# Bad bank to deepen IBC use; special insolvency framework for MSMEs in the works: IBBI chairman Sahoo

MS Sahoo, the chief of the insolvency regulator IBBI, explains why the Budget proposals for a special insolvency framework for MSMEs as well as a 'bad bank' led by lenders are important.

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MS Sahoo, the chief of the insolvency regulator IBBI

MS Sahoo, the chief of the insolvency regulator IBBI, explains why the Budget proposals for a special insolvency framework for MSMEs as well as a 'bad bank' led by lenders are important. In an interview to FE's Banikinkar Pattanayak, Sahoo also asserts that the number of insolvency cases is unlikely to jump substantially after the one-year suspension of bankruptcy proceedings against Covid-related default is lifted from March 25. A pre-pack insolvency scheme, suggested by a panel under him, will yield faster resolution and help maximise the value of a stressed firm, he says, refuting the notion that a shorter time-frame for the submission of a resolution plan under the proposed scheme may not draw the best bidder. Edited excerpts:

**The Budget for 2021-22 proposes a special insolvency resolution framework for MSMEs. What is expected?**

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MSMEs are different from other companies in many ways for the purpose of resolution. These are: MSMEs generally have loans from informal sources, which do not have access to resolution frameworks as available to banks; many of them do not have stamina to sustain a full-fledged CIRP-style resolution process; the value of an MSME firm often lies in informal arrangements, making it difficult for a third party to harness value through a resolution plan; the market for resolution plans for an MSME firm is local, while the entire globe is the market for a bigger firm; etc. In recognition of their uniqueness, a special framework,tailor-made for resolution of MSMEs is under consideration.


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**Will the proposed 'bad bank' in any way reduce the attractiveness of the Insolvency and Bankruptcy (IBC)?**

Actually, the 'bad bank' will, in many ways, deepen the use of IBC. It will specialise in resolution of stress, which, in turn, will build business acumen to distinguish between financial stress and economic stress and then adopt the right strategy to resolve the stress. It will also develop professional capability to evaluate feasibility and viability of resolution plans to approve the best of them. Further, the process of decision-making by the committee of creditors will be smooth as the 'bad bank' will have in most cases the voting power required for the decision. Thus, the 'bad bank' will be better placed to use the IBC, and this will improve outcomes from IBC processes.

**Once the suspension of IBC proceedings against Covid-related default is done away with from March 25, is there a possibility of a flurry of cases coming up, and is NCLT prepared for this?**

The number of applications for initiating insolvency is likely to increase, but the increase may not be significant. It is because the stakeholders are continuing to resolve stress through: (a) corporate insolvency resolution process in respect of stress other than COVID-19 stress, (b) scheme of compromise or arrangement under the Companies Act, 2013, and (c) the RBI's prudential framework. They are exploring innovative options for resolution of stress while taking several cost cutting measures to avoid stress. Further, (a) the viable companies would have normal business operations after the pandemic subsides; (b) higher threshold of default for initiation insolvency proceedings keeps most MSMEs out of insolvency proceedings; and (c) COVID-19 period defaults remain outside insolvency proceedings forever. Nevertheless, being fully aware of the need to provide commensurate NCLT capacity, Government has proposed in the budget that NCLT framework will be strengthened and e-Courts system shall be implemented.

“Pre-pack” allows 90 days to applicants to submit resolution plans and another 30 days to NCLT to approve or reject them. This is less than a half of the maximum of 270 days allowed under the extant rules for the CIRP. While fast resolution is important, will such a short time-frame weigh on the maximisation of stressed asset value, as only fewer bidders may wrap up their due diligence by then?

The Insolvency and Bankruptcy Code, 2016 (Code) envisages 180 days, extendable to 270 days, for the completion of a corporate insolvency resolution process (CIRP). It does not provide for 180/270 days for a resolution applicant to take a business decision. Further, prepack, by design, avoids some tasks of CIRP like appointment of an interim resolution professional, and executes some tasks before commencement like preparation of draft information memorandum. This helps to conclude the process faster. In fact, market is getting ready for ‘Ultrafast Pre-pack’ whereby Full Beauty Brands and Sungard Availability Services emerged from Chapter 11 bankruptcy in 24 hours and 19 hours, respectively.

The USP of pre-pack is that it takes less time for conclusion, increasing the probability of revival of a firm, at a higher value. Longer time for resolution typically depletes the value of the firm and increases resolution costs associated with time, making the possibility of revival bleak. Pre-pack usually maximises value while reviving a firm. It offers possibilities and it is for stakeholders to use it or not, based on their own assessment of the market.

**How does “pre-pack” protect the interests of operational creditors? Will there be a distribution of formula for them?**

The proposed prepack framework has the rigour and discipline of the Code. It does not impair rights of any party beyond what is provided for in a CIRP. An operational creditor shall have the same protection as available to it under section 30(2) read with section 30(4) of the Code.

**What does the panel mean when it recommends that “pre-pack” should offer two optional approaches-without Swiss challenge but no impairment to operational creditors (OCs), and with Swiss challenge with rights of OCs and dissenting financial creditors subject to minimum provided under section 30(2)(b)?**

The proposed pre-pack framework offers two optional approaches for committee of creditors (CoC). If the base plan (resolution plan submitted by the debtor) realises dues of operational creditors in full, the CoC may approve it, subject to meeting other requirements, without putting the said plan to Swiss challenge. If the base plan does not realise dues of operational creditors in full, the CoC must put the said plan to Swiss challenge and approve the better of the base plan and Swiss challenger plan,subject to minimum entitlement of operational creditors and dissenting financial creditors.

**How will “pre-pack” for pre-default be implemented? Will it be at the stage of SMA-0 or SMA-1?**

SMA classification is based on the number of days an account is overdue, that is, the duration of default. However, the Code allows initiation of CIRP if there is


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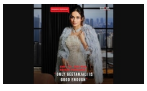

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a default of a threshold amount. If one cannot initiate pre-pack till it is classified as SMA-2, that is, till expiry of 60 days from default, it may willy-nilly resort to CIRP and in that case, the pre-pack framework may not serve a very useful purpose. Keeping the discipline of the Code, pre-pack should be allowed if there is a default. Further, SMA classification is relevant only in case of credit extended by RBI regulated entities, which cannot serve as a basis for initiation of pre-pack by other creditors. However, depending on policy objective, capacity of the NCLT and availability of other options for resolution of stress, the implementation prepack could be phased and in due course, pre-pack for resolution of pre-default stress could be considered, with appropriate checks and balances.

**While no liquidation is allowed for Covid defaults and defaults up to Rs. 1 crore, why did the panel allow this option for non-Covid defaults above Rs. one crore when resolution is the primary focus of "pre-pack"?**

Typically, prepack is a liquidation-remote resolution framework. It should either end with a resolution plan or close if there is no resolution plan. However, where the CoC considers that liquidation is the only option for resolution of stress of the firm, it may opt for liquidation, with approval of creditors having 75% of voting share. It does not serve much purpose to initiate CIRP in such cases, letting further depletion of value, and then proceed for liquidation with 66% of voting share. However, CIRP is not available in respect of pre-default stress, default below the threshold for initiation of CIRP and Covid-19 defaults. In such cases, liquidation through CIRP is not possible. Therefore, pre-pack must not yield liquidation in these situations.

**Is the government considering bringing in an ordinance to implement the new scheme?**

Since enactment of the Code, Government has been proactive to address the issues arising from its implementation. It has invited public comments on the recommended pre-pack framework. Considering all relevant factors, it would take a decision regarding pre-pack, including its format and manner of implementation.



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