

Changes in Insolvency Act: RSTV - Big Picture

Anchor:

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Participants:

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Context:

The Insolvency and Bankruptcy Code (Amendment) Bill, 2021 has been introduced in Lok Sabha. These bills seek to replace the orders issued in April 2021 which offered an alternate bankruptcy resolution scheme for the [MSME](#) sector.

Introduction:

- The Insolvency and Bankruptcy Code (Amendment) Bill, 2021 creates a framework for small enterprises in the MSME sector to also be part of the insolvency resolution process.
- It means that when a small company, that belongs to the MSME sector and which has an annual turnover of not more than 250 crores, wants to close shop then the resolution process that is currently there i.e. the corporate insolvency resolution process is actually rather costly and given the size and scale of an MSME company, it is really not necessary to go through the entire framework.
- Therefore, the government is now introducing a pre-packaged insolvency resolution through this bill. In other words, there will be the debtors who can bring the resolution possibility to the insolvency board and the insolvency process will be started. Naturally, it will be faster, cheaper, and easier to handle.

Read more on the [Insolvency and Bankruptcy Code](#) in the link.

Provisions of the Bill:

- It specifies a minimum threshold of not more than Rs 1 crore for initiating the pre-packaged insolvency resolution process.
- It provides for disposal of simultaneous applications for initiation of the insolvency resolution process and pre-packaged insolvency resolution process, pending against the same corporate debtor.

The rationale behind bringing this mechanism:

- This alternative mechanism has been brought in a very timely fashion because this is a new mechanism that has worked well in other jurisdictions. It allows the debtors to come with a package to which the creditors can agree.
- It has the advantage of providing a speedy resolution and also does not choke the capacity of the existing system because the IBC system is already burdened to a large extent by the large firms.

So, if the smaller firms are also to go through the same route, it would hit very severe capacity constraints.

- Hence, this amendment bill allows a faster mode of resolution that if worked efficiently and smoothly by both sides (debtors and creditors) could lead to an outcome that will be a win-win for both parties.

How does this mechanism work?

- If a small unit which has an investment of 30 crores or 40 crores comes into debt because of any reason (such as the market has turned or the product is not valuable anymore or the promoters have lost their interest, etc.), the amount of 40 crores which the company has raised from the banks now needs to go back to the banks.
- Apart from this, there are costs of raw materials as well which add to the burden of debt. Before the introduction of this Pre-packaged Insolvency Resolution Process (PIRP) in the Bill, the resolution process was started by the banks against the [SARFAESI Act](#) and the case was taken to the court which used to take a lot of time in resolution.
- This doesn't help the promoters and the creditors as well because they are locked up till the case is not closed and they cannot make a fresh investment.
- Land, labour, and capital remain locked up and the economy suffers. The ordinance has brought a shortcut process. Under the Pre-packaged Insolvency Resolution Process (PIRP), the debtors will be their first charge. This is the critical difference between normal insolvency and this insolvency process. Under the normal insolvency process, it is the creditors or banks who will bring resolution and the insolvency proceedings. In PIRP, it is the debtors that are operational debtors, people who have given loans to that company under normal circumstances, people who have supplied raw materials or capital. These people have the right to give a package resolution process. The PIRP can be agreed upon and voted upon by everybody who is involved.
- This will also quickly clean up the balance sheets of banks.
- If the debtors or the firm can come up with a credible resolution package where the creditors take some haircuts and both sides agree that under the circumstances, this is the best thing, then also the resolution will take place. It also proposes an opportunity as well as a challenge to both sides to come up with a fair resolution proposal.
- Challenges are due to the fact that when a unit is closed down, some will not be in favour of closing down and others will not be in favour of the way the unit is getting closed. Similar challenges were there when IBC was introduced.
- It is significant in the COVID situation because such potential cases are many.
- Under PIRP, the debtors have to present a resolution plan in two days. The committee of creditors has to be constituted within seven days and the resolution plan has to be voted on by the committee of creditors by a majority of 2/3rd of the voting shares within a time period of 90 days. In such cases, parties may state that they are not getting a chance to put their case forward.
- Also, the Parliament has passed the factoring bill, a bill that allows for discounting of the MSME's bills.

Performance of IBC:

- The IBC process has worked well because, in IBC, there are enough checks and balances. It is also working at a reasonable speed.
- The resolution professionals and the code have acquired credibility and respect in the market.
- However, there are certain challenges also which are reflected in one or two cases in which there have been massive haircuts for the companies.
- Overall, IBC is required more for small companies than for big companies because they need not be at the mercy of very long judicial proceedings.
- It needs to be highlighted that the insolvency process gives more benefits to the MSME sector.
- In PIRP also there is a need for a few successful initial proposals so that it could acquire credibility. PIRP can be a turning point for MSMEs along with the factoring bill passed by the [Lok Sabha](#).

The issue of haircuts for MSMEs:

- The issue of haircuts in MSMEs is a big challenge and banks need to be more charitable.
- In the case of big companies, larger haircuts cannot be the norm but such larger haircuts can be adopted in the case of MSMEs.
- Banks should have the confidence to make decisions that they think fit without any anxiety about what will happen in the future.

Conclusion:

The MSME sector is a crucial sector of the economy given that it is the second-largest employer after agriculture. The Pre-packaged Insolvency Resolution Process (PIRP) has opened a lot of scope for the resolution of various disputes related to MSMEs. This will help in the revival of the MSME sector as well as in freeing up of resources that can then be put to better use.

Read all the [RSTV articles](#) in the link.