

Legislative Brief

The Insolvency and Bankruptcy Code, 2015

The Code was introduced in Lok Sabha on December 21, 2015 by Finance Minister, Mr. Arun Jaitley.

The Code was referred to a Joint Committee of Parliament (Chairperson: Mr. Bhupender Yadav) on December 23, 2015.

The Joint Committee submitted its report on April 28, 2016.

Recent Briefs:

[The Enemy Property \(Amendment and Validation\) Bill, 2015](#)
April 29, 2016

[The Prevention of Corruption \(Amendment\) Bill, 2013 with 2015 amendments](#)
March 23, 2016

Aravind Gayam
aravind@prsindia.org

Vatsal Khullar
vatsal@prsindia.org

May 5, 2016

Highlights of the Code

- ◆ The Code creates time-bound processes for insolvency resolution of companies and individuals. These processes will be completed within 180 days. If insolvency cannot be resolved, the assets of the borrowers may be sold to repay creditors.
- ◆ The resolution processes will be conducted by licensed insolvency professionals (IPs). These IPs will be members of insolvency professional agencies (IPAs). IPAs will also furnish performance bonds equal to the assets of a company under insolvency resolution.
- ◆ Information utilities (IUs) will be established to collect, collate and disseminate financial information to facilitate insolvency resolution.
- ◆ The National Company Law Tribunal (NCLT) will adjudicate insolvency resolution for companies. The Debt Recovery Tribunal (DRT) will adjudicate insolvency resolution for individuals.
- ◆ The Insolvency and Bankruptcy Board of India will be set up to regulate functioning of IPs, IPAs and IUs.

Key Issues and Analysis

- ◆ Time-bound insolvency resolution will require establishment of several new entities. Also, given the pendency and disposal rate of DRTs, their current capacity may be inadequate to take up the additional role.
- ◆ IPAs, regulated by the Board, will be created for regulating the functioning of IPs. This approach of having regulated entities further regulate professionals may be contrary to the current practice of regulating licensed professionals. Further, requiring a high value of performance bond may deter the formation of IPAs.
- ◆ The Code provides an order of priority to distribute assets during liquidation. It is unclear why: (i) secured creditors will receive their entire outstanding amount, rather than up to their collateral value, (ii) unsecured creditors have priority over trade creditors, and (iii) government dues will be repaid after unsecured creditors.
- ◆ The Code provides for the creation of multiple IUs. However, it does not specify that full information about a company will be accessible through a single query from any IU. This may lead to financial information being scattered across these IUs.
- ◆ The Code creates an Insolvency and Bankruptcy Fund. However, it does not specify the manner in which the Fund will be used.

PART A: HIGHLIGHTS OF THE CODE

Context

Insolvency is a situation where individuals or companies are unable to repay their outstanding debt. This may be resolved by changing the repayment plan of loans, writing off some outstanding debt or making operational changes in the management of a company. If insolvency cannot be resolved, the assets of a debtor (person who owes money) may be sold to raise money for repayment of outstanding debt.

There are several laws which regulate insolvency resolution for companies in India. These include (i) Sick Industrial Companies Act, 1985*, (ii) Recovery of Debt Due to Banks and Financial Institutions Act, 1993 (DRT Act), (iii) Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI), and Companies Act, 2013.^{1,2,3,4} These laws provide for the restructuring of debt, seizure and sale of the debtor's assets for repayment of outstanding loans. Similar laws such as the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920 regulate insolvency resolution for individuals. While these laws specify processes for resolving insolvency, a creditor may also approach civil courts for recovery of debt.

The Bankruptcy Law Reforms Committee in 2015 observed that there have been delays in insolvency resolution. These delays are on account of overlapping jurisdictions of laws and lack of clarity in their provisions.⁵ As of 2015, insolvency resolution in India took 4.3 years on an average, which was higher when compared to United Kingdom (1 year), United States of America (1.5 years), and South Africa (2 years).⁶ Further, time taken by courts and tribunals in delivering judgements was long due to various reasons including capacity of courts. For example, there were 62,000 cases pending before the Debt Recovery Tribunals as of December, 2014, while the number of cases disposed during the year was around 10,000.⁷

The Insolvency and Bankruptcy Code, 2015 was introduced in Lok Sabha on December 21, 2015. It proposes a time-bound process for resolving insolvency. The Code was examined by a Joint Committee of Parliament, which submitted its report on April 28, 2016.⁸

Key Features

The Code seeks to consolidate the existing framework by repealing the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920. In addition, it amends 11 laws including Companies Act, 2013, DRT Act, 1993 and SARFAESI Act, 2002. The Code specifies a framework for time bound insolvency resolution, with two similar processes for (i) companies and limited liability partnerships (liability of partners restricted to their investment), and (ii) individuals and partnership firms. The following institutions will be created under the proposed framework.

