Insolvency Profession: An Institution in the Making

Why does an economy develop or develop faster, while another similarly endowed languishes or lags? Many believe that it is because the former has better resources - human, finance, technology, etc. But why does one economy get better resources, and while the other does not? Conventional wisdom tells us that institutional milieu encourages and attract 'superior' resources and are, therefore, deeper determinants of development.

Institutions are the foundations of a well-functioning market economy. They define the contours of freedom, protect rights, enforce obligations, and penalise deviant behaviour and thereby bring in predictability of actions and certainty of outcomes. They entitle an entity to the fruits of its effort and thereby motivate it to behave and perform at its best.

The economies of scale and scope enable increasing returns and accelerated growth. This prompts organisation of firms for undertaking economic activity. However, a firm is an amalgam of interests of many stakeholders. Its operations often impact their interests differently. It occasionally trades off limited liability of a stakeholder for unlimited liability of another.

With the shift to a market economy, the number as well as size of firms has been increasing over time. The larger the firm, the larger is the number of stakeholders, the larger is the distance of stakeholders from the firm, and the larger is the effort required to balance and watch their interests. This calls for new institutional arrangements.

A professional records and reports performance of a firm, another safeguards minority interest, yet another ensures compliance with applicable laws, and so on; some of these are second order State functions that address market failure. The State is increasingly using them on its behalf to exercise oversight on the firms. Thus, a profession is a key institution of a market economy.

Indian economy is witnessing a proliferation of professions. The need for professional services has been increasing over the years, so also their influence in the making of the economy. Given the growing complexity and importance of services, professionalisation to a large extent determines the competitive edge of nations and sustainability of prosperity.

A market thrives on competition and innovation. However, the higher the incidence of competition and innovation, the higher is the likelihood of failure of a firm, and consequently default and insolvency. Insolvency is often an outcome of the market micro-structure adversely impacting an entity. Therefore, the Code rightly envisages a market process for resolution of insolvency and provides for supporting institutions.

A key supporting institution under the Code is insolvency profession. An insolvency professional (IP) exercises the powers of the Board of Directors of the firm under resolution, manages its operations as a going concern, and complies with applicable laws on behalf of the firm. He conducts the entire insolvency resolution process: he is the fulcrum of the process and the link between the Adjudicating Authority and stakeholders - debtor, creditors-financial as well as operational, and resolution applicants.

The process culminates in a resolution plan that maximises the value of assets of the firm. This presupposes availability of many competing resolution plans and identifying the best of them. The key is generation of many promising resolution plans. This requires provision of and access to complete and accurate information about the firm for prospective resolution applicants and continued operation of the firm.

The Code casts this duty on the IP. He organises all information relating to the assets, finances and operations of the firm, receives and collates the claims, prepares information memorandum, and provides access to relevant information, so that there is complete symmetry of information among the entitled stakeholders, while maintaining confidentiality. He thus addresses the market failure arising from information asymmetry.

The resolution balances the interests of the stakeholders. This requires the services of a third person who does not side with any stakeholder and has no conflict of interests. The law casts this duty on the IP and makes several provisions to ensure his integrity, objectivity, independence and impartiality. It also requires him to be a fit and proper person.

Given the responsibilities, an IP requires the highest level of professional excellence. Accordingly, the law makes an individual with 10-15 years of professional experience eligible for registration as an IP on passing the Limited Insolvency Examination and completing a pre-registration educational course. He is also required to undergo continuing professional education to remain relevant. The IBBI and the IPAs are organising capacity development programmes for them.

The law facilitates and empowers the IP to discharge his responsibilities effectively. It obliges every officer of the firm to report and the promoter of the firm to extend all assistance and cooperation to him. There is an assurance of supply of essential goods and services to, and a moratorium on proceedings against, the firm. The Code empowers the IP to appoint professionals to assist him. He can seek orders from the Adjudicating Authority if he comes across any preferential, undervalued, extortionate, or fraudulent transaction. He can take support services from insolvency professional entities.

In order to ensure that an IP performs his role, the law empowers the IBBI and the IPAs to monitor his performance. It provides for appropriate sanctions for any kind of wrongdoing. Though a client proposes the name of an IP for appointment, he is actually appointed by the Adjudicating Authority. He may be removed from a process by the Adjudicating Authority if it is not satisfied with his performance.

The appointment and removal by the Adjudicating Authority secures and sanctifies the position of IP. He has protection for actions taken in good faith. His conduct can be investigated only by the IBBI/IPAs which has to follow a due process for the purpose. There is bar on trial of offences against an IP except on a complaint filed by the IBBI.

The insolvency profession is in its infancy. It is in a stage in which reputation is formed. Once the society forms a perception about a profession, it is very difficult to change it. It is, therefore, incumbent upon the IPs to build and safeguard the reputation of the profession which should enjoy the trust of the society and inspire confidence of all the stakeholders. They must justify the exalted status of an institution bestowed on them under the Code.

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