

# CORPORATE INSOLVENCY RESOLUTION PROCESS UNDER INSOLVENCY AND BANKRUPTCY CODE 2016 AND ITS IMPACT ON THE NON-PERFORMING ASSETS

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**Abstract:** This paper examines the Corporate Insolvency Resolution Process which is one of the most important legal frameworks under the IBC,2016 which designed to resolve the financial distress of the corporate debtors while balancing the interests of the creditors and other stakeholders. It also examines the structure and functioning of the CIRP and it evaluates its effectiveness in improving the financial system of the banking sector. The major objectives of the insolvency and bankruptcy code was to reduce the burden of the non- performing assets (NPAs) which had the severely affected the stability and profitability of the Indian banks. So, by enabling the faster resolution, asset maximization and recovery of the dues the CIRP has contributed to strengthening the credit discipline among the borrowers. The paper also highlighted on the role of the institutions such as the national company law Tribunal, Committee of Creditors and the insolvency professionals in the resolution process. However, the CIRP have faces the several challenges which is in delays in the resolution, judicial backlogs and low recovery rates in the certain cases. The paper also focuses on the issues and assesses whether the IBC has successfully achieved its goal of the reducing the NPAs and improving the banking efficiency and it concluded with by suggestion reforms to enhance the effectiveness of the insolvency legal framework in India.

**Keywords:** Corporate Insolvency Resolution Process (CIRP), Insolvency and Bankruptcy Code,2016(IBC), Non-Performing Assets (NPAs) Debt Recovery Mechanisms, Banking Sector and Committee of Creditors.

## 1. INTRODUCTION

The impact on the banking sector and Non- Performing Assets under the Corporate Insolvency Resolution Process of the Insolvency and Bankruptcy Code,2016[1] which focuses on the legal framework for the resolving corporate insolvency under the IBC,2016 and its effect on the non- performing assets recovery. In the economic development it is closely linked to the economic freedom in which countries with fewer restrictions and more freedom for the businesses which tend to grow faster.

In 1990s economic liberalization began in India. When the government reduced to control and gave more freedom to the institutions and markets and this led to the significant increase in the economic growth compared to the earlier slow growth period. In Economic system there are two types which are inclusive and extractive system. In inclusive systems which allow the people freedom to start and run the businesses and it encourages innovation and investment. On the other hand, in extractive systems the concentrate power and wealth in a few hands and it restrict the economic freedom.

In India it gradually moved toward the inclusive system by introducing the reforms that promotes the economic freedom. There are three stages in market which are entry, operation and exit. After the 1990s India focused first on the making it easier to start the businesses in the year 1992, Law like the SEBI Act, which helped the companies to access the capital market easily. In the second stage the focused on the improving the competition through the laws like the Competition Act, 2002 which ensured the fair practices in business.

In the recent years the focus has shifted to third stage which is exit from the market.[2] The business failure is the common in a competitive economy and can happen due to the poor planning, mismanagement and changing market conditions. When the businesses fail, they may default on the payments which affecting not only the stakeholders but also the economy. If these defaults are not resolved quickly then they can lead to business closure and financial instability. India lacked an efficient exist mechanism before the IBC.

In the year 2015- 2016 the economic survey described this problem as the “Chakravyuha Challenge” where the entry and competition were easy but the exit was difficult and time consuming. In the year 2016 was IBC introduced to resolve the issue by providing the time bound and effective insolvency resolution process.

The IBC ,2016 had a major impact on the banking sector. Banks are often struggled for recovery the loans which lead to rise in NPAs and reduced the lending capacity. The IBC provides a structured system for resolving the insolvency either by reviving the businesses or liquidating the assets. It also shifts the control from debtors to creditors which making the process more efficient and accountable. However, the IBC, 2016 has improved the insolvency legal framework that strengthened the banking system and which contributed the better management to the NPAs.[3]

## **2. NON- PERFORMING ASSETS AND INSOLVENCY BANKRUPTCY CODE, 2016 : A CRITICALY ANALYSIS**

In the banking sector the health of the economy is the key indicator for the non- performing Assets (NPAs). Every year, the government of India writes off large amounts of the bad loans to reduce the burden on the banks. From the past ten years the banks have written off about rupees10.72 Lakh crore [4] of the NPAs mainly arise when the businesses or individuals fails to repay the loans with the corporates being the biggest contributors. However, the NPAs cannot be completely eliminated they can be reduced through the proper laws and reforms. The impact of the Insolvency and Bankruptcy Code 2016 helps the companies to recover from the financial distress and prevents the further growth of the NPAs. It also focuses on the RBI and IBBI data especially in corporate cases and the impact of the COVID- 19[5] and section 10A of the IBC that stopped the filing of the new CIRP applications and it examines the effect of this Amendment.[6]