Insolvency Professionals

- A specialised cadre of certified professionals known as insolvency professionals (IPs) will be created to handle insolvency resolution. These IPs will conduct the insolvency resolution process, take over the management of a company, assist creditors in the collection of relevant information, and manage the liquidation process.

Insolvency Professional Agencies

- The IPs will be enrolled with insolvency professional agencies (IPAs). The IPAs will conduct examinations, certify IPs, and enforce a code of conduct for their functioning. Further, an IPA will furnish a performance bond to the regulator (Bankruptcy Board) on the commencement of insolvency resolution by a member IP. This bond will act as a surety against any misconduct by the IP during the resolution process.

Information Utilities

- Information utilities will be set up to collect, collate and disseminate financial information related to debtors. Such information will be collected from creditors and include records of debt, liabilities and defaults of a debtor.
- The information available with these utilities will be used as evidence to initiate insolvency resolution, and assist creditors in drafting a plan to resolve insolvency.

Insolvency and Bankruptcy Board of India

- The Insolvency and Bankruptcy Board of India will be set up as a regulator to oversee functioning of entities created under the Code, including IPs, IPAs and information utilities.

* Sick Industrial Companies Act, 1985 was repealed in 2003. However, the repealing legislation has not been brought into effect.

- The Code provides that until the Board is set up, a financial sector regulator (such as RBI, SEBI, IRDA and PFRDA) will act as an interim regulator and carry out functions of the Board.

Adjudicating Authorities

The Code proposes two adjudicating authorities to: (i) evaluate applications for initiating insolvency proceedings, (ii) approve appointment of IPs, and (iii) approve resolution plans. These authorities are:

- National Company Law Tribunal (NCLT) will adjudicate cases for companies and limited liability partnerships. Appeals against its orders will be heard by the National Company Law Appellate Tribunal.
- Debt Recovery Tribunal (DRT) will adjudicate cases for individuals and partnership firms. Appeals against its orders will be heard by the Debt Recovery Appellate Tribunal.

Insolvency Resolution Process

The Code provides similar insolvency resolution processes for companies and individuals. The steps are as follows:

- **Initiation:** When a default occurs, the creditors or debtor may apply to the tribunal (NCLT or DRT) for initiating the resolution process. Once the application is approved, the resolution process will have to be completed within 180 days. This time limit may be extended by up to 90 days. During this period, the debtor will be immune towards creditors' claims and lawsuits.
- **Appointment of interim IP:** When the resolution process begins, an interim IP will be appointed by the creditors or tribunal. The IP will: (i) take control of the debtor's assets and company's operations, (ii) collect financial information of the debtor from information utilities, and (iii) constitute the creditors committee.
- **Creditors committee:** A committee consisting of financial creditors will be constituted for taking decisions regarding insolvency resolution. Financial creditors may either be: (i) secured creditors, whose loans are backed by collateral (security), or (ii) unsecured creditors whose loans are not backed by any collateral. The creditors committee will take decisions by a 75% majority. It will oversee management of the debtor's assets and appoint a permanent IP to conduct the resolution process.
- **Resolution:** The creditors committee will decide to: (i) restructure the debtor's debt by preparing a resolution plan (such as revising the repayment plan), or (ii) liquidate (sell) the debtor's assets to repay loans. If no decision is made during the resolution process, the debtor's assets will be liquidated to repay the debt.
- **Approval of plan:** On the approval of a resolution plan by the creditors committee, the IP will submit it to the tribunal for final approval. The tribunal will approve the plan based on criteria which includes ensuring that operational creditors have received as much as they would have received during liquidation. The resolution plan will then be implemented.
- **Liquidation:** In case of liquidation, proceeds from the sale of the debtor's assets will be used to repay outstanding dues. A secured creditor may choose to not participate in the process, and enforce his security under any other law (such as the SARFAESI Act). The financial obligations of the debtor will be repaid in the following order: (i) fees of the IP and other costs related to the resolution process, (ii) secured creditors (if he chooses not to enforce his security) and worker dues (up to 12 months), (iii) employee wages (up to 12 months), (iv) unsecured creditors, (v) dues to government and remaining debt owed to secured creditors (residual amount if the creditor enforces his security), (vi) any remaining debt, and (vii) shareholders.

