

Reinforcing the code

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Contact details

CRISIL

Manish Gupta
Senior Director,
CRISIL Ratings Ltd
manish.gupta@crisil.com

Nitesh Jain
Director,
CRISIL Ratings Ltd
nitesh.jain@crisil.com

Gouri Prasad Panda
Associate Director,
CRISIL Ratings Ltd
gouri.panda@crisil.com

Gaurav Chaturvedi
Senior Rating Analyst,
CRISIL Ratings Ltd
gaurav.chaturvedi@crisil.com

Aditi Phatak
Rating Analyst,
CRISIL Ratings Ltd
aditi.phatak@crisil.com

ASSOCHAM

Dr. Rajesh Kumar Singh
Deputy Director & Head,
ASSOCHAM, Department of Banking &
Financial services
rajesh.singh@assocham.com

Mr Kushagra Joshi
Senior Executive,
ASSOCHAM, Department of Banking &
Financial services
kushagra.joshi@assocham.com

Mr Vivek Tiwari
Senior Executive,
ASSOCHAM, Department of Banking &
Financial services
vivek.tiwari@assocham.com

Mr Mayank Kanojia
Executive,
ASSOCHAM, Department of Banking &
Financial services
mayank.kanojia@assocham.com

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Executive summary

The Insolvency and Bankruptcy Code (IBC), 2016, is a defining reform in the Indian financial landscape.

In the five years since its promulgation, it has brought about many path-breaking changes in the insolvency resolution process, the most important being a seismic shift in the credit culture in the country. It has tilted the power equation in favour of 'creditors' from 'debtors'. Operational creditors (OCs) have been granted equal treatment in invoking the code.

All this has helped catapult India's position in the World Bank's Ease of Doing Business ranking to 63 in 2020 from 130 in 2016.

That said, the code's efficacy has been tested by prolonged delays in resolution and a high number of liquidation cases.

To date, IBC has been successful in recovering ~Rs 2 lakh crore against admitted financial claims of Rs 5 lakh crore, a recovery rate of 39%, for the 348 resolved cases.

A deeper look at the data shows the recovery was driven by a few large cases – excluding the top nine of the 12 cases referred by the Reserve Bank of India (RBI), the recovery rate was 24%. Furthermore, almost a third of the admitted cases went into liquidation with a meagre recovery of ~5%.

Adherence to resolution timelines remains a major issue. On average, it took 459 days to conclude cases under resolution and ~80% of the outstanding cases have been pending for over 270 days, against the prescribed timeline of 330 days.

That said, the recovery rate and resolution timeline under the IBC are definitely better compared with other existing recovery mechanisms.

The efficacy of the IBC needs to be seen in the context of settling of a new law, development of the associated ecosystem, resolution of vintage cases,

and of course, pandemic-led disruptions.

Despite teething issues, the operationalisation of IBC has been swift. The government has proactively amended the code on several occasions.

Recent changes such as increase in the default threshold to file a case under IBC to Rs 1 crore from Rs 1 lakh, recovery through personal guarantor(s) of the corporate debtor (CD), pre-packs and additional relaxation for micro, small and medium enterprises (MSMEs) augur well.

Having said that, the effectiveness of the IBC will be tested by the potential spike in non-performing assets (NPAs) as the standstill on initiation of fresh insolvency cases for a year ended in March 2021 and as most of the pandemic-induced policies or measures are unlikely to be continued. NPAs are expected to rise to 8.5-9.0% by March 2022, driven by slippages in retail and MSME accounts, besides some restructured assets.

The code's performance is expected to be judged on its twin objectives – maximisation of recovery and time-bound resolution.

It is imperative that all stakeholders – regulators, the judiciary, professionals, lenders and investors – come together to resolve issues and strengthen the IBC to meet its objectives.

Recently, the standing committee on finance provided valuable feedback such as the need for increasing the National Company Law Tribunal (NCLT) strength and training its members, time-bound resolution, and a code of conduct for the committee of creditors (CoC).

In the road ahead, time-bound resolution, strengthening of the judicial infrastructure with sharper focus on digitisation, quick implementation of a group/cross-border insolvency framework, and a comprehensive framework for financial service providers must be addressed head-on to consolidate the gains.

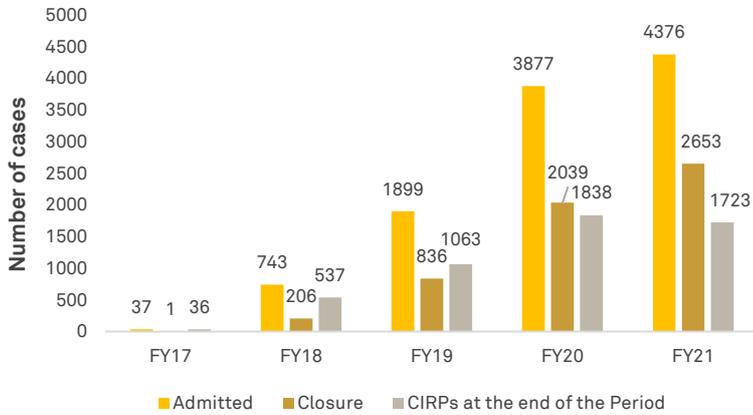
1. The IBC journey so far



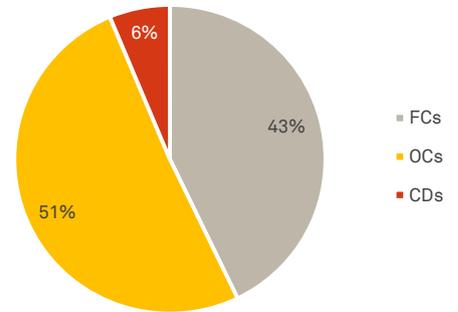
The IBC provides a time-bound, market mechanism for reorganisation and insolvency resolution of a corporate debtor (CD) in distress. The objective of such reorganisation and resolution is maximisation of value of assets of the persons to promote entrepreneurship, enhance availability of credit, and balance the interests of all stakeholders. In case of corporate insolvency, the creditors assess the viability of the CD and endeavour to rescue it through a resolution plan. The corporate insolvency resolution process (CIRP) ends up either with an approval of a resolution plan rehabilitating the CD or an order for its liquidation.

While there has been swift progress in its implementation, the IBC and its associated ecosystem have been evolving over the past five years. There has been an increase in cases admitted under IBC from diverse sectors and a shift in power to 'creditors' from 'debtors' – OCs triggered ~51% of the CIRPs, followed by about ~43% by financial creditors (FCs) and the remaining by the CDs. The number of insolvency professionals and registered valuers has also increased steadily.