### **2.1 NON- PERMONING ASSETS**

The economists believe that a well-functioning financial system is which reflected in the smooth movement of saving into the investments and it helps in promoting the economic growth.[7] The efficiency of such system depends on how effectively it allocates the resources across the different sectors and while dealing with this challenges which are market imperfections and socio-economic issues that may hinder the long-term development. However, Resolving the Non- Performing Assets is very important that helps in maintain the stability and efficiency of the financial system.

### **2.2 DEFINITION OF NON- PERMONING ASSTES**

Non- performing Asset is a loan that no longer generates income for the bank. However, the banks expect the repayment of both the principal and interest and when a borrower fails to repay the loan then it becomes the unproductive and it is treated as an NPA. Banks classify such loans into different categories which are standard, doubtful and loss assets as per the RBI guidelines.[8] NPAs can arise for many reasons like sometimes the borrowers are unable to repay the due to business failure or financial problems and while in other cases the defaults may be intentional the common causes which include is poor business planning, overestimating profits, misuse of funds, excessive borrowing lack of the commitment by the promoters and willful defaults.

### **2.3 CLASSIFICATION OF ASSETS**

In the Indian banking system, the asset classification began in the year 1985 when the Ghosh Committee introduced an eight-category health code system [9] which classify the loans from the satisfactory to doubtful. Therefore, this system was subjective and not in line with the international standards. The Narasimham committee in the year 1991[10] addressed this issue and recommended and classifying the assets into four categories which are standard, substandard, doubtful and loss-assets.[11] Through these prudential norms which are introduced in the year 1992-1993 which improve the income recognition and the provision for bad loans and these norms were further strengthened in the year 1998 and it was updated in the year 2004 which reducing the NPA recognition period from 180 days to 90 days.[12] Under the current norms NPAs are classified into three categories which are

substandard assets which are unpaid for up to one-year ,doubtful assets which are remain unpaid for more than one year with low recovery chances and last is loss assets which are identified as uncollectible and that have very little or no value.[13]

### 3. RECOVERY OF NON- PERFORMING ASSTES LEGAL MECHANISMS

The banks and financial institutions which are registered with Reserve bank of India mainly accept the deposits and provide the loans to the individuals and companies. Therefore, when the borrowers fail to repay the loans and these turn into non- performing assets. However, the banks will approached the civil courts for the recovery but due to the heavy backlog the process was slow and the time consuming and to address this the government set up the Tiwari Committee which has recommended a special body for the recovery cases and as result the recovery of the debts due to the banks and Financial Institutions Act,1993 was enacted and establishing the Debt Recovery Tribunals (DRTs) for the cases which are above rupees 10 lakhs. However, The DRTs had the exclusive jurisdiction and they can soon become overburdened. And after, The SARFAESI Act, 2002 was introduced and giving banks more power to recover the dues without any court intervention. It allows the banks to take the possession of secured assets and sell them and recover the loans after the giving a 60 days' notice that led to the creation of the Asset Reconstruction Companies (ARCs) for the efficient recovery. The recovery mechanism which are Lok Adalat [14], Debt Recovery Tribunals and The SARFAESI Act,2002 are the main mechanisms for the recovery of NPAs. Lok Adalat which deals with the small cases below the rupees 10 lakh and it settles the dispute through the mutual agreement and its decisions are binding and cannot be challenged in the court. The recovery rates are usually very low around 10- 20 %.And the second one is the DRTs which have exclusive jurisdiction over the cases above rupees 10 lakhs and it handle the claims of the banks and the financial institutions but however they often face the delays due to the heavy workload and the lack of the expertise.[15] And the last one is The SARFAESI Act,2002[16] which allows the banks to recover the loans without any court intervention by issuing a 60 days' notice and it taking the possession of the secured assets for sale or auction but it applies only to the secured loans.

