Corporate Insolvency Resolution in India: Lessons from a cross-country comparison

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Corporate Insolvency Resolution in India: Lessons from a cross-country comparison[1]

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Abstract

In this paper we analyse the corporate insolvency resolution procedures of India, UK and Singapore within a common framework of well-specified principles. India at present lacks a single, comprehensive law that addresses all aspects of insolvency of a firm. It has a multiple laws, regulations and adjudication fora, each of which have created opportunities for debtor firms to exploit the arbitrage between these to frustrate recovery efforts of creditors. This adversely affets the resolution process, the time to recovery and the value recovered. The importance of a comprehensive, well-functioning insolvency resolution framework has been documented in literature. In India, the Bankruptcy Law Reforms Committee (BLRC) was constituted in 2014 with the objective of proposing a comprehensive framework for resolving the insolvency of firms and individuals. We undertake a comparison of the corporate insolvency resolution framework in UK, Singapore and India, with the underlying motivation to highlight the similarities and differences across the laws, procedures and institutional context of the three countries. The objective of this comparison is to draw lessons for the Indian reform process, in context of the formation of the BLRC. The BLRC has recently proposed an Insolvency and Bankruptcy Bill (IBB) which has been presented in Parliament and is currently being deliberated upon by a Joint Parliamentary Committee.

Keywords: Resolving insolvency, Liquidation, Reorganisation, Adjudicator, Loss given default, Recovery rate, Timeliness, Insolvency professional, Information system

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1. Introduction

At the current time when India, a major emerging economy, is endeavoring to revive and sustain its high growth rate, it is imperative that financing constraints in any form be removed and a favorable environment be created for fostering business and competition. In this context, a well functioning and orderly corporate insolvency framework consisting of well-defined rules, procedures and timelines as well as efficient institutions, is critical for encouraging the development of robust domestic credit markets. There is significant evidence in the literature that indicates legal protection of creditors' rights supports development of credit markets. Studies have also shown when lenders can easily enforce repayment, they are more willing to extend credit and at lower prices. See for example, Porta et al (1996, 1997), Djankov et al (2007), Levine (1999), Aghion et al (1992), Aghion and Bolton (1992), Davydenko and Scharfstein (2008) and Qian and Strahan (2007) among others.

India, at present, lacks a single, comprehensive law that addresses all aspects of insolvency of an enterprise. The current legal and institutional framework for dealing with corporate distress is fragmented and dysfunctional. In fact the current system has been described as one of "capitalism without exit". In principle, the Companies Act, 1956 contains the main legal provisions for dealing with corporate insolvency. In reality though, there are two major laws regarding corporate insolvency, two laws regarding recovery and two regulatory provisions regarding restructuring. Each of these mechanisms has their own institutional context and agencies with inevitable conflicts of jurisdiction between them. The current system is focused on the recovery rights of banks as secured creditors and largely ignores the interests of unsecured creditors (such as bond holders), domestic institutional creditors other than banks (such as Non-Banking Finance Companies or NBFCs) and foreign creditors.

Development of institutions that support the insolvency resolution process, such as dedicated bankruptcy benches in tribunals, official liquidators, the credit registry and credit bureaus, has also lagged behind, both in capacity and capability. The legal system is fragmented and fraught with delays in enforcement. The outcomes of the current system with regard to time taken to resolve corporate insolvencies, costs associated with the proceedings as well as creditors' recovery rates, have been extremely poor and lagging far behind other economies, resulting in sustained criticisms of the overall framework over the last couple of decades. The system creates challenges for creditors in the form of the size and diversity of their credit portfolio and for debtors in the form of access to credit.

The poor outcomes of India's corporate insolvency process are reflected in the country's rankings in the World Bank Doing Business Rankings (2016) as shown in Table 2. With regard to Insolvency Resolution, India's rank is as low as 136 among the 184 countries surveyed. Outcomes on time to recover and on recovery rates are also poor. The absence of a well functioning and effective corporate insolvency framework reflects in the state of credit markets in the country. Credit markets in India are small as a proportion of its GDP (Tables 1 and 2).

Moreover, banks in India have become increasingly vulnerable to the problem of stress on loans made to corporates. Stressed assets at banks, which include NPAs and advances that have been restructured, have increased from 3.6% (on a base of Rs. 23.3 trillion of advances) in 2008 to 10.9% (on a base of Rs. 67.4 trillion of advances) in 2015. This acts as a serious constraint on the lending capacity of Indian banks, thereby further choking the already inadequate and shallow credit market, and making it harder for business enterprises to fund themselves.

Table 1: Insolvency resolution parameters			
Indicator	**India**	**South Asia**	**OECD**
Time (years)	4.3	2.6	1.7
Cost (as a % of estate)	9.0	10.1	8.8
Recovery rate (cents on the $)	25.7	36.2	71.9
Outcome (0=piecemeal sale; 1=going concern)	0	0	1
Domestic credit by financial sector to GDP (%)	74.8	69.5	201.8
Source: World Bank Doing Business, 2016; World Development Indicators, 2015.			

India has, over time, become an important emerging economy experiencing high growth rates. It is the fifth largest economy in the world with a GDP in excess of $2 trillion and growing at an average rate of 5% to 7% per annum. If this growth is to be sustained, Indian debt financing has to move from the constraints of a limited, homogenous, bank dominated market to a large, heterogeneous market with a diverse set of lenders. To achieve this goal reform of the corporate insolvency resolution framework in the country is a critical need. In the past, policy makers have acknowledged this need. This was done in the form of expert committees studying the shortcomings of the existing framework, its adverse impact on the credit markets and making recommendations for reform. In implementation however, the reform process has so far taken the approach of "interim fixes designed to solve the problem at hand" (Aghion et al. 1992).

