

# Strengthening the Code

Success of the Insolvency and Bankruptcy Code hinges on timely resolution of stressed assets and a conducive ecosystem

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## Message from ASSOCHAM



**Balkrishan Goenka**

President, ASSOCHAM

The Insolvency and Bankruptcy Code (IBC) had been implemented with a view to consolidating insolvency and bankruptcy laws and addressing NPA issues affecting the economy.

Having gained traction since then, it has brought about a paradigm shift in the recovery and resolution process by empowering the creditor. It has also brought about a time-bound resolution process, through a transparent mechanism for creditors to recover their dues. While, investors also gain from available opportunities, the tendency of borrowers to default has been curbed. The resulting increase in M&A activity also has been driven by the lure of valuable assets being made available at attractive prices.

Over the past few years, the code has helped improve the governance framework, the result of which has been the improvement in India's Ease of Doing Business ranking.

It is commendable that in comparison to similar bankruptcy laws in other countries, its implementation in India has been far quicker, resulting in recovery of creditors' dues and protection of their rights.

While the IBC has been a landmark regulation, largely addressing concerns of industry, government and other stakeholders, some challenges do remain, as pertaining to the large number of cases to be disposed of by NCLT and integration of earlier regulations under the single body of the Insolvency & Bankruptcy Board of India (IBBI).

The National Conference on "*Insolvency & Bankruptcy Code*" being organised by ASSOCHAM would assess the journey of the IBC and provide the framework for a discussion for the way forward.

ASSOCHAM and CRISIL have prepared this knowledge paper, which would incite discussion on the issues and challenges faced by various stakeholders.

We hope this study would considerably help regulators, investors, organisations, government and researchers in further deliberations towards more effective implementation of the IBC.

I extend my best wishes for the success of the conference.

## Message from CRISIL



**Gurpreet Chhatwal**

President – Ratings, CRISIL

The Insolvency and Bankruptcy Code (IBC), which completes three years this month, has gained traction with every passing year and helped contain both existing non-performing assets (NPAs) and fresh slippages in the banking system.

As of March 2019, 94 cases had been resolved under IBC, with a recovery rate of 43% and an average resolution timeline of 324 days – much better than for other recovery mechanisms available.

Compared with the recovery rate of 27% for India as per the World Bank's Ease of Doing Business Report 2019, too, this is nothing short of an achievement. Little surprise, IBC has helped improve India's 'ease of doing business' ranking to 77 in 2019 from 130 in 2017.

Still, challenges remain – adherence to the IBC timeline being a major one. Of the 1,858 cases admitted in the National Company Law Tribunal (NCLT) under IBC, 1,143 cases were outstanding as on March 31, 2019. Of these outstanding ones, ~32% had surpassed the stipulated 270-day resolution timeline.

Then, there are other challenges such as burden on NCLT to resolve the large number of cases, clarity on priority of claims, limited number of information utilities, and creation of a secondary asset market, which need to be addressed.

This report touches upon all these issues, categorising them under four broad progress indicators, while presenting a bird's eye view of resolutions.

It is heartening to note that the government has been proactive in taking feedback from stakeholders and acting on that, as testified by the fact that the code has undergone two major amendments already. We believe the changes will support the overall governance framework and quicken resolution of NPAs.

We hope this report will form the basis for further deliberation among stakeholders and aid constructive action, for, as is the case with any law, IBC's success will hinge on effective implementation.

## Executive summary

Has the Insolvency and Bankruptcy Code (IBC), 2016, really been a game changer? That is the big question almost three years into its implementation.

To be sure, bad loans have emerged as the proverbial millstone around the neck of the Indian financial system. Despite a plethora of laws, recovery remains a cumbersome, protracted affair. Recovery via channels such as debt recovery tribunals and lok adalats, and The Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act have had limited impact. However, the government appears to have come out ahead of the curve. And it has been proactive in fixing the teething issues and bringing in changes via reforms and regulations.

Undoubtedly, IBC is a key reform in the path of strengthening identification and resolution of insolvencies in India and in an expedited manner. The code has provided creditors and other stakeholders the ammunition to obtain the maximum value for stressed assets by shifting the balance of power from debtors – a big plus.

In fact, the Reserve Bank of India's (RBI's) stressed assets resolution norms, coupled with increased resolution of large-ticket NPAs under the IBC framework, have contributed to recovery of NPAs, which ballooned to a massive level in the past.

As on March 31, 2019, under the Corporate Insolvency Resolution Process (CIRP), a resolution plan for 94 stressed assets was approved by the NCLT. For this set of 94 accounts, resolution has been reached for ~Rs 75,000 crore out of ~Rs 1,75,000 crore total claim of financial creditors admitted. That makes for a respectable recovery rate of 43%. Also, post implementation of the IBC, CRISIL estimates the banking sector's gross NPA (aggregate) dropped to ~10% in March 2019 from 11.5% at the end of fiscal 2018. Also, India's resolving insolvency score has improved to 40.8 in 2019 from 32.6 in 2016.

But it has not been smooth sailing. The average resolution timeline for the resolved 94 cases was 324 days vis-à-vis the stipulated insolvency resolution timeline of 270 days. Also, there are a few big-ticket accounts for which resolution has not been finalised for over 400 days. As on March 31, 2019, there were 1,143 cases outstanding under CIRP, of which resolution in 32% of the cases was pending for more than 270 days.

If a comparison is being drawn, though, this still is considerably faster than the recovery time of 3.5-4 years taken by asset reconstruction companies. Also, it is far better than the World Bank's 'Doing Business 2019' report, which pegs the recovery timeline for stressed assets in India at 4.3 years.

Meanwhile, the Supreme Court's (SC) recent judgment quashing the RBI's February 12, 2018, circular has given rise to a number of questions. The RBI circular had mandated referring stressed assets to NCLT if banks were not able to implement a resolution plan within 180 days of the date it became overdue. This was a stringent timeline given the processes banks are used to. The apex court's decision is supposed to give banks greater flexibility and time in resolving stressed assets, while stating that the provisions of the IBC would be available to them. Also, earlier in the quarter, IBC was upheld in toto by the Supreme Court, which is a huge positive.

Given the development, and the amendments we have seen already, the stressed assets resolution framework in the country is still a work in progress. The government will need to relook at the code based on stakeholder suggestion, and keep the credit lines well-oiled. But one thing is certain – there is no going back to the pre-IBC era.

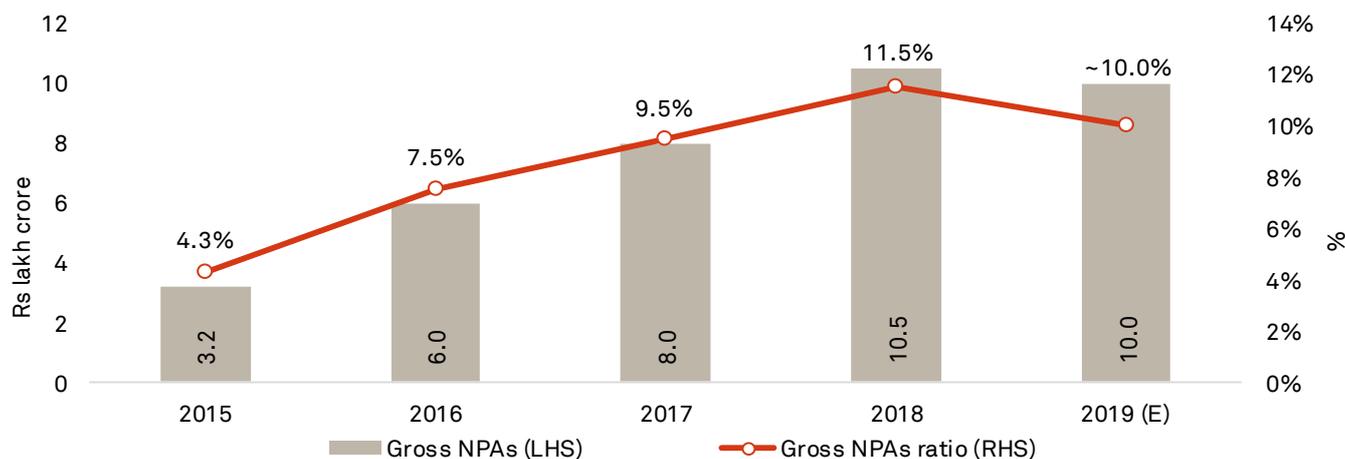
# 1. IBC has helped contain fresh NPAs in the Indian banking sector

## NPAs of banks to decline with fewer fresh slippages

Asset quality concerns in the banking sector peaked in the past few years with the sharp rise in non-performing assets (NPAs).

However, stringent stressed asset resolution norms of the Reserve Bank of India (RBI) coupled with increased resolution of large-ticket NPAs under the Insolvency and Bankruptcy Code (IBC), 2016 framework have contributed to the recovery of NPAs. Key amendments in the IBC would hasten the resolution of stressed assets. One of the amendments, i.e. Section 29 A, can render the promoters of the insolvent companies (*except those of micro, small and medium enterprises*) ineligible to bid for their own entity. This has instilled a significantly better sense of credit discipline. As per the Insolvency & Bankruptcy Board of India (IBBI) report, almost Rs 2.02 lakh crore of debt pertaining to ~4,452 cases were disposed of even before admission into the IBC as the borrowers made good the amounts in default to their creditors.<sup>1</sup> Given this, CRISIL estimates the banking sector's gross NPA (aggregate) dropped to ~10% in March 2019 from 11.5% at the end of fiscal 2018.

