of creative destruction. Instead, five years later, it is still seen as a work in progress. Very slow progress indeed, so much so that the Parliamentary Standing Committee on Finance, headed by Jayant Sinha, has come down heavily on the working of the IBC and called for an extensive overhaul of the Code.

What is the way forward? How can we best realise the promise of IBC? To discuss this and more, NCAER, as part of its 'Conversations with NCAER series', is hosting a webinar featuring three experts: Jayant Sinha, Member of Parliament, Lok Sabha, and Chairperson for the Standing Committee on Finance and a member of the Public Accounts Committee for 2019-2020; M.S. Sahoo, former Chairperson of the Insolvency and Bankruptcy Board of India; and Pallav Mohapatra, Chief Executive Officer and Managing Director of Asset Reconstruction Company (India) Ltd. (ARCIL).

With a view to facilitate the Q and A session following the panel discussion, following is a brief backgrounder on IBC:

The Insolvency and Bankruptcy Code (IBC)

Bad debts, or in banking parlance, non-performing assets (NPAs), are integral to modern banking. Banking without NPAs, as the wag would say, is like religion without sin – it does not exist! This is true the world over. What distinguishes NPAs in advanced countries from those in India, however, is the inordinately long and protracted process of recovery in India. Indian banks have been hamstrung by their inability to recover their dues from borrowers with the result that not only is bank credit locked up in unproductive avenues but the cost of credit to other credit-worthy borrowers also goes up, the bottomlines of banks are adversely affected, and the entire economy suffers as a consequence.

Over the past few decades, attempts have been made to initiate several institutional and policy measures in a bid to resolve bad debts. The institutional measures include setting up the Board for Industrial and Financial Reconstruction (BIFR, 1987), Lok Adalat, Debt Recovery Tribunal (DRT, 1993), Corporate Debt Restructure (CDR, 2001), Securitisation and Reconstruction of Financial Assets and Enforcement (SARFAESI, 2002), and Asset Recovery Company (ARC, 2002).

Despite these efforts, resolution has remained tardy. The RBI on its part launched many measures to resolve NPAs, primarily through restructuring of stressed assets. Under the former RBI Governor, Raghuram Rajan, an ambitious programme of Corporate Debt Restructuring was attempted, but without much success.

It is against this background that the IBC was introduced in 2016. The landmark legislation marked a welcome departure from earlier measures in that it envisaged a legally time-bound resolution and a shift in the skewed balance between the debtor and creditor wherein the former effectively called the shots. The shift to the creditor-in-control model as opposed to the earlier debtor-in-possession system was a seminal change as under this, the promoter lost control over the management of the company. This was expected to rule out lengthy litigation and ensure speedy resolution of NPAs. The mandate before the IBC set-up was clear — to nip any souring debt in the bud by divesting promoters of control and resolving it as soon as possible, while also realising the best possible value, thus paving the way for fresh credit and investments.

Five years on, there is a sense that IBC has been underwhelming. While it has, undoubtedly, instilled a sense of fear in recalcitrant corporate borrowers, who in the past siphoned off funds and defied attempts by banks to bring them to book, the overall record has been disappointing. After the initial burst when the 'dirty dozen' accounts were resolved with some big promoter names in steel and cement losing control of their companies, and banks recovering impressive sums, it appears that defaulters have figured out how to game the IBC now.

The numbers vary, depending on how you calculate the resolution percentage of loans referred under the IBC, but there's no disputing that haircuts have been huge — in some cases going up to as much as 95%.

Taking a grim view of the situation, the Parliamentary Standing Committee on Finance, headed by Jayant Sinha, in its report, 'Implementation of Insolvency and Bankruptcy Code — Pitfalls and Solutions', observed that the IBC may have 'digressed from the basic design' and the last six amendments to the law have given it a 'different orientation, not originally envisioned'.

The report tabled in the Lok Sabha in August 2021 says that financial creditors took 4,356 companies to the National Company Law Tribunal (NCLT) under the IBC to recover Rs. 6.77 lakh crore, while the operational creditors moved the court against 8,331 companies to recover their dues worth Rs. 78,000 crore. In 266 cases, the companies themselves moved NCLT after they failed to repay debt worth Rs. 52,000 crore.

The Committee highlighted that IBC has low recovery rates with 95% haircuts; over 71% of the cases are pending for over 180 days. According to the Committee's report, out of 20,963 cases pending in tribunals, 13,170 cases are of IBC, involving an amount of Rs. 9.20 lakh crore.

Calling for "greater clarity in purpose with regard to strengthening creditor rights through the mechanism devised in the IBC, particularly considering the disproportionately large and unsustainable 'haircuts' taken by the financial creditors over the years," the Committee recommended that a benchmark be put in place for the quantum of such 'haircuts' to be taken by creditors, in line with global standards.