An effort at comprehensive reform was undertake when the Ministry of Finance in India set up the Bankruptcy Legislative Reforms Committee (BLRC) committee in 2014. The mandate of the committee was to recommend an "Indian Bankruptcy Code (IBC)", applicable to all non-financial corporations and individuals that would replace the existing framework. The Committee submitted its report and the draft Insolvency and Bankruptcy Code (IBC) to the government in November 2015.

2. Motivation for cross-country comparison and choice of countries

India is not unique in seeking to reform its bankruptcy law. Djankov et al (2007) records 162 instances of reform in bankruptcy laws across 99 countries during the 1978 - 2004 period. The World
Bank records 145 instances of insolvency reforms across 82 countries from 2008 - 2016. These include both comprehensive and incremental reforms. The spread and frequency of reform in this area across countries is not surprising considering that well-functioning insolvency laws have been viewed as fundamental to the development and growth of robust credit markets. The process of legislative reform, however, is a complex one.

While the importance of a well-functioning insolvency resolution framework can hardly be overstated, there is no single, internationally accepted framework with well-defined rules and standards laid out for organizing an efficient in- solvency resolution process. Corporate insolvency regimes vary substantially across countries and in different respects. These differences reflect variations in their underlying economic context, legal traditions, institutional structures and political economy considerations. As a result, whilst the basic principles and standards of what comprises an effective framework are well defined, there is no generally applicable best design solution. Moreover, as mentioned above, insolvency laws are not static and in fact evolve over time, making it even more difficult to arrive at a ready recipe for designing a proper resolution system. However, important lessons can be learned from other countries, by comparison with their laws as well as by studying their experiences with legislative reform process.

Given the absence of a universal framework for resolving corporate insolvencies, in this paper we compare and contrast the insolvency resolution procedures of non-financial enterprises of two countries namely, UK and Singapore alongside that of India. The underlying motivation of this comparison is to be able to systematically identify the principal elements in the construct and the implementation of the chosen countries' corporate insolvency regimes. The objective is that this comparison will yield important lessons for India at a stage when it is poised for a significant reform of its corporate insolvency laws. A comparison with systems of other countries will enable its learning process in designing its own.

The choice of UK, and Singapore for the cross-country comparison has been motivated by three factors. First, each of these countries follows the common law legal tradition. UK, in fact, is the country of origin for corporate insolvency law, which emerged as an outcome of the limited liability company structure. Both Singapore and India follow the common law tradition and their insolvency codes find their origins in the English system. Second, despite the common legal tradition, the three countries' laws have followed different evolutionary paths and have achieved different outcomes. This is reflected in their rankings in the "Insolvency Resolution" area of the World Bank's Doing Business Report, 2016. UK ranks 13, Singapore ranks 27 whereas India has a rank of 136. It also reflects in the size and structure of credit markets in these countries. Table 2 shows that while banks are the dominant source of credit to the non-financial sector in India, the UK and Singapore have larger credit markets, a significant share of which is with non-bank sectors', including debt capital markets.

Finally, each of these countries is at a different stage in the process of reform of its corporate insolvency framework. UK has already undertaken two rounds of significant reform, in 1986 and in 2002. The 1986 reform was comprehensive and was based on the Cork Committee report of 1982. Singapore is in the advanced stages of reforming its code. The Insolvency Law Reform Committee (ILRC) of Singapore, set up in 2010, submitted its recommendations in 2013. India initiated major reforms in 2014, with the Ministry of Finance constituting the BLRC.

In this paper we compare the Indian framework for insolvency resolution with that in the UK and Singapore and highlight the lessons from this comparison that aided the BLRC in designing the economic thinking behind the draft IBC.

3. Corporate insolvency system: function, form and objectives

Before launching into a cross-country comparison, it is useful to layout a context. Some key elements that need to be considered when evaluating a corporate insolvency system are:

Role: The corporate insolvency system performs an important function in an economy-that of dealing with firm distress. Distress in firms can be of two types: (1) financial distress, where the firm has a viable business but an unviable financial structure; and (2) economic distress, where the firm's business itself is unviable. The basic role of an insolvency resolution system is to preserve fundamentally "viable" firms and liquidate "unviable" firms.

Table 2: Insolvency resolution parameters and credit markets

Indicator	**UK**	**Singapore**	**India**
Rank	13	27	136
Time (years)	1.0	0.8	4.3
Cost (as a % of estate)	6.0	3.0	9.0
Recovery rate (cents on the $)	88.6	89.7	25.7
Outcome (0=piecemeal sale; 1=going concern)	1	1	0
Domestic credit by financial sector to GDP (%)	171.5	126.3	74.8
Bank credit to GDP (%)	85.3	56.5	93.1

Source: World Bank Doing Business, 2016; BIS Debt Statistics, 2014; World Development Indicators, 2015.

System: The framework for corporate insolvency includes not just the law but also other elements that contribute to the achievement of the objectives to which this law is directed. The corporate insolvency system, hence, includes:

- The legal system – the law of insolvency, its rules of procedure and the interaction of this law with other laws of the country.
- The adjudication system – the formal process for insolvency resolution is essentially a judicial process and the courts and judiciary form an integral part of it.
- The professional system – the professionals that provide services to- wards the insolvency resolution process.
- The information system–information regarding firm's finances, database for defaults, credit registries, collateral/security information etc.
  For the system to be effective, each of these elements individually and together need to be effective.