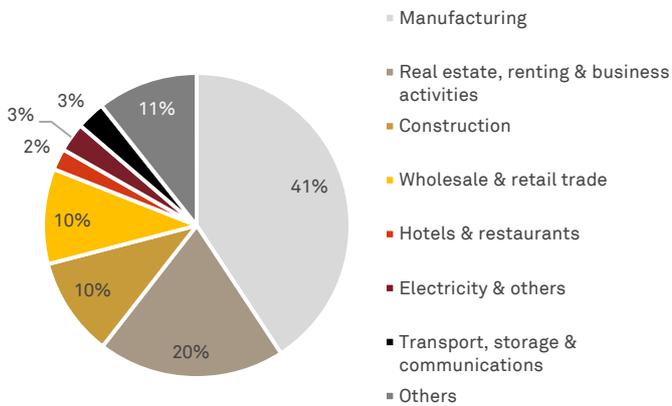
Rapid increase in cases admitted



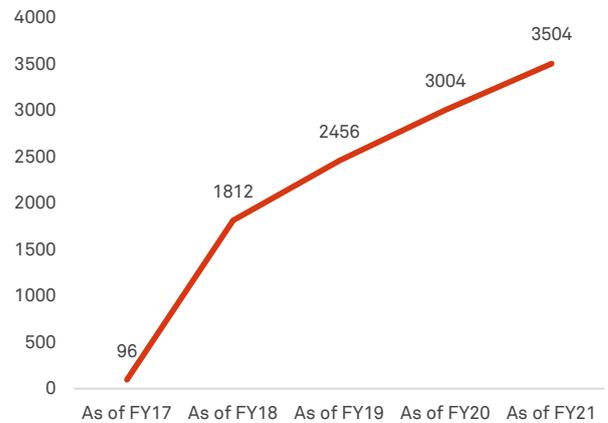
Almost half of the cases filed by OCs



Bulk of admitted cases from manufacturing



Insolvency professionals multiplying



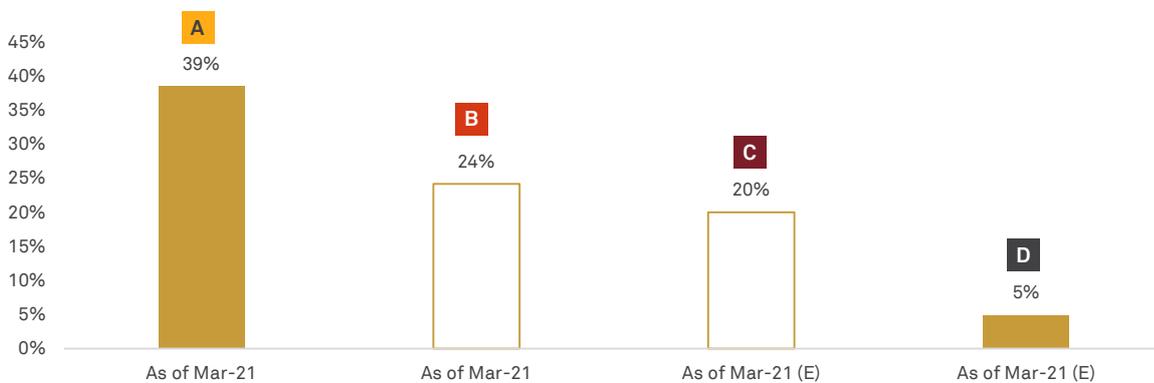
Source: IBBI

2.Recovery rates higher under IBC, though driven by a few large assets



As on March 2021, 4,376 cases were admitted under the IBC, of which 348 or roughly one-tenth of the cases were resolved, ~30% cases (1,277 cases) went into liquidation, 1,028 cases were closed under appeal/ review/withdrawal and almost 40% i.e. 1,723 are outstanding.

IBC has been successful in recovering ~Rs 2 lakh crore from the 348 resolved cases, notching up a recovery rate of 39%.



Source: IBBI, CRISIL Ratings estimates

- A** Average recovery rate for 348 cases resolved until March 2021 was 39%
- B** Excluding 9 large cases (out of the Top-12 cases referred by the RBI) from 348 cases, the recovery rate is 24%
- C** If the 1,277 cases under liquidation are included along with the 348 resolved cases, the average recovery rate would be 20%
- D** Estimated recovery rate of 1,277 cases under liquidation is ~5%

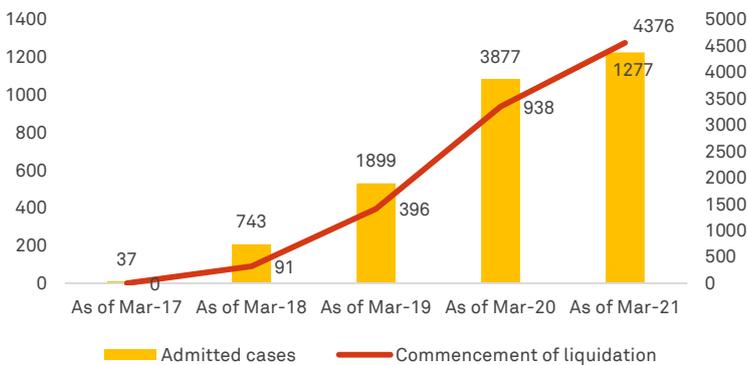
That said, the efficacy of the IBC has been tested by prolonged delays in resolution and a high number of liquidation cases. Also, recovery was driven by a few large cases – excluding the top 9 cases (of the top 12 cases referred by the RBI), the recovery rate stands at 24%.

Moreover, recovery from the 1,277 liquidation cases is ~5%. And if this is combined with the 348 resolved cases, the overall recovery rate comes down to 20%.

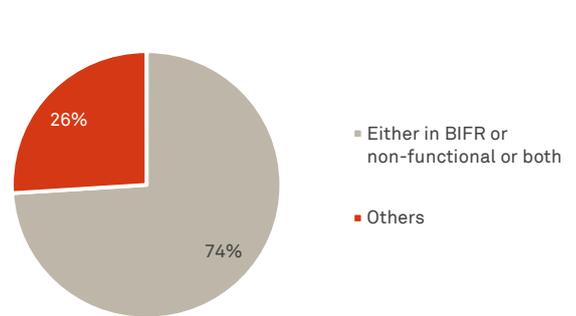
Liquidation cases on the rise

Liquidation cases increased three-fold from March 2019 to March 2021 though this is driven by the large backlog of high vintage assets.

Rise in liquidation cases over the years



Majority of cases are under BIFR or defunct



Source: IBBI

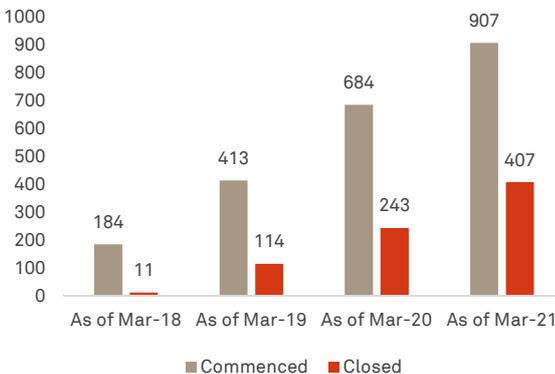
However, more than 70% of the cases were under the Board for Industrial and Financial Restructuring (BIFR) and/or defunct. Hence, the realisable value from the underlying assets would be negligible.

For more than 80% of the cases, either no viable plan or no resolution plan were received by the CoC/ adjudicating authority (AA).

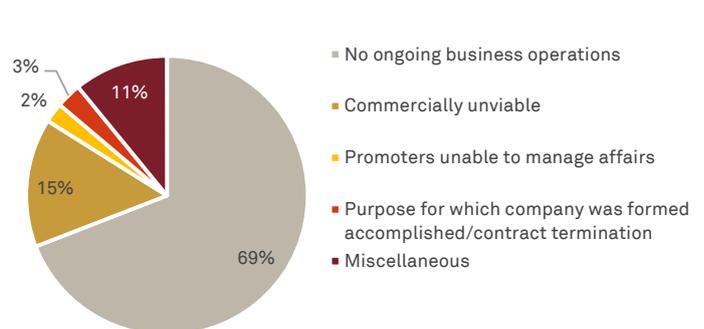
Sharp rise in voluntary liquidation cases too

There has been a sharp rise in voluntary liquidation cases too. As of March 2021, 407 of 907 such cases were closed and 500 cases were outstanding. A majority of voluntary liquidation is because the companies have no ongoing business operations.

