Individual Insolvency: The Next Big Thing

After having passed several milestones in corporate insolvency, it is time to chart the route for individual insolvency with clear phasing, sequencing, timing and destination.

In the two years since the enactment of the Insolvency and Bankruptcy Code, 2016 (Code), the entire ecosystem comprising the Adjudicating Authority (AA), the Insolvency and Bankruptcy Board of India (IBBI), Insolvency Professional Agencies (IPAs), Insolvency Professionals (IPs), Information Utilities (IUs), Registered Valuers Organisations (RVOs) and Registered Valuers (RVs) has been in place. The provisions relating to corporate insolvency resolution, including fast track resolution, corporate liquidation and voluntary liquidation have been operationalised with considerable success. The behavioural changes, as anticipated from the Code, are clearly visible on the ground. It is time now to focus on the next big thing, the individual insolvency.

Individual insolvency framework pursues the objectives enshrined in the Code. It prevents creditors from harming the debtor by racing to be the first to recover their dues, and thereby facilitates resolution of insolvency. It facilitates an individual to get in and get out of business, undeterred by honest business failure, and thereby promotes entrepreneurship. It increases creditor's expected returns and thereby promotes availability of credit. It does not take away future income of the debtor after fresh / earned start and thereby does not undermine incentive to work. It relieves the debtor of the burden of debt and isolates minimum assets for his subsistence, while improving the prospects of realisation for creditors, thereby ensuring fairness and equity. These objectives are extremely important in the Indian context, where proprietorship and partnership firms have significant contribution to income and employment, and informal financial creditors (FCs) account for a significant share of credit.

Vis-à-vis Erstwhile Framework

In case of default by an individual, a creditor typically had two remedies - against the person of the debtor and / or against his property. Historically, the remedy was directed against the person. In ancient times, the creditor had the liberty to take the debtor, and often his family, into debt slavery. Reportedly, Genghis Khan used to hang the debtor who became bankrupt for the third time. The 19th century insolvency enactments provided considerable relief to debtors from harassment, while allowing creditors relief against the property of the debtor. A recent research ('Bombay's People 1860-98, Insolvents in the City' by Asiya Siddiqui) evidences that 85% of the 20,980-odd petitioners, who filed for bankruptcy in Mumbai between 1860 and 1898, got protection from arrest or detention.

Two subsequent enactments, namely, the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920, are in force today. The Code makes several improvements over these two enactments. With its focus on rehabilitation of the debtor as opposed to adjudging him as insolvent, the Code: (a) provides an objective trigger for initiation of insolvency resolution process instead of relying on the commission of an 'act of insolvency'; (b) mandates a moratorium which provides a breathing space for the debtor and creditors to negotiate a repayment plan; (c) uses independent and qualified professionals to assist the stakeholders and the AA in conduct of processes; (d) prescribes a linear process, in which bankruptcy typically follows the failure of the insolvency resolution process; (e) enables automatic discharge instead of requiring that discharge be granted by the AA on the satisfaction that the insolvent has conducted himself well in the run up to and during insolvency; (f) provides a more comprehensive regime, including a debt relief in the form of 'fresh start', and keeps certain assets of the debtor beyond the reach of creditors for the subsistence of the debtor.

Part III

Part III of the Code provides for three processes for individual insolvency resolution, on default of a threshold amount:

(a) Fresh Start Process: This is available only to those debtors who have an annual income ≤ Rs.60,000, assets ≤ Rs.20,000, debts ≤ Rs.35,000 and do not have a dwelling unit. Only the debtor can file an application for fresh start for discharge of his debt. A resolution professional (RP) examines the application and submits a report to the AA, recommending acceptance or rejection of the application. On consideration of the report of the RP, the AA passes an order, either admitting or rejecting the application. If the application is admitted, the creditors have an opportunity to object to the process on limited grounds. On conclusion of the process, the AA passes an order for the discharge of the debtor or revokes the admission of the application. The discharge order writes off the unsecured debts, allowing the debtor to start afresh, subject to an entry in the credit history.