Form: The law of insolvency takes different forms across countries. In some countries, it is contained in a separate insolvency code, while in others it may be scattered across various laws and debt collection systems. Similarly, there are variations in the institutional mechanisms.

Outcomes: The outcome of the process is a resolution of the firm's distress in one of three ways: (1) The firm is restructured and returns to profitable trading, through a change in its financial structure, the terms of its liability contracts or a reorganisation of the firm itself; (2) Its business or assets get sold off to interested parties, prior to a liquidation; or (3) It enters immediate liquidation.

Principles: Regardless of the differences in form, an effective framework needs to have the following principles built into it:

- **Efficiency:** The framework should minimise probability of default (PD) ex ante and maximise loss given default (LGD) during insolvency and ex post. This is critical in financial contracts, where the time value of money is paramount.
- **Accountability:** The framework should create accountability for parties in a debt contract and from participants in the insolvency resolution process (courts, IPs). It should create disincentives for strategic behaviour ex ante, ad interim and ex post.
- **Expertise:** In insolvency, there is no unique and optimal equilibrium. An effective system acknowledges this and enables negotiation-based outcomes aided by experts. It also means that the law is sup- ported by clarity of procedures as well as capacity and capability of institutional systems.
- **Fairness:** The concept of fairness in insolvency has multiple dimensions. For creditors, it means that similar creditor groups should be treated similarly and as far as possible pre-insolvency priorities should be maintained. For debtors, it means that the framework should seek to preserve viable firms and only liquidate the unviable ones.

4. Comparison of the laws

The law dealing with corporate insolvency varies both in form and in substance across the UK, Singapore and India. In UK and in Singapore the formal procedures are contained in a single law (except Scheme of Arrangement in the UK which is contained in the Companies Act), whereas in India, they are fragmented across laws. In the UK, till 1985, the provisions for dealing with insolvency were contained in the UK Companies Act. In 1986, based on the recommendations of the Insolvency Law Review Committee, chaired by Sir Kenneth Cork, the Insolvency Act, 1986 was enacted. This Act carved out and consolidated all the insolvency-linked provisions. The first part of this Act had provisions for corporate insolvency and the second part had provision for individual insolvency. The Companies Act provisions were more liquidation focused and this Act sought to create a balance by introducing provisions to enable the reorganisation of companies, where feasible.[3] The Act was significantly amended in 1994[4], 2004[5] and in 2005[6]. The Insolvency Rules, 1986 form the subordinate legislation for insolvency and contain both key provisions and procedural guidelines.

3 A new procedure, Administration, was introduced by this Act

4 The 1994 amendment addressed issues regarding the personal liabilities of Administrators and Administrative Receivers.

5 The 2000 amendment introduced new provisions for company voluntary arrangements and moratorium.

6 In 2002, the Enterprise Act further significantly amended the provisions of the Insolvency Act, 1986. It abolished Administrative Receivership, except in certain specified cases. It also provided that a prescribed part of the floating charge realisations (subject to a maximum of GBP 600,000) be made available for recovery of unsecured creditors dues. Another big change was the abolition of Crown preference in the statutory priority.

Both in Singapore and in India, the respective Companies Acts continue to be the primary laws for dealing with insolvency. Despite the similarity in form, some key differences exist in the two countries laws. In Singapore the Companies Act 2006 is the primary corporate insolvency law and contains procedures for reorganisation and liquidation of companies.[7] In contrast, the Indian Companies Act, 1956 deals mainly with liquidation and winding up of companies, with insolvency as one of the conditions for winding up.[8] The only formal provisions for reorganisation of insolvent companies are laid out in the Sick Industrial Companies Act (SICA), 1985. This law, however, deals only with a sub-set of companies that are eligible[9] and are deemed to be sick[10].

This structure, where the laws are not consolidated, creates several challenges in India. Companies that are not eligible under SICA, have no formal reorganisation procedures available to them. A large number of micro and small enterprises do not register as companies. Such firms have no access to any insolvency provisions.

Another important aspect of the legal framework is the interaction of insolvency laws with other laws of the country. These could be laws pertaining to: the general functioning of companies[11], contract enforcement[12], employees/labour and their benefits[13] the functioning of financial markets[14], human rights etc. In the UK and Singapore, laws deal with the interaction of the insolvency law with other laws of the land through a combination of judicial interpretation and legislative carve-outs. This appears to be working well and reflects in their relatively low time to resolution in these countries (Table 2). In India, interaction between laws is fraught with complexity and, combined with judicial delays, has been one of the causes for delays in resolution (Ravi, 2015).

Lesson 1: We require a single, consolidated law with well defined interaction with other laws.

5. Comparison of the institutional setting

5.1. Courts

7 Part VIII (Receivers and Managers), VIIIA (Judicial Management) and X (Winding up) of the Companies Act, 2006.

8 Part VII of the Act (Section 425 – Section 560) addresses the subject of winding up of registered companies and Part X (Section 582-590) addresses the winding up of unregistered companies, including foreign companies, partnerships, societies and associations with more than seven members.

9 Industrial companies defined as a company existing immediately before the commencement of the Sick Industrial Companies (Special Provisions) Amendment Act, 1993, and registered for not less than five years.

10 Sick companies defined industrial companies as having at the end of any financial year accumulated losses equal to 50% of its peak networth during the immediately preceding four financial years.