Commencement of voluntary liquidation



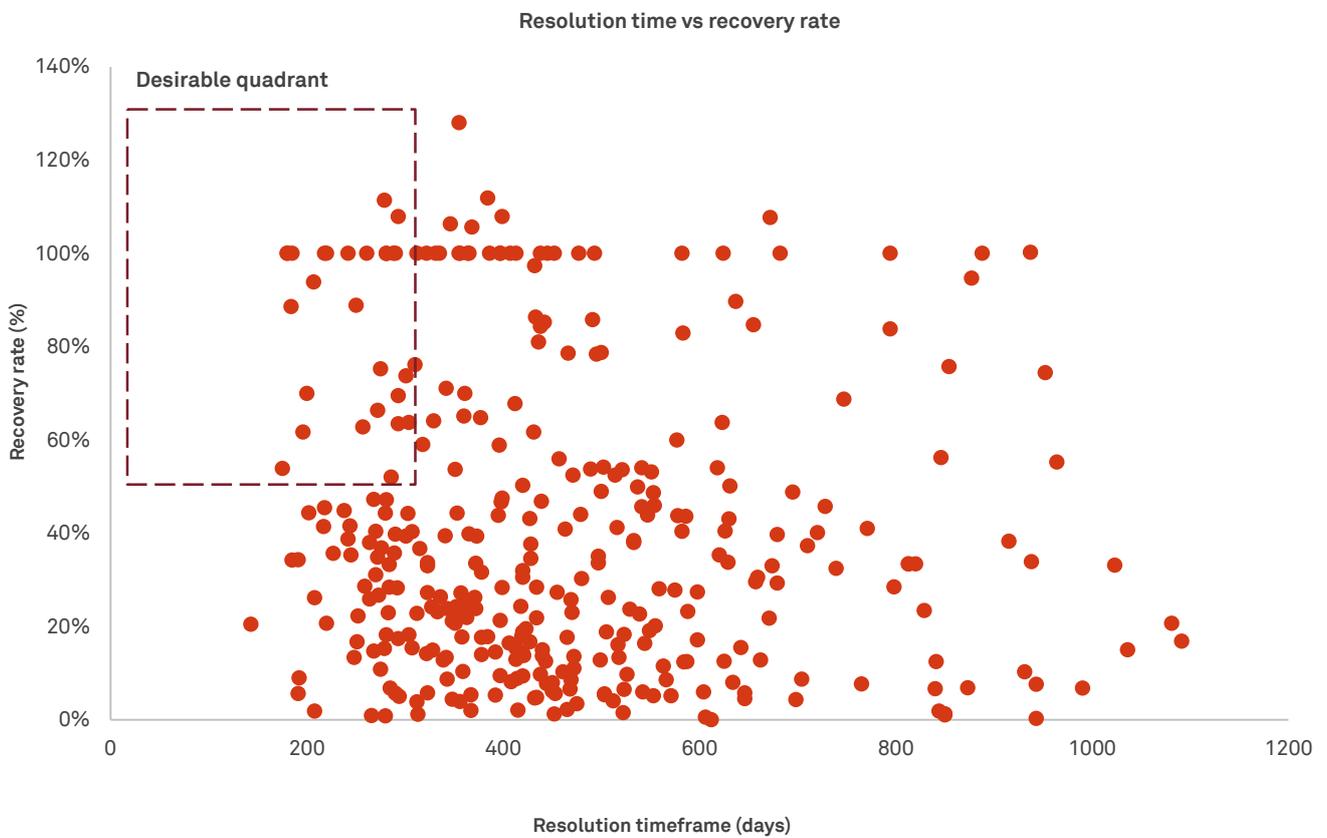
Reasons for voluntary liquidation



Source: IBBI

Majority of 348 resolved cases under CIRP outside the desirable quadrant

A two-dimensional scattered chart (see below) plotting recovery rate and resolution timeline of the 348 resolved cases under CIRP demonstrates that a majority of the cases are outside the desirable quadrant (a recovery rate of over 40% and resolution within 330 days).



Source: IBBI, CRISIL Ratings estimates

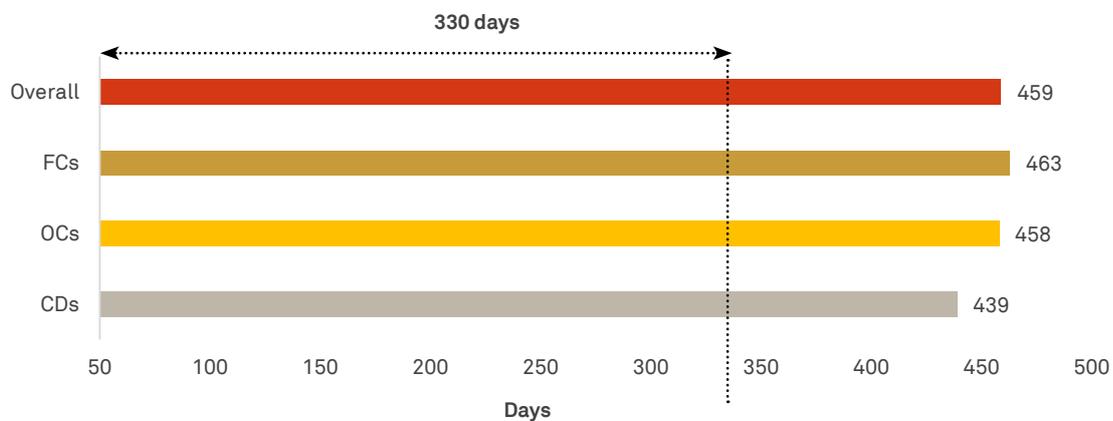
Adherence to the resolution time is an issue which needs to be addressed as soon as possible.

3. Adherence to the IBC timeline still a challenge



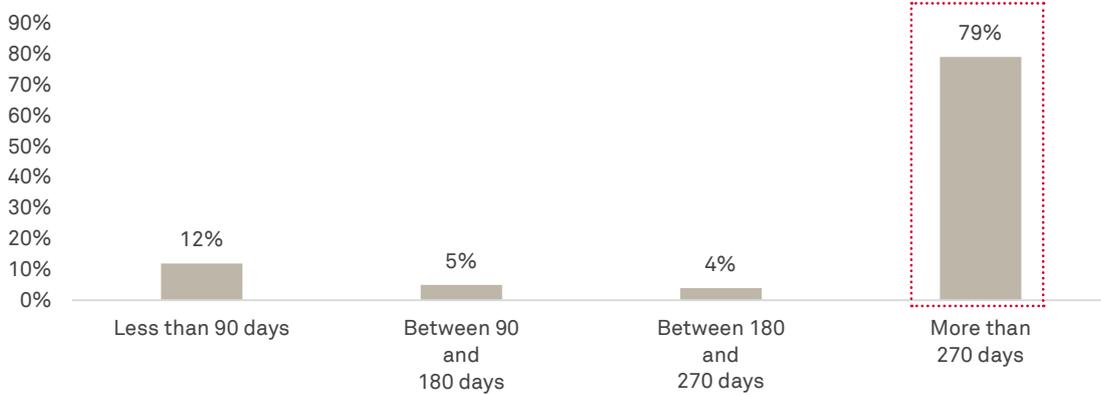
Though the average resolution timeline for the 348 resolved cases under the IBC as of March 2021 was faster compared with other mechanisms, it is more

than the 330 days prescribed in the code itself. The average recovery timeline across categories, that is, FCs, OCs and CDs, was also more than prescribed.



Source: IBCI; FC: Financial creditors; OC: Operational creditors; CD: Corporate debtors; IBC timeline refers to only the resolution timeline; the actual recovery timeline could be longer

Furthermore, 79% of the outstanding 1,723 cases as of March 2021 are pending beyond 270 days. Hence, adherence to the IBC's own timeline remains a challenge.

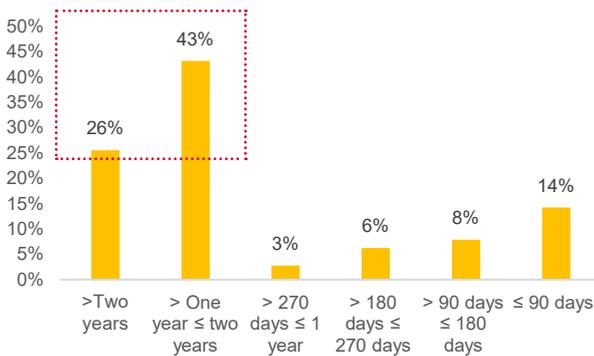


Source: IBBI

Out of 1,277 liquidation cases, only 138 have been dissolved while around 1,000 are still under liquidation for more than a year. Around 70% of the ongoing

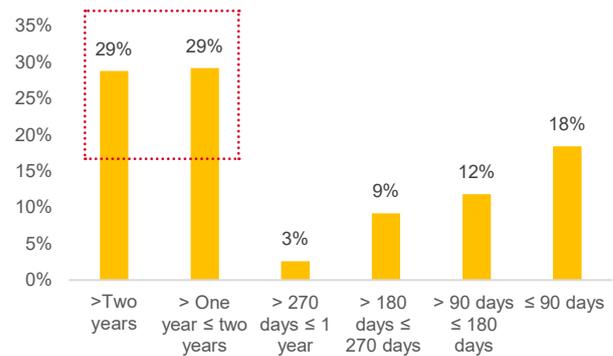
liquidation and ~60% of voluntary liquidation cases have exceeded the stipulated liquidation timeline of one year.