(b) Insolvency Resolution Process: This provides a framework for the debtor and creditors to collectively renegotiate a repayment plan under the supervision of an RP. The debtor or a creditor may make an application for initiation of the process. If the application is admitted by the AA, a public notice is issued inviting claims from all creditors. The debtor then prepares a repayment plan, in consultation with the RP. If the plan is approved by 75% of the voting share of the creditors, and thereafter by the AA, the RP supervises its implementation. On execution of the repayment plan, the AA issues a discharge order releasing the debtor from its liability in terms of the plan, and the debtor gets an 'earned start'.

(c) Bankruptcy Process: If resolution process fails or repayment plan is not implemented, the debtor or creditor may make an application for the initiation of bankruptcy process. If the application is admitted, the AA passes a bankruptcy order and appoints a bankruptcy trustee, followed by an invitation of claims from creditors. The bankruptcy trustee investigates the affairs of the bankrupt, realises the estate of the bankrupt and distributes the proceeds in accordance with the priority provided in the Code. He submits a report of administration of the estate of the bankrupt to the committee of creditors for approval. On expiry of one year from the bankruptcy commencement date or within seven days of the approval by the committee of creditors, the bankruptcy trustee applies for a discharge order and the AA passes a discharge order. This discharge order releases the debtor from the bankruptcy debt. The bankrupt, however, suffers certain disabilities during the period of bankruptcy process.

Vis-à-vis Corporate Insolvency

Individual insolvency framework differs from that of corporate insolvency on many aspects:

(a) Corporates are artificial persons with a broadly uniform structure. The Code provides a uniform process for resolution of their insolvency. It, however, categorises individuals into three categories and expects customised processes for resolution of each of the categories.

(b) There is no automatic debt relief in case of corporate entities. Individual insolvency, however, offers a fresh start process which grants automatic debt relief for a set of debtors where chance of recovery is low as compared to the efforts involved. While a corporate resolution process may yield into liquidation process, fresh start process never yields into bankruptcy process.

(c) A corporate entity and its business can be re-organised or liquidated and sold in bits and pieces. The business, if any, of an individual can be re-organised. The individual cannot, however, be liquidated or sold.

(d) Commencement of liquidation is automatic on failure of corporate resolution process. However, it is not so in the case of individual insolvency. A fresh application needs to be made either by the debtor or a creditor for commencement of the bankruptcy process, after failure of resolution process.

(e) Only on completion of liquidation, a corporate is dissolved. The bankruptcy process does not affect or is not affected by the existence of the debtor. It is not closed even on the death of the debtor.

(f) The Code does not envisage an RP to supervise the implementation of resolution plan for corporates. However, he supervises implementation of repayment plan under the individual insolvency.

(g) The National Company Law Tribunal is the AA for insolvency of corporate entities and personal guarantors to corporate entities undergoing corporate processes. The Debt Recovery Tribunal is the AA for insolvency of individuals.

Phasing

The Code envisages insolvency resolution of three categories of individuals, namely, personal guarantors to corporate debtors (CDs), partnership firms and proprietorship firms, and other individuals. Each category is unique and needs a separate dispensation for resolution of its insolvency. A category may have several sub-categories, each of which may require customised process. Further, the stakeholders need guidance on how to use the insolvency processes to their advantage. Given the scale of the country with 1.3 billion citizens, the road to implementing the insolvency regime for individuals is an uphill one and the learning curve is very steep. An appropriate phasing and sequencing of implementation of individual insolvency is essential, in sync with the legislative intention.

In the first phase, the provisions of the Code dealing with insolvency and bankruptcy of personal guarantors to corporates may be implemented. This would complement the corporate insolvency regime and put personal guarantors and corporate guarantors on a level playing field. The provisions of the Code dealing with insolvency of partnership and proprietorship firms may be implemented in the second phase. In the third phase, the provisions of the Code dealing with insolvency of other individuals may be implemented. This would enable learnings from earlier phases for design of the dispensation for subsequent phases and to have all stakeholders on board for the efficient implementation of Part III of the Code.

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