11 Companies Act

12 Contract laws, individual enforcement rights of creditors.

13 Employee laws, Union related laws, special laws for workers/labour, pensions laws.

14 Specially with respect trading on exchange platforms.

Courts play an important role of adjudicating the insolvency proceedings. Across countries, their role varies from dispute resolution, to ensuring that the law is applied duly and without prejudice, to, in some countries, even adjudging the resolution proposal for the distressed firm. Courts exercise significant discretion in all matters, including economic and commercial issues. Further, the timeliness of insolvency proceedings depends on the capacity (ability to deal with case volume) and capability (ability to deal with specialised economic and commercial matters) of the court system.

Both the UK and Singapore have a single adjudicating authority for dealing with insolvency related matters. In the UK, the Chancery Division of the High Court hears corporate insolvency matters. This court deals primarily with matters related to business and trade disputes, intellectual property and trusts and inheritance. From 2008 to 2014, approximately 18,000-25,000 new corporate insolvency cases were filed in the UK every year. In Singapore the High Court deals with all corporate insolvency matters. Adequate court capacity has been developed to ensure timeliness and effective resolution.

In India however, the fragmentation of the laws for liquidation and reorganisation is further complicated by the presence of separate adjudicating authorities under each. High Courts in India primarily deal with writ petitions[15] and are the courts of appeal for civil and criminal matters. However, for certain company related matters like liquidation and winding up, they also exercise original jurisdiction under the Companies Act. Given the problem of delays in company liquidation proceedings in the High Courts, when SICA was enacted, a specialist tribunal was created to administer it to ensure the speediness of the rescue process. The Board of Industrial and Financial Reconstruction (BIFR) and the Appellate Authority of Industrial and Financial Reconstruction (AAIFR) were set up, which are deemed to be civil courts[16], and have jurisdiction over reorganisation cases under SICA.

The courts face serious capacity challenges that reflect in their high levels of pendency. Data from BIFR shows that the average pendency of BIFR cases is 4.5 years. Anecdotal evidence suggests that the pendency of liquidation cases in High Courts is 9-10 years (Eradi, 2000).

The presence of multiple laws and adjudication fora has also created opportunities for the debtor firms to exploit the arbitrage between the two systems to frustrate the recovery efforts of creditors and to adversely impact the timeliness of the resolution process.[17] SICA provides that the orders and proposals made under the Act cannot be appealed in any other civil court except the AAIFR, However the BIFR and the AAIFR are deemed quasi-judicial bodies and hence subordinate to the High Court. This means decisions taken by them can be appealed at the High Court. Ravi, 2015 finds that, often BIFR and AAIFR decisions are reviewed afresh by the High Courts.

Lesson 2: We require a single adjudicating authority with adequate capacity to ensure timeliness in adjudication.

Lesson 3: We need to precisely define the role of the adjudicating authority and build capacity at courts commensurate with their role in the process.

15 Under Article 226 of the Constitution

16 For the purpose of Section 195 and 196 of Chapter XXVI of the Code of Criminal procedure, 1973.

17 Also referred to as forum shopping.

5.2. Insolvency Professionals

Insolvency professionals such as liquidators and administrators play a central role in insolvency proceedings. Their role may range from due diligence, valuation, management of the company during the proceedings, to preparation and implementation of the resolution proposal and realisation and distribution of proceeds. In doing all these, they need to ensure that due process in compliance of the law is followed and hence, it is important that they have adequate knowledge of the law, sufficient experience in commercial and financial matters and integrity in their functioning.[18]

In the UK, Insolvency Practitioners (IP) are a private competitive industry regulated by the government. The ministerial responsibility for insolvency matters rests with the Ministry of Business, Innovation and Skills (BIS). The Insolvency Service, an executive body of the BIS is the regulator for this area and specifically for the IPs who are regulated under the Insolvency Act. An IP needs to be licensed before being appointed in relation to an insolvency matter. The standards for licensing, practice, setting fees are well defined and monitored by seven professional bodies that also act as Self Regulating Organisations (SRO)[19]. Applicants need to pass a qualifying exam[20] in addition to meeting the authorising body's insolvency experience requirements. A licensed IP can be appointed as an Administrator, Liquidator, Receiver or Supervisor in an insolvency procedure.

In Singapore, the Insolvency and Public Trustees Office of the Ministry of Law empanels and regulates a private industry of insolvency professionals. The qualifications for becoming an insolvency professional are laid out in the Companies Act and typically vary based on the type of case that they are appointed to.[21] In most cases the government Official Assignee or the Official Receiver is appointed to administer insolvency.

In India, the Official Liquidators are appointed by the central government and each High Court has the office of an OL attached to it. The provisions for appointment of an OL are laid out in the Companies Act[22]. Under SICA, generally a public financial institution or a scheduled bank acts as an operating agency (OA)[23] and aids the eligible company in proposing a draft rehabilitation plan. In addition to being plagued with capacity challenges, the role and incentives of the OLs and OAs in the insolvency resolution process has received much criticism (Eradi, 2000).

18 International Monetary Fund Orderly and Effective Insolvency procedures, 1999 – Chapter on Institutions and Participants.

19 The following professional bodies have been authorised by the Insolvency Service to conduct exams and provide oversight to IPs from within their domain: (1) Association of Chartered Certified Accountants; (2) Insolvency Practitioners Association; (3) Institute of Chartered Accountants in England & Wales; (4) Institute of Chartered Accountants in Ireland; (5) Institute of Chartered Accountants of Scotland; (6) Law Society of Scotland; and (7) The Solicitors Regulation Authority.

20 JIEB exams

21 For example: A Judicial Manager has to be a public accountant. A liquidator must be a public accountant who is certified as an approved liquidator by the government.

