

“Debt Recovery and Resolution Mechanisms for Financial Institutions under the Insolvency and Bankruptcy Code (IBC)”

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Introduction

The implementation of the Insolvency and Bankruptcy Code (IBC) in India has brought about a significant transformation in the domain of debt recovery and resolution within the nation. The framework in question offers a thorough approach to the process of insolvency resolution, with the goal of facilitating the efficient and prompt resolution of assets in distress, while also ensuring the protection of the rights and interests of all parties involved. Financial entities, including banking institutions and non-banking financial corporations (NBFCs), are pivotal in the recuperation and settlement of liabilities pursuant to the IBC. This article explores the debt recovery and resolution mechanisms available to financial institutions under the IBC.

Sick Company

The term "sick company" refers to a business entity that is experiencing financial distress and is unable to meet its financial obligations.¹ The term "sick companies" pertains to enterprises that are incapable of fulfilling their financial commitments and are at the brink of cessation. India has multiple legislative measures in place to address the issue of distressed companies, such as the “Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), the Insolvency and Bankruptcy Code, 2016 (IBC), and the Companies Act, 2013.”

As per the “Sick Industrial Companies (Special Provisions) Act of 1985”, a company is deemed to be "sick" if it has incurred losses that are equivalent to or surpass its complete net worth, and it has failed to reimburse its debts for a minimum of three successive quarters. The legislation entails the establishment of a panel designated as the Board for Industrial and Financial Reconstruction (BIFR), which is tasked with scrutinizing the financial state of the enterprise and proposing strategies for its resuscitation. The Board for Industrial and Financial Reconstruction (BIFR) possesses the authority to mandate the liquidation of the enterprise or propose a plan for its restoration.²

The Insolvency and Bankruptcy Code of 2016 offers a structured approach for the settlement of insolvency and bankruptcy proceedings. As per the provisions of the Code, an enterprise is deemed to be in a state of financial distress if it is incapable of discharging its debts as and when they fall due or if it has failed to meet its payment obligations for a period exceeding 90 days. As per the provisions of the Code, an Insolvency Resolution Professional (IRP) is

¹ The Sick Industrial Companies (Special Provisions) Act, 1985.

² Report of The Committee on Industrial Sickness and Corporate Restructuring, IBBI (June 02, 2023), <https://ibbi.gov.in/uploads/resources/31Goswamicommitteoftheindustriaisicknessandcorporaterestructuring1993.pdf>.

designated to assume control of the company's management and propose a plan for resolution. In the event that the creditors do not approve the resolution plan, it is possible that the company may undergo liquidation.³

The revival of financially distressed companies is also a provision outlined in the Companies Act of 2013. As per the provisions of the Act, a corporate entity is deemed to be in a state of illness if it has failed to fulfill its debt repayment obligations and is incapable of fulfilling its financial commitments. The legislation stipulates the designation of a Company Liquidator, whose responsibility is to assume control of the company's administration and dispose of its assets in order to satisfy its creditors. The aforementioned legislation additionally allows for the commencement of a revival and rehabilitation program for the enterprise, which may encompass the reorganization of its financial obligations, the injection of novel funds, and the designation of fresh leadership.

Importance of debt recovery and resolution mechanisms for financial institutions

The financial ecosystem relies heavily on debt recovery and resolution mechanisms, which are especially critical for financial institutions. These mechanisms are deemed crucial for various reasons. Primarily, financial institutions utilize them to protect their assets and retrieve unpaid debts, which is crucial for upholding their financial well-being and endurance. The implementation of efficient debt recovery mechanisms serves to reduce the potential hazards linked to non-performing assets and guarantee the steadiness of the organization's financial statement.⁴

Furthermore, the implementation of debt recovery and resolution mechanisms serves to enhance trust and assurance in the financial system. Creditor confidence in the timely and equitable recovery of debts fosters trust and promotes lending activities. Consequently, this facilitates the expansion of the economy by affording enterprises and individuals the opportunity to obtain credit for investment and consumption objectives.

Moreover, these mechanisms play a role in enhancing the overall efficacy of the financial market. The expeditious resolution of debt-related matters enables financial institutions to concentrate on their primary operations, such as lending and delivering financial services, without being encumbered by protracted and resource-intensive debt recovery procedures.

The mechanisms for debt recovery and resolution also function as a deterrent against intentional defaulters and discourage imprudent borrowing conduct. The establishment of a clearly defined legal structure for the retrieval of debt conveys a message that failure to meet

³ Insolvency – Law And Practice, ICSI (June 03, 2023), https://www.icsi.edu/media/webmodules/FINAL_INSOLVENCY_LAW&PRACTICE_BOOK.pdf.

