We must assess IBC's success in relation to its objective, which is reorganisation

Interview/ M.S. Sahoo, outgoing chairperson, Insolvency and Bankruptcy Board

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M.S. Sahoo

Q. Five years ago, the insolvency and bankruptcy code was enacted so that stressed assets could be resolved in a time-bound manner. What are the key achievements of the IBC?

In a short span of five years of its existence, the Insolvency and Bankruptcy Code, 2016 has established the supremacy of markets and the rule of law in the resolution of stress and professionalised the process of stress resolution. From providing freedom of exit to rescuing companies in financial stress to releasing idle resources from inefficient uses to

helping creditors realise their dues and, most importantly, bringing about a behavioural change amongst the debtors and creditors alike, the list of achievements of the Code is a long one. As per the latest Doing Business 2019 report, India has made a quantum leap in its ranking in resolving insolvency parameter to 52nd position from 136th rank three years ago.

There is a tendency to consider the Code as a panacea for all economic evils and then look at its success in relation to those. Instead, we must look at its success or otherwise in relation to its objective, which is reorganisation, as stated in its long title.

The Code provides for reorganisation in two ways, first by the rescue of the company through a resolution plan, failing which, by the closure of the company through liquidation. It enables the market to make the choice. The market usually chooses to rescue a company if its business is viable or close it if it's unviable. The stress of over 20,000 companies, for which applications have been filed for initiation of insolvency proceedings, has been resolved. The resolution has happened both prior to admission and after the admission, and by way of withdrawal, resolution plan or liquidation. What is important to look at is the time frame of and the cost incurred in such resolution, and the quality of resolution in terms of value maximisation. In terms of all three parameters - time, cost, and quality of outcome - the Code has delivered a multiple of those obtained under the erstwhile regime.

Q. In some of the early resolutions, we saw banks recovering a sizable portion of their dues. But, in some of the recent cases, we have seen hair cuts of as much as 95 per cent to creditors. Are lenders getting a raw deal now?

It is axiomatic that a company coming to IBC does not have adequate assets to fully repay all its creditors. The companies, which have been rescued by resolution plans till March 2021, had assets valued, on average, at 22% of the amount due to creditors when they entered the IBC. This means that the creditors were staring at a haircut of 78% to start with. The IBC not only rescued these companies but also reduced the haircut to 61% for financial creditors.

About a year ago, Ghotaringa Minerals Limited, and Orchid Healthcare Private Limited caught media attention. They together owed Rs 8,163 crore to creditors, while they had absolutely no assets when they entered the IBC process. Obviously, creditors had to take a 100 per cent haircut. On the contrary, Binani Cements and MBL Infrastructure have yielded zero haircuts, in addition to rescuing the companies. Why does IBC yield zero haircut in one case and 100 per cent in another depends on several factors, including the nature of business, business cycles, market

sentiments, and marketing effort? It, however, critically depends on at what stage of stress, the company enters the IBC, as much as at what stage a patient arrives in the hospital. The best hospital can do little if the patient reaches with a substantial haircut to his health. Similarly, if the company has been sick for years, and the assets have depleted significantly, the IBC may yield a huge haircut or even liquidation.

It may be appropriate to see a haircut in relation to the assets available on the ground and not the claims of the creditors. Because the market offers value in relation to what a company brings to the table, and not what it owes to creditors. IBC maximises the value of the assets at the commencement of the process, not of the assets which probably existed earlier.

Q. Do you think banks are perhaps delaying starting insolvency proceedings against stressed borrowers?

Banks weigh various options available to them. They choose IBC only when they find it better than any other option in a case of a stressed asset under the circumstances.

Subject to their commercial wisdom, they should use it in the early days of stress, when the value of the company is intact, and close the process quickly before value recedes further, to minimise the possibility of liquidation or even avoid haircut. In the early days of default, enterprise value is typically higher than the liquidation value and hence the stakeholders have the incentive to resolve the stress of the company rather than liquidate it. The longer it remains in stress, the higher is the loss of its value. With the passage of time, the possibility of resolution of stress by a resolution plan decreases or a resolution plan yields a larger haircut.

There was some reluctance in the early days of IBC, which required an amendment in banking law enabling the RBI to direct banks to invoke IBC in specific cases. The reluctance has disappeared as the banks experienced wholesome outcomes of IBC.

Q. The conduct of the Committee of Creditors has also come into question of late. IBBI too reportedly is looking to increase the capacity of CoC. What are the issues here and what needs to be fixed?