### Gross NPA trajectory

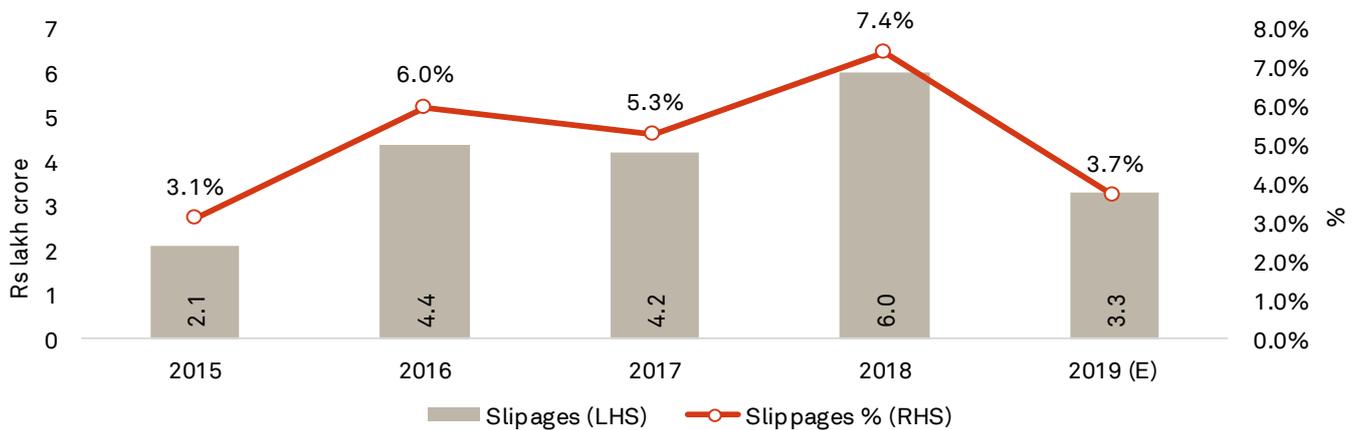


E: Estimated

Source: RBI and CRISIL analysis

<sup>1</sup> [https://ibbi.gov.in/webadmin/pdf/whatsnew/2019/Jan/Two%20years%20of%20insolvency%20and%20Bankruptcy%20Code%20\(IBC\)%20\\_%20Facebook\\_2019-01-03%2015:32:48.pdf](https://ibbi.gov.in/webadmin/pdf/whatsnew/2019/Jan/Two%20years%20of%20insolvency%20and%20Bankruptcy%20Code%20(IBC)%20_%20Facebook_2019-01-03%2015:32:48.pdf)

### Trend in slippages



E: Estimated

Source: RBI and CRISIL analysis

### Key contributors to help banks improve their asset quality

1. Incremental slippages to NPAs trending lower	2. Reduction in SMA-2 loans	3. Expected resolution of large-ticket accounts under IBC
<ul style="list-style-type: none"> <li>As most existing stressed assets have been recognised as NPAs and credit quality of corporates is on the mend (on the back of firm commodity prices, stable macros, and improvement in capital structure and debt protection metrics)</li> </ul>	<ul style="list-style-type: none"> <li>The quantum of stressed loans that had the potential to become NPAs in the near term have declined</li> </ul>	<ul style="list-style-type: none"> <li>Better recovery will reduce NPAs</li> </ul>

However, NPAs remain high in public sector banks, which will take a couple of years to reduce to levels seen before the surge in the past few years.

Further, the Supreme Court's (SC) recent move to quash the RBI's February 12, 2018 circular on resolution of stressed assets provides the banking system more flexibility and time in resolving stressed assets. While the RBI circular intended to speed up the resolution process, the apex court's ruling now puts the onus on banks for ensuring timely and effective resolution of stressed assets; the provisions of the IBC, though, continue to be available to them for resolution.

The banks' decisions to resolve stressed assets through IBC could be led by whether such accounts involve wilful defaults or have become stressed because of adverse business conditions and environmental factors. CRISIL has put out a press release dated April 3, 2019 on "SC ruling on RBI's norms to extend resolution timelines of NPA". (Please refer to the annexure for the press release.)

## 2. Better recovery rates under IBC vis-à-vis other resolution mechanisms

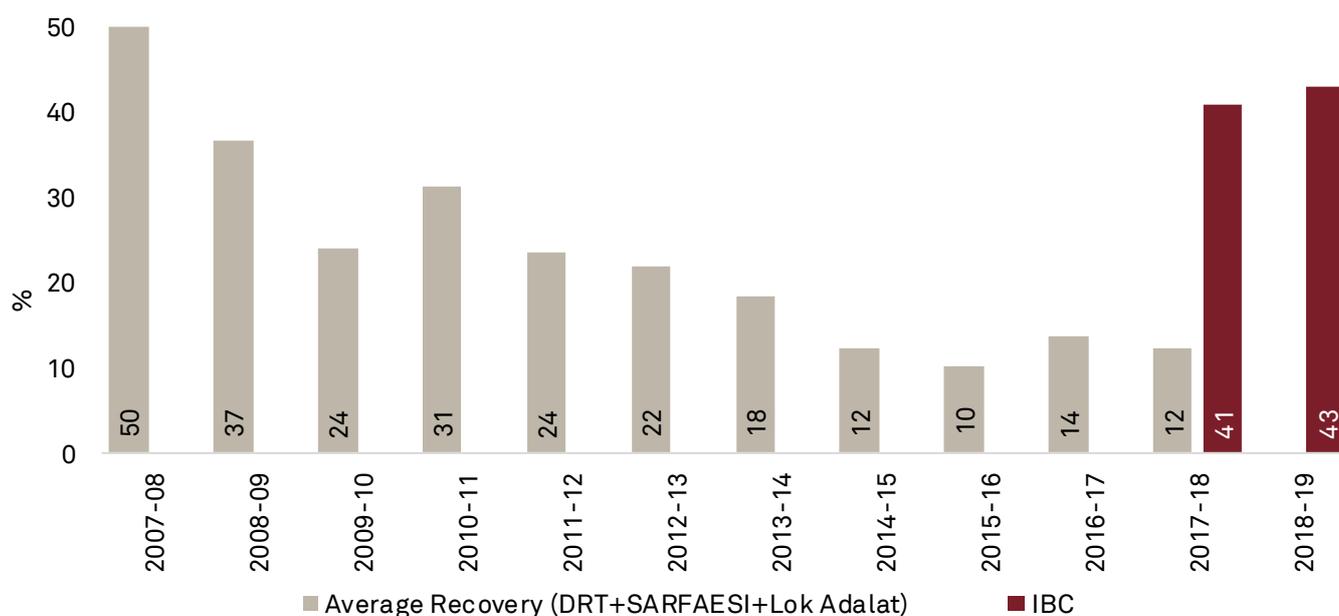
The enactment of the IBC has brought a sea change in insolvency resolution in India and shifted the balance of bargaining power from debtors to creditors. The focus is on optimum debt reduction, including through potential transfer of assets to a new management that can bring in the resources needed to scale up cash-flows. To be sure, IBC has structurally strengthened the identification and resolution of insolvencies in India in a faster manner.

As on March 31, 2019, under the CIRP, a resolution plan for 94 stressed assets has been approved by the National Company Law Tribunal (NCLT).

For this set of 94 accounts, resolution has been reached to the tune of ~Rs 75,000 crore as against total claims admitted of financial creditors (FCs) of ~Rs 1,75,000 crore, i.e. the recovery rate<sup>2</sup> is 43%, which is an improvement from 41% as of fiscal 2018. Had these 94 cases undergone the liquidation process, the recovery rate for the financial creditors would have been 22% which is significantly lower than the recovery rate through normal resolution process.

However, recovery through channels such as debt recovery tribunals, The Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act (SARFAESI Act), and lok adalats has been lower than expected on account of pendency of legal issues and infrastructure-related constraints.

