India insolvency code is a vital growth enabler: Let’s enhance it

- **By Amitabh Kant & Richa Roy**

The Insolvency & Bankruptcy Code (IBC) transformed India's approach to financial distress. Once, we were characterized by the notion that India transitioned from "socialism without an entry” to “capitalism without an exit." This paradigm shifted with the introduction of the IBC, which provided a much-needed mechanism to address insolvency issues in a time-bound and efficient manner.

The IBC, passed in May 2016, has played a transformative role in the Indian economy. At the time of its enactment, we were grappling with a twin balance sheet crisis, where Non-Performing Assets (NPAs) were hovering close to 12%. This resulted in the choking of fresh credit, which is the jet fuel for any economy, stalling economic growth. The IBC emerged as a lighthouse of a new era, ushering in what J. Nariman eloquently paraphrased from John Milton, as a “Defaulter’s Paradise Lost.”

It engendered a culture of corporate accountability and credit discipline. Credit contract regained their sanctity. A behavioural shift occurred for borrowers who repaid their debt. NPAs are now at the historic low, bank balance sheets are robust, credit is growing at a healthy clip, and **growth is back on track.** The IBC was successful because the entire ecosystem and the institutional infrastructure – from regulators, including the newly created IBBI, the legislature, the courts, the banks, and the market came together and played their part.

However, in 2024, we must acknowledge some concerns regarding the present functioning of the IBC, indicating a need for a second generation of reforms.

Analysis of IBBI’s own data shows that insolvency resolution at the National Company Law Tribunal averaged 716 days in the last fiscal year, up from 654 days in 2022-23. More concerning is the average time taken for the admission of cases, which stood at 468 days in FY21 and increased to 650 days in FY22. Recovery from defaulters under the Insolvency and Bankruptcy Code decreased in 2023-24 from the previous year, although 42% more cases saw resolution during that financial year. The rate of recovery fell to 27% of the creditors' admitted claims in 2023-24 from 36% in the previous year, pulling down the cumulative recovery since the IBC was introduced in 2016 to 32%.

However, recovery touched 85% of the fair value of stressed companies when admitted for resolution and 161.8% of the liquidation value. The creditors are applying for admission under IBC more than two years after the account has been NPA. Delay in filing applications is leading to a loss of value for the asset. The IBBI studies show that about 50% of value is eroded before the companies are admitted in IBC. Therefore, it is necessary that the creditors should apply for admission as early as possible. Moreover, the IBC allows for withdrawal in case of settlement with creditors post admission.

There is an inverse relation between time and value, and accordingly, the delays are depressing the value recovered. The institutional infrastructure needs significant augmentation to improve admission and resolution timelines.

Recent rulings regarding the IBC have deviated from the established position regarding: the supremacy of the commercial wisdom of the committee of creditors and the established waterfall of dues with the state dues being subordinated; the requirement for the NCLT to admit a petition when a financial debt exists, without exercising any measure of discretion.

Substantive changes to the IBC on issues of cross-border insolvency, creditor rights, sector-specific nuances, and pre-packs are necessary. The finance minister is cognizant of this and, in her Budget Speech, stated, “Appropriate changes to the IBC, reforms and strengthening of the tribunal and appellate tribunals will be initiated to speed up insolvency resolution.”

The IMF had termed IBC as a “big bang” reform. Let us examine its evolution. There have been three phases of the development of IBC since its inception:

Phase I: 2016-2020: The IBC as a statute utilized a combination of international best practices and India-specific reforms, considering ground realities. It adopted a creditor-in-control model, which was distinct from the US' Chapter 11 and somewhat similar to the UK system. The IBC sought to forge consensus among creditors and prevent holdouts by providing for cross-class cram down, ensuring that when 66% of creditors agree, it is binding on all.This model was protected by offering liquidation value, reflecting a World Bank best practice that has since been incorporated into the UK's Corporate Insolvency and Governance Act 2020. The IBC also established a new institution—a new regulator, the IBBI, which has been agile, adaptive, and adept at responding to the challenges of this transformative new law, along with specialized courts and a class of professionals known as resolution professionals. All arms of government and regulators worked together to ensure its success, with the judiciary providing crucial decisions that upheld the constitutionality and the architecture of the Act.

Phase II: 2020-2022: A moratorium on new cases was issued in March 2020 due to the COVID-19 pandemic, barring creditors from filing applications.Provisions were added to specify that no applications for initiation of Corporate Insolvency Resolution Process (CIRP) for defaults occurring during the COVID period could ever be filed. A modified version of the IBC was utilized to resolve non-bank finance company distress—one of the largest cases was the resolution of DHFL and stress of INR 85,000/

Phase III: 2022-Present: Since the resolution of the last cases, there has been a significant slowdown in the process.The capacity of the Tribunal is a major concern that impacts both speed and quality.Several important amendments, including those concerning cross-border insolvency and prepacks, are currently on hold.The increased use of private credit may necessitate the review and adjustment of upcoming legal frameworks.

Proposed Reforms:

- ***Tribunal Process Reengineering*:**

Justice delayed is justice denied. It is essential to minimize judicial bandwidth on administrative matters while opening non-core functions to innovative non-sovereign or private players to deploy technology for improved court management. Science and technology can solve pressing issues. We need to open our doors to the private sector and cutting-edge technology while carefully preserving the core of the sovereign judicial functions. For example, the privatization of passport Seva Kendras has resulted in a seamless process, and similar models could work for court processes. Innovations from global examples, such as the autonomous His Majesty's Courts and Tribunals Services in the UK can guide us in transforming our judicial processes. With investments in private capital and future-ready innovations, judicial process reengineering could enhance the administration of justice in India, thus significantly reducing arrears.

- ***Clarifying Ambiguity on Key Legal Principles***:

  It is necessary to clarify the position on government dues following the Rainbow case. The Rainbow Papers case highlighted the statutory priority of VAT vs. IBC, stating that the committee of creditors cannot secure their own dues at the cost of statutory dues owed to any Government. This seems to contradict the legislative intent behind the IBC, which aimed for lower priority for government dues compared to secured lenders and financial institutions. A statutory amendment is required.

- ***Addressing Legislative Lacuna on Cross-Border Insolvency***:

  India has yet to adopt a cross-border insolvency framework, under the UNCITRAL Model Law on Cross-Border Insolvency Framework. Sections 234 and 235 of the IBC provide only an enabling framework for cross-border insolvency, which is yet to be acted upon. We will need a model law on cross-border insolvency.

A comprehensive review of IBC was undertaken last year, and amendments are under consideration of the Government. These amendments are expected to reduce delays and increase the recovery to creditors. The progress we have made over the past eight years is commendable and has earned recognition. However, as we step into the next phase of our journey, continuous dialogue, collaboration, and innovation will be essential to strengthening our insolvency framework. Enhancing the IBC is a vital enabler of economic growth and creating a resilient and sustainable insolvency regime and robust economy.

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