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Impact of Insolvency & Bankruptcy Code, 2016 on Commercial Banks

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ABSTRACT

This article deals with the affect of The Insolvency and Bankruptcy Code, 2016 on the commercial banks and further as to how it impacted the Indian banking system and economy. Banking system has been explained in brief hereby. The IBC, 2016 has also been dealt with with its regard to the amendments which should be brought in it and which have been brought in. This article delves into the related aspects in a detailed manner.

Keywords: *Insolvency, Bankruptcy, Assets, Stressed, Economy, Scheduled, financial, operational, sector, Amendment*

I. INTRODUCTION

The Banking system in any country plays an instrumental role in its growth and development and is considered as being the backbone of any industry's success. After the financial sector reforms that were initiated in 1991 by the then Prime Minister Mr P. V. Narsimha Rao and Finance Minister Dr (Mr) Manmohan Singh, the banking system in India has transformed significantly with the aim of further boosting the economic set up of the country³. The Banking System in India consists of two types of banks - Scheduled Banks and Non - Scheduled Banks. The former ones have been mentioned in the Second Schedule of the Reserve Bank of India Act, 1934 whereby it is further classified as nationalized banks, State Bank of India and its Associates, etc. Non Schedule Banks are those which have a reserve capital of an amount less than five lakh rupees⁴. Unlike Scheduled Banks which have been defined under Section 42(6)(a) of the RBI Act, 1934, Non - Scheduled banks are not allowed to take any loan from

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³ Arti Chandani, Rajiv Divekar, Abdus Salam and Mita Mehta, "A Study To Analyze Impact Of Insolvency And Bankruptcy Code 2016 On NPA's Of Commercial Banks With Reference To Iron And Steel Sector", Research Gate (July 22, 2020 06:00 pm)

https://www.researchgate.net/publication/335658219_A_Study_To_Analyze_Impact_Of_Insolvency_And_Bankruptcy_Code_2016_On_NPA's_Of_Commercial_Banks_With_Reference_To_Iron_And_Steel_Sector

⁴ Ibid

the RBI except for in abnormal circumstances or cases of emergency. The term commercial bank includes within its ambit both types of banks as laid down under the Banking Regulation Act, 1949.

At present, the economy of India is one of the fastest growing economies in the world and it is expected that it might be among the top three economies in the next two decades due to the democratic nature of the country and its flourishing ties with the major world economies. Indian economy is a type of mixed economy. It is the seventh largest economy in the world in terms of Gross Domestic Product or GDP. In the era post liberalization in 1990, India experienced the yearly growth rate of 6 % to 7 % of GDP. It was because of the country's financial structure and system which comprises of the different types of banks that such a GDP was achieved. Any country's banking system plays an instrumental role in developing the economy as it aids the process of wealth creation by establishing a link between the savings and investments⁵. The Indian banks are regulated by the keeping check on Cash Reserve Ratio (CRR), Statutory Liquidity Ratio (SLR), Repo Rate and Reverse Repo Rate. These things ensure the fact that functioning of the banks goes on smoothly and there is no dearth of funds in times of any form of financial distress. The increase in the number of Non Performing Assets or NPA over the previous decade ultimately led to the introduction of the Insolvency and Bankruptcy Code, 2016 by the Reserve Bank of India in its attempt to prompt certain corrective measures and minimize the recovery period. The code was implemented in 2016 also in order to merge the laws dealing with insolvency and bankruptcy⁶.

II. ERA OF BANKING POST IBC, 2016

In the past decade, concerns regarding the quality of assets in the banks reached the peak due to the steep rise in Non Performing Assets or NPA. However, combination of asset resolution norms and increased resolution of NPAs under the IBC, 2016 has largely aided the recovery of NPAs'. As per the report by the IBBI, a debt near about Rs 2.02 lakh crore was disposed of before its admission to the IBC because the borrowers have settled the accounts to the creditors⁷. Because of this very reason, Credit Rating and Information Services of India Ltd or CRISIL has estimated that aggregate of banking sectors' total NPA dropped from 11.5 % in 2018 fiscal year to 10 % in 2019 fiscal year. The Apex Court's much recent move of quashing

⁵ Esther Tensingh & Dr Suresha B, "A STUDY ON THE IMPACT OF INSOLVENCY AND BANKRUPTCY CODE, 2016 ON INDIAN COMMERCIAL BANKS- A PRE AND POST EVENT ANALYSIS", 6 *Jetir*, 68-75 (2019)

⁶ *Ibid*

⁷ <https://ibbi.gov.in/webadmin/pdf/whatsnew/2019/Jan/Two%20years%20of%20insolvency%20and%20Bankruptcy%20Code>

the RBI circular dated February 12, 2018 regarding the resolution of stressed assets provided the system of banking a flexible opportunity to deal with the stressed assets with much ease⁸. With the recent move initiated by the Supreme Court, shifted the onus of managing the timely and hassle free resolution of NPA from the RBI to the commercial banks. However, the provisions of IBC do not cease for the purpose of resolution of stressed assets⁹.

