

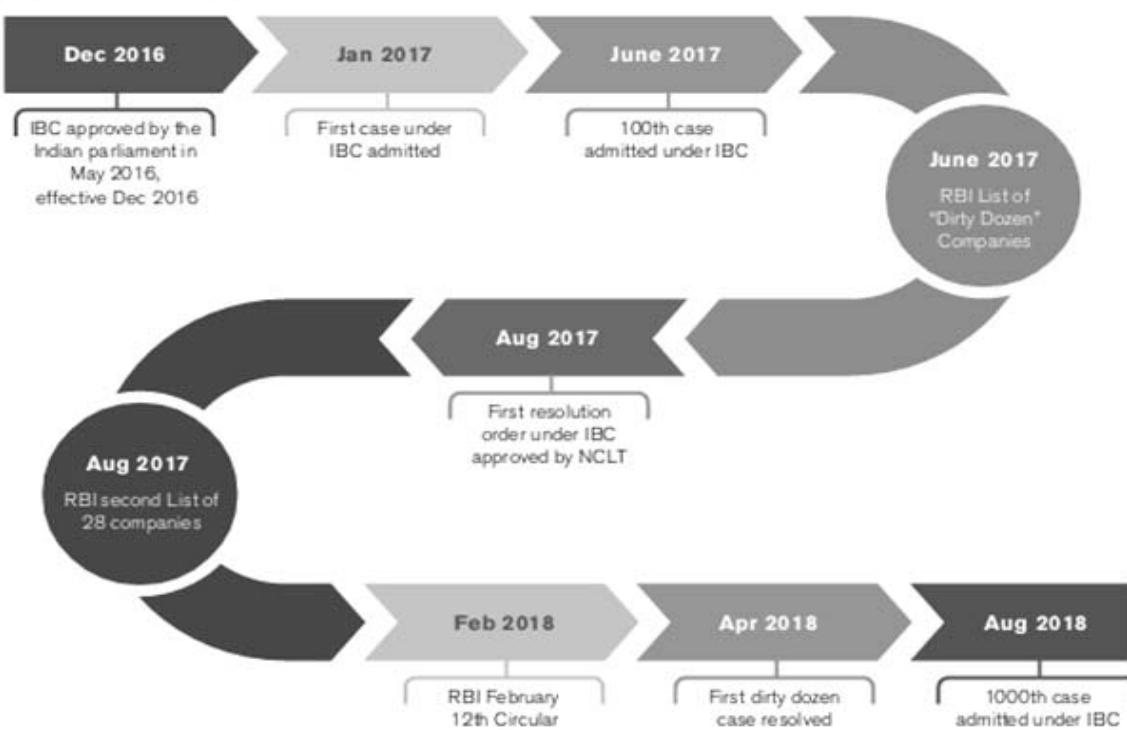
IBC-a good beginning but a long way to go