22 There are a total of 22 OLs across 24 High Courts in India.

23 There are 24 OAs.

Lesson 4: We require the private sector to step in to create a competitive industry of insolvency professionals.

Lesson 5: We require strong oversight regulation to enforce minimum standards of professional and ethical conduct, and to formulate correct incentives for insolvency professionals.

6. Comparison of procedures

There two main possible outcomes for a firm in distress. It can either get reorganised and continue as a going concern or it can get liquidated. Reorganisation of a firm can be through: (i) an informal work-out, where the debtor firm and its creditors agree to a plan of reorganisation through private negotiations; (ii) a voluntary reorganisation process under the law, where the negotiations are voluntary but are conducted under the supervision of the court; and (iii) a formal process for assessing viability and deciding between reorganisation and liquidation, typically supervised by the court. Liquidation in turn can have two procedures: (i) voluntary liquidation, where the firm itself proposes liquidation when it becomes insolvent; and (ii) compulsory liquidation, where the creditor(s) applies to the court for liquidating the firm. In addition to these, several countries also have individual enforcement procedures available to certain eligible creditors. These provide creditors powers in addition to their ability to exercise their own security interest.

The wide variety of procedures available reflects the complexity in dealing with a failing firm. There are two models that countries follow in the design of their procedures. Some countries follow the linear model, where a common linear process evaluates the viability of the firm before deciding whether it should be reorganised or liquidated. For example, under the new German law, all insolvencies are conducted initially under the same rules and, for an initial period of up to three months, there is no presumption as to whether the enterprise will be rehabilitated or liquidated. The proceedings only separate into liquidation and rehabilitation processes once a determination has been made as to whether rehabilitation is, in fact, possible.

Given the complexity and subjectivity in assessment of value, most countries follow a non-linear model where both reorganisation and liquidation procedures are made available to concerned parties and the choice of procedure is left to the party initiating the process. Since all procedures have costs associated with them, it is expected that parties will choose those procedures that will minimize their costs while yielding the highest value. Each of these models has advantages and disadvantages. A linear model is well suited for countries that are capacity constrained in institutional infrastructure. However, they impose an additional cost of a common procedure on all parties. The non-linear model provides choice to the concerned parties but adds to complexity.

6.1. Reorganisation procedures

The objective of a reorganisation procedure is to either enable the distressed firm to return to profitable trading or to preserve its business as a going concern, even if the company gets liquidated. This is because, unlike liquidation, which creates value only for the recipients of the liquidation proceeds, reorganisation creates value for all stakeholders and the economy in general.

For a reorganization procedure to be used and for it to achieve its objective, its design needs to create appropriate incentives for both the debtor and creditors. Creditors must be incentivised to participate in reorganisation proceedings by giving them the confidence that these will not be used to delay liquidation and to undermine the value of their claims. For example, reorganisation proceedings need to be time bound and give control to creditors to approve or reject the plan of reorganisation or to convert it to liquidation proceedings. Further, creditors that have security over the firm's assets also need confidence that they would get at least as much as they would in liquidation.

Debtors must be incentivised to trigger formal proceedings at the early signs of distress. This is unlikely to happen if initiation of insolvency proceedings automatically takes away control of the business from them. However, debtors may be incentivised to trigger even if they lose control, if they receive relief from creditor or legal action through a moratorium. Also, punitive measures for company directors who delay insolvency proceedings despite being aware of distress, may further aid the process.

6.1.1. Formal procedure for assessing value

Administration in the UK, Judicial Management in Singapore and BIFR filings in India are formal reorganisation procedures. The main differences in procedure across the three countries are as follows:

- In the UK and Singapore, both the debtor and the creditors can initiate the procedure. In India, the primary onus of initiating the procedure lies with the debtor. If the company or its unsecured creditors trigger the procedure, actual or impending insolvency needs to be established for the procedure to commence. Only if a creditor with a qualified floating charge (QFC) initiates the procedure, insolvency does not need to be established. In Singapore, evidence of inability to pay debts is required. Both these facilitate trigger by a debtor on early signs of distress. In India, erosion of balance sheet net worth is the trigger for the procedure. This creates disincentives for early trigger by debtors.

- Both in the UK and in Singapore, the existing management and Board of the company lose control of the business of the company. A moratorium on creditor actions and legal suits comes into force for a defined period of time once insolvency proceeding is triggered. In India, while a moratorium comes into force, the existing management and Board remain in control during the procedure.

- Both in the UK and Singapore, the reorganisation plan is adopted through a vote by the creditors' committee where as in India, the BIFR adjudges and approves the plan.

- In the UK, the Administrator is generally appointed by the debtor with the consent of the creditors. In Singapore, the Judicial Manager is appointed by the court and is monitored by the court and by a committee of the creditors. In India, the Operating Agency under SICA is appointed by and acts under the directions of the court. The key decisions regarding rehabilitation are thus made by the court.

- The court's role is the lowest in the UK where it is not uncommon for an Administration to complete without a court judgment. The court mainly acts as a body for dispute resolution and providing guidance to the Administrator. In Singapore, the court plays a more active role in the process and can adjourn creditors' meeting, as well as allow amendments to the rescue plan. In India, the BIFR plays the critical role in deciding on the plan of rehabilitation.

6.1.2. Voluntary reorganisation

Voluntary reorganisation procedure enables debtors to negotiate with their creditors under the supervision of the court. The key difference between these and the formal reorganisation procedure is that, (i) insolvency does not need to be established for the use of this procedure, and (ii) the debtor remains in control during the procedure.