### Recovery rates across recovery mechanisms

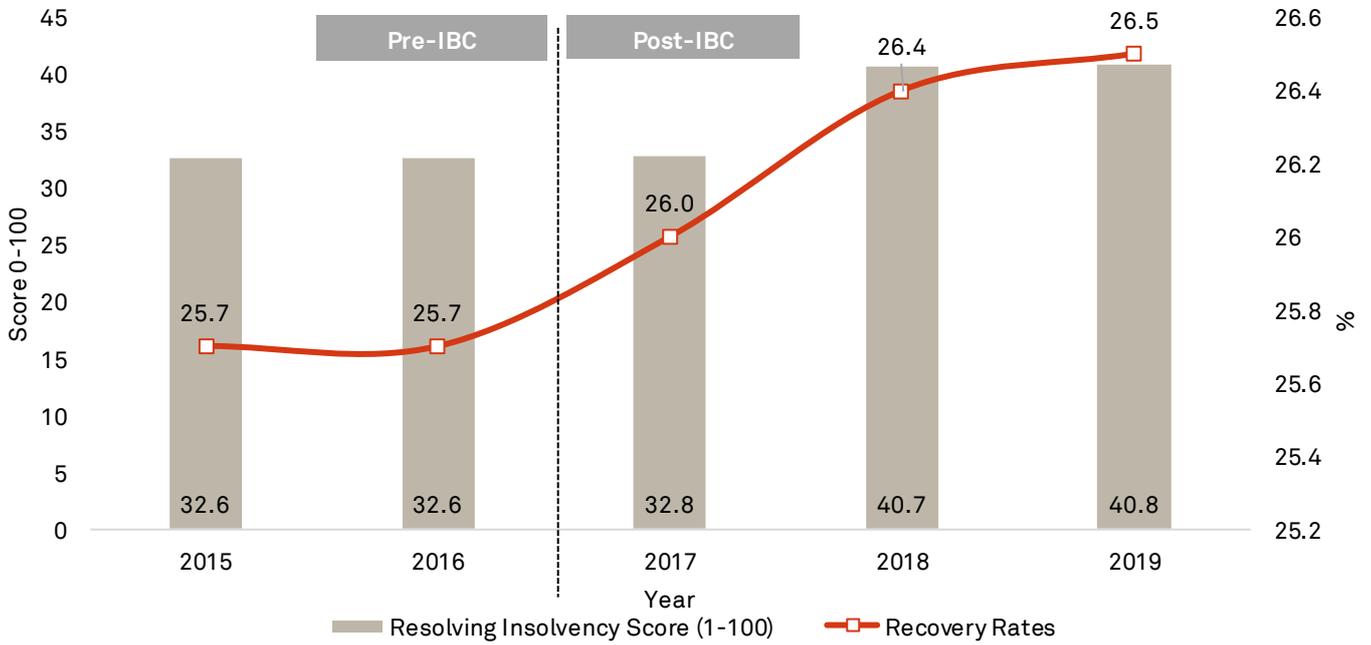


Source: RBI, IBBI

<sup>2</sup> Defined as resolution for FCs amount upon total claims admitted for FCs

Post IBC implementation, India’s resolving insolvency score (measured on a scale of 1 to 100: 1 being lowest and 100 being highest) has also improved to 40.8 in 2019 from 32.6 in 2016.

**Insolvency scores pre and post IBC**

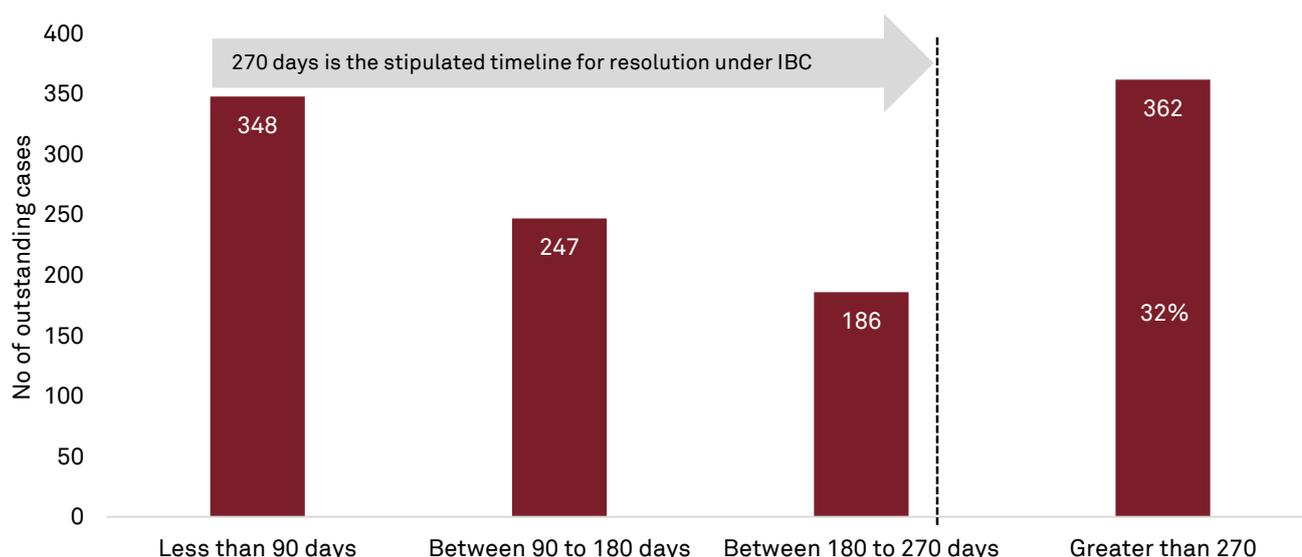


Source: Ease of doing business – World Bank reports 2015 to 2019

### 3. Adherence to IBC timelines still a challenge

As of March 2019, the average resolution timeline for the resolved 94 cases was 324 days vis-à-vis the stipulated insolvency resolution timeline of 270 days. Also, there are a few big ticket accounts for which resolution has not been finalised for over 400 days. In fact, as on March 31, 2019, the outstanding cases under the CIRP was 1143, of which resolution for 32% of the cases is pending for more than 270 days, which is substantial in number.

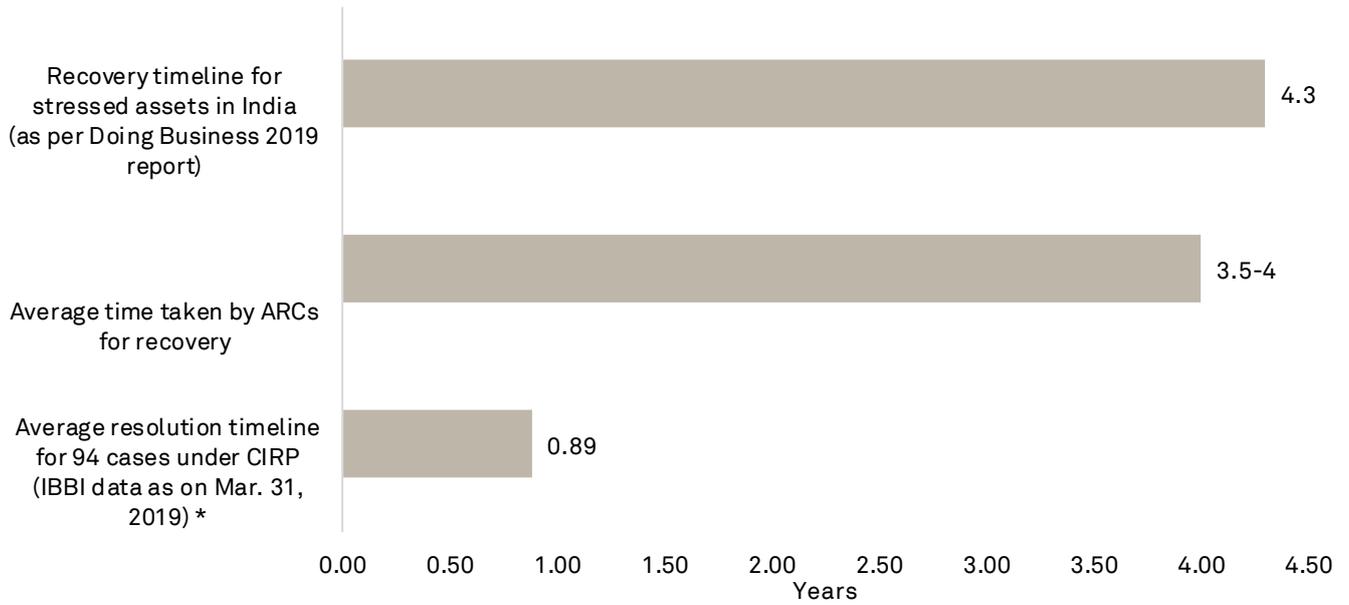
#### Resolution timelines for outstanding cases as of March 2019



Source: Insolvency & Bankruptcy Board of India (IBBI) newsletter – March 2019

However, if a comparison is being drawn, this is considerably faster than the recovery time taken by asset reconstruction companies (ARCs), which is 3.5-4.0 years. Also, as per the World Bank's 'Doing Business 2019' report, the recovery timeline for stressed assets in India is 4.3 years.

### Recovery timeline comparison



*\* Refers to only resolution timeline. Actual recovery timeline could be longer*

*Source: IBBI data, Doing Business 2019 report and CRISIL estimates*

While resolution in a time-bound manner remains a challenge along with other teething issues, the IBC, undoubtedly, since the time of its enactment has evolved considerably. Many amendments have been brought in to smoothen the processes and to instill discipline among stakeholders.

## 4. Key amendments of IBC – a long-term positive for resolution of stressed assets

Amendments to the IBC are an earnest attempt to address a number of issues faced in ongoing stressed assets cases, and will help reduce timelines, enhance transparency and improve realisation from their resolution. In fact, currently IBC consultation paper is out for public views.

### Key amendments and impact

Key amendments	CRISIL's view
Allow promoters of micro, small and medium enterprises (MSMEs) who are not categorised as wilful defaulters to bid for their assets	Promoters under genuine distress can participate in the bidding process. Will reduce liquidation proceedings and improve the bank's loan recovery rate
Pegs the rights of homebuyers on par with financial creditors	This ordinance classified homebuyers as other financial creditors (OFCs). They have a say in the CoC through a representative, along with the voting rights, as per their share
Section 29 (A) of IBC tweaked to exempt pure-play financial entities from being disqualified to bid for assets	Expands the eligible pool of bidders and will enable better price discovery and, therefore, lesser haircuts for banks
Lower the minimum voting threshold for the committee of creditors (CoC) to 66% from 75% for key decisions, and to 51% from 75% for routine decisions	Significantly improves the decision-making powers of the CoC and can reduce resolution timelines
Streamlines the bidding process by discouraging exits and late offers	Aids in bringing faster closure to the resolution process
Liberalisation of terms for interim finance during insolvency process	Will help resolution professional to keep the asset on a going concern basis and preserve its value

## IBC amendments address concerns of MSMEs

Micro, small and medium enterprises (MSMEs<sup>3</sup>) form the foundation of the Indian economy, and are key drivers of employment, production, economic growth, entrepreneurship and financial inclusion. As per the Annual Report of Ministry of MSMEs (2017-18), there are ~630 lakh MSMEs, which contribute significantly to industry output and export.

