

Insolvency and Bankruptcy Code, 2016



Following the recommendations of the Viswanathan Committee (Bankruptcy Law Reforms Committee) set up to study the corporate bankruptcy legal framework in India, the Government introduced a comprehensive Insolvency and Bankruptcy Code, 2015 in Parliament, after public consultation. After careful deliberation and scrutiny the Insolvency and Bankruptcy Code, 2016 has been passed by the Lok Sabha on 5 May 2016, and Rajya Sabha on May 11, 2016, thereby paving the way for the act to come into force, after approval of the President of India.

What is Bankruptcy?

Bankruptcy is a legal status which is usually imposed by a Court on an individual or a firm that is unable to meet debt obligations.

Why is the new Bankruptcy Code required?

Considering the banking and other sectors:

- Banks are increasingly being saddled by the burden of NPAs/Bad Debts and are vulnerable to poor recovery of loans made to the corporate sector. The Gross NPA in India is around 4 Lakh.
- Restructured advances (i.e. the loans whose terms have been revised and which have a higher probability of becoming NPA in the future) have increased manifold.

- Bad Loans of Corporate entities constitute 56% of the total bad loans of public sector banks.
- Presently there are around 70000 pending cases of liquidation in some state of trial in India.
- Presently it takes around 4 years to conclude a case and wind up an ailing company in India (This is almost double the amount of time taken in other countries like China etc.).
- There are around 12 laws (Some of them are more than 100 years old) to tackle Insolvency in India.

In India, currently, there are multiple laws dealing with the insolvency of a company or an entity, which complicate the process leading to significant delays in closing a company in the case a company goes bust or simply to wind up a company. This situation also dissuades foreign investment since it becomes very difficult for a company of foreign origin to wind up its business and get out.

India also ranks extremely poorly in World Bank's ease of doing business/Resolving Insolvency Ranking:

- Ease of Doing Business Ranking – 130 out of 189 countries in 2016.
- Resolving Insolvency Ranking – 136 out of 189 countries in 2015.

The new Bankruptcy Code seeks to consolidate the existing framework and is envisaged to create a new, faster and far more effective institutional framework. It attempts to create a formal **Insolvency Resolution Process (IRP)** for businesses, either by proposing a viable survival mechanism or by ensuring speedy liquidation of the insolvent entity.

Under the ambit of this Bill a new entity called the **Insolvency and Bankruptcy Board of India** would be set up, to regulate insolvency professionals and information companies - which would store all the credit information of corporate sector.

The Bankruptcy Code has proposed two different authorities to deal with bankruptcy and insolvency scenarios:

The **National Company Law Tribunal** would be tasked to adjudicate cases for companies and limited liability partnerships.

The **Debt Recovery Tribunal** would do the same in cases involving individuals and partnership firms.

Potential of the new law:

Ensures speedy resolution of NPA problems, especially in PSU banks which are in dire need of some relief. Now the Banks have a far more solid mechanism to go after firms and entities that have NPAs and can resolve the issue by either speedily recovering the money or can opt for reconstruction. The time-bound nature of resolution promises a better functioning financial services industry.

- Due to this time bound nature of dispute resolution, the law goes a long way towards ensuring investor confidence and increasing ease of doing business.
- Effective implementation holds the promise of giving a significant boost to job creation through the skills development mission (which aims to create 40 crore jobs by 2022) and should also provide the required ecosystem for the success of “Make in India” initiative.
- It is a positive step and provides an impetus for good governance and upholds would the rule of law, since the organisation or the people who file for bankruptcy must repay their debts.
- Any possible demerit could be addressed by holding discussions and by building consensus.

Key facts:

- For resolution of individuals, two distinct processes namely- “Fresh Start” and “Insolvency Resolution”.
- For resolution of insolvency, liquidating and bankruptcy, it provides for the establishment of National Companies Law Tribunal (NCLT) and Debt Recovery Tribunal (DRT) as a nodal adjudicating authority.
- It also strengthened the rights of workers and the creditor.
- The code gives a push for ease of doing business in the country.
- It gives a clear and speedy process for identifying financial distress and resolution of companies and limited liability entities.
- It also enables the provision to deal with cross-border insolvency.

Till date due to the weak insolvency regime, significant inefficiencies and systematic abuse are some of the major reasons that have led to the

distressed state of credit markets(Banks/lending institutions) in India. With the enactment of this code, the Government has sent a positive signal with promises of bring about far-reaching reforms with a thrust on insolvency resolution that is creditor driven. Aiming at early identification of fiscal distress and financial failure the law envisages maximising the asset value of an insolvent firm. With provisions to address cross-border insolvency through bilateral and reciprocal arrangements with other countries it strives to provide a level playing ground to businesses in India at par with other developed and developing nations.

This Bankruptcy law accepts that firms and business ventures can fail and it allows entrepreneurs to make a new start. The focus of this unified regime on structured and time-bound process for insolvency resolution and liquidation could significantly improve debt recovery rates and revitalise the ailing Indian Banking System and corporate bond markets.

While it facilitates failed/debt-ridden firms to wind up in a painless manner, the code also paves the way for resurrection too.

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