The UK has two procedures for voluntary reorganisation, the Company Voluntary Arrangement (CVA) under the Insolvency Act and the Scheme of Arrangement under the Companies Act. A CVA enables a company to restructure its debt or reorganise its business, with the consent of its creditors while a Scheme could be an arrangement with creditors for debt restructuring, mergers and takeovers or other forms of reconstruction such as capital structure changes. A CVA can only be proposed by the Board of a company, and does not require any evidence of current or impending insolvency. The Board of the company retains control and, with the help of an IP, proposes a reorganisation plan for approval by the creditors and the shareholders of the company. A Scheme of Arrangement is proposed by the Board of the company, which retains control during the Scheme and proposes a plan for consideration by the creditors. There is no IP involved in the process. A Scheme is subject to close judicial scrutiny for procedural compliance and is approved by a creditors' vote and by the court.

In the UK, companies may prefer the voluntary reorganisation proceedings as they allow for reorganisation to be proposed even when there is no actual or impending insolvency. The other difference is that the Board retains control during these procedures whereas in Administration, the Board loses control. The problem however is that both these procedures do not have a moratorium period that allows companies to negotiate with their creditors. Further, a CVA plan, though light on court involvement, cannot be crammed down on secured creditors. While a Scheme can be crammed down on all creditors, the extent of court involvement makes it an expensive procedure. As a result of these shortcomings, both these procedures are not used frequently and Administration continues to be the procedure of choice for reorganization.

In Singapore, voluntary reorganisation can only be through a Scheme of Arrangement under the Companies Act, a procedure very similar to the Scheme in UK. The Board of the company proposes a Scheme and retains control during its approval process and its implementation. The court is closely involved in the approval process and in determining whether the Scheme is fair and reasonable. A validly approved Scheme is binding on all creditors. Similar to the process in UK, Schemes are wide ranging and include any form of compromise or 'give-and-take' agreements between debtors and creditors, including debt for equity conversions, debt moratoriums, extended repayment schedules, fresh equity contributions, or in the case of a group, its reorganization or merger.

In India, Scheme of Arrangement is allowed under the Companies Act and the procedure is similar to the UK and Singapore. A company or its creditors can make an application to the court to call for a meeting of the creditors to approve a Scheme. Till SICA was enacted in 1985, the Scheme of Arrangement was the only procedure available to companies for reorganisation. This holds true even today for companies that are not eligible under SICA.

6.1.3. Informal workouts

The insolvency resolution law can create ex ante incentives for the debtor and the creditors to voluntarily negotiate in the shadow of the formal process. This is optimal because formal insolvency procedures come at a cost, both monetary and reputational. However, a voluntary solution can be worked out only if parties have recourse to the formal framework in the case of a breakdown in negotiations.

In the UK, there is an informal, non-binding process for workouts using the London Approach, supported by guidelines from the Bank of England. In Singapore, informal workouts are aided by the INSOL principles laid out in the Statement of Principles for a Global Approach to Multi Creditor Work-outs, 2000. The four main principles on which this approach relies are: (i) Standstill-lenders agree to not exercise individual enforcement rights while the work-out is being considered; (ii) Information-all decisions are made based on reliable information that must be shared between all lending banks and that remains confidential; (iii) Negotiation and decision on viability-lending banks should take a collective view on whether to support the debtor and in what form; and (iv) Business plan and new money-all lending banks should share the burden of supporting the debtor.

In India, procedures for informal workouts have evolved as a consequence of the failure of the formal framework rather than on the back of it. The Reserve Bank of India (RBI) has set up the Corporate Debt Restructuring (CDR) process, the Joint Lenders' Forum (JLF) and the Strategic Debt Restructuring (SDR) process as an alternate system of insolvency resolution. These provide RBI-regulated lenders, mainly banks, mechanisms to recover or restructure their loans to companies.

The Indian CDR mechanism, while based on the 'London Approach', which encourages creditors to opt for an out-of-court agreement, differs from it in many respects. Unlike the London Approach, which is an informal procedure, CDR is a formal process where the decision to grant a CDR to a company is taken by a body of institutional creditors namely banks, financial institutions and asset reconstruction companies and is governed by detailed guidelines issued by RBI.[24] These guidelines include norms on eligibility of companies for CDR, the nature of the restructuring, the timelines, the roles and responsibilities of the parties and the procedure for exit from CDR. The CDR process is also unique in that the RBI provides relief on prudential norms for loan accounts that have been restructured using the CDR mechanism. Over time, in India, CDR has become a mechanism for addressing the asset quality problem of banks rather than a mechanism for reorganizing distressed companies.

In addition to CDR, in June 2015, RBI introduced a Strategic Debt Restructuring (SDR) mechanism to help banks recover their loans by taking control of the distressed listed companies. Under this scheme a consortium of lending institutions or Joint Lenders' Forum (JLF) may at their discretion, convert loan dues into equity shares. At the time of initial restructuring, the JLF must incorporate an option in the loan agreement to convert the entire or part of the loan including the unpaid interest into equity shares if the company fails to achieve the milestones and critical conditions stipulated in the restructuring package.