As on March 31, 2018, the NPAs in this sector was a substantial ~Rs 91,000 crore<sup>4</sup>. The main reason for the NPAs in the MSME sector is inaccessibility to timely working capital funding. Further, owing to large entities being taken into insolvency under IBC, MSMEs, which are typically operational creditors to these entities, usually suffer a credit crunch because of delay in receivables – this impacts the business sustainability of MSMEs, which may potentially lead to liquidation.

In order to address the concerns of MSMEs, the Insolvency & Bankruptcy Board of India (IBBI) introduced an amendment. Now, the promoters of MSMEs facing insolvency proceedings are permitted to bid under the IBC process (a relaxation under Section 29 A), unless they are wilful defaulters or there is any disqualification related to Section 240A (2) of the IBC Act, 2016. This would:

- Avert liquidation of the entity as well as increase the chances of receiving better resolution proposals from its promoters under CIRP, and, hence, put the company back on track
- Help protect the interest of the stakeholders of the MSME to a large extent and ensure continued employment

While the code is taking shape via amendments to help and protect stakeholders, the underlying ecosystem is also being evolved, which is setting a base for smooth implementation of the code.

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<sup>3</sup> Companies engaged in manufacture or production of goods in any industry - Investment in plant and machinery ranging from less than Rs 25 lakh to Rs 10 crore; Companies engaged in providing services - Investment in equipment ranging from less than Rs 10 lakh to Rs 5 crore;

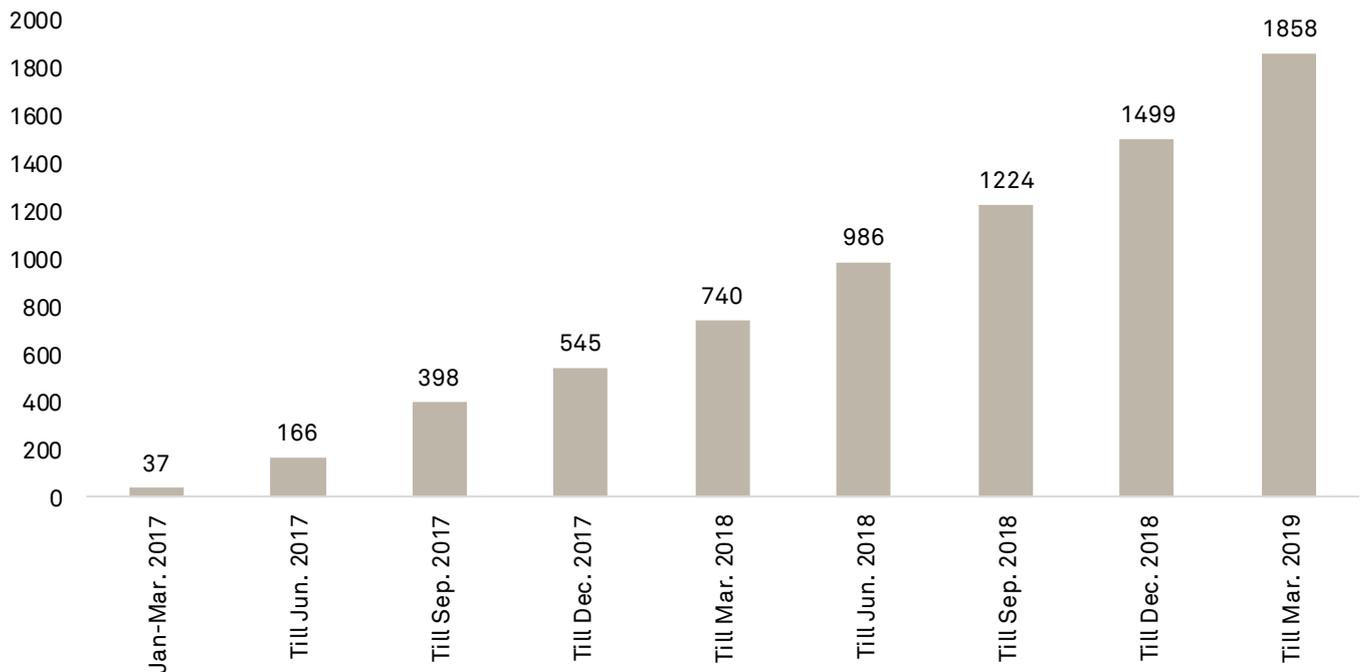
<sup>4</sup> Source: RBI report on trend and progress of banking in India 2017-18

## 5. Conducive ecosystem for effective implementation of IBC

### Rise in number of cases referred to NCLT

Post enactment of the IBC in May 2016, IBBI was set up on October 1, 2016, with various mechanisms under its purview. There has been significant progress since. 1,858 cases have been admitted through CIRP to NCLT benches till March 2019 versus 37 cases till March 2017.

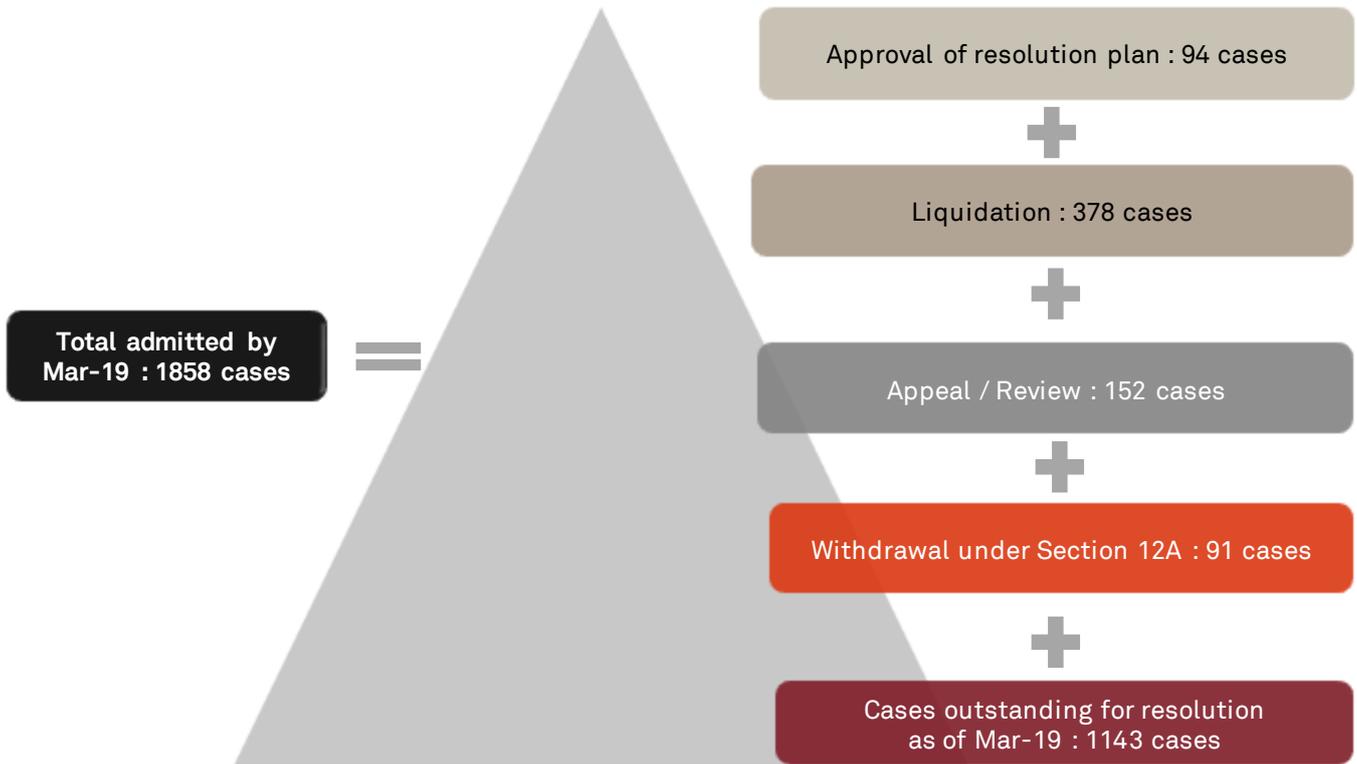
### Number of cases admitted in NCLT (cumulative)



