The enactment of Insolvency and Bankruptcy Code in India is a culmination of 60 years and is perhaps one of the best reforms in the financial market. Till the year 1985, the legal framework for dealing with corporate insolvency and bankruptcy in India consisted of only one law - The Companies Act, 1956. This was followed by The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDBBI) under which DRTs were established. Finally, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) was enacted in 2002. Around the same time when SARFAESI Act was introduced, Reserve Bank of India introduced a Corporate Debt Restructuring Scheme.

The IBC has met with much success in its short period of 3 years. The success rate of companies under several regulations pre-2016 was abysmally low and varied from 16% to a maximum of 25%. In contrast, the success rate of companies under IBC in terms of closure is already at 41% and increasing! The recovery rate is 43%, up from 12% in FY15 through other mechanisms with defaulting promoters losing control of the company.

However, the working of the IBC could be made even more successful through some tweaks.

Firstly, out of 2542 cases admitted, around 1232 cases i.e. 48% are initiated by operational creditors, while financial creditors initiated around 43% i.e. 1086 cases and remaining 9% were initiated by corporate debtors. Given very small threshold limit of Rs 1 lakh, operational creditors seem to be more aggressive in dragging the Corporate Debtor into NCLT, eating the bandwidth of the courts and thereby delaying resolution of the bigger cases. Additionally, recovery through Lok Adalats and DRTs has declined significantly post FY16 alongside the number of cases referred, partly indicative of growing clout of the IBC mechanism for resolution of stressed assets. It seems even small creditors are preferring IBC rather than SARFAESI, DRT etc. and using the platform more as a recovery tool. This must be avoided. For such Government should first significantly increase the minimum threshold limit of Rs 1 lakh and second, increase the number of NCLT benches in the country.

Secondly, it is also observed that more than 23% of the admitted companies ended with liquidation. One way of looking into this is, at the time of lower demand and economic downturn there are not so many takers of the stressed assets and hence entities ended with liquidation. It is in this context, sectors such as Construction, EPC, Electricity etc. where there are no hard assets have also been dragged to NCLT. Efforts should be made to find a resolution of such companies outside the NCLT if possible, as these could save resources and time for the already hard pressed NCLT benches!

Thirdly, for IBC to be successful in India, culture should be increasingly playing a role! Culture plays a substantial role in Chinese laws, especially its bankruptcy laws. Same is in Japan.

Finally, we firmly believe that the IBC could perhaps fast track the development of corporate bond market in India!

### The Road to IBC: 60 years of Changes in Law Beginning 1956

- Till 1985, the legal framework for dealing with corporate insolvency and bankruptcy in India consisted of only one law - The Companies Act, 1956. Despite several sections addressing the resolution process, the original Act of 1956 was incapable of dealing with corporate insolvencies.

- In 1985, the Sick Industrial Companies Act, 1985 (SICA) was enacted. The SICA had several shortcomings, and abuse of Section 22 of SICA is often highlighted as an example of the inherent deficiency in its provisions.

- This was followed by The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDBBI) under which DRTs were established. Initially the system functioned well. But as time progressed Act failed to make any improvements in the muddled insolvency landscape, primarily due to the fact that SICA had precedence over RDBBI.

- Finally, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) was enacted in 2002. Around the same time when SARFAESI Act was introduced, Reserve Bank of India introduced a Corporate Debt Restructuring Scheme (“CDR Scheme”) that provided broad guidelines for debt restructuring by Banks. It was thus clear by the year 2010 that a single, comprehensive framework was needed to effectively tackle delay in insolvency and bankruptcy proceedings. Thus the IBC was established!

**IBC HAS MANY SUCCESSES BUT IT MUST BE PURELY A RESOLUTION MECHANISM AND NOT A RECOVERY TOOL**

- Interestingly, this 60 years of Indian experience in insolvency resolution (till IBC came into existence) suggests a similar story as in the US (the first bankruptcy law was passed on April 4, 1800 in USA).

- The success rate of companies under several regulations pre-2016 was abysmally low and varied from 16% to a maximum of 25%. In contrast, the success rate of companies under IBC in terms of closure is already at 41% and increasing! The recovery rate is 43%, up from 12% in FY15 through other mechanisms with defaulting promoters losing control of the company.

---

**Resolution Mechanism in India**

<table>
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<tr>
<th>Quarter</th>
<th>No. of CRPs at the beginning of the Quarter</th>
<th>Admitted</th>
<th>Appeal/Review</th>
<th>Withdrawn under section 12A</th>
<th>Approval of Resolution Plan</th>
<th>Commencement of Liquidation</th>
<th>No. of Corporates undergoing Resolution at the end of the Quarter</th>
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*Source: RBI; IBBI; SBI Research*
As per the latest available number with IBBI, 2542 cases were admitted up to Sep’2019, wherein 1045 cases were closed either by way of appeal/review, Resolution plan, Liquidation etc. and 1497 cases are ongoing process.

The main feature of the IBC was that there would be a time-bound settlement of insolvency and faster turnaround of businesses. Further, the code was envisaged to make it easier for financial institutions and banks to deal with NPA and have a faster and non-invasive resolution process. As of March 2019, the average resolution time for the resolved 94 cases was 324 days vis-à-vis the stipulated insolvency resolution timeline of 270 days.