The Code rests on the commercial wisdom of the CoC. This requires the CoC to have the capability to distinguish between a viable company to be rescued by a resolution plan and an unviable one to be closed through liquidation. It needs to assess the feasibility and viability of competing resolution plans. It needs to visualise limitless possibilities of the resolution, including restructuring by way of merger, amalgamation, or

demerger; a change of management, technology, or product portfolio; acquisition or disposal of assets, businesses, or undertakings; restructuring of the organisation, business model, ownership, or balance sheet; strategy of turn-around, buy-out, acquisition, or takeover; and so on. It needs to visualise the underlying value of the distressed asset and make the value visible to the prospective resolution applicants.

Further, it needs to play its role in accordance with the Code. There are several instances where its conduct has not been above board. In some cases, it has strayed into matters which do not fall into the commercial domain and has unduly influenced the resolution professional. If any of the decision-makers does not play its role, as envisaged in the Code or does not cooperate or resorts to active non-cooperation or malafide actions, the process may not either conclude in time or yield the optimum outcome. To address the issues, the IBBI has been organising workshops for banks and has recently proposed to introduce a code of conduct for CoC.

Q. Data from IBBI shows of 2,653 CIRPs that were closed as of March 31, liquidation was commenced in as many as 48 per cent of them, while a resolution plan was approved only in 13 cases. Why is that so?

This narrative of more CDs landing up in liquidation is not correct. You are watching only the end game, where you see about 2600 cases reaching the finishing line, that is, ending up with a resolution plan or liquidation. Please consider the universe of companies for which applications are filed for initiation of the IBC process. Over 90 per cent of them are closed midway either before or after admission. Of the universe, the percentage of companies proceeding for liquidation is negligible. I am not even considering the resolution happening outside IBC, but on account of IBC.

Further, of the companies proceeding for liquidation, three-fourths were defunct, and of the companies rescued, one-third were defunct. This means that two-thirds were defunct to start with. The companies ending up with liquidation had assets, on average, valued at about 6% of the outstanding debt, when they entered the CIRP. If a company has been sick for years and its assets have depleted significantly, the market is likely to liquidate it.

In value terms, companies accounting for 70% of the stressed assets were rescued, while those accounting for 30% of the stressed assets proceeded for liquidation.

I anticipate that post disposal of pre-IBC legacy matters, as relatively ‘recent’ stress cases, are dealt with, liquidations will be less. Let me make it clear that liquidation per se is not all bad. It is one of the means of

reorganisation envisaged under the Code. It is through liquidation that the resources sunk in the failed firms are released for more efficient uses in the economy.

Q. The IBC has gone through several amendments in the past few years. Do you think in legislations like this, where there was no precedence, a periodic review is the way forward?

An economic law is essentially empiric, and it evolves continuously through experimentation. The Code is no exception. The Code has witnessed six legislative interventions since its enactment to strengthen the processes and further its objectives, in sync with the emerging market realities. Each of the six amendment Acts addressed specific issues which could not have been anticipated earlier. Addressing the issues promptly is testimony to the dynamism of the journey and the commitment of the Government to the underlying reform. A standing committee, the Insolvency Law Committee, continuously reviews the implementation of the Code to identify issues and make recommendations to address them.

Q. In bankruptcy cases, should existing promoters be given a chance if they come up with a credible plan?

There is absolutely no prohibition on promoters wresting control of their companies through a resolution plan. The prohibition is only on a person, whether a promoter or not, who does not have credible antecedents. Any person, who is connected or related to the prohibited person, is also prohibited. This disincentivises opportunistic behaviour and helps to reduce moral hazards.

Q. What are key things that you feel need to be addressed to make IBC more effective?

An insolvency proceeding is like an orchestra where many constituents have specific roles. In particular, the CoC needs to be in the shoes of businessmen and its conduct needs to be above board; Government needs to submit claims in time and avoid litigation relating to claims post-resolution, and it must ensure a clean slate for successful resolution applicant; the Adjudicating Authority needs to have adequate bench capacity to admit applications for commencement of insolvency proceedings, approval of resolution plans and dispose of applications in respect of avoidance transactions, in a time-bound manner; and promoters and board of directors need to avoid resistance to commencement of insolvency proceedings on frivolous grounds and extend all co-operation to the IP in running a business as a going concern. Some process improvements are required to ensure certainty of outcomes. Markets for distressed assets should become deeper so that for every distressed asset, there are many resolution plans for value maximisation.