~70% of ongoing liquidation cases have exceeded the one-year stipulated timeline



Source: IBBI; Ongoing liquidation cases: 1037 out of 1277 cases; balance 240 cases already liquidated

...even ~60% of ongoing voluntary liquidation cases have exceeded the one-year timeline

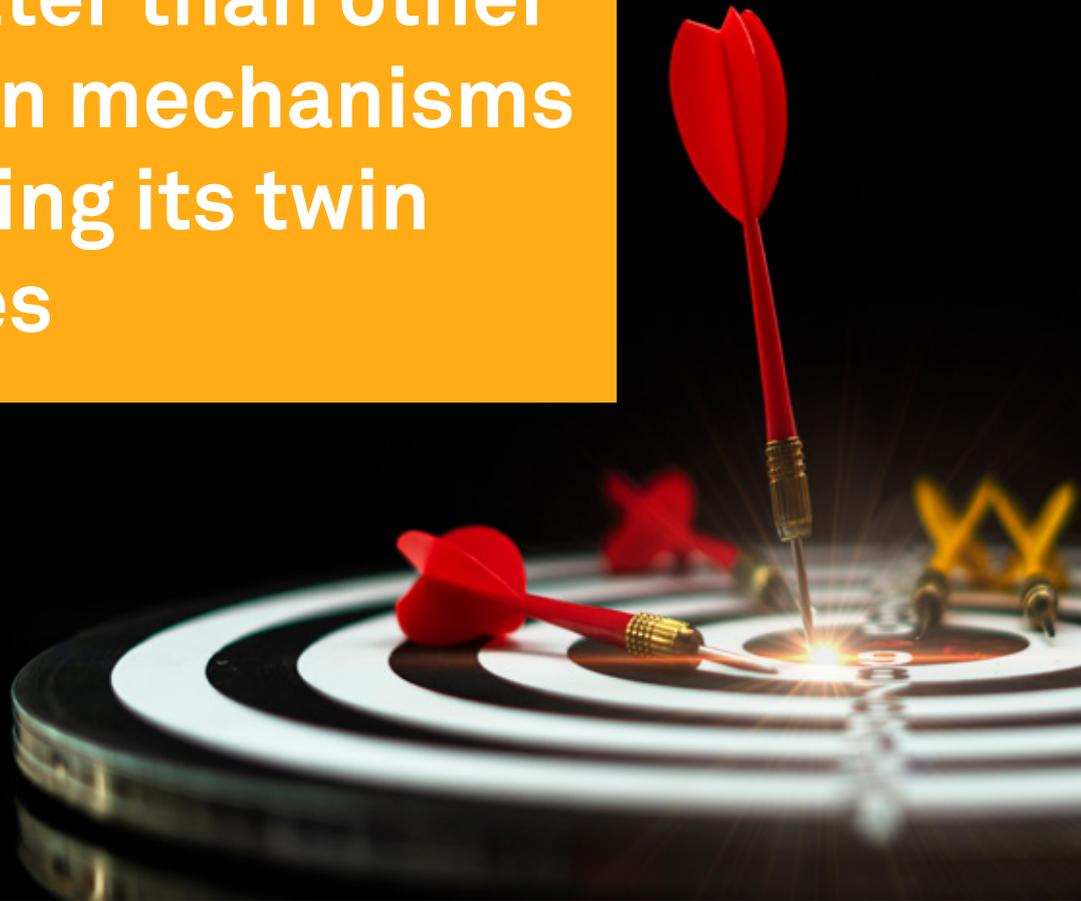


Source: IBBI; Ongoing voluntary liquidation cases: 500 out of 907 cases; balance 408 cases already liquidated

While there are several reasons for this, limited marketability of assets is a critical factor according to a study in February 2021 by the Insolvency and Bankruptcy Board of India (IBBI) on CIRP timelines in its sample set of liquidation cases.

Legal issues, inter creditor issues, priority or charge related issues, attachment of assets by various statutory authorities and/or probe agencies ultimately result in delay in the liquidation process. These issues have to be addressed to fasten the process.

4. However, IBC has fared better than other resolution mechanisms in achieving its twin objectives

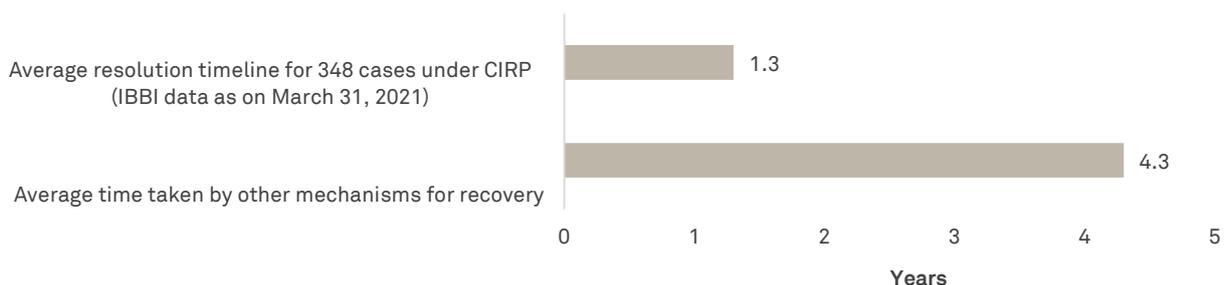


Resolution timeline under the IBC is better than other mechanisms

Resolutions under the IBC are undoubtedly faster compared with other mechanisms such as Lok Adalats, debt recovery tribunals (DRTs), and the Securitisation and Reconstruction of Financial Assets

and Enforcement of Security Interest (SARFAESI) Act, 2002, at 1.3 years (459 days) for resolved cases as of March, 2021, compared with 3.5-4.0 years through other routes. This corroborates with the resolution timeline of 1.6 years mentioned in the World Bank’s Doing Business 2020 report.

Recovery timeline comparison

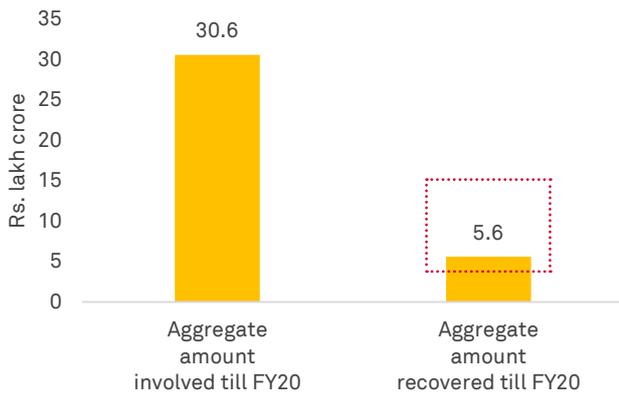


The IBC has better recovery rates

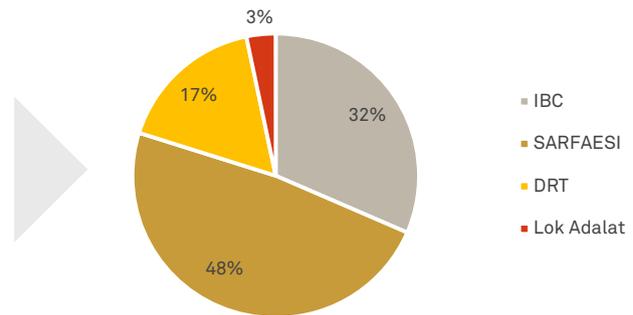
The focus in the IBC is on optimum debt reduction, including through potential transfer of assets to a new management that can bring in the resources needed to scale up cash flows. The recovery rate under IBC

has been better than that through other channels such as DRTs, the SARFAESI Act and Lok Adalats, which are burdened by pending legal issues and infrastructure constraints.