However, NPA recovery faces many problems due to the multiple laws, different norms and overlapping of rules that caused the confusion and delays. Legal mechanisms are like SARFAESI ACT, DRT, BIFR and SICA were not fully effective in the resolving stressed assets. Therefore, there was a need for a single, clear and fast recovery system and then the government introduced the insolvency and bankruptcy code (IBC)in the year 2016. The IBC, 2016 provides a unified and time- bound process for resolving the insolvency and it aims to improve the credit discipline and it ensure the faster recovery and strengthen the financial system and it also brought changes to the existing laws like SARFAESI ACT, RDDDBFI ACT, SICA and the Companies Act, 2013.

### 4. INSOLVENCY AND BANKRUTCY CODE , 2016

In India ,earlier there were many different laws for resolving the bad debts of the Individuals, Partnerships and Companies. This made the process complicated and confusing. The legal system of the India introduced the Insolvency and Bankruptcy Code,2016.This code replaces the multiple laws and covers all type of the business entities. Its main aim is to balance the interests of all the stakeholders, reduce losses and revive the businesses to support the economic growth.

In IBC Works on Main four pillars [17] which are :-

1. Insolvency and Bankruptcy Board of India(IBBI) : It is the main regulator that supervises the Insolvency Professionals, Agencies and Information Utilities. It also sets the rules, registers members and it ensures the proper functioning.
2. Insolvency Professionals (IP) : The Insolvency Professionals[18] are trained experts who manage the company during insolvency process. They take the control from the owners, handle daily operations and carry out the Corporate Insolvency Resolution Process.
3. Information Utilities (IU): The Information Utilities which store and provide the financial data about debts and defaults which ensuring the accurate and easily accessible to the information.
4. Adjudicating Authorities: The National Company Law Tribunal (NCLT) is responsible for the companies, while for the individuals and partnerships, The Debt Recovery Tribunal (DRT) who handled the cases. Appeals cab be made to the higher tribunals and then finally to the supreme court.

#### 4.1 UNDER THIS CODE THE EFFECTIVE MECHANISMS

1. **The Time-bound process:** The Insolvency and Bankruptcy Code, 2016 that ensures the time-bound in the resolution process. The entire process of the insolvency must be completed within 330 days and if there is necessary for extension then possible extension is 90 days and they should provide the valid reasons in writing by the resolution professional. For speed recovery it was introduced, as earlier the process used to take around 4.3 years before the IBC came into force.[19]
2. **The Minimum Default Amount :** Under the IBC default means non- payment of the debt either they are fully or partially. While initiating the insolvency proceedings the minimum amount of default[20] must be rupees one crore which was added through an amendment in the year 2020.

## 5. IMPACT OF BANKING SECTOR AND NON- PERFORMING ASSETS UNDER IBC

There were many laws for recovery of debts such as the recovery of debts act, 1993, SARFAEESI Act, 2002 and sick industrial companies Act, 1985 and these multiple laws made the process complex and slow and came before the Insolvency and Bankruptcy code, 2016.[21] After the IBC came it created a single and simplified system. If the cases are pending before BBIFR and AAIFR then they were cancelled if refiled under IBC within 180 days[22] or even if the cases are pending before the DRT or high courts then it could also be refiled under IBC.

Under the section of IBC all creditors which is including the banks and non-banks then they can initiate the insolvency proceedings. Once the case is admitted by National Company Law Tribunal a moratorium period starts and during this period all the legal cases will be stay. Then there will formation of committee of creditors which approved the resolution plan. If the plan is approved by the COC and NCLT then the plan is implemented and if it is not implemented then the company will go into the liquidation and then the recovery happens only through the liquidation process.

### 5.1 RBI GUIDELINES FOR THE APPLICATION OF IBC ON NPAs

In the year 2018 the Reserve Bank of India issued a circular which created a lot of discussion and which required the banks and financial institutions to start the corporate Insolvency Resolution process against the companies which had taken the loan and defaults of more than rupees 2000 crore and if the issue was not resolved within 180 days then the circular also made it compulsory for the banks to quickly identify the stressed assets as special mention accounts. Even if there is one day delay in repayment then they had to report to the RBI and immediately being with the resolution plan.

If the circular removed earlier the recovery methods like the corporate debt restructuring and strategic debt restructuring then these are making the process stricter and more time-bound.