This option must be corroborated with a special resolution since the debt-equity swap will result in dilution of existing shareholders. This scheme will result in lenders acquiring 51% ownership of the distressed companies. From the time SDR is invoked, JLF must approve the debt-equity conversion within 90 days. JLF will get 90 more days to actually do the conversion. Thereafter, JLF will hold the existing asset status of the loan for 18 more months once the debt-equity conversion is completed. At the end of 18 months JLF must divest their holdings in the equity of the company. The biggest challenge under this scheme will be for the lenders to continue to run the distressed companies till they are able to find a suitable buyer. It can be a chicken and egg situation wherein until the companies are turned around and become viable, finding a suitable

24 Issued first in 2008 and further augments in 2012 and 2013.

buyer might be difficult and may take much longer than 18 months. The primary incentive to use these mechanisms is related to the asset reclassification benefits provided by the RBI to lenders who participate.

Lesson 6: We require early trigger of the resolution process. We require both the debtor and the creditors to have the ability and the incentives to trigger early.

Lesson 7: We need to ensure that assessment of viability of a company is done by the concerned parties. Courts should merely aid but not adjudicate upon this decision.

Lesson 8: We require a procedure design that will set the correct ex ante incentives for all parties. For example, penalty for fraudulent or frivolous triggers, loss of control by existing management in exchange for a moratorium, and safeguards against abuse of process by debtor, creditors and IP.

Lesson 9: We need to ensure that while an effective formal framework may create ex ante incentives for informal workouts in the 'shadow of the law', informal workouts cannot replace a formal, all encompassing framework.

6.2. Liquidation

Liquidation of a distressed company should, in theory, occur only if it is economically unviable. In practice, liquidation is the most likely outcome in insolvency. Preserving value in liquidation and ensuring that it is conducted in an orderly manner as compared to a piecemeal liquidation by creditors racing to collect their dues is an important function of the insolvency resolution process. An effective and timely liquidation process is characterized by three features:

1. It provides certainty to creditors regarding a minimum level of recovery and of the priority in distribution;
2. It provides a time-bound exit to the debtor company and allows capital to be released for more productive deployment; and
3. It creates a ‘threat’ in the context of which parties consider and implement reorganisation.

In the UK, Singapore and in India, liquidation precedes the winding up of the company. In the UK, winding up is a remedy available under the Insolvency Act, 1986, while in Singapore and India, it is available under the respective Companies Acts. The general procedure followed in the three countries is very similar to each other. There are two modes of winding up in an insolvency situation. The first is a voluntary winding up by creditors. In this procedure, the company, through a resolution of its shareholders and in consultation with its creditors, petitions the court to be wound up without making an accompanying declaration of solvency. The second is a compulsory winding up by the court and is initiated by the creditors. A creditor can initiate compulsory winding up proceedings through an application to court on grounds that company has either defaulted in a debt of a defined threshold or is unable to pay its debts as they come due.

The liquidation procedure has several key components: (i) the commencement of liquidation and appointment of a third-party administrator known as the liquidator; (ii) administration of the company’s affairs and assets by liquidator; (iii) ascertainment of company’s liabilities and recovery and realisation of company’s assets; (iv) distribution of the proceeds of realisation to company’s creditors and members; and (v) the eventual dissolution of the company.

In Singapore and the UK, creditors nominate the liquidator, and the court usually accedes to this nomination. In India, each bench of the High Court has an Official Liquidator attached to it. The court appoints the OL for liquidation proceedings. Once a liquidation proceeding is commenced, the company normally ceases business. The liquidator is empowered to manage the affairs of the company in liquidation. In both compulsory and voluntary winding up, there is no statutory time limit on liquidation proceedings.

The big difference across the countries is in the time taken for the liquidation proceedings to be completed. In the UK and in Singapore, liquidation proceeding may get completed within a period of 1-2 years. In India, on the other hand, these proceedings go on for around 9-10 years on average, and up to 25 years in some cases. Liquidation should be a credible 'threat' that keeps the debtor and the creditors on the negotiating table during the insolvency resolution process. Delays of the type witnessed in India reduce the confidence of concerned parties in the formal resolution framework.

Furthermore, a well-defined priority of distribution of liquidation proceeds provides the creditors the ability to estimate their loss-given-default. This plays a critical role in the development of the credit markets. For example:

- Financiers will be wiling to extend interim financing during the insolvency process only if they are given super-priority;
- Secured creditors need to know that they will receive priority in liquidation payments to the extent of their security;
- In the UK, the Crown gave up its priority on tax dues in exchange for a defined amount of payment to the unsecured creditors. This was done to promote unsecured credit in the economy.

In India, interim finance during insolvency does not get priority. This reflects in BIFR cases in the form of lenders' unwillingness to extend any further credit to the company. Secured creditors in India prefer the use of individual enforcement under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI 2002) to the formal framework for insolvency resolution as, in the latter their rights are *pari passu* with workers.

Lesson 9: We require timely and effective liquidation.

Lesson 10: We require a well-defined priority of distribution of liquidation proceeds. This sets ex ante incentives for development of credit markets as well as for use of the formal resolution framework by various classes of creditors.

6.3. Individual enforcement procedures

In addition to the formal procedures for reorganisation and liquidation, each of these countries also has an individual enforcement procedure available to certain categories of secured creditors. Administrative Receivership in the UK, Receivership in Singapore and SARFAESI (The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act) in India fall under this category. The powers available to eligible creditors under these procedures are founded on the principle of enforcement of security rights and go far beyond contract enforcement. These include the power to take action without court sanction, the power to Take over running of the company and precedence over formal reorganisation and liquidation proceedings.