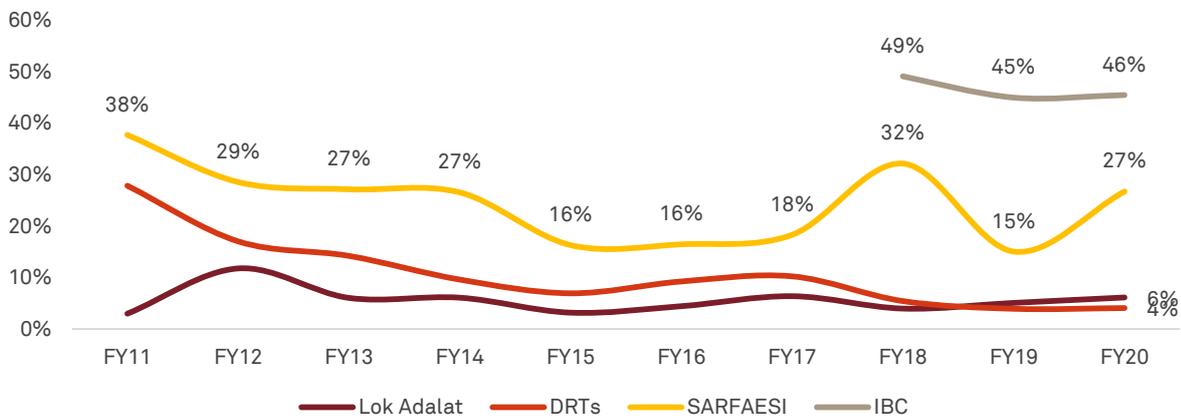
Aggregate data till FY20



Recovery through various mechanisms as of FY20



Comparison of year-on-year recovery rate under various mechanisms



Source: RBI

As depicted above, the first chart is the aggregate recovery across resolution platforms which is Rs 5.6 lakh crore till March 2020. IBC contributed almost a third despite just five years of existence. The above

line chart shows the annual recovery rates across resolution mechanism. IBC shows superior recovery and reinforces its potential in the medium to long term.

5. Timely amendments in the IBC will streamline operationalisation

Fiscal 2019

- Reduced the minimum voting threshold for the CoC to 66% from 75% for key decisions, and to 51% from 75% for routine decisions
- Allowed promoters of MSMEs who are not categorised as wilful defaulters to bid for their assets
- Pegged the rights of homebuyers on par with FCs
- Section 29A of the IBC tweaked to exempt pure-play financial entities from being disqualified to bid for assets

Fiscal 2020

- Increase in threshold to initiate CIRP from Rs 1 lakh to Rs 1 crore
- Suspension of the IBC process for one year under sections 7, 9 and 10 due to Covid-19
- Government allowed creditors to proceed against personal guarantors for recovery of loans given to a company under the IBC

Fiscal 2021

- Section 32A introduced to protect CD and its assets from prosecution upon the approval of a resolution plan, if the resolution plan results in a change in the management or control of the CD

Fiscal 2022

- Pre-package insolvency resolution framework for MSMEs introduced (The Insolvency And Bankruptcy Code (Amendment) Ordinance, 2021)
- The Supreme Court upheld the government's November 2019 notification to allow creditors to initiate insolvency proceedings against personal guarantors

Recovery through personal guarantee to CD to aid recovery levels

A brief background

On November 15, 2019, the government notified allowing creditors to proceed against personal guarantors for recovery of loans given to a company under the IBC. The notification was challenged by various petitioners before several high courts initially. The Supreme Court transferred all the pleas against the notification to itself at the government's request. On May 21, 2021, the Supreme Court upheld the government's move to allow creditors to initiate insolvency proceedings against personal guarantors which clarified that approval of a resolution plan for the CD does not discharge the liability of the personal guarantor as that arises out of a separate contract.

Key takeaways of recovery through personal guarantors

- It will strengthen the IBC to achieve its twin objectives of faster resolution and better recovery
 - Expected to benefit all creditors by ensuring an optimal resolution process
 - Resolution applicants would find it more attractive to participate in the bidding process
- This should maximise the recovery potential (from personal guarantees) apart from realisable value under the insolvency process
- It is expected to enhance the bargaining power of creditors to deal with the promoters/directors of the CD
- CoC would get a clear picture on additional avenues for recovery of their dues
- This will instill better credit discipline amongst promoters/directors as they would avoid unwarranted consequences on invocation of personal guarantee
 - Potentially may lead to settlements within a shorter timeline
- Amalgamation of the process, that is, parallel proceedings against the CD and its personal guarantor/s under a common forum (NCLT)
 - Should provide NCLT better clarity about the extent of debt of the CD, its available assets and resources, as also the assets and resources of the personal guarantor

6. Gains for stakeholders under IBC

The IBC is aimed at protecting the interests of multiple stakeholders, including banks and financial institutions, secured and unsecured creditors, and employees. Even ARCs stand to benefit from speedy recovery, and stakeholders would gain clarity on their

share of dues. Besides, if implemented well, it can help deepen the corporate bond market by facilitating lower-rated issuances as well as further improve India's Ease of Doing Business ranking.

The following chart depicts the benefits of IBC for each set of stakeholders.

Corporates and MSMEs

- Fosters innovation and entrepreneurship
- Pre-packs for MSMEs to protect their business and ensure business continuity

ARCs

- Helps churn capital faster and enhances returns



Creditors

- Enhances creditor rights

Economy

- Improves 'Ease of Doing Business' and Global Competitiveness' rankings
- India's Ease of Doing Business ranking improved from 100 in 2018 to 63 in 2020

Banks

- Quickly resolves stress and enables release of capital in the banking system
- Instils better credit discipline among

Bond markets

- Predictable recovery process improves investor confidence
- Could help deepen the Indian bond market beyond the 'AA' and 'AAA' rating categories

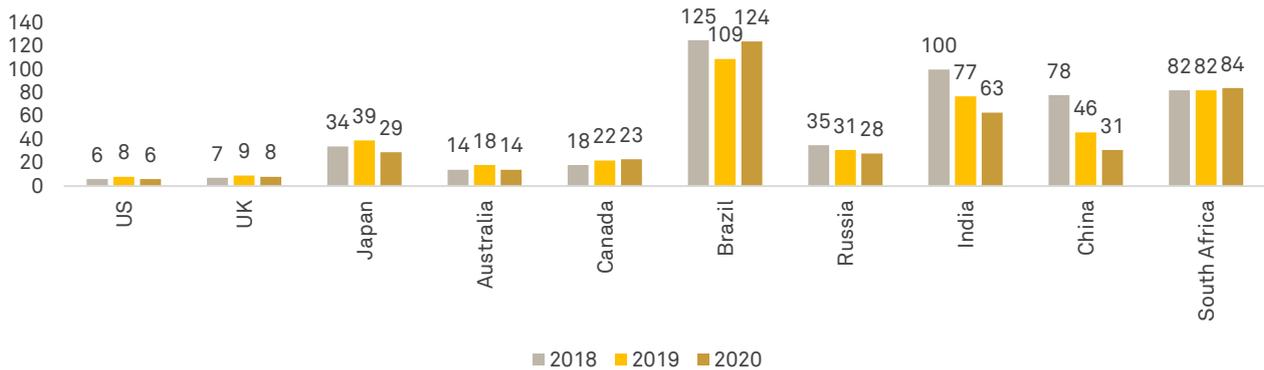
Let us examine the impact of IBC on each stakeholder in more detail.

Economy

Ease of Doing Business ranking has improved: Implementation of the IBC has helped improve India's position in the World Bank's Ease of Doing Business ranking, and attract more foreign investors.

In 2020, the ranking weighed 190 countries. India's rank improved to 63 from 100 in 2018, mainly because of the IBC implementation.

Ease of Doing Business rankings, 2020



Source: Doing Business, World Bank report

Strengthening insolvency framework: World Bank's Ease of Doing Business ranking is based on 11 parameters. One of the parameters is linked to insolvency framework. The Doing Business 2020 report puts the ease of resolving insolvency score and rank of India at 62.0 (up from 40.8 in 2019) and 52 (108 in 2019), respectively, citing the strengthening insolvency resolution framework. The significant jump in India's score can be attributed to the IBC, which prescribes clear timelines for the resolution process.

Banks and financial institutions

The expected increase in gross NPAs (GNPAs) of both banks and non-banks this fiscal because of the pandemic will provide an opportunity for players in the stressed assets market through resolution via various routes, with IBC likely to be the most preferred.

Banking GNPAs to cross ~Rs 10 lakh crore by March 2022



Source: RBI & CRISIL Ratings

GNPAs of banks have declined from the peak seen in March 2018 and were lower as of March 2021 vis-à-vis March 2020 on account of supportive measures, including the six-month debt moratorium, emergency credit line guarantee scheme (ECLGS) loans and restructuring measures.