Source: IBBI

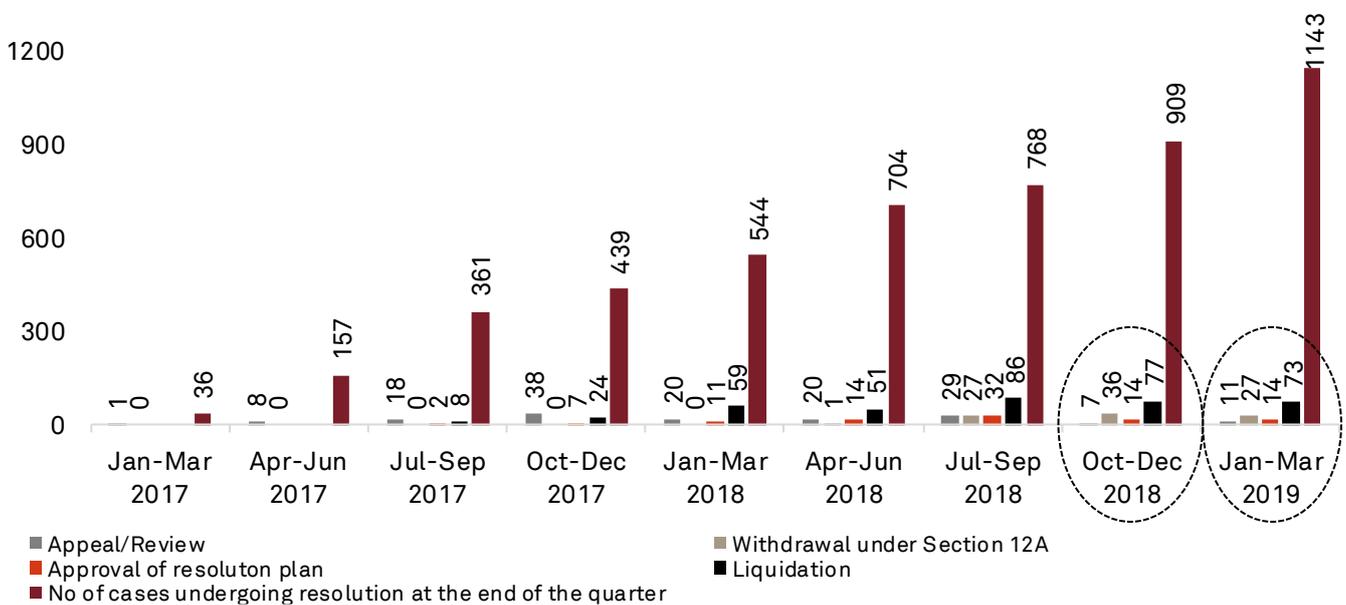
As of March 2019, NCLT benches had approved resolution plans and liquidation orders in 94 and 378 CIRP transactions, respectively, whereas 152 CIRPs that were admitted were set aside for appeal or review or settlement. Further, 91 cases were withdrawn under section 12A of the IBC.

### Summary of cases admitted under IBC



Source: IBBI

### Approval of resolution plan / liquidation spurred in recent quarters (circled)



Source: IBBI

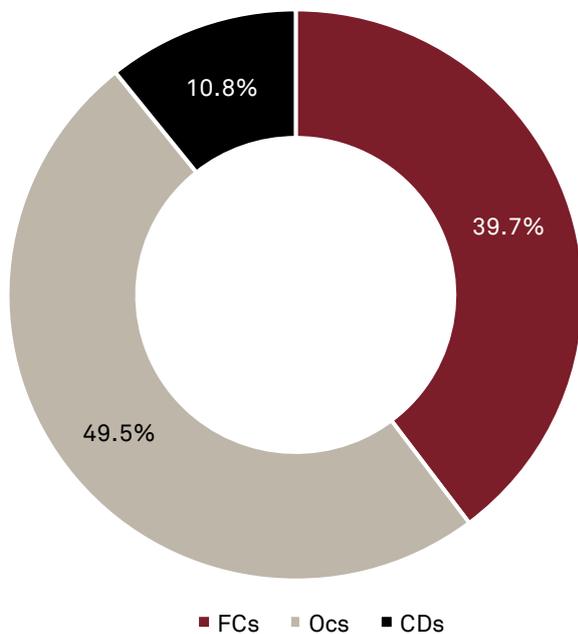
## Creditor-friendly regime

The IBC has enhanced the rights of a creditor (irrespective of the type, i.e. whether it is a financial or operational entity), and has improved the identification of bankruptcies and initiation of resolution proceedings.

It has especially empowered operational creditors (OCs) such as trade suppliers, employees and workmen to initiate the insolvency resolution process – a provision that was not available in either earlier restructuring mechanisms or current ones such as SARFAESI Act 2002 and the Recovery of Debts Due to Banks and Financial Institutions Act, 1993.

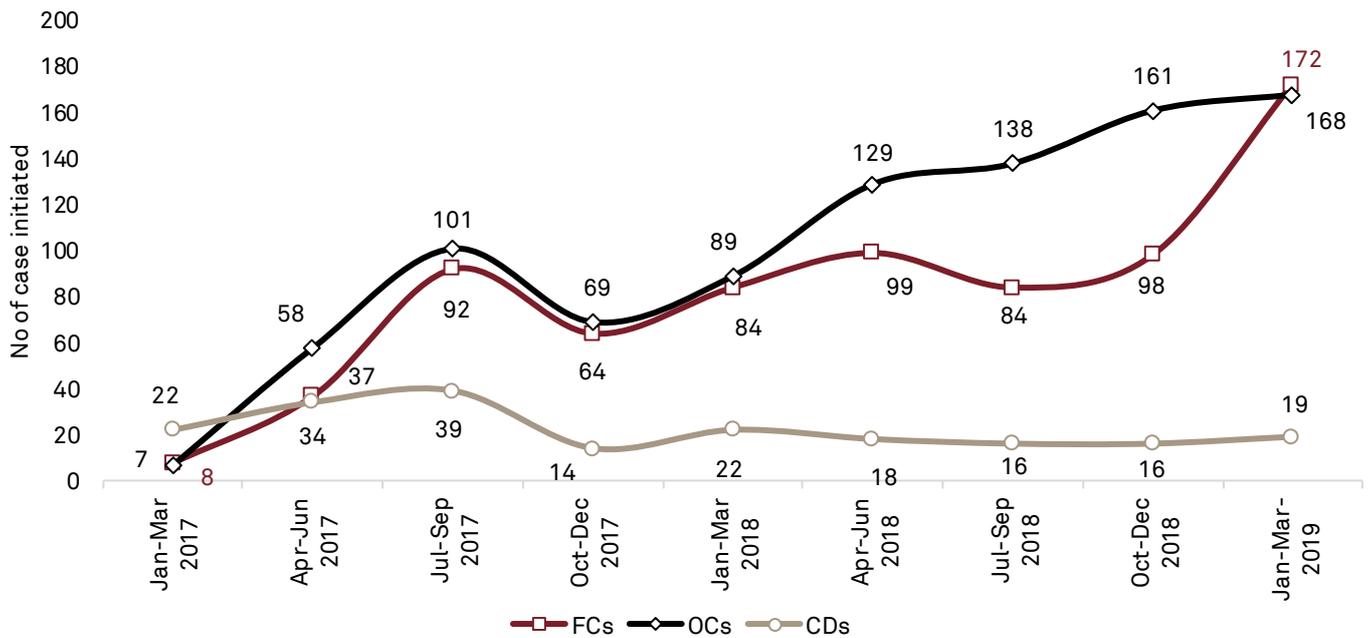
Thus, it is no coincidence that the number of CIRPs initiated by OCs is more than that of financial creditors (FCs) and corporate debtors (CDs), though both have seen significant increase.

### Share of CIRP applications initiated by OCs, FCs and CDs



Source: IBBI

### CIRPs triggered by OCs and FCs jumped last fiscal



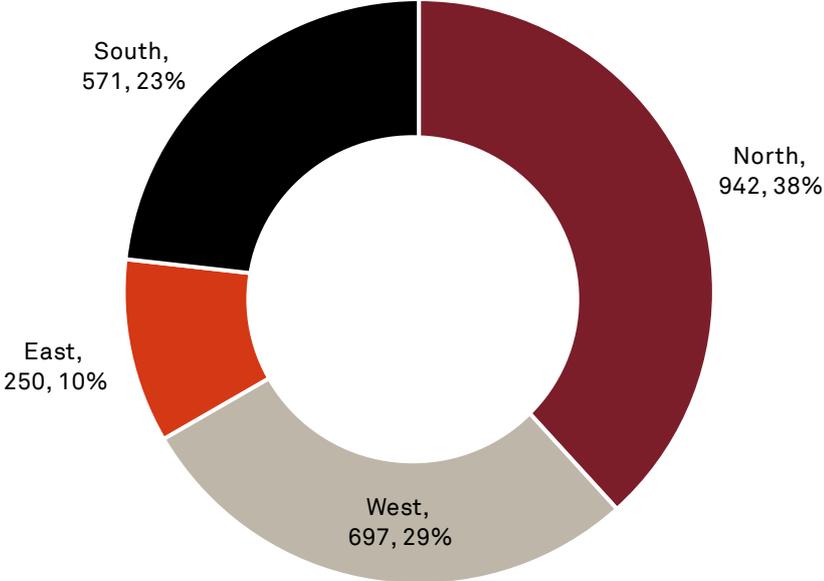
### Rise in number of insolvency professionals and entities

Since December 31, 2016, individuals who have the required qualification and experience, and have passed the Limited Insolvency Examination are being registered with the IBBI as insolvency professionals (IPs).

As on March 31, 2019, 2,456 individuals were registered as IPs across India, and the following insolvency professional agencies (IPAs) were acting as frontline regulators for the IPs:

- The Indian Institute of Insolvency Professionals of Institute Chartered Accountant of India
- ICSI Institute of Insolvency Professionals
- Insolvency Professional Agency of Institute of Cost Accountants of India

Number and share of registered IPs by region as of March 2019



Source: IBB

## 6. Key issues and challenges

While multiple steps have been taken for the implementation of the IBC, CRISIL has broadly analysed certain key issues and challenges that persist at multiple levels.