The Administrative Receivership procedure in the UK was available to a specific category of secured creditors known as 'floating charge holders' and provided wide array of powers for recovery of dues, including sale or liquidation of the company. The Enterprise Act, 2002 abolished Administrative Receivership prospectively. This was done to strengthen the Administration procedure and to increase the possibility of reorganisation. In Singapore, Receivership is a common remedy used by secured creditors and has precedence over liquidation and Judicial Management. In India, the SARFAESI Act, 2002 provides wide ranging powers to some categories of secured creditors with regard to recovery of the loans made by them. It allows eligible lenders to take possession of the collateral security without even court intervention. They also have the power to take over the management of the company and to stay BIFR and liquidation proceedings if they comprised a certain threshold in value.

Lesson 12: We need to ensure that individual enforcement procedures for secured creditors, coexist with the formal framework for insolvency resolution.

Lesson 13: We require a balance between enforcing property rights of individual creditors and collective resolution of insolvency for the benefit of all creditors.

7. Economic rationale behind IBC

A comprehensive analysis of the laws and procedures of the three countries yields crucial lessons for the way forward for India. These have been incorporated in the economic rationale behind the design of the Insolvency and Bankrupty Code proposed by the BLRC in November 2015:

- A consolidated Code.
- An institutional framework for implementing the Code consisting of a single adjudicating authority supported by a court administrative unit, and a regulated but private and competitive industry of insolvency professionals.
- A collective, time bound process to assess the viability of an enterprise.
- Assessment of viability by concerned private individuals, treated as a commercial decision.
- A calm period in which to assess viability along with moratorium imposed on claims and balanced by the transfer of control of the company from the debtor to the insolvency professional.
- The insolvency professional to be liable to the committee of creditors.
- A timely liquidation process with a well-defined waterfall of priorities.
- Design of the code to enable appropriate ex-ante incentives through penalties for fraudulent or frivolous trigger, wrongful trading, extortionate transactions, fraudulent preference and several such built in safeguards.
- A balance between individual enforcement rights and collective resolution; moratorium to apply even to SARFAESI actions and enforcement rights under SARFAESI to be re-instated on the lifting of the moratorium.

8. Conclusion

The objective of our paper is to analyze the corporate insolvency resolution procedures of India, Singapore and the UK. The underlying motivation of this exercise is to highlight the similarities as well as differences across the laws and procedures of these three countries and to learn important lessons for India, in context of the formation of a new committee in 2014 to reform the country's corporate bankruptcy law. The fragmentation of the existing legal framework and the delays in enforcement in India have created incentives for rent seeking by various participants in the insolvency process. If a robust market for credit is to develop in India, the corporate insolvency process must give clarity to all debtors as well as all classes of creditors about the procedures and rules to deal with in an event of insolvency. Only then will a credit market without concentration of any one class of debtors or creditors can develop.

A comprehensive analysis of the laws of these three countries yields some crucial lessons for the way forward for India. The presence of multiple laws and adjudication fora has created opportunities for the debtor firms to exploit the arbitrage between the systems to frustrate the recovery efforts of creditors and to adversely impact the timeliness of the resolution process. Thus, it is imperative to consolidate the multiple laws and fora in India, a strategy that seems to work well for both UK and Singapore. Furthermore, in the UK procedures like Receivership could be used to stall the Administration mechanism as is the case in Singapore too. As a result, UK has placed greater focus on reorganization and has abolished the Receivership procedure altogether. In India too SARFAESI can be effectively used to stall the reorganisation proceedings under BIFR proceedings as well as liquidation. This needs to be addressed to create a consolidated framework. Also the mechanism for informal work out in UK and Singapore work without any regulatory interference or required sanction. In contrast in India, the RBI has allowed prudential and provisioning norms to be changed under the CDR mechanism thereby bringing it within the regulatory ambit implying that the process no longer remains informal. There is thus an urgent need to consolidate the laws in India including the individual enforcement as well as informal procedures.

Secondly, the formal process for insolvency resolution is essentially a judicial process and the courts and judiciary form an integral part of it. Countries have chosen to deal with this in their own ways. For instance the UK law has devolved large portion of the responsibilities to the insolvency professionals thereby minimizing the role of the judiciary, which is now involved primarily in dispute resolution and for setting guidelines for the parties involved. In Singapore on the other hand, the court plays a more active role in the judicial management process and the IP is in a way subservient to the court system. However, Singapore has also taken considerable effort in significantly improving the capacity and capability of its court system. Thus for India the choice is open-either to opt for large scale, thorough judicial reforms to improve the efficiency of the court system or to build an effective, well functioning IP institution so as to support a relatively weaker judiciary. Having said that, given that the role of the courts in resolving insolvency will always remain crucial, India still needs to work on improving and reforming the judicial machinery.

Another key element of an effective insolvency resolution framework is to create a strong and well-defined liquidation law, which can act as a viable threat forcing parties into reorganization. While the reorganization procedures themselves need to be effective and well designed, a timely and well-enforced liquidation mechanism will create substantial incentive for the parties involved to push for reorganization. Finally, the insolvency resolution law should be such that at various points in the entire process there should be clear predictability of outcomes, well written rules under the laws clarifying procedures, as well as specific and clearly defined timelines, so as to design a resolution framework that will minimize the probability of default and maximize the loss given default. Furthermore mechanisms need to be built at every stage of the law to create sufficient disincentives for strategic behaviour by the parties involved. Likewise the IP system must also be a strong one such that their objectives are aligned with those of the insolvency resolution system.

While the corporate insolvency resolution law can lay out clear and well-defined provisions governing the procedures at each stage, effective and timely resolution of an insolvency case will depend to a large extent on the efficiency with which those provisions and rules are enforced. Hence the success of the new law proposed by a committee in any country including India will depend critically on the extent to which good institutions can be created and adequate State capacity can be built.

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