The Non-Performing Assets and their fate under the IBC

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At the time of enactment of the Insolvency and Bankruptcy Code (IBC), resolution of the Non-performing loans or assets (NPA) of the banks was not a stated purpose for the enactment of the law.[1] Instead, the primary policy objective was easing the business environment in India. However, it has been assumed that the IBC can more effectively tackle the NPA problem of the banks, which was threatening to become systemic and could have impacted the macro economic scenario of India.[2]

Consequently, the Reserve Bank of India (RBI) wanted that the large NPA accounts should be subjected to the IBC process and resolved as quickly as possible. However, there was a problem since the RBI is the regulator of the banks rather than a commercial bank in itself. It does not directly hold the NPA accounts. The respective banks hold them. Accordingly, the Banking Regulation Act was amended and the RBI was armed with powers to compel individual banks to initiate the corporate insolvency process under the IBC.[3] The RBI, subsequently referred the twelve largest NPA accounts in June 2017 to be proceeded against under the IBC.[4] These accounts collectively represented 25% of the gross value of the NPAs in the banking system of our country.[5]

The RBI referred these cases so that the health of the banks remains viable and they are able to realise as much of their amount lent as possible.

Per the latest available data, 9 out of the 12 accounts have been resolved, and the process is still ongoing for one and two are being liquidated.[6] These 9 cases present us an opportunity to appraise the effectiveness and efficiency of the resolution process which has been introduced under the IBC. The other three cases are not being considered because, obviously, resolutions have not happened in them.

Table 1 below presents us with data on the claims and the realisations in the nine concerned cases.

Table 1:

Name of CD	Amount Admitted (FCs)	Amount Realised (FCs)	Realisation by FCs as % of Claims	Realisation by FCs as % of Liquidation Value
Electrosteel Steels Limited	13175	5320	40.38	183.45
Bhushan Steel Limited	56022	35571	63.50	252.88
Monnet Ispat & Energy Limited	11015	2892	26.26	123.35
Essar Steel India Limited	49473	41018	82.91	266.65
Alok Industries Limited	29523	5052	17.11	115.39
Jyoti Structures Limited	7365	3691	50.12	387.44
Bhushan Power & Steel Limited	47158	19350	41.03	209.12
Amtek Auto Limited	12641	2615	20.68	169.65
Jaypee Infratech Limited	23083	20363	88.22	114.61

Source: Insolvency and Bankruptcy Board of India[7] (All numbers are in crores).

By CD, we mean the corporate debtor, which is the company under the insolvency process. By FC, we mean the financial creditors, which are usually either the banks or the Non – Banking Financial Companies (NBFCs). Since we are currently only concerned with financial institutions, we are only dealing with the claims of the FCs. The second column indicates the claims of the FCs against the corporate debtor in absolute value. The third column indicates the

value the FCs could eventually realise from the resolution process.

The fourth column indicates the percentage of claims that were realised as against the total amount claimed represented under column 2. The figures here have attracted a lot of public debate and criticism, arguing that the IBC as a law may not be as successful as the government may have wanted it to be while enacting it as a policy measure. This can be firmly argued because of cases like Monnet Ispat, Alok Industries, and Amtek Auto, where the financial creditors could barely realise one-fifth of the claims owed to them. Only two of these nine resolutions – Jaypee and Essar – could realise more than 80% of the claims.

This argument is ultimately used to deduce by the critics that since NPAs should be resolved in a manner where the banks do not have to take significant haircuts, and if they end up doing it in at least three of these cases (of around 80%), then the IBC mechanism must not be very efficient and is possibly flawed. Based on this, political attacks have also happened on the IBC and its perceived failure based on lower recovery rates in the above mentioned sense.

However, this line of reasoning is flawed in two significant ways. Firstly, the claims of the financial creditors do not just include the principal amount but include cumulative interest, which may have been accumulating for years.[8] If the corporate debtor has been defunct for a considerable time, then the interest component in the claims can be significant and substantially more than the principal amount. Consequently, the realisation would seem meagre when compared with the sum of the principal amount and interest. It can be substantial when exclusively compared to the principal amount. In such a situation, considering the metric of realisation as a percentage of claims may not be appropriate.

