### In focus: Insolvency and Bankruptcy Code

<table>
<thead>
<tr>
<th><strong>The Upper House of the Parliament, in a landmark decision, passed the Insolvency and Bankruptcy Code 2016 last week.</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The Code is likely to lead to more productive use of economic resources, improve ease of doing business, promote entrepreneurship and aid the banking sector.</strong></td>
</tr>
<tr>
<td><strong>Reaping the slew of benefits entailed by the Code warrants the setup of several new entities (in tandem with its four pillars) and addressing existing inefficiencies, such as pendency and disposal rate of DRTs.</strong></td>
</tr>
<tr>
<td><strong>In fine, we believe that while some positive changes may be seen in the short term, the full impact will only be seen in the medium term.</strong></td>
</tr>
</tbody>
</table>

In a landmark decision, the Rajya Sabha last week, passed the Insolvency and Bankruptcy Code 2016 in a bid “to promote entrepreneurship, credit availability and balance the interests of all stakeholders”. The move is a welcome step as it will help improve efficiency in markets, and aid business and investment sentiment.

### Insolvency resolution under the Bill

The Code details out four pillars of institutional infrastructure- insolvency professionals, information utilities, adjudicatory bodies and regulator- to be established to aid the early detection and action to resolve the issue. Further, it allows for a comprehensive resolution process to be triggered by either a creditor or debtor.

Once the process is initiated, the oversight is provided by insolvency professionals (who also manage the debtor’s assets during this period). This process can last for a period of 180 days (extendable by another 90 days) and failure to reach a revival plan within this time leads to the commencement of the liquidation process. During this process, no legal action can be taken against the debtor.

### Landmark decision to have a multitude of positive effects

The Code, noted to be only second in importance to the impending GST Bill, will have a significant impact (as detailed below), on both a macro and micro level, such as:

- More productive use of economic resources via timely detection of unviable businesses
- Banking sector to receive some support as the Code provides a legal platform for timely recovery of loans and acts as a deterrent to borrowers to default/delay payments
- Improve ease of doing business and promote entrepreneurship
- Provide provisions to deal with cross border insolvencies
- Further, a consolidated reform framework (instead of a multitude of laws) will provide for a greater clarity in law and effectively enable the application of provisions

### Need to address key challenges in the short term

While the consolidated framework described above will result in a slew of positive changes, it is not without challenges. The Code will require the setup of several new entities (in tandem with its four pillars) and addressing existing inefficiencies, such as pendency and disposal rate of Debt Recovery Tribunals (DRTs).

In fine, we believe that while some positive changes may be seen in the short term, the full impact will only be seen in the medium term.
Upper house of Parliament passed the key Insolvency and Bankruptcy Code last week

In a landmark decision, the Rajya Sabha last week, passed the Insolvency and Bankruptcy Code 2016 in a bid “to promote entrepreneurship, credit availability and balance the interests of all stakeholders”. The move is a welcome step as it will help improve efficiency in markets, and aid business and investment sentiment.

The new Code will replace a string of existing laws such as the Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920. In addition, it amends laws such as the Companies Act, 2013, and the Recovery of Debts Due to Banks and Financial Institutions Act, 1993. The law will apply to insolvency of companies and limited liability entities (including limited liability partnerships and other entities with limited liability), unlimited liability partnerships and individuals.

Insolvency resolution under the Bill

The Code details out four pillars of institutional infrastructure to be established to aid the early detection and action to resolve the issue. The resolution process involves the following key steps:

- **The insolvency resolution process (IRP) is initiated** by either a debtor or creditor on the occurrence of a default.
- **A committee consisting of the financial creditors will be formed** to decide the future course (reschedule repayment, asset liquidation etc) to resolve the issue of the outstanding debt owed to them. 75% of the creditors have to agree on the revival plan. The information utilities provide the required financial information to creditors. This process is overseen by the insolvency professionals (who also manage the debtor’s assets during this period). This process can last for a period of 180 days (extendable by another 90 days). During this process, no legal action can be taken against the debtor.
- **The liquidation process commences** post the 180 days (if no decision is taken within this period). The insolvency professional will maintain oversight of the liquidation process.
- The Code provides for a **waterfall structure for repayment** in the following order: i) insolvency resolution costs, including the remuneration to insolvency professionals, ii) secured creditors, dues to workers, other employees, iii) unsecured creditors, iv) dues to government, v) priority shareholders and vi) equity shareholders.

