

# Current state of insolvency resolution in India

5th March, 2016

# What is insolvency?

The state of being unable to pay money owed.

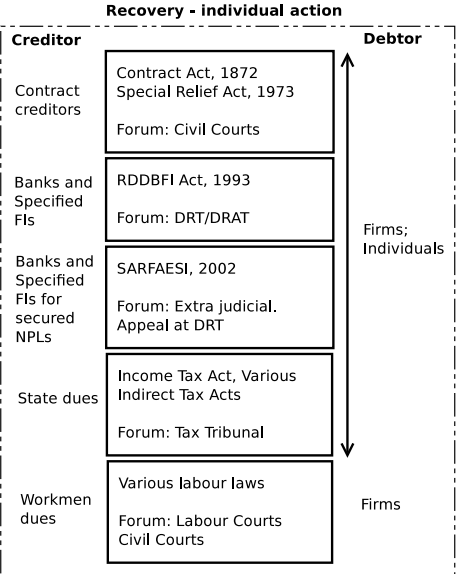
Observed through:

- ▶ Default,
- ▶ Distress, or
- ▶ Declaration.

# Mechanisms for dealing with insolvency

- ▶ Mechanism 1: individual legal action for recovery
- ▶ Mechanism 2: collective legal action for resolution
- ▶ Mechanism 3: workout

# Mechanism 1



# Performance of individual recovery mechanisms

- Average time to enforce contracts – 4 years. Can go up to 20 years.
- 33 DRTs and 5 DRATs. Cases piling up, recovery rates declining.

	2008	2010	2013
Referrals (No.)	3,728	6,019	13,408
Amount involved (Rs. bn)	58	98	310
Amount recovered (Rs. bn)	30	31	44
Recovery %	52	32	14

Source: RBI Report on Trends and Progress of Banking in India

- Average ticket size of a SAEFAESI case Rs. 36 lakhs – individual or small/medium enterprise. Recovery rates declining.

	2008	2010	2013
Referrals (No.)	83,942	78,366	1,90,537
Amount involved (Rs. bn)	73	142	681
Amount recovered (Rs. bn)	44	43	185
Recovery %	61	30	22

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- DRTs known to frequently waive off requirement to deposit 60% of claim value for SARFAESI appeals.

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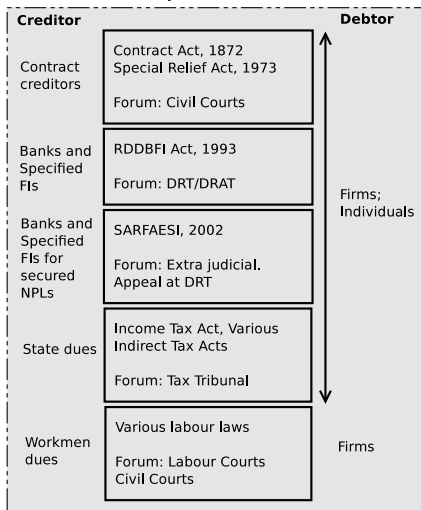
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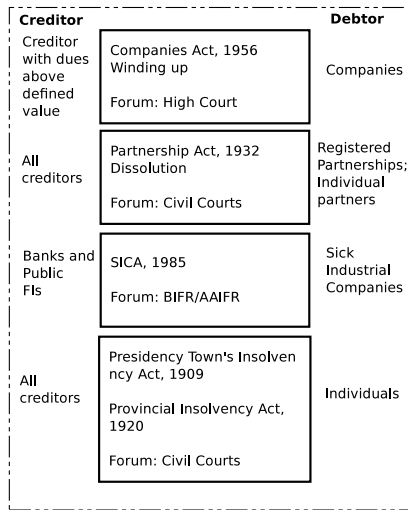
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# Mechanism 2

## Recovery - individual action



## Resolution - Collective action





# Performance of collective resolution mechanisms

- 9.5 lakh active companies in India in 2014. Around 60,000 – 70,000 new companies added every year. Yet only around 300 – 400 new winding up cases in High Courts.

	2008	2010	2013
Opening cases	6,653	6,155	5,727
Added during the year	376	225	331
Completed during the year	896	261	575
Pending cases	6,133	6,119	5,483

Source: Ministry of Corporate Affairs Annual Report

- Winding up cases take an average of 5 – 8 years, in extreme cases up to 25 years.
- 22 OLs across 24 High Courts. Issues with capacity, capability and incentives.

# Performance of collective resolution mechanisms

- A total of 5,819 cases referred to BIFR between 1987 and 2013. Average time taken 5.8 years.