CRISIL has also broadly categorised those aspects under the following heads, and believes these issues and challenges need to be addressed for a successful implementation of IBC over the medium term.

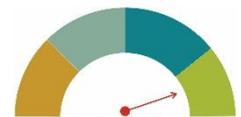
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	More/quick action needed
	In place, but needs to be strengthened
	Work in progress
	On track

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### Creditor in control:

#### Enhanced rights of creditors of all categories



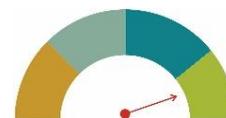
The code enhances the rights of a creditor to identify bankruptcies and initiate resolution proceedings through an ecosystem that will include a regulator, insolvency professionals, information utilities, and an insolvency fund.

Alongside financial creditors (FCs), the code empowers operational creditors (OCs) to initiate insolvency process for settlement of dues – *empowered OCs, such as trade suppliers, employees, and workmen, to initiate the insolvency resolution process.* Further, home buyers are going to be treated at par with FCs.

The number of CIRPs initiated by OCs is more than that of FCs and CDs, though both have seen a significant increase

## Financial discipline and resolution:

### Instils better financial discipline among borrowers



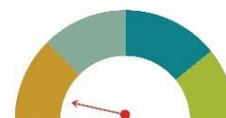
To be sure, the code has managed to bring in transition in the borrower mindset along with other stakeholders, with a clear intention to deal with the distress situation, towards revival and recovery.

Until March 2019, 94 cases were resolved under CIRP with a resolution amount of ~Rs.75,000 crore for FCs against admitted FC claims of ~Rs. 1,75,000 crore.

Further, some of the recovery has also been made through payments by borrowers after default, but before the initiation of the CIRP under the code<sup>5</sup>. As per the Insolvency & Bankruptcy Board of India (IBBI) report, almost Rs 2.02 lakh crore of debt pertaining to ~4,452 cases were disposed of even before admission into the IBC as the borrowers made good the amounts in default to their creditors.

## Timeliness of resolution:

### Adherence to time-bound resolution critical



Given the track record of various stakeholders in finding a resolution plan for stressed assets, the current 180-day (plus 90 days) period is not being adhered to nail down a resolution plan, especially in complex/large cases.

Of the first dozen cases in the IBC referred by the RBI, the majority have crossed the maximum 270 days of resolution timeline. As on March 31, 2019, the number of outstanding cases under the corporate insolvency resolution process was 1143. In 32% of these cases, the resolution is pending for more than 270 days, which is substantial.

For this to be successful, various stakeholders need to work constructively together. The development of insolvency professionals, who have integrity and necessary skills to perform the onerous tasks in insolvency and bankruptcy cases, is also critical.

<sup>5</sup> Source: as per the media reports & FICCI press conference – MCA secretary

## Judicial infrastructure:

### Burden of a large number of cases at NCLT



Currently, there are 12 benches, with 16 judicial members and nine technical members at NCLT<sup>7</sup>.

This may not be sufficient to deal with a large number of pending cases. This is because, in addition to insolvency cases, the NCLT is required to resolve cases that were earlier filed under the Company Law Boards and the Board for Industrial and Financial Reconstruction.

Along with this, winding up and amalgamation cases in the high courts and corporate cases in debt recovery tribunals would also be transferred.

While the NCLT is increasing the presence and resources across cities to manage and resolve cases, clearing the huge pile of pending cases will be a long and tedious process. To address this issue, the Ministry of Corporate affairs is contemplating to double the NCLT benches amid the rise in insolvency cases coming up before the tribunal.

An immediate ramp-up of NCLT and NCLAT infrastructure, digitisation of the NCLT/NCLAT platform, proactive training/on-boarding of judges, lawyers and other intermediaries will be necessary for effective implementation of the code.

## Role of Committee of Creditors (CoC):

### Critical role in the resolution process



Members of the CoC hold several responsibilities including invitation, receipt, consideration and approval of resolution plans under IBC. Their conduct has serious implications for continued business of a corporate debtor and consequently on the economy.

In a number of cases, the adjudicating authority has observed that the members of the CoC nominated by financial creditors are not given the authority to take decisions upfront, leading to delay in process completion. Also, conflicts are common even among secured creditors.

These aspects can result in increased conflicts of interest in agreeing to a revival plan within a stipulated timeframe. The provision for automatic liquidation means the end of the road for companies that could otherwise have been revived.

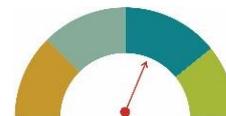
The CoC must work dynamically with the resolution professionals to revive the company and should be better equipped through various training programmes to handle professional challenges. Further, logistical challenges need to be addressed to deal with the large number of participants attending the CoC meetings in order to have a constructive decision oriented discussion.

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<sup>7</sup> As per NCLT website

## Creditor classification & prioritising their claims:

### More clarity on the mechanism is need of the hour



The waterfall mechanism under Section 53 of the code discusses distribution of proceeds based on priority, which is followed for the liquidation process. However, there is limited clarity regarding creditor classification on the basis of their charge details. For example, within secured FCs, there is limited clarity on how to prioritise the claims amongst first charge/exclusive charge and second charge holders, and, subsequently, how the distribution of proceeds needs to be done.

Further, for normal resolution under CIRP also, there is no clarity on the aforementioned aspect. This is an evolving area and needs to be thoroughly examined and clarity should be given.

## Information utilities (IUs)

### Limited number of IUs



IUs provide access to credible and transparent evidence of default, which helps in expediting the process of ascertaining a default for initiating the resolution process. The IUs also facilitate quick formation of CoC, as all information regarding creditors' claims required to form the committee can be easily collected from them.

Without proper IU infrastructure, the NCLT gets involved in evaluating whether a default has taken place; this can be a time-consuming process and eats into the bandwidth of NCLT.

Further, in the absence of IUs, the formation of CoC may take longer, making it difficult to adhere to the 180-day timeline for completing the resolution process, as creditors will have less time to agree to a resolution plan, leading to an extension of the timeline.

There is only one IU, namely, National eGovernance Services Limited (NSEL), which was registered with the IBBI on September 25, 2017. Also, the authentication of financial information available with NSEL needs to be properly scrutinised. Further, technological infrastructure needs to be strengthened to avoid any kind of data loss and to maintain confidentiality.

## Liquidation under a 'going concern' basis

### To maximise value and protect stakeholders' interest

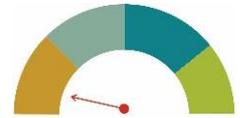


If a resolution for an operating entity under CIRP doesn't fructify within the stipulated timelines under IBC, it goes for liquidation which erodes the underlying value of assets. However, **liquidation under going concern** provides an option to transfer the company's ownership at a going concern level to preserve the value of the underlying assets with an option of revival; also, to protect the interest of stakeholders of the company mainly employees and workmen.

That said, cases of successful liquidation through this route are limited, and there is a question mark over whether it can shore up interest substantially so as to raise the bid quantum to a level that will satisfy the lenders. Therefore, this remains a monitorable.

## Market for secondary assets

### For improved valuation of distressed assets



Unlike the US, India does not have an active organised market for secondary/used industrial assets, such as plant and machinery. This limits the lender's ability to take possession of secured assets in case of insolvency, as they don't have buyers. Further, banks are sceptical about funding these assets.

An active secondary market and funding from banks could foster entrepreneurial interest, helping in faster redeployment of these assets and ensuring better price discovery.

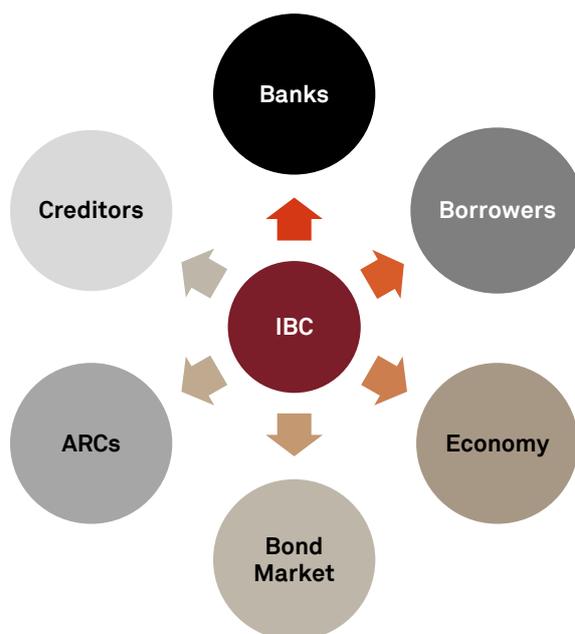
To be sure, these issues and challenges addressed by CRISIL are a few key ones among many that need to be addressed and brought to the notice of IBBI for a quicker resolution of the teething issues. However, the IBBI has been taking proactive steps in this regard and taking up various steps to address the concerns. In a recent press release, dated April 20, 2019, the IBBI has sought comments from stakeholders and public on making changes to the current regulations notified under IBC, 2016. The comments received between April 2019 and December 2019 shall be processed together and, following the due process, regulations would be modified to the extent considered necessary. The IBBI is expected to bring the modified regulations into force on April 1, 2020.

The primary objective is to speed up the resolution process after accommodating all the changes/suggestions, so that all its stakeholders would be benefitted in the long run.