Other provisions

- **Fresh Start Process:** The Code provides a Fresh Start Process under which an individual will be eligible for a debt waiver of up to Rs 35,000. For an individual to be eligible for this process, he should have: (i) annual income of less than Rs 60,000, (ii) assets under Rs 20,000, and (iii) no ownership of a house.
- **Offences and penalties:** The Code specifies penalties for offences committed by a debtor under corporate insolvency (like concealing property). The penalty will be imprisonment of up to five years, with a fine of up to Rs one crore. For offences committed by an individual (like providing false information), the imprisonment will vary based on the offence. For most of these offences, the fine will be up to Rs five lakh.
- **Insolvency and Bankruptcy Fund:** The Code creates an Insolvency and Bankruptcy Fund for the purposes of insolvency resolution proceedings. Sources of the Fund will include grants from the government, deposits made by persons, and interest received from investments made from the Fund. Any person may withdraw up to the amount of his deposit if insolvency proceedings are initiated against him.

PART B: KEY ISSUES AND ANALYSIS

The successful implementation of the Code will depend on establishment and smooth functioning of new entities: (i) Insolvency and Bankruptcy Board of India, (ii) insolvency professionals, (iii) insolvency professional agencies, and (iv) information utilities. It also requires adjudication by two agencies: (a) The NCLT under Companies Act, 2013, which has not yet been set up, and (b) DRTs which are overloaded with pending cases. (As of December 2014, there were 62,000 cases pending with DRT and the disposal rate is about 10,000 cases per year.)

Insolvency Professionals and Agencies

Code:
Clauses 196, 205, 208 Under the Code, the Bankruptcy Board will regulate insolvency professional agencies (IPAs). The primary function of the IPAs will be to regulate insolvency professionals (IPs) by conducting examinations to enrol them, and enforcing a code of conduct. The IPs will be responsible for carrying out the resolution process and managing the company during insolvency resolution. In this context, we discuss some aspects related to IPAs and IPs.

Performance Bond may make IPAs unviable

Code:
Clause 206 The IPAs will be jointly and severally liable for the conduct of a member IP during the resolution process. For this purpose, they will have to furnish a performance bond with the Bankruptcy Board at the beginning of the process. The value of such bond should be equal to the asset value of the defaulting debtor. It is unclear how the IPAs will have the capacity to raise a large amount of funds in case of insolvency resolution for high asset value companies. It may be argued that such provisions may increase the entry threshold for an IPA, and discourage their establishment.

For example, if a company with assets of Rs 50,000 crore files for insolvency resolution, an IPA will have to furnish a performance bond equal to this amount. In the United Kingdom, the insolvency administrator is required to furnish a bond as well; however, this amount is capped at a value of £5 million (approximately Rs 50 crore).⁹

The IP receives a fee for his professional services in the resolution process. The Code does not attribute this revenue to the IPA. It is not clear why the IPA (which will also have other members) is being made jointly and severally liable for any losses due to the fraudulent actions of a member IP.

The Joint Committee of Parliament, which examined the Code, observed that requirement of furnishing a performance bond may deter IPs and IPAs from entering the sector. It recommended that provisions related to furnishing the bond should be removed from the Code.⁸

Regulation of IPs by regulated entities, different from existing frameworks

The Code envisages a regulatory framework in which the Bankruptcy Board regulates the functioning of IPAs, and the IPAs regulate the IPs. This may lead to regulated entities (IPAs) further regulating professionals (IPs). The Code also allows all IPAs to: (i) conduct examinations to certify and enrol IPs, and (ii) enforce a code of conduct. The rationale behind multiple IPAs overseeing the functioning of their member IPs, instead of a single regulator is unclear. It may be argued that such a structure of regulation may lead to a conflict of interest for an IPA.

The Code allows for multiple IPAs to operate simultaneously, which could enable competition in the sector.⁵ However, this may also lead to a conflict of interest between the regulatory and competitive goals of the IPAs. On one hand, an IPA will regulate the IPs by enforcing a code of conduct. On the other hand, it may want to project a positive public image to stay competitive in the sector. In an attempt to project the image of a high quality institution, the IPA may be unwilling to take action against its erring members.

