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Highlights

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Towards more 'Resolvability' in the corporate sector

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The Hon'ble Finance Minister, Ms Nirmala Sitharaman ji, in her speech on the occasion of Insolvency and Bankruptcy Board of India's (IBBI) Annual Day on 1st October, 2022 had highlighted the objectives and important role of Insolvency and Bankruptcy Code (IBC) in the Indian economic framework and stressed that we cannot afford to lose its sheen. As per news reports, the government is proposing a slew of amendments in the IBC to address some of the challenges it faces like delays in admission, bringing about a timely conclusion of the process, improve the realisation for creditors etc.

While amendments in law can facilitate the process of resolution of stressed debt, the issue is whether a company can do anything to ensure that when there is economic or financial distress, there is a smooth transition to new promoters either through an insolvency process or even without it. The promoters benefit from this as this gives them an honourable exit especially when the reasons for the company's problems are due to external factors and beyond their control. The lenders should encourage such arrangements as delays in debt resolution of such companies leads to destruction of the enterprise value which ultimately affects lenders of such companies.

As an individual, making a will is often seen as anathema. It is as if writing a will would hasten one's demise! There are news reports that crores of sums of money are with banks and insurance companies as the next of kin are either not aware or do not have the proper documents to claim the money. However, gradually awareness has grown especially among HNIs and the upper middle class. Many Indians are now resorting to making a will to ensure that after one's death the property flows to those to whom they are intended to, in a seamless manner without legal intervention.

Is there a case for a company to also have a will? As per an article in Financial Express (5th March, 2020), the average life of S&P 500 companies has reportedly reduced from 90 years to 18 years over the last century. A 2015 research paper reveals that the average life of publicly-traded companies, considering acquisitions, mergers and bankruptcy is about 10 years. Thus, a company often believed to having indefinite life, now lives shorter than a human being ! Having a will can increase the resolvability of a company in distress or be more amenable to M&A, but what could be the mechanism for creating such a living will.

A company can create such a living will by making use of an institution like the information Utility or the IU. The Bankruptcy Law Reforms Committee (BLRC) which conceptualised the IBC felt that in India there is information asymmetry which is usually a barrier to fair negotiations between the debtor and creditor when the CD is unable to pay its debts. It proposed the setting up of the IU, an electronic repository of financial information to address the issue of information asymmetry. The IU has no parallel anywhere in the world and is a product of Indian innovation.

The IBC provides that all financial creditors shall submit financial information to the IU. However, any creditor, even a supplier of goods on credit or even a debtor can submit information to the IU, so besides banks, NBFCS and ARCs, even private financial creditors, debenture trustees and operational creditor have been submitting information which is stored with the IU after due validation as provided in the Code. The Credit Facility Report of the IU, available to all users of the IU, with the consent of the debtor, provides a 360-degree view of the borrower across all borrowing entities. The IU has to ensure the identification of the creditor submitting information and also that of the debtor who authenticates the information, which ensures the robustness of the information. Finally, the information in the IU has evidentiary value, the IBC provides for the National Company Law Tribunal (NCLT) to ascertain the existence of default from the records of an IU and approve initiation of insolvency proceedings against a company when the application for the same is made before it.

An even more important feature of the IU is that when a creditor submits information regarding the default of a borrower, the IU performs the validity checks as provided in law. On completion of the same, a default broadcast is sent to all the creditors registered on the IU platform about the default related to the debtor. The creditors get to know about incipient stress in the accounts of the debtor and can take measures to protect their interests. The debtor is provided ample opportunity to settle the default before the information of default is broadcast to debtors, besides it can also dispute any information provided by the creditors. Incidentally, default in this context could mean delay in payment by even a day.

A potential investor or a creditor can access the IU with the consent of the company and obtain details of the information submitted by various creditors, the security provided for various credit information, details of default reported by the creditors and also the debtor's response if any to the information submitted by the creditors. The IU has rolled out a platform for Digital Document Execution (DDE), which as it gains popularity, can enable potential investors do a due a diligence of contracts including loan agreements entered into by the company. Similarly, the electronic Bank Guarantee or eBG facility, recently introduced, provides details of all guarantees issued on behalf off or in favour of the company.

A question may arise in the minds of readers and investors as to how reliable is the information in the IU. The IU is an equitable institution in that it provides the debtor the facility to accept or to record a dispute an information submitted by the creditor. A dispute needs to be settled outside the IU and after a settlement, a fresh information can be submitted by the creditor. The information on all submissions to the IU and the debtor's response becomes part of the credit history of the company. If a company disputes the information submitted by a creditor, it gives the opportunity for the creditor to resolve the same before the company goes into insolvency when it is unlikely to cooperate in regard to the same.

Another important issue is that of data privacy and confidentiality. The IU is not a public credit registry and access to the IU is per the provisions of the Code. The regulator, IBBI has provided for various measures to ensure the safety, security and integrity of the data. However, the data can be shared with the consent of the debtor. So, if required, a debtor can provide access to the data to a potential investor for a strategic stake sale in case of stress either through the insolvency process or even otherwise.

Is there any interest for a company to have such a living will. After all the experience shows promoters try to hold on to such debt ridden companies, often resisting the commencement of insolvency proceedings or even try to retain control through debt resolution mechanisms which involve losses to their lenders. The benefit is that such companies would be more attractive to investors of debt and equity capital. This would increase their valuation and also help the company restructure and deleverage if required and could even avoid economic and financial distress.

The IU has the information regarding the debts of a company, it offers the facility of DDE, wherein the documents evidencing the debt and other contracts can be securely stored. The eBG facility provides details of contingent liabilities like the BGs issued on behalf or in favour of the company. The IU therefore has the potential to become a repository of the living will of corporates.

A company can improve its resolvability by using the services of the IU, i.e., by authenticating the information by the IU, it can accept it or dispute it by giving reasons. By using the DDE and eBG services of the IU it provides an audit trail of the contracts executed by the company which are also become available at one place for a potential investor. As the IU is a fully digital repository, it would also meet their objectives of sustainability and make it attractive for ESG investors. The IU can therefore be used for potential investors at the time of fund raising, when the company can authorise access to its information in the IU. If at all the company is unable to pay its debts, the information in the IU can be accessed by potential investors in stressed debt or the Insolvency professional in the process of insolvency resolution.

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