Our bankruptcy code is world-class

The IBC has reduced cost and time of insolvency proceedings, and focusses on revival. The World Bank should appreciate this

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The endeavour of every nation is to continuously improve business regulation to make it easier to do business.

The World Bank conducts an annual examination to gauge the 'Ease of Doing Business' in nearly 200 economies and ranks them on ten sets of parameters, which include 'Resolving Insolvency'. India ranked 142nd in 'Ease of Doing Business' for 2015. In terms of resolving insolvency, the country ranked 137th. The government set an ambitious target of breaking into the top 50 on this index, and initiated a plethora of institutional reforms, including an overhaul of the insolvency framework. After four years, India ranks 77th, up by 65 places, in the aggregate rankings, and 108th on 'Resolving insolvency'.

The Indian insolvency regime has many welcome features. Its primary focus is revival of an ailing firm, while recovery by creditors is an incidental outcome. The World Bank methodology, however, captures the incidental outcome. Secured creditors have absolute priority over other claims in insolvency (liquidation) proceedings. 'Getting credit', instead of 'Resolving insolvency' parameter captures this feature.

This article does not examine the appropriateness of the scope and methodology of measuring ease of doing business by the World Bank. Instead, it attempts to assess how India measures up on the 'Resolving insolvency' parameter, as articulated by the World Bank.

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The ongoing annual examination of the World Bank measures the perception of stakeholders in respect of insolvency parameter on two indicators, namely, recovery rate and the strength of insolvency framework, as at end-December 2018.

The recovery rate is a function of time, cost and outcome of insolvency proceedings. In addition to reviving ailing firms, the insolvency proceedings under the Insolvency and Bankruptcy Code, 2016 (Code) have returned 210 per cent of liquidation value for creditors. They are realising on an average 48 per cent of their claims through reorganisation, as compared to the erstwhile regime which recovered 26 per cent.

The Code provides a timeline of 180 days to conclude a corporate insolvency resolution process (CIRP), extendable by a one-time extension up to 90 days. Probably, no other regime in the world mandates a time-bound resolution. This push has meant that proceedings under the Code take on average about 300 days, including time spent on litigation, in contrast with the previous regime where processes took about 4.3 years.

The insolvency resolution process cost, which includes fee of insolvency practitioner and other professionals, and expenses related to meetings of committee of creditors (CoC), public announcements, filings and litigations, etc., have been 0.5 per cent of the realisation by the creditors in contrast with a cost of 9 per cent under the previous insolvency framework.

Given the significant reduction in cost and time of insolvency proceedings, the Code has become the preferred mode for insolvency resolution of a defaulting firm. This explains why about 15,000 applications were filed with the Adjudicating Authority for initiation of CIRP during the last two years. There are thousands of instances where debtors have settled their debts immediately on filing of an application for initiation of CIRP, but before it was admitted.

There are settlements after admission of an application also. With realisation of 48 per cent of claims through reorganisations coupled with pre-admission and post-admission settlements, the Code has proved to be an efficacious remedy even for loan recovery. With the Code in place, the defaulter's paradise is lost. The strength of an insolvency framework is a function of four indices relating to commencement of proceedings, management of a firm's assets, reorganisation proceedings, and creditor participation.

Bankable The IBC has all the essential elements and practices that any mature insolvency regime GETTY IMAGES/ISTOCKPHOTO

A threshold amount of default entitles a stakeholder — a financial creditor, an operational creditor or the debtor itself — to commence CIRP of the firm. A stakeholder files an application for commencement of CIRP which may end up either with reorganisation of the firm as a going concern or liquidation of the firm. The Code does not envisage separate applications or processes for reorganisation and liquidation.

Managing the assets

As regards management of a firm's assets, the Code facilitates continued operations of the firm during CIRP. An insolvency practitioner manages the affairs of the firm as a going concern and protects and preserves the value of its property. He may discontinue overly burdensome contracts and file applications with the Adjudicating Authority for avoidance of vulnerable transactions. He may also raise interim finance to carry on the business of the firm. The interim finance and the cost incurred in raising such finance is included in the insolvency resolution process cost, which gets priority over all other claims in the insolvency proceeding. The Code prohibits discontinuation of supply of essential goods and services to the firm during CIRP.

The Code envisages a resolution plan for reorganisation of a defaulting firm. The identification and approval of the best resolution plan require two abilities, namely, the ability to restructure the liabilities and the ability to take commercial decisions. In view of their abilities, the CoC typically comprises financial creditors. Where there is no financial creditor, it comprises operational creditors.

Irrespective of the composition of the CoC, other stakeholders have a right to receive the agenda and participate in the meetings of the CoC and the claims of all creditors, who are not part of CoC, are also met through reorganisation. In sync with the objectives of the Code, a resolution plan is required to balance the interests of all stakeholders and dissenting creditors and assenting creditors get similar treatment.

The CoC takes major decisions on behalf of the firm under CIRP. It appoints the insolvency practitioner to run the operations of the firm as a going concern and run the process as well.

Any creditor may seek any information about the firm's business and financial affairs from the insolvency practitioner. Any creditor may contest the decision of the insolvency practitioner accepting or rejecting its own claims or claims of other creditors.

Though the Code does not envisage sale of assets of the firm during CIRP in view of its focus on revival, it allows limited sale under stringent conditions, with prior approval of the CoC.

It is a matter of satisfaction that within two years of the enactment of the Code, the Indian insolvency regime has all the essential elements and practices that any mature insolvency regime ought to have. Not surprisingly, it bagged the award for the 'Most Improved Jurisdiction' for 2018 from the Global Restructuring Review. Hopefully, it will also pass with flying colours in the ongoing examination of the World Bank.

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