

Five Years of the Insolvency and Bankruptcy Code, 2016



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"It is not the strongest of the species that survives, nor the most intelligent, but the one most responsive to change."

- Charles Darwin

Charles Darwin's philosophy of embracing perpetual change for survival befits order of the economy just as much as the order of the ecology. Economic order is maintained through a

careful calibration of macroeconomic policies and economic legislations that evolve to meet changing market dynamics. Macroeconomic policies are undoubtedly the most visible forms of government interventions that aim to boost economic growth and prosperity. Policy discourse in the short term is often centred around these visible fiscal and monetary interventions that seek to correct market failures and restore market equilibrium. However, there is growing consensus that economic legislations, particularly those that determine the quality of business regulations and are 'enablers' of economic activity, are vital organs that impart strength, stability and steady growth to the economy. These 'enablers' of economic growth help in removing 'various types of unfreedoms (exclusion from opportunities)' that prevent where these unfreedoms reduce peoples' capacity to exercise "their reasoned agency."¹ One of these unfreedoms is the lack of an institutional and legal framework that allows businesses to exit in case of honest business failures. To fill this void, the insolvency and bankruptcy law of a jurisdiction comes into play.

The objective of an insolvency and bankruptcy law is to provide an orderly process for the reorganisation or liquidation of insolvent entities. On one hand, it provides a legislative framework for winding up of a business if it is unviable due to economic failure and cannot be brought back to life. On the other hand, in case of financial failure of the firm, implying that the firm may be viable but is under stress, the process provides for a resolution mechanism where the business can be resurrected back to life, in a new form with a new or revamped management. In other words, the law provides comfort in the form of a safety net for business activity by offering mechanisms for rescue or value maximising

exit from business. An effective system for insolvency resolution must be able quickly to distinguish between those firms that can be saved and those that must exit fast.

In the absence of an exit mechanism, either for the firm or the entrepreneur even when it is in deep distress, the Indian economy suffered the inefficiencies of several zombie entities in the system. Given that the resources are scarce, and failures are routine in a dynamic market economy, India needed a codified and structured market mechanism to put the under-utilised resources to more efficient uses continuously and free entrepreneurs from failure. With the enactment of the Insolvency and Bankruptcy Code, 2016 (Code/IBC) on May 28, 2016, India ushered in a modern insolvency and bankruptcy regime in the country.

Five years of a landmark economic legislation

The IBC has been a game changer in the realm of economic legislations with a remarkable journey to its credit and a sincere attempt to resolve pressing issues of our times. Not only were all the elements for its effective roll-out put in place in rather a short amount of time, these elements of the ecosystem have evolved and stood the test of time. Today, the Code is a well-oiled apparatus, buttressed by a thriving ecosystem comprising of about 3500 Insolvency Professionals, three Insolvency Professional Agencies, about 80 Insolvency Professional Entities, one Information Utility, 16 Registered Valuer Organisations, more than 3900 Registered Valuers, several benches of the Adjudicating Authority with pan India presence and a massive volume of jurisprudence that has facilitated the cause of the Code time and again.

Five years into operation, the outcomes under the IBC have been more than encouraging for all stakeholders. The Code has rescued lives of corporate debtors (CDs) in distress through resolution and at the time same time has aided filtering out of unviable firms through timely liquidation. The Code has rescued 348 CDs till March, 2021 through resolution plans, one third of which were in deep distress. On the flip side, it has referred 1277 CDs for liquidation, three-fourth of which were either sick or defunct. The CDs rescued had assets valued at Rs. 1.11 lakh crore, while the CDs referred for liquidation had assets valued at Rs. 0.46 lakh crore when they were admitted to corporate insolvency resolution process (CIRP) under the Code. Thus, in value terms, around three fourth of distressed assets were rescued on account of the Code.

The Code has also facilitated recovery of non-performing assets by banks. RBI data indicates that as a percentage of claims, scheduled commercial banks have been able to recover 45.5 per cent of the amount involved through

IBC for the financial year 2019-20, which is the highest as compared to recovery under other modes and legislations.

The Code, being preventive in nature, is also to an extent a behavioural law, having brought about a cultural shift in the dynamics between lenders and borrowers, and promoters and creditors. It has made an impact in the way repayment of debts are being viewed and treated by promoters and management of the defaulting firms. The first signs of distress now serve as early warnings for management to take corrective actions to avoid defaults. Thousands of debtors are resolving distress in early stages of distress when default is imminent, on receipt of a notice for repayment but before filing an application, after filing application but before its admission, and even after admission of the application, and making best effort to avoid consequences of resolution process. Most companies are rescued at these stages. Till March, 2021, 17,305 applications for initiation of CIRPs of CDs having underlying default of Rs. 5,33,145 crore were resolved before their admission. Only a few companies, who fail to address the distress in any of earlier stages, pass through the entire resolution process.

Timelines have been significantly streamlined under the Code. Unlike the previous regimes which could take as much as 4.3 years to close an insolvency proceeding², the Code has compressed timelines to an average of 406 days (after excluding the time excluded by the Adjudicating Authority) for resolution of 348 CIRPs and 351 days in case of 1277 CIRPs that yielded liquidation by the end of March, 2021.

The Bankruptcy Law Reforms Committee, which conceptualised the Code, was of the view that under a common law in the form of the IBC, resolution can be synchronous, less costly and help more efficient recovery. Till March, 2021, resolution of about 322 CIRPs (for which data was available) costed on an average 0.92 per cent of liquidation value and 0.49 per cent of resolution value. This is a significant improvement in comparison to the erstwhile regime that entailed a cost of almost 9 per cent of estate value³.

As prescribed by Charles Darwin, the key to survival is continuous change. The Code is an embodiment of this prescription, having been amended six times over the last five years. Each amendment added tremendous value to the Code, moulding it appropriately to match the emerging needs of the market and self-correcting its way in anticipation of possible pitfalls. The recent amendment to the Code that introduced provisions for pre-packaged insolvency resolution process for MSMEs, especially in the wake of the financial distress caused by the COVID-19 pandemic, is a case in point.

The aforementioned outcomes of the Code have been recognized globally, reflected by the improvement India's ranking in ease of resolving insolvency indicators internationally. India's rank moved up from 136 to 52 in terms of 'resolving insolvency' in the last three years in the World Bank Group's Doing Business Reports. In the Global Innovation Index, India's rank improved from 111 in 2017 to 47 in 2020 in 'Ease of Resolving Insolvency'.

Through the looking glass

The Code has been navigating uncharted waters for the past five years. In this journey, many milestones have been achieved and a lot many lessons have been learnt. However, this journey into the unknown is far from over as the next big stops viz. cross border insolvency, enterprise group insolvency, remaining elements of individual insolvency and fresh start process, are yet to be explored. Further, the use of pre-packaged insolvency resolution process for MSMEs will also gain traction in the market in the near term. To match the growing bandwidth of the Code, it is expected that the ecosystem comprising of professionals and institutions will also grow in capacity and competence to meet the expectations of the market and stakeholders. Supported by the commitment of the government, the judiciary and the players of the ecosystem, it is hoped that the gains made so far will only magnify going forward and the challenges on the way will be dealt with the same commitment and alacrity as has been done over the last five years.

Views expressed are personal

¹ World Development Report (2017), Governance and The Law, World Bank Group Flagship Report

² As per World Bank's Doing Business Reports

³ Ibid