However, with the second wave hitting the country in the first quarter this fiscal, NPAs are expected to rise to 8.5-9.0% by March 2022. The current asset quality stress cycle will be different than that witnessed a few years back. NPAs then came primarily from bigger, chunkier accounts. This time, smaller accounts, especially the MSME and retail segments, are expected to be more vulnerable than large corporates, as the latter have consolidated and deleveraged their balance sheets considerably in the past few years. While the restructuring scheme announced for MSMEs and small borrowers should prevent the NPAs from rising too much, there is opportunity for stressed asset investors with expertise and interest in these asset classes.

Unsecured loans and MSME finance worst hit:

Stressed assets of NBFCs were estimated at Rs 1.5 lakh crore as of March 2021. While gold and home loans are expected to be affected the least, MSME, unsecured and wholesale loans will take a bigger hit as these borrower segments have been affected more by the pandemic.

IBC amended regularly to improve credit culture and strengthen the resolution framework:

Section 29A renders the promoters of insolvent companies (except MSMEs) ineligible to bid for their own entities, significantly enhancing credit discipline. This has resulted in resolution of cases at the pre-admission stage in the IBC, as the fear of losing their companies loomed large before the promoters. A press release from the Ministry of Corporate Affairs dated December 15, 2019, stated that ~9,600 cases involving Rs 3.75 lakh crore were disposed of under the IBC at the pre-admission stage.¹ Furthermore, the IBC amendment regarding recovery from personal guarantor/s of a CD will also help in facilitating recoveries. Amendments made during the pandemic will help contain the rise in NPAs as its consequence. These measures include raising the minimum threshold to initiate insolvency proceedings to Rs 1 crore from Rs 1 lakh; suspension of fresh initiation of insolvency proceedings for a year till March 24, 2021; exclusion of pandemic-related debt from

the definition of 'default' under the code for the purpose of triggering insolvency proceedings; and introduction of insolvency pre-packs for MSMEs.

Regulatory changes instilling better credit discipline in borrowers:

The risk management practices of Indian banks, especially public sector banks, have scope for improvement. Moreover, in the past, laws were not in favour of lenders and allowed erring promoters to exploit the tedious recovery procedure. This is borne out by the high number of wilful defaulters of banks. However, the RBI has tightened norms for such defaulters and made stressed asset resolution norms more stringent. That, coupled with increased resolution of large-ticket NPAs under the IBC framework, have contributed to better recovery of NPAs.

Help release capital for banks: Banks deploy substantial capital as provisions against stressed assets. Faster resolution will help release capital that can be used for credit expansion.

Unsecured loans market getting a boost: The IBC will promote unsecured financing as the distribution waterfall of recoveries following liquidation gives unsecured FCs (apart from all secured creditors) precedence over government dues.

Bond markets

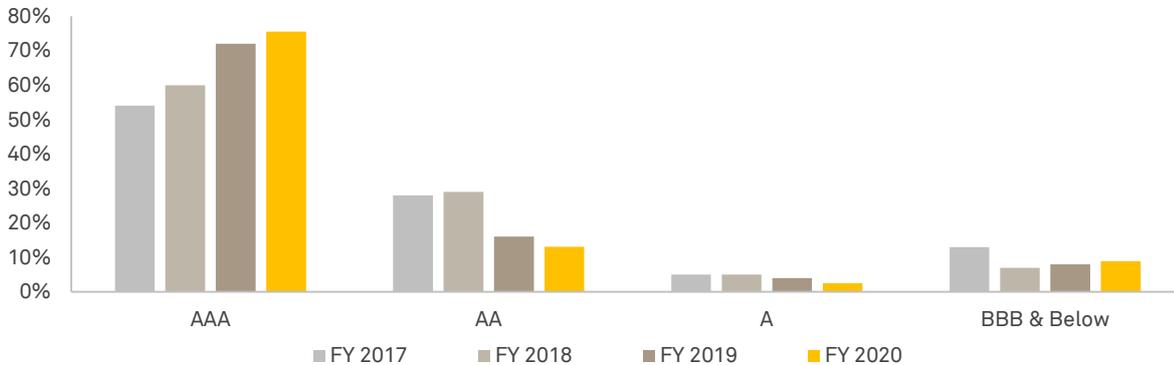
Better and faster resolution will deepen the bond markets:

With a robust IBC ecosystem and certainty of resolution outcomes and adherence to timelines, the interest of both domestic and foreign investors in lower-rated paper is expected to increase over time. The gradual shift in investor confidence will lead to higher penetration of bond markets in India. Currently, the corporate bond market forms only ~23% of India's gross domestic product (GDP), compared with ~146% in the United States (US) and ~85% in South Korea, on account of lack of investor confidence and the nascent insolvency regime.

The low investor interest is clearly reflected in India's corporate bond market, which is skewed towards highly rated bonds. About 90% of trading is restricted to the 'AAA' and 'AA' rating categories. The primary reason for the aversion to lower-rated paper (below 'AA' category) is poor recovery in case of a default.

¹<https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1596523>

Distribution of bond issuances by rating category



Source: Prime Database, CRISIL Research

The RBI has also implemented norms for limiting individual/group exposures in banks and encouraging large corporate borrowers to access the bond markets for funds. This, along with the IBC, should help boost the Indian corporate bond market over time.

ARCs

With IBC improving borrower discipline, recoveries could climb: Access to capital sources is a critical aspect for ARCs as their collective networth is pegged at just Rs 9,500-10,000 crore (CRISIL Ratings estimate as on March 31, 2021), and they have limited room to tackle mounting NPAs. However, ARCs have been trying to implement strategies to improve recovery rates backed by positive changes in the regulatory framework, improved credit discipline among borrowers because of the IBC, and acquisition of lower vintage assets.

Creditors

For the first time, OCs can also initiate insolvency proceedings: The IBC has uplifted the rights of the creditor (irrespective of type, that is, FC or OC), and sharpened identification of bankruptcies and initiation of resolution proceedings. It has especially empowered OCs such as trade suppliers, employees and workmen to initiate the insolvency resolution process. The provision was not available in earlier and even other current restructuring mechanisms, such as the SARFAESI Act, 2002, and the Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993. OCs are now initiating more CIRPs than FCs. As of March 2021, out of 4,376 cases under CIRP, ~51%

were initiated by OCs, ~43% by FCs and the remaining by CDs.

Corporates and MSMEs

To be sure, the IBC has instilled better credit discipline among borrowers, that is, corporates including MSMEs. This has led to faster resolution and better recovery in and outside the IBC platform. The code also provides some respite for start-ups, which, if 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. This may also help entrepreneurs initiate insolvency proceedings voluntarily. Over a period of time, the code is expected to promote entrepreneurship and increase the role of professionals from various fields such as law, accountancy and finance.

While the IBC fosters innovation and entrepreneurship, the recently introduced insolvency pre-pack is a step in the right direction to protect and ensure business continuity for MSMEs.

According to the Ministry of MSME's report for fiscal 2021, India's MSME sector is dominated by micro-enterprises. Of an estimated 6.33 crore MSMEs, 6.30 crore (99.47%) are micro-enterprises^[1], 3.31 lakh (0.52%) are small^[2], and 5,000 (0.01%) are mid-sized^[3]. Rural areas have 51% of the MSMEs in the country. As per National Sample Survey 2015-16, ~67% of the MSMEs are from the manufacturing and trading segments and the remaining from other services; and 51% are rural-based and the remaining in urban areas. Till June 2021, only 35 lakh MSMEs were registered as per Udayam registration data. Udyam Registration

[1] Micro: Investment up to Rs 1 crore and sales up to Rs 5 crore

[2] Small: Investment up to Rs 10 crore and sales up to Rs 50 crore

[3] Medium: Investment up to Rs 50 crore and sales up to Rs 250 crore

is mandatory to avail benefits under most of the schemes of Ministry of MSME and availing credit from financial institutions as per RBI notification no. RBI/2020-2021/26 dated 21st August, 2020.

Given their crucial role as a catalyst for economic growth, the Micro, Small and Medium Enterprises Development Act, 2006, gave MSMEs special status by way of relaxations, exemptions and relief under various government schemes, and several laws including the IBC.

The IBC provides relaxations to MSMEs through Section 240A, wherein if the CD is an MSME, section 29A of the IBC, is exempted. The exemption has allowed a window to promoter-directors of MSMEs to submit resolution plans under the code, thereby increasing their chances of revival.

