

NPA Crisis: Is IBC the Need of the Hour?

Shreya Verma

B. A., LL. B (H), Semester 5, Amity Law School Noida, Amity University, Uttar Pradesh, India

Abstract: *Nothing in this world is perfect and everything has its own set of advantages as well as disadvantages. This principle equally applies to any policy or legislation formulated by the government, irrespective of the nature or type of the policy and the IBC is not an exception to this. With the aim of resolving the NPA crisis in India and enabling a smooth flow of credit within the economy in mind, the Insolvency and Bankruptcy Code was enacted by the government in 2016. Although the IBC seemed to be quite a robust and sophisticated policy, it eventually became a victim to the loopholes of the system. These loopholes affected its functioning and overall productivity thereby affecting the end results. Though the Insolvency and Bankruptcy Code did play an instrumental role in bringing down the gross percentage of the non - performing assets and eventually changing the scenario of insolvency in India, it did not live up to the desired expectations of the people. The author through this research paper tries to throw some light on the events which lead to the enactment of the IBC and a critical analysis of the Code.*

Keywords: NPA, IBC, non - performing assets, insolvency and bankruptcy code, corporate insolvency resolution process

1. Introduction

India is the second largest economy in the world and like every other economy of the world, it is also affected by the menace of non - performing assets. There is an increment in the cases of the non - performing assets (NPAs) over the course of years, which can have an adverse impact on the performance, credibility, reliability and stability of the banks.

A non - performing asset arises as a result of the poor lending decisions made by the banks. The interest taken by the banks on the loans or advances given by them serves as a profit for them and thereby, is an asset (performing asset) for the banks. When the borrower defaults in paying the interest or the principal amount or both then the loan or the advance becomes non - performing. According to the Reserve Bank of India (RBI) [1], when a loan, advance or an interest remains unpaid for more than 90 days then it becomes non - performing for the bank or the lender but the time period can also depend on the agreement between the lender and the borrower. An NPA causes the loss of both the interest and the principal amount to the bank. Since the interest on the loan is the primary source of profit for the banks, the failure to get the same causes a huge loss to the banks. Also, if the banks do not get the principal amount back then it is a setback for their capital base. In this way, non - performing assets pose a huge challenge towards the stability, lending power and the credibility of the banks.

The government has come up with various strategies, legislations and policies to curb the menace of NPAs from time to time. One such policy is the Insolvency and Bankruptcy Code (IBC) enacted in 2016.

2. Background

The menace of the non - performing assets kept on increasing and in order to curb the same, the government after 1991 came up with a lot of policies, strategies and legislations including but not limited to the introduction of the Asset Restructuring Companies, several types of restructuring schemes like corporate debt restructuring,

strategic debt restructuring, scheme for sustainable structuring of stressed assets, creation of departments such as the Board for Industrial and Financial Reconstruction among others. The legal strategies include the setting up of Debt Recovery Tribunals (DRTs) in order to speed up the resolution of non - performing asset cases, enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) and the Sick Industrial Companies Act, 1985 (SICA).

However, all of these policies and legislations could not meet the required expectations and owing to a lot of legislations, there was a lack of coordination among them. Also, it was necessary to adopt such a strategy which would help in the speedy recovery of the debts. Eventually, a need was felt to enact a more sophisticated and robust policy and a single law instead of various legislations resulting in the enactment of the Insolvency and Bankruptcy Code on May 28, 2016 which also introduced certain changes in some of the existing legislations. The main objective of the IBC is not just to tackle the NPA crisis but also to introduce some discipline in the borrowing - lending process and bring the ailing corporate debtors out from the clutches of insolvency effectively and in a time bound manner so that the business is able to continue properly.

How is the IBC solving the NPA Crisis?

In order to streamline and speed up the process of recovery of the default amount, the IBC has provided for various types of mechanisms and strategies. The greatest perk of IBC is that it provides for a time bound recovery of the default amount unlike the previous laws which helps in disciplining the defaulters.

The IBC via Section 6 [2], empowers a financial creditor, an operational creditor and even the corporate debtor itself to initiate the corporate insolvency resolution process (CIRP) with respect to any default which the corporate debtor commits. The IBC by way of Section 12 [3], fixes a time period of 180 days for the completion of the corporate insolvency resolution process from the date of admission of the application to initiate such process and only if the Adjudicating Authority is satisfied that the process won't be able to get completed within the specified time, it will allow

for an extension of not more than 90 days but the extension will only be provided once. Section 12 also makes it mandatory for the entire process of corporate insolvency resolution to wind up in 330 days from the date of commencement of the insolvency including the extension period and the time taken in the legal proceedings with respect to the corporate insolvency resolution process. After that, the Adjudicating Authority will pass the order for the liquidation of the assets of the corporate debtor [4].

The Insolvency and Bankruptcy Code also provides for the establishment of five authorities i. e., the Insolvency and Bankruptcy Board of India (IBBI), Insolvency Professional Agencies (IPA), Insolvency Professionals (IP), Information Utilities (IU) and the Adjudicating Authority which act as the pillars of the IBC, supporting it in achieving its aims.

