



Role of the Insolvency and Bankruptcy Code 2016 in Management of Non- Performing Assets

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Abstract

A stable banking sector is must for a sustained inclusive growth and development of an economy. From past a few decades rising NPAs of the public sector banks has posed a threat to the economy. The earlier insolvency and bankruptcy regimes proved to be a failure in resolving the insolvency matters. The different governments have brought in various regulatory and legislative reforms to strengthen the assets resolution mechanism. . In the series of these reforms, the Insolvency and Bankruptcy Code was enacted in 2016. It was perceived as the most effective and progressive resolution tool for recovery of NPAs. This code repealed various archaic laws and amended others to bring an overhaul in the resolution of NPA problem of the country. The current paper examines the various provisions of the code for the management of NPAs of the Indian public sector banks. The paper also explores the various new provisions which were introduced in the code to make it the most advanced legislation up till date. The study uses secondary data and is exploratory in nature.

Keywords: Non-performing assets, Bankruptcy, Insolvency, Insolvency and Bankruptcy Code 2016, Public sector banks.

1. Introduction

At the time of independence, the government of India adopted a mixed system of running economy so that the underprivileged Indian masses could enjoy fruits of economic growth and development. Indian state is a socialistic state, which works for the welfare of its citizens. In alignment with this philosophy of the state, banks were nationalized in two phases first in 1969 and then in 1980. This led to the formation of public sector banks in country.

With the biggest market share in the Indian banking industry, public sector banks are owned and run by the government, which uses them as the catalyst for financial policies created to advance the nation's and its citizens' economic development. They act as the backbone of the financial system of the country. They allow the financial inclusion of unbanked areas and masses into the financial system (Singh, 2016)¹ Though they have sustained major economic crisis from time to time, e.g., financial recession of 2008, growing NPAs has always acted as the sword of Damocles over the sustainability, profitability and growth of the banks. Increasing NPAs not only require huge provisioning for lost assets but also erodes the credit lending capacity of the banks. Due to liberal and loosed credit policies, higher concentration of loans in few large borrowers and specific sectors, the NPAs of the public sector banks have been on rise (Brahmaiah, 2019)². Their management has been weak and inefficient. Crony capitalism is also major problem of PSBs.

The problem of NPAs in PSBs has been a topic of heated debates in public and in the Parliament. Governments have introduced legislative and infrastructural changes, from time to time, in its efforts to resolve the NPA issue. It established DRTs to handle individual and group insolvency cases in 1993 with the Recovery of Debts Due to Banks and Financial Institutions Act. In 2002, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act was passed, allowing banks and financial creditors to collect debts from debtors without the need for judicial intervention. Lok adalats were introduced as option of amicable out of the court settlement option via compromise method. But all these options were lacking provisions like time bound settlement of matters, no preferential treatment of creditors in repayment of loans. Various definitions are ambiguous in these acts. To overcome these limitations, idea of a comprehensive act was conceived which would be at par with the required international



standards and allow an easy exit mechanism and realize maximum value of assets. This gave birth to the Insolvency and Bankruptcy Code 2016.

2. Objectives

To review the 2016 Insolvency and Bankruptcy Code's role regarding public sector banks' NPA management.

3. Literature Review

The literature review involves the study of current literature covering the area of research on the management of assets done under the IBC.

1. Gupta (2018)³ concluded that the success of the code depends on the way provisions of the code are being implemented. She used data of a first few years of the code and found that the success of the code can't be denied in the sight of challenges of code namely, stringent timelines, differential treatment of different categories of creditors, too much power in the hands of committee of creditors, liability of the insolvency professional, silence on third party contracts, variance of behavior of stakeholders at odds with the overall objective of the code.

2. Gupta and et.al. (2020)⁴ in their study highlighted the background of the code and challenges faced by the Indian economy while transitioning from the old regime to new regime. They also examined how the code affected the nation's macroeconomic situation, focusing on how well it worked to lower non-performing assets. They examined the efficacy in light of many factors, including the handling of non-performing assets, the increase in foreign direct investment, the rise in mergers and acquisitions, and more.

3. Gupta and Singh (2020)⁵ attempted find out whether the code is an effective tool in recovery of NPAs by analyzing secondary data on various aspects of IBC and recovery of NPAs by banks in India through various channels. They opined that infrastructural improvement is must for expedite resolution process.

4. Bagga and Sahni (2020)⁶ in their study appraised the pattern of NPAs and reduction in NPAs, before and after enactment of the IBC. They analyzed the secondary data available in the Punjab National Bank's annual report. They found a significant decrease in the levels of PNB's NPAs after the code and have found that the code has aided in expeditious recovery of non-performing assets.

5. Intelly and Chandra (2022)⁷ conducted a study on the role of the IBC in sustaining the Indian economy and highlighted the deficiencies in the code. They found that the deficiencies in the adjudicating authority in context

of number of benches of the NCLT posing a challenge in successfully meeting the timeline of the resolution process.