It is pertinent here to look at how the pandemic has led to changes in the provisions of the IBC, to the further benefit of corporates, especially MSMEs. The intention of the IBC relaxations such as increasing default threshold to Rs 1 crore and introduction of pre-packaged insolvency resolution process (PPIRP) for MSMEs was to provide a breather during the pandemic, given that MSMEs do not have the wherewithal to sustain for long if referred to the IBC. These measures also shield MSMEs from value erosion of their business because there may not be too many takers under the IBC due to the nature of their business.

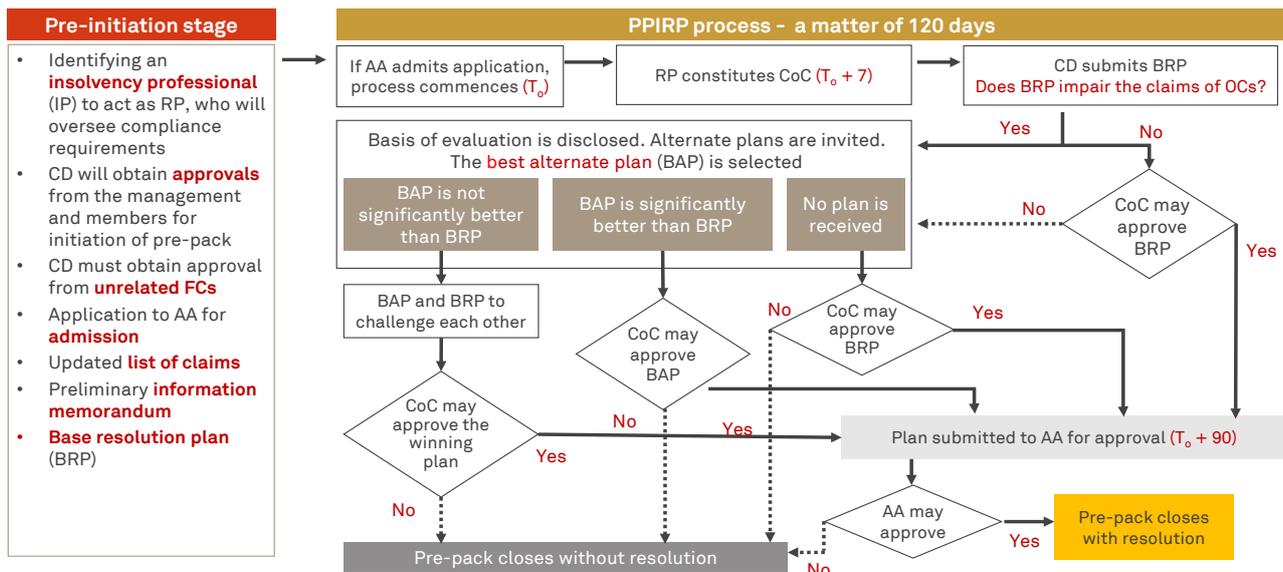
Insolvency pre-packs: A shot in the arm for MSMEs

On April 4, 2021, the President of India promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance to allow PPIRP for CDs classified as MSMEs. The minimum default threshold is Rs 10 lakh. This new regime under the IBC aims to provide MSMEs quicker, more cost-effective resolution than the traditional CIRP route.

The pre-packaged insolvency process for MSMEs is based on the 'debtor-in-possession' model, wherein the CD proposes a resolution plan to the secured creditors before the initiation of CIRP and the entity continues to be controlled by the existing management instead of a resolution professional. Once the proposal is approved by 66% of the creditors, it comes under CIRP wherein the timeline for resolution is 120 days vis-à-vis 330 days for corporates referred directly under CIRP. The exemption of Section 29A for MSMEs is applicable under the PPIRP as well.

The PPIRP process flow

The pre-initiation stage of PPIRP is one of the most critical stages in the process and a majority of the pre-resolution tasks are completed in this stage.



Source: IBI

Benefit of PPIRP

- A **hybrid process**, involving formal and informal methods of resolution, facilitates debtor and creditor participation
 - The informal process provides **flexibility** in developing an effective resolution plan before the formal process starts
 - Takes the stipulated timeline for the approval of the resolution plan in the formal process
- Should effectively facilitate group entities for a combined solution
 - May help the interested buyer assess the correct enterprise value

- Helps in **value maximisation**
 - Provides flexibility in rationalising cost
- **Faster resolution** within 120 days
 - Shorter duration reduces cost and saves time
- May reduce job losses by pre-empting stress build-up in the firm
 - Foster innovation and entrepreneurship
- Should **free up the bandwidth of courts**, which are overburdened
 - May reduce unnecessary stalling of cases due to litigation

Source: IBBI



Challenges

- A significant number of MSMEs are currently ineligible for PPIRP as they need to be registered first. Only ~35 lakh MSMEs (out of a total of 6.33 crore) were registered till June 2021.
- Current regulation keeps proprietorship, partnerships and Hindu Undivided Family forms of MSMEs out of the ambit of the pre-pack process and allows only companies and limited liability partnerships.
- There is limited marketability of MSMEs at present.



The way forward

- The effectiveness of PPIRP needs to be tested to understand teething issues.
- Potential expansion of PPIRP beyond MSMEs is the need of the hour.
- Development of a secondary market for stressed assets to enhance their marketability is a crucial step.

7. Key challenges and potential resolutions



Time-bound resolution should be the prime objective

In a number of cases, stakeholders are failing to formulate a resolution plan within the prescribed 330 days, especially in complex/large cases.

Of the first 12 cases in the IBC referred by the RBI, the majority crossed 270 days for resolution. As on March 31, 2021, there were 1,723 cases under CIRP, of which 79% were pending for more than 270 days.

The standing committee on finance, in its report 'Implementation of Insolvency and Bankruptcy Code – Pitfalls and Solutions' released in August 2021, highlighted that there are around 13,170 IBC cases pending with NCLT which involve claims of around Rs 9 lakh crore and 71% of these cases are pending for more than 180 days. The committee highlighted that NCLT takes considerable time for admission which leads to value erosion of assets and other litigations as well, and recommended that cases be accepted within 30 days.

Stakeholders need to work together constructively. The development of insolvency professionals with

integrity and the necessary skills to undertake the onerous tasks in insolvency and bankruptcy cases is critical.

Delays raise the threat of liquidation, so time-bound resolution key to maximise asset value

Delay in the initiation of the insolvency process affects the liquidation value of the underlying assets, which depreciates with time. Many corporates ending up with liquidation had long-pending defaults, and were left with inadequate organisational capital.

The reasons for failure to arrive at a proper resolution plan include valuation mismatch, lack of clarity on payment of statutory liabilities, conflict among lenders, and the high cost involved in submitting such plans.

In most cases leading to liquidation, the resolution value offered is lower than the liquidation value, the plan comes from ineligible parties, or there is no resolution plan at all. Liquidation also leads to job losses, even if the firm is liquidated on a going-concern basis.

Strengthening judicial infrastructure and empowering judicial members is the need of the hour

Currently, as per the NCLT website, there are 15 benches with 20 judicial members and 21 technical members at the NCLT².

This may not be sufficient to deal with the large number of pending cases as the NCLT has to resolve cases filed earlier under the Company Law Board and the Board for Industrial and Financial Reconstruction, in addition to insolvency cases.

Winding-up and amalgamation cases with high courts and corporate cases in DRTs are also transferred to the NCLT.

To address this, the Ministry of Corporate Affairs is contemplating doubling the NCLT benches.

An immediate ramp-up of infrastructure at the NCLT and the National Company Law Appellate Tribunal (NCLAT), digitisation of the platform, and proactive training/on-boarding of judges, lawyers and other intermediaries will help implement the IBC more effectively.

The 'Implementation of Insolvency and Bankruptcy Code – Pitfalls and Solutions' report stated that more than 50% of the sanctioned strength in NCLT is lying vacant and recommended that the vacancies be filled at the earliest.

NCLT judgements are contested in NCLATs and in the Supreme Court and are overturned in a number of cases. To address this, the report advocated that the NCLT members need to be experienced and trained professionals.