The proposed structure of regulation differs from other statutory regulators overseeing regulation of licensed professionals in the corporate sector. For instance, regulators such as Institute of Company Secretaries of India (regulating company secretaries) and Institute of Chartered Accountants of India (regulating chartered accountants) are directly responsible for conducting examinations and enforcing a code of conduct on their registered members.

Eligibility of insolvency professionals to work with other IPAs unclear

The Code allows every IPA to conduct its own examination to qualify and enrol an IP. However, it does not clarify if an IP qualifying an examination by one IPA, will also be eligible to work as an IP with another IPA. Further, the Code does not clarify if an IP will be eligible to enrol with multiple IPAs. If there is a restriction in an IP moving from one IPA to another, there would be adverse implications for a competitive environment for IPAs.

Priority in distribution of assets different from existing regime

Code:
Clauses 52,
53

Under the Code, the creditors committee may choose to either revive a company or liquidate its assets for repayment of the debtor's outstanding dues. In case of liquidation, the assets will be distributed based on an order of priority.

If the creditors committee decides in favour of liquidation, a secured creditor may: (i) opt to participate in the process and give up his right over the collateral, or (ii) opt out and sell the collateral to recover his outstanding dues. If he participates in the process, he will be ahead of all other creditors (except workmen's dues for one year) in receiving his dues. It is unclear why the secured creditor will have priority in receiving his entire outstanding amount, rather than the amount equal to the collateral value held by him.

For example, a secured creditor X extends a loan of Rs 1,000 to a debtor Y, backed by a collateral which is liquidated at a value of Rs 750. Under the Code, when other assets of Y are liquidated, X will get preference over other creditors for the remaining Rs 250 owed to him. This provision is different from the United Kingdom, where a secured creditor would receive priority in distribution of assets, only to the extent of collateral held by him.¹⁰

Further, during liquidation, trade creditors (such as raw material suppliers) will receive their dues after unsecured financial creditors in the priority order. It may be argued that financial creditors extend credit after assessing the risk involved, whereas trade creditors may not undertake the same level of assessment, owing to the nature of their business. The order of priority in the Code differs from Companies Act, 2013, where both unsecured creditors and trade creditors are treated at par.⁴ Similarly, insolvency laws in United Kingdom and United States of America treat the unsecured creditors and trade creditors on the same priority level, during distribution of assets.^{11,12}

The Code also provides that the government dues will be paid off after paying secured creditors, unsecured creditors, employees and workmen. This differs from Companies Act, 2013, where government dues are repaid after secured creditors and workmen, but alongside employees and before other creditors (including unsecured financial creditors).⁴

Presence of multiple Information Utilities may scatter financial information

Code:
Clauses 209,
215 (2)

The Code seeks to create multiple information utilities (IUs) to collect and store financial information related to a debtor. This information can trigger the resolution process and be used as evidence at various stages of the process. However, the presence of multiple IUs may scatter financial information across different IUs.

The Code does not specify if this information will be networked to allow for a person to access information across IUs, through a single query at any IU. In the absence of such a facility a creditor or IP will have to individually approach several IUs for collecting information related to a single debtor. The Joint Committee recommended that the IUs should be made interoperable to have a seamless network of information.⁸

Mandating operational creditors to submit financial information to IUs may be impractical

The Code mandates operational creditors to submit financial information to IUs. It may be argued that submitting all financial information available with an operational creditor may not be practical. For example, in a firm the telecom providers, contractual staff, stationery suppliers, and hospitality services providers will be required to submit financial information to an IU, on a real-time basis. Mandating all operational creditors to submit this information may create a burden for small creditors, who may not have the necessary resources to provide such information to IUs. The Joint Committee recommended that submission of information by operational creditors to IUs should be made optional.⁸

Purpose of establishing the Insolvency and Bankruptcy Fund is unclear

Code:
Clause 224

The Code creates an Insolvency and Bankruptcy Fund which may receive voluntary contributions from any person. A person contributing these funds will be able to withdraw them only in case of insolvency proceedings being initiated against him. In addition, the contributors will not earn interest on the funds contributed by them. The Code does not mention any other purpose for which the fund may be used. It is unclear why any person will voluntarily contribute to the Fund. The Joint Committee recommended that there was a need to specify the purposes for which money may be withdrawn from the Fund.⁸

Rationale behind proposing an interim regulator is unclear

Code:
Clauses 188,
195

The Code sets up the Insolvency and Bankruptcy Board of India to act as a regulator for supervising entities being established under it. However, it also provides that until the Board is established, a financial sector regulator (such as RBI, SEBI, IRDA and PFRDA) will discharge its functions. Since provisions for setting up the Board have been provided in the Code, it is unclear why an interim regulator has been proposed.