The enactment of The IBC, 2016 has brought about a colossal change in relation to bankruptcy and insolvency resolution. The IBC took the bargaining power from the debtors and gave it to the creditors. IBC structurally strengthens the process of insolvency resolution so as to bring in an optimum level of debt reduction. On March 31, 2019 a plan for resolving around ninety four non performing assets was approved by the National Company Law Tribunal (NCLT). The recovery rate with regards to these ninety four assets came out to be 43 % which is a 2 % increase from the 2018 fiscal year's recovery rate. However, debt recoveries initiated through debt recovery tribunals, The Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act (SARFAESI Act) and Lok adaalats was much lower than the expected recovery levels because of a variety of reasons like huge pendency of cases and infrastructure related issues. In March 2019, the average time period for resolution of the ninety four stressed assets or NPAs was three hundred twenty four days as opposed to the specified time period of two hundred seventy days. Also, post the enactment of IBC, 2016 score on insolvency resolution scale improved from 32.6 in the year 2016 to 40.8 in the year 2019.

III. SUGGESTED AMENDMENTS IN THE IBC, 2016 AFTER ITS ENACTMENT

Several amendments in the IBC, 2016 had been suggested since its enactment and also on the basis of the insolvency data recovered so as to hasten the process of debt recovery. Certain key amendments as suggested are as follows¹⁰ :

1. It has been suggested that the promoters of MSMEs who are are not classified as defaulters of wilful nature should be allowed to bid their assets. If such amendment is initiated, the promoters who are genuinely under distress would be able to be a part of the process of bidding. It will reduce the overall number of liquidation proceedings and improve the recovery rate of debts of the bank.

⁸ CRISIL, “ Strengthening the Code : Strengthening of the Insolvency and Bankruptcy Code hinges on timely resolution of stressed assets and a conducive ecosystem “ (May 2019)
<https://www.crisil.com/content/dam/crisil/our-analysis/reports/Ratings/documents/2019/april/strengthening-the-code.pdf>

⁹ Ibid

¹⁰ Ibid

2. The IBC, 2016 shall be amended to set the rights of home buyers as equal to those of financial creditors and thus classify them in the same category. They should be allowed to have a say by way of their representatives in the Committee of Creditors along with voting rights, all of which shall be in proportion with their shares.
3. Section 29(A) if introduced in to the IBC, 2016 shall render the promoters of insolvent companies as being ineligible for bidding their own entities. This amendment however has not been proposed for micro, small and medium industries. The introduction of Section 29(A) in IBC, 2016 shall also lead to an expansion in the number of eligible bidders which would further mean better price discovery and thus ultimately lead to cuts in the banks.
4. The lowering of minimum voting threshold for COC from 75 % to 66 % for the purpose of making key decisions and from 75 % to 51 % for the purpose of making routine decisions. This would significantly improve the decision making powers of the Committee of Creditors and also reduce the time period of resolution of insolvency related issues.
5. It has also been suggested that the process of bidding should be streamlined by not promoting the exists and late offers. This step would be instrumental in bringing in better and faster closures to the insolvency resolution process.
6. The terms as laid down for the interim finance should be liberalized during the process of insolvency. It shall aid the insolvency resolution professionals in preserving the assets on the basis of going concern and thus contain the value of the assets.

IV. AMENDMENTS BROUGHT IN IBC, 2016 IN THE YEAR 2019

The IBC, 2016 was amended in 2019 whereby a total of eight amendments were done in the act. The ministry of corporate affairs in its memorandum regarding the amendments made state that they are aimed at filling the lacunae in corporate insolvency resolution framework while simultaneously aggravating the value from the Corporate Insolvency Resolution Process (CIRP). The ministry stated that the intention of the government behind initiating these amendments was to maximize the value of a corporate debtor as a matter of going concern while adhering to the stringent timeline¹¹. The amendments made are as follows :

1. The major amendment initiated was that instead of two hundred seventy days, the period for insolvency and bankruptcy resolution was increased to three hundred and thirty days. This time

¹¹ Himanshu Mishra, "Recent amendments made to the Insolvency and Bankruptcy Code 2016", IBC Laws (July 26th 2020, 05:00 pm) <https://ibclaw.in/recent-amendments-made-to-the-insolvency-and-bankruptcy-code-2016/>

also includes the time period of litigation within which it is mandatory to complete the resolution process.

2. The powers of Committee of Creditors (COC) have been increased regarding the decision making process on matters of fund distribution to the different categories of creditors. In IBC, 2016 financial creditors have been prioritized over the operational creditors in matters of distribution under any plan of insolvency resolution. Earlier, Section 53¹² was silent on the matter of distribution to creditors other than financial and operational creditors. However after the amendment made in Section 53¹³, the COC has been vested with the power to decide the distribution of claims within various creditors.

3. The reduction of voting threshold as suggested earlier was incorporated by the amendments made in 2019 so as to minimize the time period for resolution processes.

4. Section 7¹⁴ was amended so as to include the home buyers as financial creditors for the initiation of corporate insolvency resolution process.

5. The amendments in 2019 clarifies that any plan which is related to dues of a corporate debtor shall be binding on all stakeholders including the central and state government or even a local authority.

V. CONCLUSION

The Insolvency and Bankruptcy Code, 2016 was enacted with the aim to reduce the unnecessary and ineffective legislation regarding insolvency and bankruptcy. This act consolidated the laws and laid down several effective measure for improving the efficiency of insolvency resolution process. This code played the role of a catalyst in dealing with the major issue of all the commercial banks that is of Non Performing Assets. The IBC, 2016 has played a positive role on the country's economy since the time its has come into force. Many amendments were suggested after the act was enacted so as to further increase its positive impact on the economy. Several of these amendments were made which further impacted the commercial banks and thus the economy in a good way. Many more amendments have been suggested which would hopefully further strengthen the Indian economy.

¹² The Insolvency and Bankruptcy Code, 2016

¹³ Ibid

¹⁴ Ibid