Indian bankruptcy reform

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Outline

- First principles
- The Indian framework
- Why reform?
- The IBC approach

Part I

First principles

- Enterprise needs capital: equity, debt.

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- The limited liability bargain:

  1. Firms' shareholders accept disclosure and agree to work with lenders within the bankruptcy framework
  2. In return, their liability gets capped. Shareholders get to keep their Mercedes Benz even when the firm is in default

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    2. If it is economic, it needs to close down, releasing capital and resources. This too is good for the economy.
- Capitalism is all about trying new ideas, products and technologies, even though they may fail. There's nothing wrong or immoral about failure.

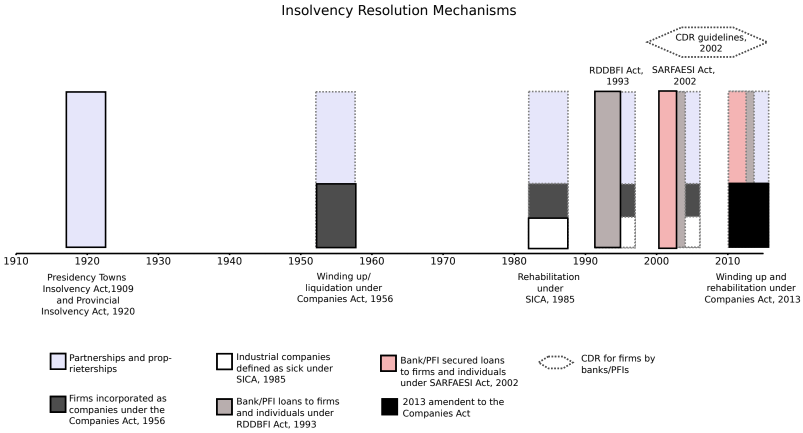
  An mechanism that allows failed firms to exit enables innovation and growth.

- Individuals too need debt: for enterprise or for smoothing consumption.
- Individuals who can't repay debt need a humane mechanism to exit these debts and get a fresh start.

Part II

The Indian framework

How it evolved



Where we are

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

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  - Recovery rates – 14%.

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- SARFAESI:
    - 12.4 lakh cases worth Rs. 4.7 trillion under SARFAESI in 2015.
    - Recovery rates – 24%.

Insolvency framework

- Winding up:
  - 9.5 lakh active companies in India in 2014. Around 60,000 – 70,000 added every year. Only 300 – 400 new winding up cases in High Courts. 4,800 winding up cases pending.
  - Average time to wind up: 4-5 years.

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- Rehabilitation via BIFR:
  - 5,800 cases over three decades.
  - Only one BIFR bench. Average time taken 5.8 years.
  - 65% of BIFR cases abated or found not sick.
  - Schemes sanctioned in 10% cases.

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- Individual insolvency:
  - Laws barely used.
  - Banks and eligible FIs use DRTs or SARFAESI. Other lenders use Arbitration Act or take security cheques and use provisions of Negotiable Instruments Act.

Work outs

- CDR:
  - 655 cases referred between 2002 – 2015. Of these 65% of between 2010 – 2014, when regulatory forbearance was given.
  - Sanctioned in 530 cases, total debt of Rs. 4 trillion (around 7% of banking sector advances).
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- Similar challenges with other schemes like SDR and S4A.
- Private resolution through the ARC mechanism plagued with regulatory and other challenges.

Part III

Why reform?

Broken insolvency framework

- Legal framework: complex, fragmented.

  No concept of time value of money.
- Priority: unclear, between laws and between fora, between lenders and their rights.

  In distress, pre-insolvency priority does not hold.
- Arbitrage: differential access, varied procedures.

  Stacked in favour of banks and FIs.
- Institutional capacity: insufficient, courts, professional services, information systems.

  No capacity to deal with the demands of a growing economy.

Broken insolvency framework

	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

Source: World Bank: Doing Business, 2015;

Under developed credit markets

	India	U.S.A.	U.K.	Singapore	Canada
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

Limited access to debt finance for firms

As % of total	1991-92	2009-10	2012-13
Equity	22.60	34.87	37.21
Retained earnings	10.56	21.05	6.85
Fresh issuance	12.04	13.82	30.36
Depreciation	17.64	9.69	3.56
Borrowing	35.32	29.48	21.57
Banks	17.14	17.83	15.20
Bonds	7.87	3.94	0.96
Inter-corporate	1.28	2.28	3.32
Foreign	5.51	3.22	0.74
Current liabilities	24.42	24.19	37.65
D:E	1.56	0.85	0.58

Source: CMIE Prowess

Banking sector stress

	2011	2012	2013	2014	2015	2016
Advances	40.8	48.0	55.3	62.8	68.8	73.2
GNPA (%)	2.5	2.4	3.4	4.2	4.7	7.6
Restructured advances (%)	5.0	5.8	5.8	6.0	6.4	3.9
Stressed advances (%)	7.5	8.2	9.2	10.2	11.1	11.5

Source: RBI

Why reform?

- Better 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.

Part IV

The IBC approach

1. A systemic reform, not tinkering. Many laws replaced by a single comprehensive law.
2. Clarify control between equity and debt. Respect for limited liability.
3. Protect organisational capital, in a sensible way. Failure is a possibility, viability a commercial decision.
4. A calm period to consider resolution, collectively. Firm is immune to the claims and suits; managed by a Professional reporting to creditors.
5. Liquidation: Clear waterfall of priorities.
6. Need for speed. Use technology speed up the process, avoid disputes.
7. The role of the judiciary: Ensure legal processes are followed.

Thank you.