Code:
Clause 80

Eligibility limits for Fresh Start Process may be unreasonable

The Code provides for a Fresh Start Process, under which an individual having assets and debt under a threshold will be eligible for a debt waiver of up to Rs 35,000. These limits include (i) gross annual income of less than Rs 60,000, (ii) assets under Rs 20,000, and (iii) no ownership of a house. It may be argued that these limits are unreasonably low as there may be few individuals that meet these criteria and who will be credit-worthy to receive loans.

Comparison of international bankruptcy laws with proposed framework

The table below compares the provisions of the Insolvency and Bankruptcy Code, 2015 with laws in other countries.

Table 1: International comparison of insolvency laws

Action	United States	United Kingdom	India (Proposed Code 2015)
Initiation of proceedings	Debtors or creditors	Debtors or creditors	Debtors or creditors
Forum for proceedings	Court	Both in court and out of court procedures specified by the law.	Out of court
Administrator	United States Trustee (government employee)	Insolvency Practitioner (private)	Insolvency Professional (private)
Control of Debtor's assets	Debtor	Insolvency Practitioner	Insolvency Professional
Proposals to resolve insolvency made by	Debtor and creditors	Insolvency Practitioner	Creditors committee, consisting of financial creditors
Voting on proposals	Impaired creditors*	All creditors	Creditors committee (secured and unsecured creditors)
Value of performance bond	US Trustee to determine the value of the bond	Bond value equivalent to the assets of the debtor, but capped at £5 million ⁹	Bond value equivalent to the assets of the debtor
Reporting financial information	Not required by law	Not required by law	Mandated by the Code

Note: * Creditors whose rights towards the debtor change as a result of the proposed plan. Example: unsecured creditors, who, as part of the proposed plan will be receiving less than the amount owed to them.

Sources: United States Code Title 11-Bankruptcy; United Kingdom Insolvency Act, 1986; PRS.

1. Sick Industrial Companies (Special Provisions) Act, 1985, <http://financialservices.gov.in/banking/SICA%201985.pdf>.
2. Recovery of Debt Due to Banks and Financial Institutions Act, 1993, <http://www.drat.tn.nic.in/Docu/RDDBFI-Act.pdf>.
3. SARFAESI Act, 2002, <http://www.drat.tn.nic.in/Docu/Securitisation-Act.pdf>.
4. Companies Act, 2013, <http://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf>.
5. Bankruptcy Law Reforms Committee, Ministry of Finance, 4 November 2015, http://finmin.nic.in/reports/BLRCReportVol1_04112015.pdf.
6. "Time to resolve Insolvency (years)", World Bank, <http://data.worldbank.org/indicator/IC.ISV.DURS>.
7. Starred Question No. 256, Lok Sabha, Answered on March 13, 2015, Ministry of Finance.
8. Report of the Joint Committee on the Insolvency and Bankruptcy Code, 2015, April 28, 2016, http://164.100.47.134/lssccommittee/Joint%20Committee%20on%20Insolvency%20and%20Bankruptcy%20Code.%202015/16_Joint_Committee_on_Insolvency_and_Bankruptcy_Code_2015_1.pdf.
9. "Information for Insolvency Practitioners.", <https://www.gov.uk/guidance/insolvency-bonds-information-for-insolvency-practitioners>.
10. Clause 60 of United Kingdom Insolvency Act, 1986, http://www.legislation.gov.uk/ukpga/1986/45/pdfs/ukpga_19860045_en.pdf.
11. United Kingdom Insolvency Act, 1986, http://www.legislation.gov.uk/ukpga/1986/45/pdfs/ukpga_19860045_en.pdf.
12. United States Code Title 11-Bankruptcy, <https://www.law.cornell.edu/uscode/text/11>.

DISCLAIMER: This document is being furnished to you for your information. You may choose to reproduce or redistribute this report for non-commercial purposes in part or in full to any other person with due acknowledgement of PRS Legislative Research ("PRS"). The opinions expressed herein are entirely those of the author(s). PRS makes every effort to use reliable and comprehensive information, but PRS does not represent that the contents of the report are accurate or complete. PRS is an independent, not-for-profit group. This document has been prepared without regard to the objectives or opinions of those who may receive it.