<table>
<thead>
<tr>
<th>Four pillars of institutional infrastructure</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insolvency Professionals</td>
<td>Information Utilities</td>
<td>Adjudicatory bodies</td>
<td>Regulator</td>
<td></td>
</tr>
<tr>
<td>The resolution process and efficient working of the bankruptcy process will be done by licensed professionals and agencies</td>
<td>These would collect, collate (and disseminate) information about lenders and terms of lending.</td>
<td>The National Company Law Tribunal (NCLT) will be the forum where firm insolvency will be heard and Debt Recovery Tribunal will be the forum where individual insolvencies will be heard.</td>
<td>‘The Insolvency and Bankruptcy Board of India’ will have regulatory oversight.</td>
<td></td>
</tr>
</tbody>
</table>

Source: Finance Ministry, ICICI Bank Research

Landmark decision to have a multitude of positive effects

The Code, noted to be only second in importance to the impending GST Bill, will have a significant impact (as detailed below).

**Macro impact:**

- **Productive use of economic resources:** The Code sets the path for coherent and timely detection of viable businesses from unviable ones. Restructuring/exit of unviable businesses will help freeing up resources (capital, labour etc).
- **Banking sector to receive some support:** Given the ongoing concerns of assets quality that plagues the banking sector, the Code enables creditors (read: banks) a legal platform to recover their loans in a time bound manner. Further, it will act as a deterrent for borrowers to skip/delay payments.
• **Improve ease of doing business**: India currently ranks 136 out of 189 countries on World Bank’s solving insolvency ranking with average duration of insolvency proceedings pegged at over 4 years. This is significantly higher than that seen in US, UK, Japan and China. Further, even on the recovery rate India ranks poorly vis-à-vis other countries. The passage of the Code is likely to improve this and aid India’s move up on the ease of doing business rankings as well.

• **Promote entrepreneurship**: A well-structured process to address insolvency and effectively deal with the succeeding proceedings is likely to aid investor sentiment and promote entrepreneurial spirit.

<table>
<thead>
<tr>
<th>Solving insolvency ranking</th>
<th>Resolving insolvency ranking</th>
<th>Average duration of insolvency proceedings* (in yrs)</th>
<th>Recovery rate**</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finland</td>
<td>1</td>
<td>0.9</td>
<td>90.1</td>
</tr>
<tr>
<td>Japan</td>
<td>2</td>
<td>0.6</td>
<td>92.9</td>
</tr>
<tr>
<td>Germany</td>
<td>3</td>
<td>1.2</td>
<td>83.7</td>
</tr>
<tr>
<td>Korea</td>
<td>4</td>
<td>1.5</td>
<td>83.6</td>
</tr>
<tr>
<td>US</td>
<td>5</td>
<td>1.5</td>
<td>80.4</td>
</tr>
<tr>
<td>UK</td>
<td>13</td>
<td>1.0</td>
<td>88.6</td>
</tr>
<tr>
<td>South Africa</td>
<td>41</td>
<td>2.0</td>
<td>35.3</td>
</tr>
<tr>
<td>Thailand</td>
<td>49</td>
<td>2.7</td>
<td>42.5</td>
</tr>
<tr>
<td>Russia</td>
<td>51</td>
<td>2.0</td>
<td>41.7</td>
</tr>
<tr>
<td>Philippines</td>
<td>53</td>
<td>2.7</td>
<td>21.4</td>
</tr>
<tr>
<td>China</td>
<td>55</td>
<td>1.7</td>
<td>36.2</td>
</tr>
<tr>
<td>Vietnam</td>
<td>123</td>
<td>5.0</td>
<td>20.1</td>
</tr>
<tr>
<td>India</td>
<td>136</td>
<td>4.3</td>
<td>25.7</td>
</tr>
</tbody>
</table>

*The time of the proceedings is recorded in calendar years and includes all appeals and delays.

