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A code for the committee of creditors

Several proceedings have witnessed a variety of contraventions of provisions of the insolvency law by market players

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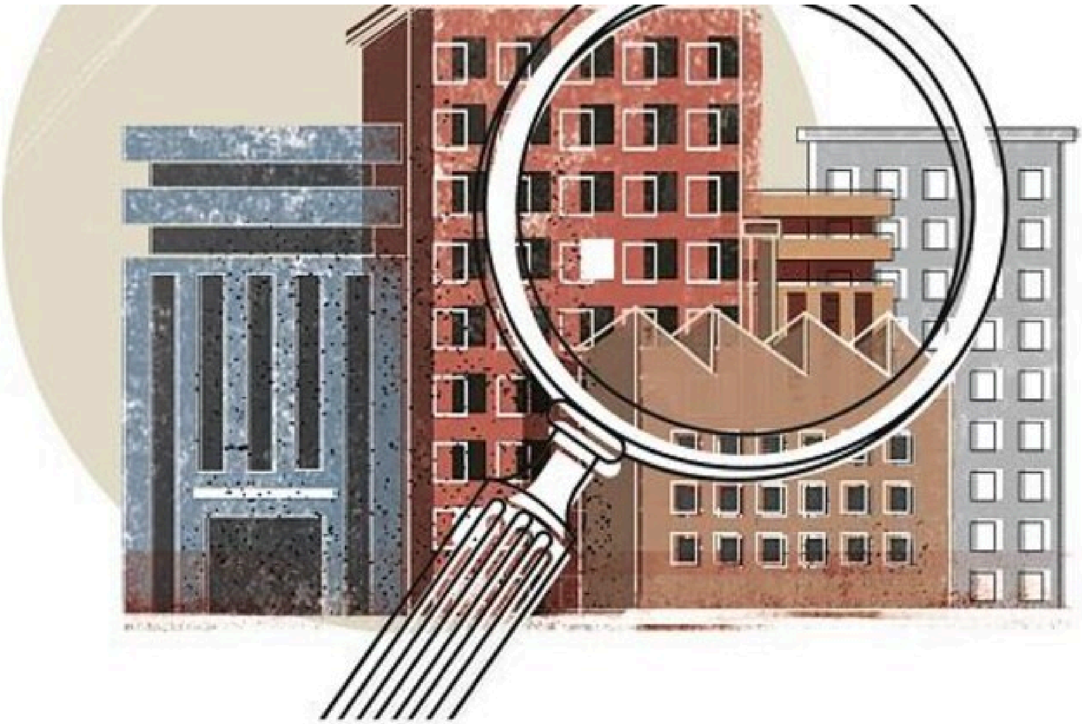

The Insolvency and Bankruptcy Board of India (IBBI) issued a discussion paper in August 2021 proposing a code of conduct (code) for the committee of creditors (CoC) to ensure transparency in its functioning. This followed the observation of the Parliamentary Standing Committee of Finance in its 32nd Report in early August, "...there is an urgent need to have a professional code of conduct for the committee of creditors which will define and circumscribe their decisions". There has been intense debate since then on who should issue and enforce the code.

A sound regulatory design avoids any kind of regulatory overlap and gap. Since CoCs are not regulated, there exists a regulatory gap. The CoC usually comprises financial creditors (FCs). Most FCs having relatively large voting powers are banks. The Reserve Bank of India (RBI) is the regulator for banking. Some argue that if the code is prescribed by the IBBI, this will subject banks to regulations of both the IBBI and RBI, creating regulatory overlap. Instead, if at all required, the code may be prescribed by the RBI.

A code by the RBI does not address the regulatory gap. Firstly, because the RBI does not regulate the CoCs as such; it only regulates some of its members, namely banks. Further, there are several classes of FCs; the RBI does not regulate debenture holders, homebuyers, personal guarantors, as well as the operational creditors who may constitute the CoC at times.

Does a code by the IBBI create regulatory overlap? No, because the role and conduct of either the CoC or its members under the insolvency law are not regulated at present. An entity being governed by several regulators for its different activities per se is not regulatory overlap. A bank may be regulated by the RBI for banking, by the Securities and Exchange Bank of India (Sebi) for its public issue, by the Competition Commission of India for fair trade practices and by the Financial Intelligence Unit for prevention of money laundering. The issue of regulation of entity versus activity is long settled. An initial public offering (IPO) by a firm, whether in the business of insurance, banking, or telecom, is regulated by Sebi; not by the regulator of the business concerned. It is not feasible to regulate different classes of FCs — banks, homebuyers, debenture holders — by different regulators and still leave out a larger number of FCs that are outside the regulatory purview.

The issue of general versus sectoral regulation is also long settled. The general (non-sectoral) regulations — competition, securities and insolvency — provide the same dispensation for all businesses and all firms in an economy and thereby ensure optimum allocation of resources all the time. A separate dispensation for any firm or business, say insurance firm, for making an IPO distorts the choice of market players and, therefore, yields sub-optimal resource allocation. This explains why insolvency norms need to be uniform across the market.

Ideally, a code for the CoC is a misnomer. FCs should have been driven by their self-interests; in concluding the resolution process fast, efficiently and by maximising their return. Still, and despite their disparate regulators notwithstanding, a code for them to travel on the track of norms has become a necessity. Assigning that code to different business/entity regulators is a sure way to defeat the intent and effect of the code.

In fact, the issue under the insolvency law is not limited to FCs or the CoC. A corporate insolvency proceeding is a team effort where the company, its management, creditors, the CoC, and resolution applicants, take commercial decisions in sync with one another. Imagine a proceeding where the corporate debtor is a telecom company subject to regulation of the Telecom Regulatory

Authority of India, the FC is a bank regulated by the RBI, and the resolution applicant is an alternative investment fund regulated by Sebi. Will such a proceeding ever conclude if each player plays by the rules of the regulator of its business? It will be an "impossible" matrix, if a proceeding has several FCs, several businesses and several resolution applicants — each regulated by a different regulator.

Several proceedings have witnessed a variety of contraventions of provisions of the insolvency law by market players. Since the players are not within its regulatory domain, the IBBI has tried three options, to deal with such contraventions, namely, directions to insolvency professionals to secure good conduct from players, filing of complaints in special court against the erring players, and filing of appeals to undo any irregularity. These have met with only limited success.

A parallel may elucidate the point. In its early days, Sebi was not perceived as an effective regulator in protecting the interest of investors, essentially because it did not have jurisdiction over the issuers of securities. It was directing its efforts only at the lead managers and merchant bankers, who were intermediaries and signatories to the prospectus, requiring them to make disclosures on behalf of companies. That was also challenged in courts of law as being beyond the jurisdiction of Sebi. This infirmity was addressed by the Securities Laws (Amendment) Act, 1995, which incorporated section 11A (which has been further strengthened in 2002) in the Sebi Act, 1992, to expand Sebi's regulatory jurisdiction over corporates in the issuance of capital, transfer of securities and other related matters.

Successful implementation of the insolvency law requires all players play by the rule book and are subject to regulatory discipline, with quick consequences for contraventions. Regulatory jurisdiction must rest with one regulator, be it the IBBI, RBI or Sebi. Only one of them should specify a code of conduct, monitor compliance and adjudicate contraventions against all market players.

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