The IBC also strives to protect the interests of the corporate debtors by making it mandatory that any personnel associated with the corporate debtor who caused the corporate debtor's insolvency will not be involved in any way with the Committee of Creditors (CoC) as was also held in the case of *Phoenix ARC Private Limited v. Spade Financial Services Limited & Others* [5]. The Top Court in the case of *Chitra Sharma v. Union of India* [6] held that the purpose of this provision of IBC is that the defaulters don't get any opportunity of getting involved with the CoC. The sole object behind this is to prevent the defaulter (s) from influencing the CoC.

The IBC has introduced the concept of moratorium which is introduced after an insolvency petition is admitted. A moratorium tries to protect the interests of the corporate debtor by being liberal with the corporate debtor but not with the personnel who caused the insolvency. It protects the rights of the corporate debtor but not of the defaulters. The Supreme Court in *P. Mohanraj v. Shah Brothers Ispat Private Limited* [7] held that the main purpose of a moratorium is to ensure that no proceeding is initiated against the corporate debtor during the corporate insolvency resolution process and there is no further erosion of the corporate debtor's assets.

The IBC also provides a lot of powers to the NCLT which can not only hear cases but also has the authority to decide upon all the questions regarding insolvency and liquidation of the corporate debtor. But the NCLT can't question the wisdom of the Committee of Creditors and if there is any problem with the resolution plan submitted by the Committee then the NCLT can only sent it back for re-submission as was held by the Apex Court in the *Jaypee Kensington* [8] case.

Is the IBC able to solve the NPA Crisis?

With the enactment of the IBC, the situation of insolvency in India has undergone a complete overhaul. The IBC has given more power and control in the hands of the creditors as compared to the debtors as a result of which, there is more discipline and less exploitation in the borrowing - lending process. As per a few reports, IBC has been instrumental in returning approximately 2.5 lakh crore rupees to the system.

Because of a fixed time period for the finishing up of the corporate insolvency resolution process and the mandate of liquidation of the assets of the corporate debtor after that, many entities have the fear of losing their assets and business and therefore, have started to discipline themselves.

The cases which used to get resolved in approximately 4 years, nowadays get resolved in approximately 330 days although there are some exceptions. According to Business Today [9], the debt recovery rate was 26% before but now it is more than 45%. More and more applications of insolvency are getting registered nowadays. The most historic case of insolvency resolution is the case of Bhushan Steel which was bought by Tata Steel which in turn repaid 35, 200 crore rupees out of 56, 079 crore rupees to the creditors. Although there was a haircut, the majority of the default amount was repaid [10].

According to a report by the World Bank [11], the ranking of India has increased from 136 in 2017 to 52 in 2020, all thanks to the enactment of the IBC. India's position in the ease of doing business according to the World Bank has improved from 142 in 2014 to 63 in 2022 [12] because of IBC.

3. Challenges

Although the IBC has played an instrumental role in bringing down the percentage of gross non - performing assets, it still has a very long way to go. Like every other legislation and policy out there, the IBC has its own share of lacunas and faces a lot of challenges.

The major challenge which IBC faces is that the total amount of NPA does not get recovered in the insolvency cases. There is always some haircut in the gross amount which results in the non - recovery of some of the non - performing assets and eventually such NPAs pile up. Although the percentage of the gross NPA gets reduced but a small percentage of the NPA remains in the system. As per some reports, an average percentage of about 60% of the NPAs succumbs to haircut.

The NCLTs are reeling as a result of a shortage of workforce. Many of the NCLTs have functioned/are functioning without a President and do not have the required number of personnel which is 62. Some NCLTs have only 34 personnel. As a result of a shortage of personnel, there is lack of speedy disposal of cases and a burden on the existing personnel. As a result of which a lot of cases are getting piled up and the time limit fixed by the IBC is not met. Another drawback of such a delay is that the assets of the corporate debtor get eroded by the time the turn of liquidation of the assets comes.

Another challenge faced by the IBC is the lack of digitization. The NCLTs and NCLATs are not completely digitized due to which a lot of cases are pending. They should conduct virtual hearings in order to get back at the backlog.

Also, the huge non - performing assets have not yet been recovered and the majority of the non - performing assets

which have been recovered are the small non - performing assets.

4. The bottom line

Taking into account all the points mentioned above, it can be inferred that the Insolvency and Bankruptcy Code has quite a long way to go. It can also be concluded from the statistics and surveys that the sector which benefitted the most from the IBC is the Steel Industry. As compared to the other industries, Steel sector recovered a huge amount of NPA. Though the Code was seen as a game - changer policy of the government and played an instrumental role in improving the overall NPA situation in India and eventually the ranking of India in the insolvency statistics, it suffers from certain shortcomings and is facing a lot of challenges because of some loopholes which exist currently in the system. Unless and until the lacunas in the system are not done away with, the Insolvency and Bankruptcy Code will not be able to function to its full capacity and give the desired results. In order to achieve the desired results, there is an urgent need for the government to join forces with the private organisations and the general public at large.

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