Indian bankruptcy reform

May 14, 2016

Outline

- Elements of a sound insolvency system
- The present framework
- The IBC approach

Part I

Elements of a sound insolvency system

The economics of insolvency reform

- Breadth and depth of credit markets

  Where lenders can enforce repayment, there is: (1) higher credit access, (2) at lower price, (3) with longer maturity, (3) lower collateral requirement , and (4) from a greater number and variety of lenders.

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- Efficient allocation of assets and stability

  The possibility of exit promotes entrepreneurship. Effective exit provides a safety valve for corporate distress.

The credit continuum

Credit access	Financial distress	Enforcement/insolvency
Credit assessment	Risk assessment	**Enforcement**
Information	Information	**Security rights**
Identify security	Identify options	**Formal insolvency**
Negotiate pricing	Negotiate pricing	Information
Contracting	**Amend contracts**	Negotiation
Registry	**Possible action**	Implementation
Monitoring	Monitoring	Monitoring

Source: World Bank

Part II

What is wrong with the present framework?

Enforcement

Creditor		Debtor
Contract creditors	Contract Act, 1872 Special Relief Act, 1973 Forum: Civil Courts	Firms; Individuals; Possessory security
Banks and Specified FIs	RDDBFI Act, 1993 Forum: DRT/DRAT	Firms; Individuals; Secured/ Unsecured
Banks and Specified FIs for secured NPLs	SARFAESI, 2002 Forum: Extra judicial. Appeal at DRT	Firms; Individuals; Non-possessory security
State dues	Income Tax Act, Various Indirect Tax Acts Forum: Tax Tribunal	Firms; Individuals
Workmen dues	Various labour laws Forum: Labour Courts Civil Courts	Firms

Insolvency

Creditor		Debtor
Creditor with dues above defined value	Companies Act, 1956 Winding up Forum: High Court	Companies
All creditors	Partnership Act, 1932 Dissolution Forum: Civil Courts	Registered Partnerships; Individual partners
Banks and Public FIs	SICA, 1985 Forum: BIFR/AAIFR	Sick Industrial Companies
All creditors	Presidency Town's Insolvency Act, 1909 Provincial Insolvency Act, 1920 Forum: Civil Courts	Individuals

Work out

Creditor	Contract creditors	Banks, FIs, NBFCs, ARCs	Banks
	Statutory: Companies Act, 1956 Compromise/Arrangement Forum: High Court	Non-statutory:Individual restructuring; CDR; 5/25; SDR Forum: RBI guidelines Lenders' forum	Asset Sale to ARCs Forum: RBI guidelines
Debtor	Companies		

Enforcement framework

- Average time to enforce contracts (WBDB) – 4 years, can go up to 20 years.
- 33 DRTs, 60,000 pending cases. Recovery rates – 14%.
- 12.5 lakh SARFAESI referrals in 2015. Recovery rates – 24%. Most SARFAESI cases end up as appeals in DRT.

Insolvency framework

- 9.5 lakh active companies in India in 2014. Around 60,000 – 70,000 new companies added every year. Only around 300 – 400 new winding up cases in High Courts. Around 4,800 cases pending.
- Winding up takes an average of 4-5 years, some cases even 25 years.
- At BIFR, total of around 5,900 cases over three decades. Only one BIFR bench. Average time taken 5.8 years.
- 65% of BIFR referrals either abated or found not sick. Scheme sactioned in only in 10% cases.
- Individual insolvency laws barely used. Banks and eligible FIs use DRTs or SARFAESI. Other lenders take security cheques and use provisions of Negotiable Instruments Act.

Work out

- CDR used by banks to restructure significant amounts of debt: 530 cases with total debt of Rs. 4 trillion (around 7% of banking sector advances).
- 65% of packages between 2010 – 2014, regulatory forbearance given.
- Successful exit in 16% cases. 38% failed and 46% ongoing.
- 15 SDR cases (till December 2015) with debt of Rs. 0.8 trillion. 11 cases are from CDR and 2 from CDR group companies.
- 14 ARCs. Banks' stressed advances – 11% of assets. Sale to ARCs – 0.8%.
- *Extend and pretend* rather than *resolution*.

Where we are

- Legal framework: complex, fragmented.
- Priority: unclear, between laws and between fora.
- Arbitrage: differential access, varied procedures.
- Institutional capacity: insufficient, courts, professional services, information systems.

Problem 1: low predictability, high pendency, high cost, poor recovery.

Comparison with other common law countries

	India	U.S.A.	U.K.	Singapore	Canada
Enforcing Contracts (Rank)	178	21	33	1	49
• Time (Days)	1420	370	437	150	570
• Cost (% of claim)	39.6	22.9	43.9	25.8	22.3
Resolving Insolvency (Rank)	136	5	13	27	16
• Time (Years)	4.3	1.5	1	0.8	0.8
• Recovery rate (cents per $)	25.7	80.4	88.6	89.7	87.3
Getting Credit (Rank)	42	2	19	19	7
• Credit to non-financial sector (% of GDP)	59.5	149.8	156.3	144.8	203.9
• O/w bank credit (% of total)	93.5	33.4	57.0	85.4	51.1

Source: World Bank: Doing Business, 2015;

BIS: long series on total credit to non-financial sectors, 2015

Problem 2: credit markets under-developed, dominated by banks.

Access to finance

- Firm D:E ratios have declined over time – from 1.6 in 1991-92 to 0.6 in 2012-13. Equity issuance (30%) and trade credit (38%) main sources.
- Banking sector the largest source of long-term financing credit firms (70%). Bonds only a fraction (5%).
- Personal loans – 0.05 bn accounts, 16% banks' advances. 75% secured.

Problem 3: limited access to credit. Undue reliance on security.

Banking sector stress

	2011	2012	2013	2014	2015
Advances	40.8	48.0	55.3	62.8	68.8
Y-o-y growth in advances (%)	21.8	17.6	15.2	13.6	9.6
GNPA (%)	2.5	2.4	3.4	4.2	4.7
Restructured advances (%)	5.0	5.8	5.8	6.0	6.4
Stressed advances (%)	7.5	8.2	9.2	10.2	11.1

Source: RBI

Problem 4: real sector stress translating into financial sector stress.

Part III

The IBC approach

0. A systemic reform: Multiplicity of laws replaced by a single law.
1. Clarify control between equity and debt: When firm defaults, control should transfer to the debt holders. Respect for limited liability.
2. Protect organisational capital, in a sensible way: failure is a possibility, viability a commercial decision. Not all failure is theft/fraud.
3. Calm period: firm is immune to the claims of creditors; firm is managed by an Insolvency Professional reporting to creditors.
4. Liquidation: Clear waterfall of priorities.
5. Humane approach: balance of interest between creditor and debtor. Fresh start to individuals.
6. Need for speed.
7. The role of the judiciary: Ensure legal processes are followed.

Thank you.