4. Insolvency and Bankruptcy Code 2016

The enforcement of Insolvency and Bankruptcy Code 2016 is considered as the second- generation economic reform. The first- generation economic reforms allowed the free entry of firms in market, in 1991 and this code allows the smooth exit of the sick firms from market to readily realize the maximize the value of the assets (Raman, 2020)⁸.

In the early 2000s, the Indian economy was in a boom phase. Banks started incessantly giving loans to businesses and individuals. This led to aggregation in the problem of NPAs of the banks. This led to the twin balance sheet problem as well. As businesses was neither making any profit during the financial crisis of 2008, nor were they in a position of repaying loans of the banks. This led to increased burden of provisioning for bad debts in banks and this eroded profits for the banks. This led to an increase in number of insolvent and bankrupt firms, which in turn increased the NPAs of the banks.

All this was further aggravated by the existing laws on insolvency and bankruptcy, which lacked any time boundary on resolution process of sick firms and NPAs of the banks. They even lacked coordination among themselves. There was redundancy of various provisions in various laws and overlapping of provisions was obvious. Multiple adjudication forums caused stakeholders to become confused, which delayed the recovery of the assets' full value. Due to all of this chaos, a comprehensive law that could serve as a one-stop shop for all bankruptcy and insolvency issues was required. The Insolvency and Bankruptcy Code of 2016 was passed in order to do this. Section 243 of this code repealed the Provincial Insolvency Act of 1920 and the Presidency Towns Insolvency Act of 1909. The following laws were modified by this code:

S.No	Act Amended	Section of the Code	Schedule
1	The Indian Partnership Act, 1932	245	First
2	The Central Excise Act, 1944	246	Second
3	The Income- tax Act, 1961	247	Third

4	The Customs Act, 1962	248	Fourth
5	The Recovery of Debts due to Banks and Financial Institutions Act, 1993	249	Fifth
6	The Finance Act, 1994	250	Sixth
7	The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002	251	Seventh



8	. The Sick Industrial Companies (Special Provisions) Repeal Act, 2003	252	Eighth
9	. The Payment and Settlement Systems Act, 2007	253	Ninth
10	The Limited Liability Partnership Act, 2008	254	Tenth
11	The Companies Act 2013	255	Eleventh

5. Role of Insolvency and Bankruptcy Code in Management of Non Performing Assets of Commercial Banks

The code has made various provisions which make it a progressive and effective tool of resolving the problem of NPAs. The Code has covered following aspects of management of Non Performing Assets by helping in timely and speedy resolution of the NPAs without any hassle.

- **Effective management information system**

Having an effective mechanism of collection and management of information about creditability of the prospective and current debtors can help in early detection of possible NPA creation in future and can help in building an effective appraisal of lending mechanism of the banks. In this direction, the code sets up the Information Utilities, which act as repositories of information about debtors. Section 210 of the code covers the aspects of Information Utilities.

- **Early Trigger for Insolvency**

By specifying the maximum sum that must be paid before a case is considered insolvent, the Code also establishes guidelines for the early discovery of insolvency. For corporate debtors, this cap is INR 100,000, whereas for individuals and partnership organisations, it is INR 1,000.

- **Liquidation Procedure**

Sections 33, 34, and 35 of the code specify the procedures for corporate debtor liquidation. Section 33 lists the many circumstances in which a liquidation procedure may begin as well as the way in which it must be conducted. The circumstances in which a corporate debtor may voluntarily apply for a liquidation proceeding are

also outlined in Section 59(1).

- **Distinction between Financial and Operational Creditors**

Financial debt and financial creditors clearly have been defined in the sections 5(8) and 5(7) respectively. Similarly, operational debts and operational creditors have been defined under sections 5(21) and 5(20) respectively. This distinction helps in laying down the hierarchy of repayment of debt. The code clearly gives priority to financial creditors over operational creditors, thus avoiding the situation of conflict of interest of the different creditors.

- **Committee of Creditors**

After the Corporate Insolvency Resolution Process against the corporate debtor begins, the insolvency experts assemble a committee of creditors. It includes all of the debtor's financial creditors, and at least 75% of the committee members should support the decision the committee makes.

- **Securitization of NPAs**

Under the SARFAESI Act of 2002, Asset Reconstruction Companies were established. According to section 29A, the code grants them the status of financial creditors and permits them to apply for settlement.

- **Recovery of NPAs**

The code lays down the provisions for the Corporate Insolvency Resolution Process. It also lays down the timeline for the resolution to be achieved, which is 180 days. The code also lays down the procedure of CIRP. It also lays down the process of CIRP for the operational debtors.

6. Conclusion

The code has surely been a good initiative to strengthen the insolvency and bankruptcy regime of the country and make it at par with the international standards as given under the United Nations Commissions on International Trade Law. The code has the caliber to **self-reliant in sustaining its banking sector and achieving the inclusion of objective of the Jan Dhan Yojana**. But certain provisions of the code are not being efficiently implemented. The time bound manner resolution is defeated due to lack of enough infrastructure for adjudication, The IBBI has also been facing various lags, such as casual working of the board and appointment of the chairperson of the board. To make the code a success, it is necessary to address these issues.

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