Status	% of cases	Time (years)
Exited BIFR	85	5.4
Dismissed/Abated	41	3.9
Dropped/no longer sick	22	8.4
Winding up recommended	23	5.2
Pending in BIFR	15	7.9
Declared sick/scheme sanctioned	12	8.7

Source: BIFR

- 1 BIFR bench, in Delhi. 24 OAs, all banks and public FIs.
- Individual insolvency laws barely used. Banks and eligible FIs use DRTs or SARFAESI.
- Other FIs take security cheques and use provisions of Negotiable Instruments Act.

# Performance of collective resolution mechanisms

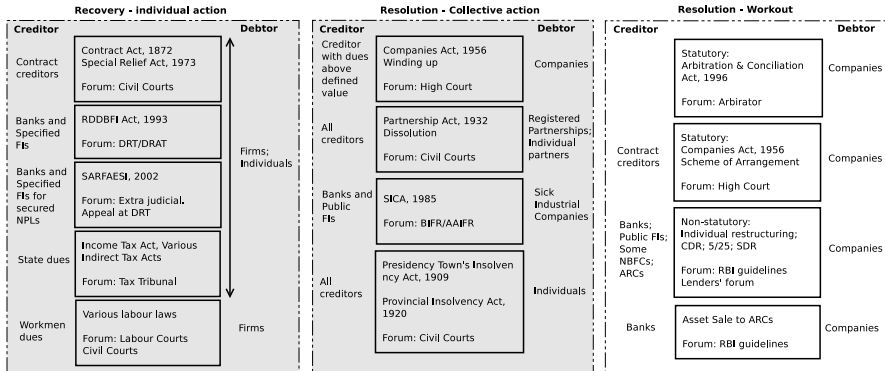
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# Mechanism 3



# Performance of workout mechanisms

- 655 cases referred to CDR Cell between 2002 – 2015. 65% of these referrals between 2010 – 2014, when regulatory forbearance was given.
- Of these, 530 cases with total debt of Rs. 4 trillion received packages.

Category	Cases	Debt (Rs. trillion)
Successful Exit	86	0.62
Failed	202	0.83
Active	242	2.57

Source: CDR Cell

- SDR invoked in 15 cases, till December, 2015. Debt of Rs. 0.8 trillion. Of these, 11 cases have earlier received CDR and 2 cases are group companies of CDR cases.
- CDR, SDR and 5/25 supported by regulatory forbearance on asset classification and provisioning. Widely seen as “extend and pretend” mechanisms.

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# Performance of workout mechanisms

- 14 ARCs registered with RBI.
- Asset sale to ARCs encumbered by poor design – issues with valuation, incentives of sellers and buyers and regulatory challenges.

	2008	2010	2013	2015
Gross Advances (Rs. trillion)	23.3	32.7	59.8	67.4
Stressed advances (%)	3.6	6.9	8.8	10.9
Sale to ARCs (Rs. trillion)	0.4	0.6	0.8	NA

Source: Report on Trends and Progress of Banking in India

- ARCs, in their current form, warehouse not restructure stressed assets.



# Information infrastructure

- MCA21: annual financial statement and charge on collateral. Data for 9.5 lakh active companies.
- CERSAI: collateral secured by equitable mortgage.
- CRILC: repository of large loans.
- Credit Bureaus: individual/corporate data reported by participating financial institutions.
- Exchange filings by listed companies: under SEBI LODR and Clause 49.

## Summary: challenges and outcome

- ▶ Legal framework: complexity; use.
- ▶ Priority: between laws; between fora.
- ▶ Institutional capacity: courts; professional services; information systems.

**Outcome: low predictability, high pendency, high cost, poor recovery.**

# Outcome: comparison with other common law countries

	India	U.S.A.	U.K.	Singapore	Canada
<b>Enforcing Contracts (Rank)</b>	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
● Judicial process index (0. . .18)	7.5	15.0	15.0	15.5	10.5
<b>Resolving Insolvency (Rank)</b>	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
● Cost (% of estate)	9.0	8.2	6.0	3.0	7.0
● Outcome (1-going concern; 0-piecemeal sale)	0	1	1	1	1
● Insolvency framework strength index (0. . .16)	6	15	11	8.5	11
<b>Getting Credit (Rank)</b>	42	2	19	19	7
● Index of legal rights strength (1. . .12)	6	11	7	8	9
● Credit bureau coverage (%)	22	100	100	58.6	100
● Total credit to non-financial sector (% of GDP)	59.5	149.8	156.3	144.8	203.9
● Bank credit to non-financial sector (% of GDP)	55.6	50.1	89.1	123.7	104.3

Source: World Bank: Doing Business, 2015;

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

## Outcome: sources of finance for firms

- D:E ratios of firms have declined over time.
- Firms increasingly dependent on new equity and trade credit.
- Banking sector continues to be the largest source of long-term financing.

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

Thank you