Empowering CoC crucial, but guidelines for conduct need to be defined

The CoC is the supreme decision-making body in the CIRP in terms of determining the viability of the business and the feasibility of future operations. It may recommend liquidation of the CD if it finds the resolution plan will not succeed. Ultimately, it is up to the "commercial wisdom" of the CoC to decide whether or not to revive the CD. The Supreme Court, through its various judgments, has upheld the primacy of the CoC and its commercial wisdom which should not be interfered by the AA. The CoC is empowered to commercially consider the feasibility and viability of a resolution plan, and the manner of distribution of proceeds in a resolution plan, which may take into account the priority and value of the underlying asset.

While the primacy and commercial wisdom of CoC is upheld,

- The CoC must balance responsibilities and duties towards all stakeholders in a fair and equitable manner in the resolution process.
- Timely decision making by the CoC is key to successful implementation of a resolution plan.
- Managing conflict of interest amongst CoC members is crucial.

The CoC members have several responsibilities including invitation, receipt, consideration and approval of resolution plans under the IBC. Their conduct has serious implications for the continued business of a CD, and consequently, the economy.

In a number of cases, the AA has observed that the CoC members nominated by lenders are not given the authority to take decisions upfront, thereby delaying the process. Moreover, 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 period. 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 professional to revive the CD and should be trained to handle professional challenges. Logistical challenges need to be addressed to deal with the large number of participants attending CoC meetings to have a constructive decision-oriented discussion.

The 'Implementation of Insolvency and Bankruptcy Code – Pitfalls and Solutions' report mentions the need for a professional code of conduct for the CoC, which will define and circumscribe decisions.

Set up robust Information Utilities (IUs) to provide credible information on claims

IUs provide access to credible and transparent evidence of default, which helps expedite the initiation of the resolution process. They also facilitate quick formation of the CoC by providing information regarding claims of creditors required to form the committee.

In the absence of IUs, the formation of a CoC may take longer, making it difficult to adhere to the timeline for completing the resolution process. It also becomes time-consuming for the NCLT to evaluate whether a default has taken place.

²As per NCLT website

India has only one IU, National e-Governance Services Ltd, which was registered with IBBI on September 25, 2017. Moreover, the financial information available with this IU needs scrutiny. Technological infrastructure has to be strengthened to avoid data loss and maintain confidentiality.

Develop a viable secondary market and information repository for stressed 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 do not have buyers. Moreover, banks are sceptical about funding such 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.

Further, setting up information repository of stressed assets can enable access of information to investors and help in bringing transparency around stressed assets.

Standardisation of valuation system across asset classes and statutes

There is high demand for valuation services in India under various statutes related to securities, tax, banking and insolvency mechanism. Under IBC, there has been a steady increase in the registration of valuers every year which augurs well for the valuation ecosystem. Currently, there are ~4,300 individual registered valuers (RVs), 40 RV entities and 16 registered valuer organisations (RVOs) under IBBI, who majorly follow International Valuation Standards. There are RVs under Companies Act and the Securities and Exchange Board of India (SEBI) regulation as well. India does not have a comprehensive valuation standard and valuers use different methods of valuation leading to variation in their values which ultimately does not serve the purpose of the report. Undervaluation could result in loss of value whereas overvaluation may lead to loss of interest in the market. Limited or no access to recent information and financial documentation, evaluation of assets in remote locations and/or units which are shut for a while also pose challenges.

Formation of National Institute of Valuers as a primary regulatory body for valuation in India, as proposed under Valuers Bill, 2020, and bringing all the statutes under one umbrella will be structurally positive steps

that will strengthen the Indian valuation system through regulation and standardisation. However, success hinges on timely implementation and international acceptance.

Fast paced digitisation of IBC platforms essential

Covid-19 has amplified the need to strengthen digital capabilities. Digitisation of records and operations with provisions for virtual hearings of NCLT and NCLAT will help clear the backlog of pending cases swiftly.

Online streamlining of various operational processes, along with constant monitoring and analysis of the workflow, outcomes with regard to resolution, recoveries and timelines will shorten the time taken for resolution. An intelligent system that enables data-based decision making for judges and registries when scheduling or prioritising cases, and allows for greater predictability and optimisation of capacity of judges and lawyers will help in time-bound resolution.

Implement group/cross-border insolvency on a fast-track basis

With the current amendments in the code, group/cross-border insolvencies in the current context should be prioritised as they are complex and entangled with legal complications. Learnings from recent transactions such as resolution of Videocon and its 13 group companies should be taken on-board to lay down a comprehensive framework. The ecosystem needs to be strengthened by increasing NCLT capacities and developing technical expertise of judges with efficient administrative functionaries.

Develop comprehensive bankruptcy framework for financial service providers (FSPs)

With increased stress in the non-banking financial sector, rules were notified by the Ministry of Corporate Affairs providing a framework for insolvency resolution of systemically important FSPs³, excluding banks. These rules are under the powers given to the government in Section 227 of the IBC and are only applicable to NBFCs (including housing finance companies) with asset size of Rs 500 crore or more as per the last audited balance sheet. The RBI will be the FSP regulator allowed to file an application. Similar to the corporate resolution framework under the IBC, a comprehensive framework for FSPs, including banks, needs to be developed as this is one of the most critical areas of the IBC.

³<https://ibbi.gov.in/uploads/legalframework/7bcd2585a9f75b9074febe216de5a3c1.pdf>

8. Annexure

A comparison with global best practices

Details	US	UK	India	Other countries
Bankruptcy initiation	A creditor may file for restructuring and liquidation and does not need to provide evidence	A creditor may file for restructuring and liquidation, but needs to produce clear evidence	In India, an FC, OC or the CD itself can initiate on default of Rs 1 crore and above	In some countries, such as Australia, Canada, Greece, Brazil and Russia, creditors may file only for liquidation
Management change	Debtor retains management control of the company and proposes a plan of reorganisation	An administrator takes over management of the company and plays a central role in the rescue process	The management of the affairs of the CD vests with the interim resolution professional appointed by the AA and approved by the CoC	
Pre-packaged rescue	Debtor company and its creditors conclude an agreement for sale of the company's business prior to initiation of formal insolvency proceedings	Same as in the US	Framework for MSMEs introduced	
Consent of resolution proposal	Each class of creditors needs to consent to the resolution plan through a vote of two-thirds of that class in volume and half the allowed claims. Provision available for 'cram-down' of dissenting creditors	Acceptance of the proposal requires a simple majority (by value) of the creditors present and voting	66% consent of CoC for key decisions, and 51% for routine decisions	In Germany, the proposal needs to be approved by each class of creditors. In France, two committees of creditors plus a committee of bond holders are established
Waterfall mechanism	In case of liquidation, costs associated with insolvency proceedings have the first claim	In case of liquidation, secured creditors have the first claim	In case of liquidation, costs associated with insolvency proceedings have the first claim followed by dues of workmen and secured creditors on a pari passu basis	In Australia, Norway, Greece, Mexico and Colombia, employees' salaries have the first claim in the order of priority
Moratorium	Law provides for an automatic moratorium on the enforcement of claims against the company and its property upon filing of a Chapter 11 petition	Law provides for an interim moratorium for the period between the filing of an application to appoint an administrator and the actual appointment	The IBC provides for an automatic moratorium of 180 days against any debt recovery action by the creditors, extendable by 90 days in exceptional cases	In Singapore and Brazil, the moratorium holds till the entire resolution plan is approved

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

It was established in 1920 by promoter Chambers, representing all regions of India.

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As a representative organ of Corporate India, ASSOCHAM articulates the genuine, legitimate needs and interests of its members. Its mission is to impact the policy and legislative environment so as to foster balanced economic, industrial and social development. We believe education, IT, BT, Health, Corporate Social responsibility and environment to be the critical success factors.

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ASSOCHAM represents the interests of over 4,50,000 direct and indirect members across the country. Through its heterogeneous membership, ASSOCHAM combines the entrepreneurial spirit and business acumen of owners with management skills and expertise of professionals to set itself apart as a Chamber with a difference.

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- Professionals (e.g. CAs, lawyers, consultants)
- Trade and Industry Associations and other Chambers of Commerce

Deepak Sood

Secretary General, ASSOCHAM
 sg@assochem.com

The Associated Chambers of Commerce and Industry of India

ASSOCHAM, 4th Floor, YMCA Cultural Centre and Library Building,
 01, Jai Singh Road, New Delhi - 110001
 Tel: 46550555 (Hunting Line)
 Fax: 011-23347008/9
 E-mail: assochem@nic.in

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