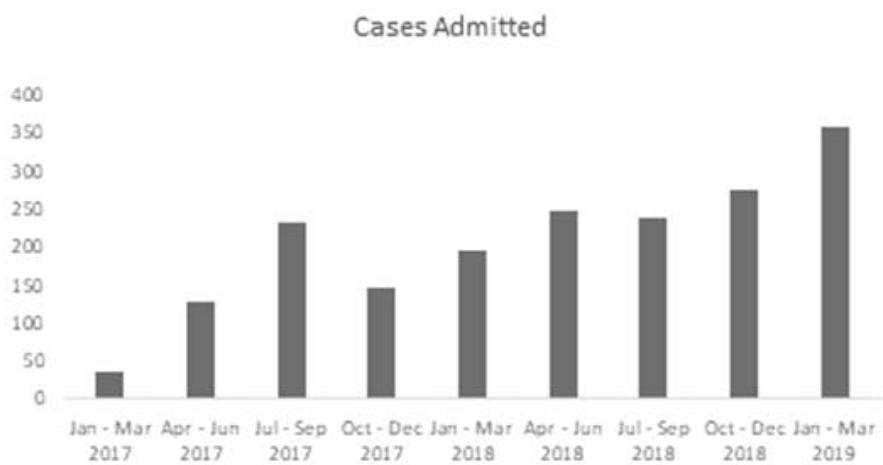
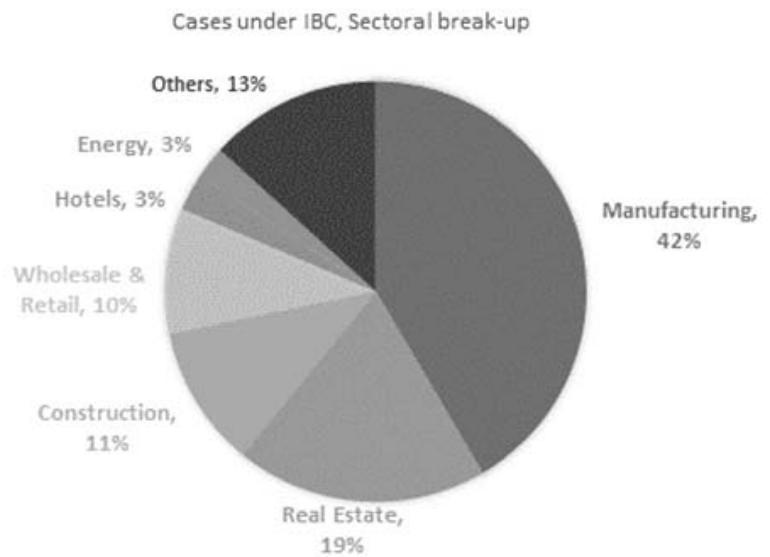
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Earlier this year, India's Insolvency and Bankruptcy Code (IBC) completed two years since being introduced and has been one of the most impactful and influential policy reforms from Government of India. While still in its infancy, IBC is proving to be more than just another acronym in a series of past failures by Indian regulators to create a viable restructuring mechanism in the country. Since its inception, over 1800 companies have been admitted into the resolution process by the end of March 2019. While initially there were some concerns that the IBC would lack the necessary ammunition, it has however been very much a positive for the Indian market. In fact, for the first time, promoters in corporate India are vulnerable and run the risk of losing control over their companies. Further IBC has created space for a new category of investment - distressed assets. Post IBC, opportunities for investors and acquirers to acquire quality assets at attractive valuations have significantly increased and in 2018 was a major contributor to the overall M&A in India. However certain recent rulings from National Company Law Appellate Tribunal (NCLAT) are principally in conflict with the code and has led to various stakeholders questioning the authority of the Code. A quick resolution towards this affect would help in ensuring that IBC retains its sharp teeth.