Secondly, it must be realised that the IBC is a law which provides a statutory framework where all the stakeholders can come together and arrive at a solution to the debt problem of a corporation. It is not per se a debt recovery tool for the banks in the first place. IBC, as a law, provides for all significant globally acceptable features of a modern insolvency law. It provides for a statutory stay on all pending cases once the insolvency process starts. It subsequently allows the creditors control of the corporate debtor, wherein they are free to take a call on whatever they may want to do with the corporation. They can decide to liquidate it, or they can also decide to transfer it to a resolution applicant who may, in whole or in part, repay their debts. The control of the corporate debtor to the creditor is justified because the corporate debtor owes money to the creditors, and they should therefore take a call concerning the company's future.

As a legal framework, however, if the corporate debtor has no value left in terms of assets or otherwise, the IBC cannot add value to it. This is to say that if a company is bankrupt with major outstanding claims but has no assets left on account of depreciation or otherwise, the banks as creditors will inevitably have to take significant haircuts in such situations. This was one of the reasons why most of the cases which were initiated under the IBC initially ended up in liquidations because no resolution was possible on account of no value being left in the corporate debtor, possibly because these companies were in winding up proceedings under the old regime of Companies Act, for years, and were undertaking no business activity. In this period, all their assets had significantly depreciated.

Thus, the appropriate measure of measuring the success of the IBC is not the ratio between claims and realisation but instead the ratio between the liquidation value and the realisation. The liquidation value is the value of the corporate debtor in terms of the value left in its assets if it were to be liquidated. Any bankruptcy process will aim to provide the creditors at least to realise the amount equivalent to the liquidation value. In column 4 of the table, we can see that in all the 9 cases of resolution, more than 100% realisation has happened with respect to the liquidation value. In six cases, close to or much more than 200% of the liquidation value was realised. This means that the legal framework of the resolution as laid down by the IBC provided an ecosystem wherein, more than double the amount of liquidation value was realised by the creditors in two-thirds of the cases.

The IBC has been clinically effective in tackling the NPA crises as it then was, at the time of the enactment of the IBC. It is no coincidence that the NPAs right now are at a historic low. It has also been acknowledged by the government that the recovery through IBC has been the highest for the scheduled commercial banks when compared to Lok Adalats, DRTs or the SARFAESI.[9] We must thank the IBC for resolving one of the most severe problems in the economy in the recent past.

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[1] Resolution of NPAs has not come up in the discussions of the Bankruptcy Law Reforms Commission (BLRC) Report which is considered to be the constitutive document for the IBC
[2] Resolution Of The NPA Problem Through IBC https://bwlegalworld.businessworld.in/article/Resolution-Of-The-NPA-Problem-Through-IBC/27-12-2022-459554
[3] https://loksabhadocs.nic.in/Refinput/New_Reference_Notes/English/The_Banking_Regulation_Amd_Ordinance_2017.pdf
[4] https://www.businesstoday.in/industry/banks/story/rbi-asks-banks-to-file-for-insolvency-in-12-large-npa-accounts-76138-2017-06-14
[5] https://indianexpress.com/article/business/material-drop-in-npas-of-the-banking-system-rbi-8404901/
[6] In the latest newsletter of the IBBI. It can be accessed here: https://ibbi.gov.in/uploads/publication/2023-05-22-112937-wu081-fc0acad96a898f9768945e95c640c890.xlsx
[7] IBBI Jan-Mar 2023 Newsletter. Extract of the Table 14 in the newsletter.
[8] *Mr. Prashant Agarwal v. Vikash Parasrampuria*, [Company Appeal (AT) (Ins) No. 690 of 2022]
[9] https://www.pib.gov.in/PressReleseDetailm.aspx?PRID=1894924