### 5.2 PETITION FILED AGAINST THE RBI CIRCLUAR 2018

Reserve bank of India's 2018 issued a circular with significant flaws in the one-day default rule.[23] Therefore, many industries like textile and power, challenged this rule in court and claiming that it was unfair and illogical. They said that the fixed 180 days' timeline did not consider the practical difficulties faced by various sector.

Another key concern was that the RBI did not take a prior approval from the central Government, as required by section 35AA of the Banking Regulation Act.[24] This provision allows the RBI to direct the banks to start the Insolvency Proceedings but only after receiving the Government permission. As an end the Supreme Court of India declared the circular invalid (Ultra Vires) since it failed to follow the legal standards which was outlined in section 35AA.

### 5.3 NEW CIRCULAR OF RESERVE BANK OF INDIA

After the Supreme Court of India invalid the RBI 2018 circular. Then in 2019 the RBI issued a new circular which deal with stressed assets.[25] Under the new circular Banks were given 30 days to access the defaulted account and decide if it should be classified as a non-performing asset.

The new Guidelines which gave more flexibility to the lender to design and implement their own resolution plan. They could even initiate the insolvency process under the IBC after 30days of default necessary. Banks were forced to sign an Inter-Creditor Agreement (ICA), which facilitates collective decision making.[26]

Previously, 100% approval from all the creditors was required but this has been modified. A resolution accepted by lenders representing 75% of the total loan value and 60% in number which is binding on all the lenders making the process faster and more efficient.

## 6. JUDICIAL APPROACH OF ITS IMPACT OF BANKING SECTOR AND NON- PERFORMING ASSETS UNDER IBC

There are number of cases relating to Non- Performing Assets (NPAs) have been resolved by the National Company Law Tribunal (NCLT) under the IBC Some of them are:

1. In the case of *Essar Steel India Ltd. v. state of Gujarat*[27] included the establishments of CIRP process by State Bank of India and Standard Chartered Bank under the IBC, 2016 .Arcelor Mittal, Vedanta and Numetal presented the resolution plans. However ,because of the initial ineligibility under section 29A , the supreme court granted the opportunity to cure the defects. Arcelor Mittal eventually succeeded. The court maintain the constitutional validity of the IBC amendments emphasized the completion of CIRP within 330 days and emphasised the importance of committee of creditors commercial judgement. It also clarified the limited role of the NCLT/NCLAT restricted the function and defined the responsibilities of resolution professionals in ensuring the lawful and complete the resolution plans.
2. In the case of *Punjab National Bank v. Bhushan Power & Steel Ltd.*[28] deals with the beginning of CIRP under the IBC, 2016 due to the loan default. The NCLT accepted the application and assigned the resolution professional, who solicited the claims and resolution plans. While the Tata Steel and JSW submitted timely bids, the committee of creditors rejected Liberty House's delayed plan. Liberty challenged this refusal, arguing that delay was procedural and contrary to the value maximisation. The Appellate Tribunal held that mere delay was insufficient grounds for the rejection and order to reconsideration of all plans and emphasizing the fairness and substantive evaluation in the CIRP Process.

## CONCLUSION

Corporate Insolvency Resolution Process under the Insolvency and Bankruptcy Code, 2016 has significantly transformed the India insolvency framework by introducing a time- bound and creditor driven the procedure resolving the distressed assets. The code has changed the efficiency of the debt recovery and reduced the delays that previously hampered the banking sector. Empirical data suggest that recovery rates under the IBC are far higher than previous system and resolution timelines have been significantly reduced. However, the IBC has increased the confidence of creditor and enhanced the credit discipline among the borrowers and help banks to reduce load from non- performing assets. Finally, the IBC has benefited the banking sector by allowing for faster recovery and settlement. If effectively implemented and continuously enhanced it has ability to boost the economic growth and make the ease of conducting business in India.

## RECOMMENDATIONS

There certain modification which are required for the Corporate Insolvency Resolution Process (CIRP) under the insolvency and bankruptcy code, 2016. First increasing the institutional capacity particularly among the NCLT and the insolvency professionals and they will help in reducing the delays and assure quick resolution. Second, improve the coordination among the creditors through the clear inter-creditor agreements should be increased to facilitate the decision- making. Thirdly, to keep the process on track, regular monitoring and tight timelines are required for the process. However, the policy support for improving the recovery mechanisms and encourage the early detection of stress in the assets is essential. These actions will further improve the recovery rates, reduce non – performing assets and strengthen the banking sector.

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