IBC – Key Milestones

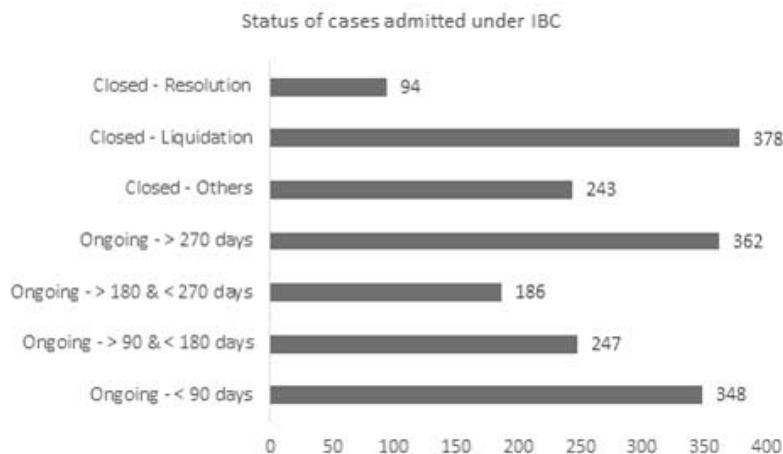


Why has IBC been successful. Firstly, and unlike previously, the IBC has had unanimous support from various stakeholders such as the government, the regulators and the judiciary (in most instances). Secondly, IBC was able to demonstrate some quick wins highlighting its efficacy and efficiency. The Reserve Bank of India (RBI) asked banks to initially focus on resolutions of the large corporate names and which generated strong global and domestic interest from investors. While only a 3 of the so called 'dirty dozen' have been resolved so far (another 3 have identified a successful resolution applicant), one cannot question the government's commitment to the process. So far, the results have largely been positive and could ultimately bring significant change to the culture between borrowers and banks in India. It's a step in the right direction but IBC still has a long way to go.



Over the past two years, banks and other creditors are increasingly opting for the IBC route to recover stressed loans. The number of cases admitted have been consistent across months suggesting this was not a onetime assertion. The judicial support toward IBC has also been welcoming. Now there are 12 dedicated NCLT benches for matters related to IBC and more are being introduced. However, this is not adequate and there is need for at least 6 more benches.

However, the IBC has had its own sets of challenges, especially with respect to the speed of resolution. Of the 1858 companies admitted under the NCLT as of March 2019, only 94 have achieved closure through resolution and another 378 through liquidation. There is a large pool of companies which are still seeking resolution. The IBC had also introduced a time bound approach with the resolution process to be completed in 180 days with a grace period of 90 days (total of 270 days). Despite the good intent of the code and introduction of multiple NCLT benches, almost 20% of companies admitted have crossed the 270-day limit and another 10% companies are between the 181st to 270th day. While one had expected many cases to be dragged into litigation, especially with promoters losing control, same cases have gone into litigation multiple times and the resolution time for the same has been slow. One expects that the current process will fasten, especially when case laws get built with each incremental resolution and courts will have past experience to rely on while giving judgements (there is an expectation that the timelines will be extended to 330-360 days but will include the litigation period). The silver lining though is that the estimated recovery on the resolved cases has been around 50%.



Another important feature of IBC has been that the promoters are consciously kept out and not permitted to participate unless they can payoff in full within a pre-specified time. The famous (or infamous) section 29A, which has seen few amendments, restricts the promoters and any related party from participating in the insolvency process. This also provides opportunity for investors to participate without the risk of promoter interference. Even for investors, introduction of IBC means that the risk of investing in these distressed assets are not much different than those in any other M&A deal. Further, many of the large distressed companies on the block have good underlying assets. In such cases, the investor with the right resources may be able to buy the asset and turn around operations. In 2017 and 2018, distressed M&A¹ values in India totaled close to \$15bn, a noticeable 12% of total M&A value including some large transactions like Bhushan Steel (US\$7.4bn), Reliance Communications (US\$3.7bn) and Fortis Healthcare (US\$1.2bn). Almost two-thirds of this volume (close to US\$10bn) have been closed in 2018 alone. Expectations are strong that distressed M&A will be an ongoing theme in the country and will increase as more companies are admitted under the IBC and make their way through the NCLT process.

IBC has brought a culture change in corporate India, but it is a journey which has only just started. Going forward, we see some risks which can impact the efficacy of IBC. Most important is the intent and the commitment of the government to support IBC. Secondly, the resolution times needs to start coming down. When IBC was introduced, what excited both creditors and prospective investors was the 270-day window for resolution. The initial cases, as expected, are taking much longer than 270 days though still faster than anything in the past. However increasingly, the success of IBC will rely heavily on ability to achieve. Lastly, IBC introduced the concept of resolution professionals to bring independence and efficiency. While over 2000 RPs have registered with IBBI, most of them don't bring restructuring or insolvency experience. Further, there exist risks of conflict of interests which are not being taken as seriously at present. Few bad episodes can have a material negative impact on the process and can result in draconian rules.

¹ For the purposes of this analysis, "distressed M&A" is defined as any transaction involving sale of a company directly in distress or where the transaction was carried out where the parent group/company was in distress.