## 7. How the IBC benefits different stakeholders

The IBC is aimed at protecting the interests of all stakeholders, including banks and financial institutions, secured and unsecured creditors, and employees. Even the ARCs stand to benefit from speedy recovery. Besides, if implemented well, it can also aid development of the corporate bond market, especially for lower-rated issuances. For the government, India's 'ease of doing business' ranking can further improve, and, for stakeholders, there is clarity on getting their share of dues.

### Stakeholders addressed under IBC

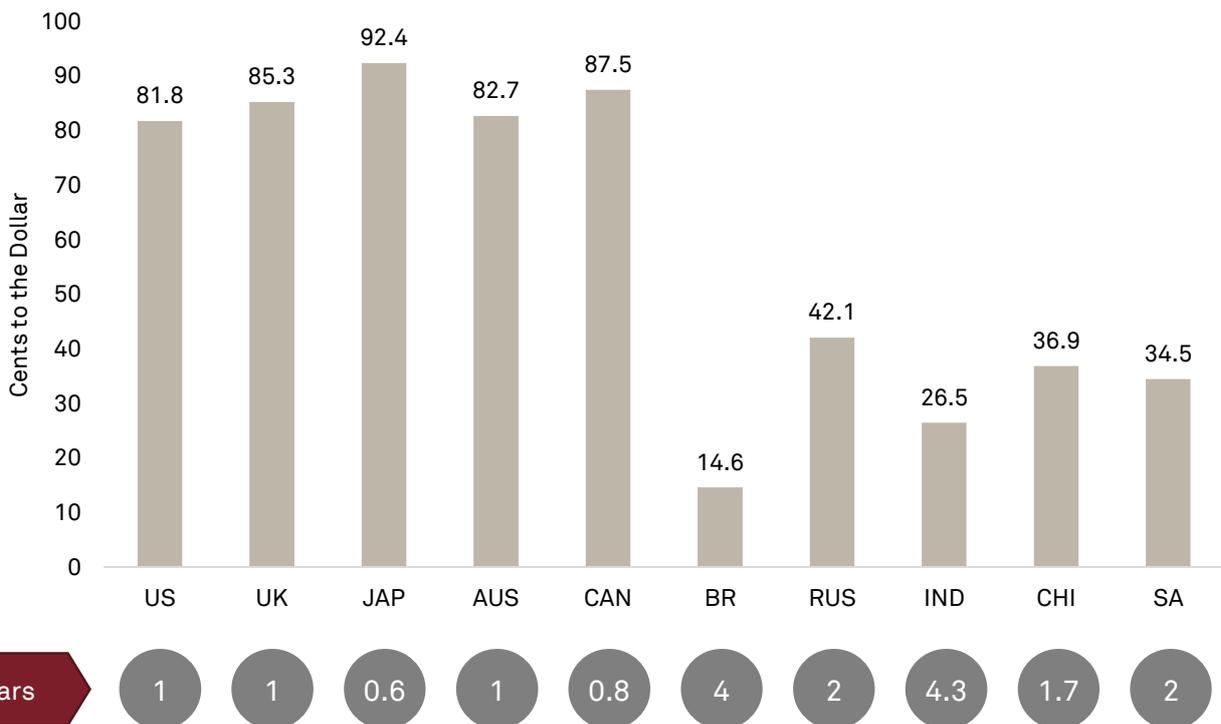


### Banks and financial institutions

- Indian banks, especially public sector ones, are reeling under a huge pile of NPAs, which have eroded their profitability and capitalisation. As on March 31, 2019, gross NPAs touched around 10% of gross advances, though they declined from 11.5% as of March 31, 2018.
- **Instilling better credit discipline in borrowers:** The risk management practices of Indian banks, especially PSBs, have remained weak. Further, the laws were not in favour of lenders, and the recovery procedure was time-consuming and tedious, which erring promoters have exploited. This is borne out by the high and rising number of wilful defaulters of banks. However, the RBI has already tightened the norms for wilful defaulters, and this, together with the implementation of IBC, will enhance recoveries from such borrowers and improve the overall credit discipline.
- **Helping release capital for banks:** A large part of banks' capital is deployed in creating higher provisions against stressed assets. Faster resolution will release capital that which can be deployed for credit expansion.

- Expanding the unsecured loans market:** The IBC is expected to promote a market for unsecured financing. That is because the distribution waterfall of recoveries following liquidation gives unsecured financial creditors (apart from all secured creditors) precedence over government dues.
- Quicker resolutions:** As per a World Bank group flagship report of 190 economies, *Doing Business 2019*, the average recovery rate in India is ~27% and it takes more than four years to resolve a stressed asset. This is lower than the average recovery rate of ~31% for emerging markets and significantly below ~86% for developed markets. The IBC prescribes clear timelines for the resolution process, which can help improve the recovery rate and the number of years taken for resolving an asset from 4.3 years currently.

### Recovery rates and timelines in developed and emerging nations



Source: *Doing Business 2019*, a World Bank report

### Asset reconstruction companies

Despite being around for more than a decade, recoveries by ARCs have remained below expectations, with resolution typically taking 3.5 to 4 years.

For small accounts (debt up to Rs 100 crore), sale of assets or settlements is the most preferred and successful strategy. These tend to have a shorter resolution timeframe and better recovery rates compared with larger ones.

For larger accounts, reconstruction is the most preferred strategy. But during reconstruction, such borrowers could take legal recourse to delay the recovery proceedings, making effective resolution within the proposed timeline a challenge.

In the long run, effective implementation of the IBC will help in preserving the value of the asset and faster resolution. That, in turn, means ARCs will be able to churn capital faster and enhance returns.

The access of ARCs to capital sources is also critical, because their collective net worth is just about Rs 7,500 - 8,000 crore (CRISIL estimates, as on March 31, 2019), and they have limited room to tackle mounting NPAs. With the RBI's proposal to increase the ARCs' net-owned funds to Rs 100 crore, a faster resolution of release of capital becomes more important. IBC, along with changes permitting ARCs to get 100% foreign direct investment through the automatic route and to operate on a multi-platform model with foreign funds, is expected to boost capital flows.

## Bond markets and investors

**Facilitating development of the corporate bond market:** The corporate bond market forms only ~14% of GDP in India, compared with ~119% in the US and ~74% in South Korea. An improvement in the recovery rate and reduction in the timeline for resolution will increase investor confidence in the Indian bond market.

### Corporate bond market penetration in India is very low

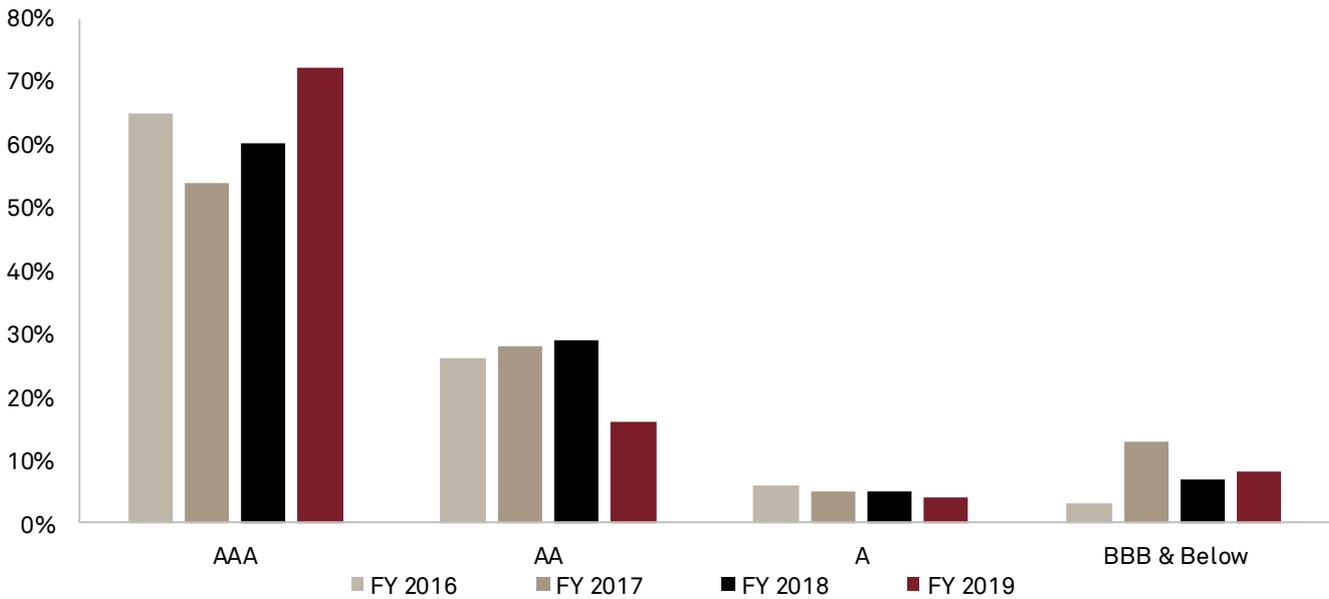
Country	Ease of doing business score*	Recovery rate* (%)	Time* (Years)	Corporate bonds / GDP ratio^
India	67.23	26.5	4.3	14%
China	73.64	36.9	1.7	20%
Singapore	85.24	88.8	0.8	33%
Malaysia	80.6	81.3	1	46%
South Korea	84.14	84.6	1.5	74%
US	82.75	81.8	1	119%

Source: \*In 'World Bank's 'Doing Business 2019 report', name of distance to frontier score has been changed to "ease of doing business score" – this score benchmarks economies with respect to regulatory best practice, showing the absolute distance to the best regulatory performance on each doing business indicator. ; ^CRISIL Research

India's corporate bond market also shows concentration of issuances with high credit-rating bonds. About 90% of trading is restricted to AAA and AA rating categories. The primary reason for the aversion to lower-rated paper – below the AA category – is poor recovery in case of a default.

