Source : www.livemint.com Date : 2020-05-30

EVOLVING RESOLUTION LANDSCAPE : IBC AND OUTSIDE

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

The suspension of IBC will necessitate a creative evolution of the resolution landscape- deploying existing legal tools as well as fashioning new ones to resolve and restructure intractable debt

David Skeel, Professor at University of Pennsylvania writing in the Wall Street Journal spoke of the burgeoning rise in bankruptcies that are likely to follow in the wake of COVID 19 and The Great Lockdown and the need “Flatten the Bankruptcy Curve". A well-studied consequence of excessive insolvency proceedings is premature liquidations, more retrenchment and fewer investments- which is borne out by India’s experience and these effects may be further amplified on account of the endemic stress.

The World Bank, in a recent blog has recommended policy measures to strengthen the insolvency framework of countries to save firms and boost economic recovery- these included extraordinary measures to suspend fillings. The Finance Minister announced a suspension of fresh fillings under the Insolvency and Bankruptcy Code, 2016 (“IBC") on May 24 and the Ordinance in this regard is awaited- India joins jurisdictions such as Spain, Turkey and Latvia to introduce suspension of fillings. Although the details are awaited, the contours indicated in the Finance Minister’s press conference indicate that it will defer fresh fillings for a period of one year- indicating that existing proceedings may continue. Additionally, default on “COVID related" debt is likely to be excluded from the definition of debt under the IBC.

The suspension of IBC will necessitate a creative evolution of the resolution landscape- deploying existing legal tools as well as fashioning new ones to resolve and restructure intractable debt. This crisis provides an opportunity to bolster other mechanisms and institutions to help preserve value in businesses and mitigate the build up of stress for the financial system.

Among the existing tools available for is a scheme of creditors arrangement under Section 230 of the Companies Act, 2013 (“Companies Act"). Although not utilised in breach so far, in the absence of the IBC, creditors schemes under the Companies Act could provide a feasible alternative to resolution under the IBC. Among the advantages it presents are that it is binding on all stakeholders and the grounds for judicial review are limited. However, a creditors scheme does not provide for an automatic moratorium, unlike the IBC, potentially leaving open the possibility that creditors could initiate precipitative action to enforce security or seek injunctions which could imperil a collective action through a creditors scheme. The NCLT may have appropriate inherent powers to provide for a moratorium, however, this is untested. Another challenge is the requirement for approval of 75% of each class of creditors, as well as shareholder approval which will be difficult to achieve in a timely manner with minimal erosion of value. The requirement for shareholder approval is particularly testing when there may be limited equity value in a stressed company. Creditors schemes may, however, be a useful device when promoters, management and shareholders are seeking to consensually restructure or resolve debt with their creditors- a debtor in possession model.

The World Bank as well as thought leaders in the insolvency space such as the International Insolvency Institute have underscored the need for buttressing out-of-court workout mechanisms. In India, the Stressed Asset Directions issued by the Reserve Bank of India provide such a framework for banks and financial institutions to consensually arrive at a

resolution plan for a borrower facing stress and has been a qualified success. However, following regulatory mandates, companies increasingly meet their funding requirement through the corporate bond route and therefore have diverse and disaggregated creditors. For a resolution to be collective and yield higher value, all creditors must come to the table and participate. This may require SEBI and other regulators to encourage their regulated entities to also participate in the resolution process. A structured process to incentivise promoter cooperation as well as for the resolution to finally bind all creditors as well as the company limits the efficacy of this route.

Greater regulatory cohesion and cooperation is indispensable to achieve effective resolution and to this end, SEBI's recent proposal to amend regulations to ease funding in stressed companies; balancing funding imperatives with governance concerns is opportune. An entire ecosystem of regulatory amendments similar to the alignments made for IBC may be useful to alleviate COVID – induced stress.

One effective way to deal with this may be to frame a mechanism for “prepacked resolution" as has been considered by certain other jurisdictions. By way of example, the UK introduced the Corporate Insolvency and Governance Bill, 2020 on May 20, 2020 which proposed a “restructuring vehicle" which corporates the many benefits of the scheme with considerable additional flexibility, such as crucially a cross class cramdown. India similarly must seize the opportunity to create a nimble yet legally binding pre-packaged insolvency framework. Such a framework should provide for collective resolution between creditors, yet permit cramdown where appropriate safeguards are provided; balance transparency and maximisation of value with expediency and bind all stakeholders. To this end, it may be evaluated by the Tribunal a) will it yield more value than individual enforcement/liquidation, (b) does it address the interests of all stakeholders (c) does the process meet the norms of transparency and maximizing value. Such a plan must be made binding on all parties. Safeguards in the prepackaged scheme should prevents creditors from writing down other categories of creditors, when they may have relinquished.

The magnitude of stress that is likely to follow compels a more systemic response. For this, a “Bad Bank" may be good idea whose time has come. This tool has been considered in policy circles since 2016 there is not time like the present to effect a well-designed, well governed bad bank – which is being considered globally, for instance in the EU, and was a response following the 2008 crisis as well. For the bad bank to have the requisite agility, the ownership must be a combination of government and private sources – Bank for International Settlements Research demonstrates that a mix of private and public sector ownership combine the relative strengths of the two sectors. Additionally, governance structures of the entity should encourage quick solutions.

The bad bank may help sweep out (and then resolve) NPAs from bank balance sheets, freeing up precious capital for fresh lending. However, a framework for financial sector resolution to deal with potential stress should also be available in the quiver of policy makers.

The landscape for resolution following the COVID crisis will be significantly different, and this is be the time to shape its contours.

Cyril Shroff is Managing Partner and L Viswanathan is Partner at Cyril Amarchand Mangaldas. The authors are speaking on the aforesaid here. Register here.

Click here to read the Mint ePaper Livemint.com is now on Telegram. Join Livemint channel in

your Telegram and stay updated

Log in to our website to save your bookmarks. It'll just take a moment.

Your session has expired, please login again.

You are now subscribed to our newsletters. In case you can’t find any email from our side, please check the spam folder.

END

Downloaded from **crackIAS.com**

© **Zuccess App** by crackIAS.com

crackIAS.com