It pointed to the repeated and long delays in the process, coming down hard on bids being placed after the announcement of the highest bidder, and called for ‘a professional code of conduct for the COC’ to define and circumscribe their decisions.

On the role of the National Company Law Tribunal (NCLT) the committee recommended that NCLT must admit cases in 30 days to cut down on delays since these delays result in asset stripping and funds diversion by the defaulting promoter. Likewise, it called for a professional self-regulator for insolvency resolution professionals (IRPs) that functions like the Institute of Chartered Accountants of India (ICAI to oversee and regulate the functioning of RPs so that there are appropriate standards and fair self-regulation.

Since cases decided at the NCLT are litigated at the appellate tribunal (NCLAT) and the Supreme Court it also emphasised the need for proper selection of the NCLT members so that they are familiar with commercial practices.

The IBC is better than what we have had so far but is it the best that we can hope for? What tweaks are needed to improve on it and help realise the promise?

The article from *Economic Times* of December 6, 2021 pasted below gives a flavour of what ails IBC.

IBC Lessons: A Bird in Hand is Worth Two in the Bush: *Sangita Mehta*

KSK Mahanadi case is a prime example of how the law is losing its edge

The plan by lenders State Bank of India and Union Bank of India to sell loans given to KSK Mahanadi Power is an example of the extent to which banks are willing to go to avoid the uncertainty of the Insolvency and Bankruptcy Code driven resolution process.

Both lenders have decided to offload their loans to asset reconstruction companies in the hope of getting 28 -31% of their verified claim amount just days before the deadline — December 22 — is set for bidders to submit a binding offer for the distressed company.

So why are lenders shunning this all-powerful recovery tool? The initial resolution of high-profile bankruptcy cases such as Binani Cement and Essar Steel was touted as the success of IBC in empowering the banks.

The KSK Mahanadi case is a prime example of how the law is losing its edge. It indicates that even when there is an operational business with solid assets, there are many challenges to the court administered resolution.

First, the promised resolutions within 270 days from admission never worked. Even the extended deadline of 330 days remains on paper. Over 75% extended beyond 270 days, show data compiled by the Insolvency and Bankruptcy Board of India.

In the case of KSK Mahanadi, the insolvency process itself started at least two years after the first default. An initial attempt by lenders to sell the company to Adani Power in February 2019 was scuttled following a tariff cut by the Uttar Pradesh government.

The road to recovery has been rocky ever since. It took almost a year for lenders to get the company admitted for resolution and insolvency. Once admitted in October 2019, another two years were lost because of the change of resolution professional and the longer time given to applicants for due diligence due to the pandemic.

The progress made in terms of obtaining expressions of interest was lost because the Hyderabad NCLT ordered a reset after a latecomer — Riddhi Siddhi Gluco Biols — complained that lenders have allowed Naveen Jindal's Jindal Power to bid without submitting an EOI. Lenders said they were only allowing Jindal to bid in place of another group company that had participated earlier.

The fresh bidding process which started last month has seen interest from Vedanta, Adani and Jindal Power, among others, for the company which has six 600MW power plants in Chhattisgarh, of which three are operational.

Lenders have learnt from experience that when it comes to bad debts a bird in hand is worth two in the bush.

KSK Mahanadi has caught the fancy of ARCs who are confident of realising value as the company has a power purchase agreement.

Aditya Birla ARC owns 20% of the debt which it purchased from Axis Bank, Bank of Baroda and Punjab National Bank over 18 months. Asset Reconstruction Company of India (Arcil), ASREC (India) Ltd and CFM ARC also have acquired small loans from other lenders.

SBI and Union Bank of India's 27% share in the company's total debt gives them clout in the resolution process. But selling it to ARCs will enable them to report higher earnings in a quarter when loan growth is sluggish.

The government has frowned upon banks selling loans of large corporates. In January 2019, SBI's proposal to sell its ₹15,431 crore Essar Steel loans was shot down by the finance ministry fearing criticism. SBI's then-chairman Rajnish Kumar said, "There is a time value for money... Every day it is costing lenders ₹17 crore, my share is nearly 25-30%. So, we don't want to wait indefinitely."

While SBI made a good recovery in Essar Steel, it took over 14 months as a series of litigations had to be adjudicated upon before the deal concluded. Similarly, Bhushan Power

& Steel, which was admitted to NCLT in July 2017, was approved for sale to JSW Steel only in September 2019. Lenders finally got their money from the white knight steelmaker in March 2021.

While the recoveries have shrunk, nothing much has changed in terms of timelines.