With greater certainty of outcome and faster resolution under IBC, the interest of both domestic and foreign investors in lower-rated paper is expected to increase over time.

**Distribution of bond issuances by rating category (fiscals 2016, 2017, 2018 and 2019).**



Source: Prime database, CRISIL Research

A strong bankruptcy code can bolster creditor rights and deepen the bond market. Steps taken in the past by countries such as Brazil, Russia, China and the UK to reform their bankruptcy laws, along with other government-specific macroeconomic structural reforms, had led to significant growth in their corporate bond markets.

The RBI has implemented norms for limiting individual/group exposures in banks and encouraging large corporate borrowers to access the bond markets for funding requirements. This, along with IBC, will provide a boost to the Indian bond market.

**Corporate bonds-to-GDP ratio nearly doubles five years after bankruptcy reforms**

Country	Year of reforming bankruptcy laws	Five-year average (pre-reforms)	Five-year average (post-reforms)
Brazil	2005	12.70%	26.30%
Russia	2009	8.10%	13.10%
India	2016	17.90%	Effect to be seen
China	2007	18.80%	33.40%
UK	2002	68.40%	106.80%

Source: World Bank Doing Business reports, ADB, CRISIL Research

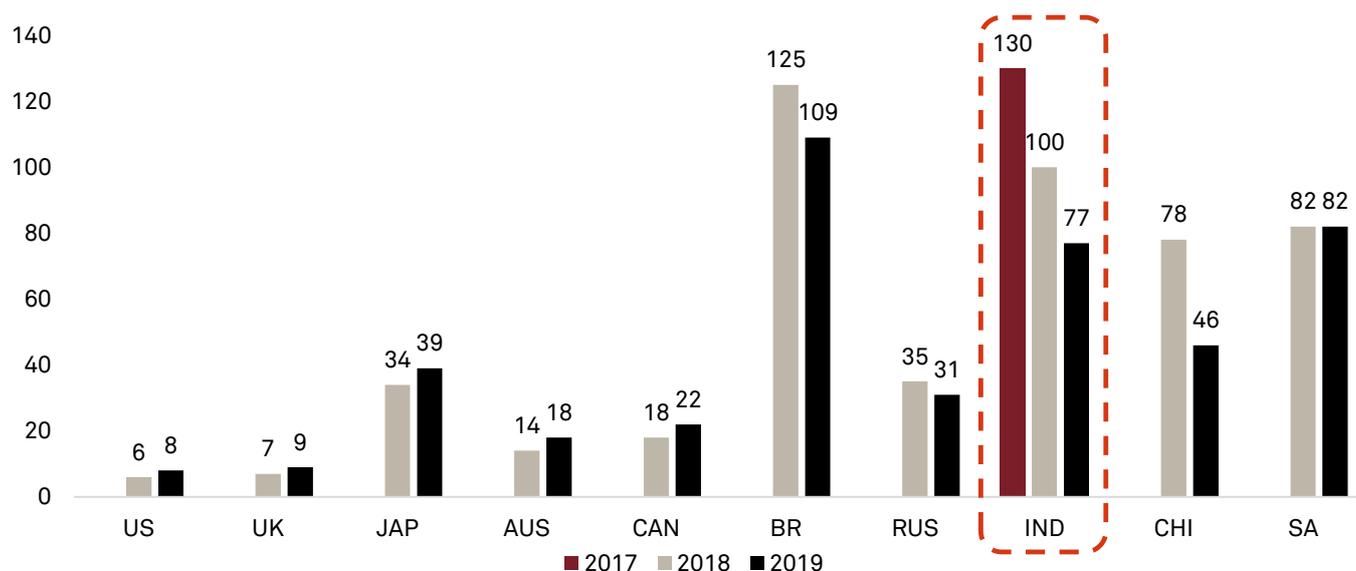
## Economy

**Improvement in 'ease of doing business' ranking:** Implementation of IBC is expected to improve India's position in the World Bank's 'ease of doing business' ranking, attracting more foreign investors.

The ranking weighs 190 countries on ten areas of reforms, with various parameters under each. It assigns an individual rank to each country on each of these areas, and then a final rank.

India's rank has improved to 77 in 2019 from 100 in 2018 and 130 in 2017, because of the implementation of a key reform – '**resolving insolvency**' for making it easier to do business.

### 'Ease of doing business' rankings of major economies in 2019



Source: *Doing Business 2019 & 2018, the World Bank Group flagship report*

## Entrepreneurs and professionals

For entrepreneurs or start-ups, winding up a business can be an uphill task. The process requires multiple approvals and leads to a substantial delay in honouring the dues of creditors. IBC will provide some respite, as a start-up firm that gets insolvent can be wound up on a fast-track basis within 90 days. Thus, creditor interest can be protected and capital can be reallocated to efficient businesses. Also, this will help entrepreneurs initiate insolvency proceedings voluntarily. Over time, it will help promote entrepreneurship and increase the role of professionals from various fields, such as law, accountancy and finance.

## Employees and workmen

Employees and workmen will benefit, as they too can initiate insolvency proceedings for unpaid dues and have greater lien in the distribution of liquidation proceeds.

## 1. Annexure

### Press Release

April 03, 2019 | Mumbai

## SC ruling on RBI's norms to extend resolution timelines on NPAs Banks' asset quality not materially impacted as bulk of stress already recognised

The Supreme Court's move to quash the Reserve Bank of India's (RBI) February 12, 2018 circular on resolution of stressed assets provides the banking system with more flexibility and time in resolving stressed assets.

The RBI circular had mandated referring stressed assets to the National Company Law Tribunal (NCLT) if the banks were not able to implement a resolution plan within 180 days from the date it became overdue – a stringent timeline in the context of the processes that banks were hitherto used to.

While the RBI circular intended to speed up the resolution process, the apex court's ruling now puts the onus back on banks for ensuring timely and effective resolution of stressed assets; the provisions of the Insolvency and Bankruptcy Code (IBC), though, continue to be available to them for such resolution.

The stressed power sector assets in the private sector will get the biggest respite from this as most of them were on the verge of being referred to NCLT. The additional flexibility on timelines does away with the imminent threat of significant haircuts on these exposures for lenders in the near term. Given the weak industry environment and limited bidder interest, the banks were staring at significant haircuts on many of these assets.

**Says Krishnan Sitaraman, Senior Director, CRISIL Ratings, "Going forward, we should see banks having greater flexibility in deciding which stressed assets to be resolved using the IBC. The IBC is a very effective mechanism that has been upheld by courts in its entirety and the banks' decisions to resolve stressed accounts through IBC could be led by whether such accounts involve wilful defaults or have become stressed due to adverse business conditions and environmental factors."**

On the other hand, the improvement in credit discipline in the past year and the expectation of quick turnaround in stressed assets resolution could come under some cloud. That's because the RBI circular prioritised speedy resolution of stressed assets. Also, fear of losing control of their companies meant promoters worked actively with lenders to avoid referral to NCLT.

Nevertheless, the Supreme Court ruling is not expected to have any significant impact on new NPA accretion levels, as accelerated NPA recognition by banks has resulted in most of the stressed assets being recognised. However, the pace of reduction in the stock of NPAs could slowdown.

**Says Rama Patel, Director, Financial Sector Ratings, "Incremental NPA formation is estimated to have halved to 3.7% (of opening net advances) for the full year ended March 31, 2019, compared with 7.4% in fiscal 2018. Further, prudent credit practices instituted by banks after the RBI circular should help avoid piling up of NPAs in the banking system over the near to medium term."**

While the near term impact of the apex court's decision on the banking sector asset quality is limited, the RBI's stance on the possible changes to regulations on resolution of stressed assets post the apex court's decision will need to be seen. That could play a key role in determining the modalities of the resolution apparatus available to the banking system in the future as well as how credit culture pans out going forward, though a return to the pre-IBC era is not expected.

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## **About ASSOCHAM**

ASSOCHAM initiated its endeavour of value creation for Indian industry in 1920. Having in its fold more than 400 Chambers and Trade Associations, and serving more than 4,50,000 members from all over India. It has witnessed upswings as well as upheavals of Indian Economy, and contributed significantly by playing a catalytic role in shaping up the Trade, Commerce and Industrial environment of the country.

Today, ASSOCHAM has emerged as the fountainhead of Knowledge for Indian industry, which is all set to redefine the dynamics of growth and development in the technology driven cyber age of 'Knowledge Based Economy'.

ASSOCHAM is seen as a forceful, proactive, forward looking institution equipping itself to meet the aspirations of corporate India in the new world of business. ASSOCHAM is working towards creating a conducive environment of India business to compete globally.

ASSOCHAM derives its strength from its Promoter Chambers and other Industry/Regional Chambers/Associations spread all over the country.

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It is India's foremost provider of ratings, data, research, analytics and solutions, with a strong track record of growth, culture of innovation and global footprint.

It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers.

It is majority owned by S&P Global Inc, a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

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