It is also observed that out of 2542 cases admitted, around 1232 cases i.e. 48% are initiated by operational creditors, while financial creditors initiated around 43% i.e. 1086 cases and remaining 9% by corporate debtors.

Given very small threshold limit of Rs 1 lakh, Operational creditors seem to be more aggressive in dragging the Corporate Debtor into NCLT eating the bandwidth of the courts and thereby delaying resolution of the bigger cases and defying the main objective of the IBC which is faster resolution and preserving economic value of the assets. Further, out of 1497 ongoing process, 36% of the cases are pending for more than 270 days from the date of admission.

Recovery through Lok Adalats and DRTs has declined significantly alongside the number of cases referred partly indicative of growing clout of the IBC mechanism for resolution of stressed assets. It seems even small creditors are preferring IBC rather than SARFAESI, DRT etc. and using the platform more as a recovery tool. This must be avoided.

Keeping in view of the increasing case load at IBC, Government should first significantly increase the minimum threshold limit of Rs 1 lakh and second, increase the number of NCLT benches in the country. This will declutter the system and release bandwidth to the NCLTs/NCLATs to achieve the desired objective that is faster resolution and preservation of economic value of the assets.

In 84% of the liquidation cases the realization value is less than the liquidation value.

It is also observed that more than 23% of the admitted companies ended with liquidation. One way of looking into it is, at the time of lower demand and economic downturn there are not many takers of the stressed assets and hence entities ended with liquidation. For example, liquidation of companies and capacity utilization are positively correlated. Our data from Q1 FY18 to Q2 FY20, indicate that the correlation ration between the above two is 0.67.

However, it is important to note that 72.86% of the CIRPs ending in liquidation (427 out of 587) were earlier with BIFR and or defunct. The economic value in most of these CD had already eroded before they were admitted into CIRP. Further in 84% cases (i.e. 494 cases) the resolution value is less than liquidation value.

Up to Sept’2019, 156 cases were resolved under IBC with a recovery Rs.1.38 lakh crore from the total admitted of Rs.3.32 lakh crore by Financial creditors i.e. 41.5%. It is pertinent to mention that liquidation value of all these 156 companies is Rs.74997 crore only and the realization by financial creditors is 184% of the liquidation value.

At the end of 30 September 2019, 498 corporate persons initiated voluntary liquidation. Most of these corporate persons are small entities. 289 of them have paid up equity capital of less than Rs.1 crore. Only 45 of them have paid -up capital exceeding Rs. 5 crore.
SECTOR-WISE BREAK-UP OF CASES ADMITTED TO CIRP

- Out of total 2542 admitted cases, 1043 cases are from manufacturing sector which includes basic metal, chemicals, textiles etc. followed by Real estate, Construction etc.
- It is also observed that sector such as Construction, EPC, Electricity etc. where there are no hard assets have also been dragged to NCLT, where the asset realization value is very less and hence the liquidation value.
- Efforts should be made to find a resolution of such companies outside the NCLT if possible as these could save resources and time for the already hard pressed NCLT benches!

RECENT SUPREME COURT JUDGMENT ON ESSAR STEEL IS CREDIT POSITIVE

- Recent Supreme Court Judgement on Essar Steel has not only settled the issue regarding standing of Financial creditors over the operational creditors but also settled various other conceptual issues. The judgment will go a long way in promoting private investment and restore confidence of financial institutions.
- This will boost the earnings in the coming quarters as most of the banks had made substantially provisions in the account. Even assuming a provision of 80%, there could be a recovery/write back of more than Rs 30,000 crore.

WILL IBC FACILITATE THE DEVELOPMENT OF CORPORATE BOND MARKETS?

- After the IBC came into force, SEBI Chairman in a Summit organized by CII in August 2017 said that: “From an investors’ standpoint, an effective and robust bankruptcy regime is important for developing the corporate bonds market. Investors have been shying away from low-rated corporate bonds and even if the rating is of investment grade, given the high rate of defaults.”
- The recent empirical work on links between corporate bond markets and bankruptcy system predict that safe firms will issue bonds but higher risk firms for which insolvency is more likely, issue bonds as long as bankruptcy is efficient! Clearly, this might require more analysis in Indian context.
- The study goes on to conclude that by bringing all countries up to U.S. bankruptcy recovery (82%), it is estimated to increase the size of the global corporate bond market by almost $1 trillion, or around a quarter of the current size. Much of this increase would happen in high-yield bonds.

ROLE OF CULTURE

- For IBC to be successful in India, culture must play a role. As an example, there is distinct difference in the attitude towards debt in Asian societies. For example, Japan makes bankruptcy a personal failure, not a business failure. This characterization of bankruptcy in Japan often leads to tragedy for the individual, be it isolation from family or otherwise. Culture plays a substantial role in Chinese laws, especially its bankruptcy laws. If a father owes a debt, his sons or grandsons would be responsible for it; bankruptcy implies a life of burden for generations to come.
- Is Indian culture any different? Interestingly, in India the ordinary household even like the poor farmers take it personally upon themselves to repay their debt. Alternatively, making IBC successful in India could be just not a financial policy issue but should also be a cultural issue in the context of larger institutions.

Contact Details:
Dr. Soumya Kanti Ghosh
Group Chief Economic Adviser
State Bank of India, Corporate Centre
M C Road, Nariman Point
Mumbai - 400021
Email: soumya.ghosh@sbi.co.in
gcea.erd@sbi.co.in
Phone:022-22742440
@kantisoumya

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