⁴ Who are eligible to recover money through Debt Recovery Tribunal?, IPLEADERS (June 04, 2023), <https://blog.ipleaders.in/eligible-recover-money-debt-recovery-tribunal-procedure-long-take/>.

financial obligations will result in repercussions, thus motivating debtors to fulfill their monetary responsibilities.⁵

The mechanisms for recovering and resolving debt contribute to the overall stability of the financial system. The implementation of these mechanisms aids in mitigating systemic risks and upholding the soundness of the banking industry by resolving distressed assets and alleviating the weight of non-performing loans. The maintenance of stability is of utmost importance in order to ensure the continuity of economic expansion, entice investments, and cultivate a propitious commercial milieu.

Process of Recovery of Debts

1. Under the IBC, financial institutions have the authority to commence the insolvency resolution process against a debtor who has defaulted. This can be achieved by submitting an application to the National Company Law Tribunal (NCLT). The application is required to meet the specified criteria, including the minimum default amounts, and must be substantiated by pertinent evidence of default. Following the acceptance of the application, the NCLT designates an interim resolution professional to assume authority over the assets and operations of the debtor.
2. The Committee of Creditors (CoC) is a group responsible for overseeing the financial affairs of a company. The Code of Conduct (CoC) holds significant importance in the process of resolving insolvency. Creditors who are financial institutions are granted membership in the CoC, thereby enabling them to participate in the decision-making process pertaining to the resolution plan for the debtor. The Committee of Creditors is predominantly composed of financial creditors and is responsible for determining the appropriate course of action to be taken during the insolvency resolution process, which includes the selection of a resolution applicant.⁶
3. The IBC provides for the recovery of debt through the insolvency resolution process, which is designed to optimize the value of the debtor's assets. The involvement of financial institutions in the resolution process is manifested through the submission of their claims to the IRP. Subsequently, the aforementioned assertions are substantiated by the Insolvency Resolution Professional (IRP) and incorporated into the roster of debtors. The CoC, with the explicit agreement of the financial institutions, chooses a resolution candidate who presents a resolution proposal aimed at revitalizing the debtor's enterprise. The proposed strategy could potentially entail the reorganization of outstanding debts, injection of capital, or divestiture of assets in order to satisfy the obligations owed to creditors.

⁵ Legal Framework for the Recovery of Debts in India, AHLAWAT ASSOCIATES (June 03, 2023), <https://www.ahlawatassociates.com/blog/legal-framework-for-debt-recovery-in-india/>.

⁶ Sudhaker Shukla, Role of Committee of Creditors, IBBI (June 04, 2023), <https://ibbi.gov.in/uploads/resources/bcb6b096e766e07c164ad5f61ebe2b01.pdf>

4. Financial institutions have the option to utilize the Insolvency and Bankruptcy Code (IBC) as operational creditors for the purpose of debt recovery, subject to certain conditions. Operational creditors refer to non-financial creditors who offer goods or services to the debtor. In the event that a financial institution possesses operational debts from a debtor who has defaulted, it may commence the insolvency resolution process by submitting an application to the National Company Law Tribunal (NCLT). The entitlements and potential for recuperation of operational creditors may diverge from those of financial creditors.⁷
5. The Insolvency and Bankruptcy Board of India (IBBI) plays a significant role in the Indian financial landscape. The IBBI assumes a crucial function in the regulation and supervision of the insolvency resolution mechanism pursuant to the IBC. The formulation of regulations, guidelines, and codes of conduct is undertaken to ensure equitable and lucid proceedings. The IBBI establishes the structure for the certification and enrollment of insolvency experts, which encompasses the IRPs designated throughout the resolution procedure. The entity in question serves as the central authority responsible for overseeing and ensuring adherence to the regulations outlined in the IBC.⁸

Conclusion

The implementation of the IBC has brought about a significant transformation in the debt recovery and resolution mechanisms employed by financial institutions operating in India. The framework offers a structured and time-bound approach that facilitates the active involvement of financial institutions in the process of insolvency resolution. By engaging in the resolution process, joining the CoC, and pursuing debt recovery as operational creditors, financial institutions can pursue maximum recovery while safeguarding the debtor's business sustainability. The implementation of the IBC has resulted in the enhancement of efficacy, lucidity, and responsibility in the retrieval and settlement of debts, thereby augmenting trust in the financial framework and expediting the resolution of troubled assets, under the supervision of the IBBI.

⁷ Sudip Mahapatra, Operational Creditors In Insolvency: A Tale Of Disenfranchisement, MONDAQ (June 05, 2023), <https://www.mondaq.com/india/insolvencybankruptcy/971940/operational-creditors-in-insolvency-a-tale-of-disenfranchisement>.

⁸ IBC- Idea, Impressions and Implementation, IBBI (June 06, 2023), <https://ibbi.gov.in/uploads/whatsnew/b5fba368fbd5c5817333f95fbb0d48bb.pdf>