**The recovery rate calculates how many cents on the dollar secured creditors recover from an insolvent firm at the end of insolvency proceedings

Source: World Bank, ICICI Bank Research

**Micro impact:**

- The Code permits for creditors or debtors to trigger the insolvency proceedings, thereby providing an equal platform to all shareholders.
- The Code provides the option of “Fresh start” to individual debtors (whose income, assets and debt are less than specified limits) to avail a ‘discharge from his qualifying debts’. This is likely to allow for a fresh beginning to individuals. Further, the stigma attached to default in case of individuals is likely to act as a deterrent to exploitation of this provision.
- A key positive is that the Bill provides for provisions to deal with cross border insolvencies.
- A consolidated reform framework (instead of a multitude of laws) will provide for a greater clarity in law and effectively enable the application of provisions.

**Positive in the medium term; need to address key challenges in the short term**

While the consolidated framework described above will result in a slew of positive changes, it is not without challenges. The Code will require the setup of several new entities (in tandem with its four pillars) and addressing existing inefficiencies, such as pendency and disposal rate of DRTs.

In particular, with the DRTs managing to clear less than one third of the new cases for recovery of loans that banks have filed with them, the backlog of cases at the end of these tribunals have burgeoned over time.
The sizable backlog in debt recovery tribunals needs to be addressed

Further, latest media reports indicate that the amount of debt in outstanding cases lying with the DRTs for the period Apr-Dec, 2015, have crossed INR 4500 bn.

In fine, we believe that while some positive changes may be seen in the short term, the full impact will only be seen in the medium term.
Policy Watch

ICICI Bank: ICICI Bank Towers, Bandra Kurla Complex, Mumbai- 400 051. Phone: (+91-22) 2653-1414

Treasury Research Group

Economics Research

Sunandan Chaudhuri  Senior Economist  (+91-22) 2653-7525  sunandan.chaudhuri@icicibank.com
Kamalika Das  Economist  (+91-22) 2653-1414 (ext 6280)  kamalika.das@icicibank.com
Samir Tripathi  Economist  (+91-22) 2653-7233  samir.tripathi@icicibank.com
Niharika Tripathi  Economist  (+91-22) 2653-1414 (ext 6943)  niharika.tripathi@icicibank.com
Sonal Surana  Economist  (+91-22) 4008-1414 (ext 7243)  sonal.surana@icicibank.com
Radhika Wadhwa  Economist  (+91-22) 4008-1414 (ext 7206)  radhika.wadhwa@icicibank.com

Treasury Desks

Treasury Sales  (+91-22) 2653-1076-80  Currency Desk  (+91-22) 2652-3228-33
Gsec Desk  (+91-22) 2653-1001-05  FX Derivatives  (+91-22) 2653-8941/43
Interest Rate Derivatives  (+91-22) 2653-1011-15  Commodities Desk  (+91-22) 2653-1037-42
Corporate Bonds  (+91-22) 2653-7242

Disclaimer

Any information in this email should not be construed as an offer, invitation, solicitation, solution or advice of any kind to buy or sell any financial products or services offered by ICICI Bank, unless specifically stated so. ICICI Bank is not acting as your financial adviser or in a fiduciary capacity in respect of this proposed transaction with you unless otherwise expressly agreed by us in writing. Before entering into any transaction you should take steps to ensure that you understand the transaction and have made an independent assessment of the appropriateness of the transaction in the light of your own objectives and circumstances, including the possible risks and benefits of entering into such transaction. You may consider asking advice from your advisers in making this assessment. No part of this report may be copied or redistributed by any recipient for any purpose without ICICI’s prior written consent.

