



IBC: The only way out is through

The implementation of the Insolvency and Bankruptcy Code is far from finished and new work is required

There is much concern about some developments in bankruptcy reform. In one transaction, the lenders got an abysmally low recovery rate. There is angst about promoters regaining control of defaulting companies at a low price. Home buyers who have paid large advances to real estate companies are worried about their losses. There are fears of the consequences of improved disclosures. However, the glass of bankruptcy reform is half full. Bankruptcy reform in India will uncover skeletons in our closet. We need to double down on the teams that pursue the nine areas of work for policymakers in bankruptcy reform. The only way out is through.

Low recovery rates

The Insolvency and Bankruptcy Code (IBC) envisions a 180-day period in which bids are invited for a defaulted firm. If 75 per cent of the debt votes in favour of a bid, that bid is accepted. In one recent case, the bid that was accepted gave lenders 6 per cent of the value of their debt. There is a procedural dispute about the precise steps through which this came about. Many worry that if the result is a paltry 6 per cent of the value of debt of a defaulted firm, then the IBC has failed.

In the field of bankruptcy, we must attach primacy to speed. Economic value is destroyed when a going concern is derailed. To protect the firm as a going concern, the bankruptcy process must commence immediately after the first default, and the new arrangement must be quickly put in place. When that is not done, the firm won't make it as a going concern. Now the firm is only worth its liquidation val-

ue. The liquidation value, in turn, decays through time as assets are poorly protected.

In India today, we have a large backlog of cases where the default took place a long time ago. Banking regulation supports banks in hiding bad news, and the IBC was missing, so we merely postponed problems. There are cases coming into the IBC where the first default was 10 or 15 years ago. Here, recovery rates will be abysmal even after the procedural problems of the IBC are fixed.

The real test of the IBC is on fresh defaults. When a default takes place today, how quickly does the machinery of the IBC swing into action? How well does it work? Is the firm saved as a going concern? What kinds of recovery rates are obtained? A sound IBC should be able to generate good recovery rates for fresh defaults.

Promoters regaining control

In the bankruptcy process, there is an open opportunity for many people to bid for the firm. If the promoter proves to be the highest bidder, that irritates some people who hold him responsible for running the

company aground. However, if an open and transparent process results in the promoter regaining control of the firm, we should not be moralistic about it.

Home buyers

The world over, a buyer puts in money and immediately gets possession of a house. In India, numerous real estate companies should have gone into bankruptcy 10-15 years ago. In the absence of the IBC, they delayed payments, and took capital from buyers.

These buyers are at best unsecured creditors, and will have a junior claim on the cash flows of the real estate company. The IBC is working as it should. In the future, the IBC will be triggered quickly when a real estate company gets into trouble, and these companies will not linger for years without the capital required to function. In the future, buyers will be more careful, and put in money only when possession is immediate.

Disclosures

In the past, default was a dark secret. It was precious information that was whispered from one person to another, and used for insider trading on the stock market. In the IBC framework, when default takes place, it must immediately go public. This will help improve the working of the IBC, which involves many players.

Consider shares and bonds that are publicly traded. The established philosophy is that all important facts must be disclosed to the market. Default by a company is material information and must be disclosed immediately. In similar fashion, if a bank has any equity or debt securities listed for trading by the public, and a major borrower defaults on the bank, this is a material event that must be disclosed to the public.

While there is a furore among banks and borrowers who are used to the old clubby ways, the Securities and Exchange Board of India (Sebi) is right to push for these disclosures.

The only way out is through

Most big ideas of the IBC are sound. When we are surprised by the outcomes, we should be careful to distinguish between two kinds of surprises. On the one hand is the disruption of our traditional ways, which were characterised by misbehaviour. On the other hand, there are problems in the implementation of IBC.

The implementation of the IBC is far from finished. New work is required in nine areas. An amendment is required to fix the mistakes in the 2016 law. The Insolvency and Bankruptcy Board of India (IBBI) has to achieve the scale required for a high-performance regulator.

An array of well-drafted regulations has to be issued by the IBBI, with a feedback loop to feed from practical and statistical experience into a robust regulation-making process to refine the regulations. A competitive industry of private Information Utilities (IUs) has to arise. A competitive industry of private Insolvency Professional Agencies (IPAs) has to arise. A competitive industry of private Insolvency Professionals (IPs) has to arise. The National Company Law Tribunal has to find its feet in dealing with corporate bankruptcy, and the debt recovery tribunal has to do similarly for individual bankruptcy. Financial firms have to develop the capacity on how to best initiate the insolvency resolution process and participate in the process to ensure an optimal restructuring plan collectively. Strategic investors, distressed asset funds, and private equity funds have to gain confidence about expected outcomes, either when making a bid for a going concern or when buying assets in liquidation. Much more needs to be done on the teams and management process that are working on these nine areas.

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SNAKES & LADDERS

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