Disclaimer for US/UK/Belgium residents

This document is issued solely by ICICI Bank Limited ("ICICI"). The material in this document is derived from sources ICICI believes to be reliable but which have not been independently verified. In preparing this document, ICICI has relied upon and assumed, the accuracy and completeness of all information available from public sources ICICI makes no guarantee of the accuracy and completeness of factual or analytical data and is not responsible for errors of transmission or reception. The opinions contained in such material constitute the judgment of ICICI in relation to the matters which are the subject of such material as at the date of its publication, all of which are expressed without any responsibility on ICICI’s part and are subject to change without notice. ICICI has no duty to update this document, the opinions, factual or analytical data contained herein. The information and opinions in such material are given by ICICI as part of its internal research activity and not as manager of or adviser in relation to any assets or investments and no consideration has been given to the particular needs of any recipient.

Except for the historical information contained herein, statements in this document, which contain words or phrases such as 'will', 'would', etc., and similar expressions or variations of such expressions may constitute forward-looking statements. These forward-looking statements involve a number of risks, uncertainties and other factors that could cause actual results to differ materially from those suggested by the forward-looking statements. ICICI Bank undertakes no obligation to update forward-looking statements to reflect events or circumstances after the date thereof. Nothing contained in this publication shall constitute or be deemed to constitute an offer to sell/purchase or as an invitation or solicitation to do so for any securities or financial products of any entity. ICICI Bank and/or its Affiliates, ("ICICI Group") make no representation as to the accuracy, completeness or reliability of any information contained herein or otherwise provided and hereby disclaim any liability with regard to the same. ICICI Group or its officers, employees, personnel, directors may be associated in a commercial or personal capacity or may have a commercial interest including as proprietary traders in or with the securities and/or companies or issues or matters as contained in this publication and such commercial capacity or interest whether or not differing with or conflicting with this publication, shall not make or render ICICI Group liable in any manner whatsoever & ICICI Group or any of its officers, employees, personnel, directors shall not be liable for any loss, damage, liability whatsoever for any direct or indirect loss arising from the use or access of any information that may be displayed in this publication from time to time. This document is intended for distribution solely to customers of ICICI. No part of this report may be copied or redistributed by any recipient for any purpose without ICICI’s prior written consent. If the reader of this message is not the intended recipient and has received this transmission in error, please immediately notify ICICI, Samir Tripathi , E-mail: samir.tripathi@icicibank.com or by telephone at +91-22-2653-7233 and please delete this message from your system.

DISCLAIMER FOR DUBAI INTERNATIONAL FINANCIAL CENTRE ("DIFC") CLIENTS:

"This marketing material is distributed by ICICI Bank Ltd., Dubai International Financial Centre (DIFC) Branch and is intended only for 'professional clients' not retail clients. The financial products or financial services to which the marketing material relates to will only be made available to a 'professional client' as defined in the DFSA rule book via section COB 2.3.2. Professional clients as defined by DFSA need to have net assets of US$ 500,000+ and have sufficient experience and understanding of relevant financial markets, products or transactions and any associated risks. The DIFC branch of ICICI Bank Ltd., is a duly licensed Category 1 Authorized Firm and regulated by the DFSA."

DISCLOSURE FOR RESIDENTS IN THE UNITED ARAB EMIRATES ("UAE"):

This document is for personal use only and shall in no way be construed as a general offer for the sale of Products to the public in the UAE, or as an attempt to conduct business, as a financial institution or otherwise, in the UAE. Investors should note that any products mentioned in this document, any offering material related thereto and any interests therein have not been approved or licensed by the UAE Central Bank or by any other relevant licensing authority in the UAE, and they do not constitute a public offer of products in the UAE in accordance with the Commercial Companies Law, Federal Law No. 8 of 1984 (as amended) or otherwise.