



ANTICIPATING THE FUNCTION AND IMPACT OF INDIA'S NEW PERSONAL INSOLVENCY AND BANKRUPTCY REGIME

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Main goals

1. Give a quick general **overview of the regime**, and then
2. Consider what **impact** it might have.

But, first ...

The background is a solid blue gradient. In the corners, there are decorative white line art elements resembling circuit boards or neural networks, with lines and small circles connecting them.

Basic policy aims of personal insolvency/bankruptcy

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1. **Creditors' tool** for debt collection -- to increase, accelerate, and/or make returns predictable – directly or by threat
2. **Debtor protection/relief** from over-indebtedness, financial distress (social insurance)
3. **Safety valve** for the **financial system**, allocate risks (ex ante) and losses (ex post) that can accumulate and clog the system

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Ideally, all inter-related --

The background is a blue gradient with decorative white circuit-like lines in the corners. These lines consist of straight segments and small circles, resembling a stylized electronic circuit or network diagram.

Personal insolvency/bankruptcy as social insurance

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2. Cost of insuring against that risk is allocated to creditors, who pass it along, like a **premium**

Personal insolvency/bankruptcy as social insurance

3. Can **promote development** of efficient (and stable, and equitable) markets for consumer credit

- by encouraging people to borrow for useful purposes
- and by **reducing the personal and social costs** of over-indebtedness and financial distress
 - restore and improve productivity
 - address emotional/psychological strain
 - enable quicker accounting of losses (by creditors, priced in)

Along with consumer protections at the transaction stage --

Thus, the queries:

1. Does the new Code **promise to improve or increase**:
 - a. creditors' recoveries from debtors and/or
 - b. the social insurance function of personal insolvency law in India
2. If so, **what will determine** whether those promises are realized and how much impact it will have?

Understanding the new regime

The old regime:

1. **Presidential and Provincial Towns Acts**, utilized but on a limited scale (6000 cases pending in Andhra Pradesh in 2006-07)
2. Debtors and creditors could file, upon an “act of insolvency”
3. Cases in courts of general jurisdiction, **heavy court involvement**
4. Stay of debt collection and discharge up to **courts’ discretion**
5. **Slow**, often used by creditors or debtors facing incarceration or aggressive debt collections

Understanding the new regime

The new regime, three alternatives/pathways:

Insolvency (**primary**)

Bankruptcy (**secondary, backup**)

Fresh Start (**low income/asset debtors**)

Understanding the new regime

Insolvency, overview 1:

- The **debtor or creds can initiate** a case if the debtor has “commit[ted] a default,” i.e., non-payment of a debt, or any part, when it becomes due – clearer standard
- a **creditor** can file only if it issued a **demand for payment** that is unmet in 14 days
- Whoever files can pick a **resolution professional**, who plays a critical, central role;
- Upon filing, a **moratorium automatically** goes into effect, stops all legal actions against the debtor “in respect of any debt” -- **applies to secured creditors (?)**

Understanding the new regime

Insolvency, overview, 2:

- The Board must approve (or appoint) the resolution profession (2 weeks)
- The resolution professional submits a report to the DRT recommending approval of the application or not (10 days)
- The Board approves or not (14 days)
- If approved, the moratorium is fixed for 180 days or until a repayment plan
- The DRT issues notice to creds, who have 21 days to submit claims

Understanding the new regime

Insolvency, overview, 3:

- Debtor prepares a **resolution plan** with the r.p., who submits a report on the plan to the DRT (within 21 days from the last creds claim received)
- Per the Code, the plan must provide for the fee to the r.p. and the r.p. must affirm that it has a reasonable chance of being approved by creds
- Per draft regs, the plan **must include**, e.g., a duration, an implementation schedule, a minimum budget for the debtor, and **may include**, e.g., modifications of obligations to any creditor (including secured) and cure of any defaults

Understanding the new regime

Insolvency, overview, 4:

- Creds meet and vote on the plan, approval by “a majority of more than three-fourth in value of the creditors voting”
- Secured creds can vote, but, if so, they forfeit the right to enforce their security interest during the repayment plan period.
- The rp submits a report to the DRT on the meeting of creds

Aside, on secured claims

- The Code does not allow debtors to adjust secured claims without the secured creditor's consent. The same seems to be true for curing of defaults to avoid enforcement of the security – consent is required in insolvency cases if the plan “affects [the secured creditor's] rights to enforce security.”
- Ability to cure and/or adjust secured claims to the value of the collateral are powerful tools in the US and elsewhere.

Understanding the new regime

Insolvency, overview, 5:

- If creds approve, the **DRT decides** whether to approve or reject the plan or require modifications (within 180 days from approval of application) “on the basis of” the rp’s report [**No other standard** given for the DRT’s determination.]
- The **r.p. implements** and supervises the repayment plan and **applies** to the DRT for the debtor’s discharge upon completion -- or earlier, if provided by the plan

Understanding the new regime

Insolvency, overview, 6:

- Throughout the Code[?], the following debts are non-dischargeable: fines, judgment debts, maintenance obligations to others, and students loans; and
- **Assets not available to creditors**: tools and materials necessary for trade, necessary vehicles, basic household furniture and domestic goods, personal ornaments of religious usage (up to a prescribed value), unencumbered life insurance policies, some value of an unencumbered dwelling unit.

Understanding the new regime

Bankruptcy, overview:

Available **only if,**

- A debtor's application for insolvency was rejected by the DRT because the debtor was found to have filed with intent to defraud a cred;
- If the DRT rejects a repayment plan; or
- If a repayment plan ends before completion.
- But: what if creditors don't approve a repayment plan?

Understanding the new regime

Bankruptcy, overview, 2:

- Whoever files can propose a r.p., who will act as trustee in bankruptcy
- Moratorium is automatic upon filing (affects secured creditors?)
- After the Board approves the r.p. (17 days), the DRT has 14 days to pass a bankruptcy order, which
 - Creates an estate of the debtor's non-excluded assets to be divided among creditors
 - Formalizes the moratorium
- The order does not affect the rights of a secured creditor to act to enforce their rights, provided that they do so within 30 days.

Understanding the new regime

Bankruptcy, overview, 3:

- After the bankruptcy order, creds have 7 days to file claims, and the trustee has 14 days to call a meeting of creds and create a cred committee if needed
- The trustee then administers the estate: “investigates affairs of the debtor”; controls and collects assets; recovers avoidable transactions (preferences, fraudulent transfers, extortionate transactions); distributes the estate to creditors

Understanding the new regime

Bankruptcy, overview, 4:

- Creds committee must approve the trustee's administration of the estate
- Trustee applies to the DRT for debtor's discharge within one year of the bankruptcy order or after the creds approve the trustee's administration, whichever is earlier
- Trustee is paid out of the estate

Understanding the new regime

Fresh Start:

A streamlined process specifically designed for low income and or low asset debtors, whose

- annual income is less than 60,000 rupees,
- assets are worth less 20,000 rupees,
- debts don't exceed 35,000,
- who don't own a home,
- and who are "unable to pay [their] debt"

Understanding the new regime

Fresh Start, 2:

- Automatic moratorium
- The r.p. reports to the DRT (within 17 days of filing), stating whether debtor is unable to repay debts, recommending whether the DRT should accept or reject the petition.
- The DRT has two weeks to accept or reject, and then creditors have 10 days to object.
- The r.p. submits a final report no later than a week before 180 days after DRT accepts the petition -- at 180 days (not before?), the DRT passes a discharge order
- No assets available to creds

Does the new regime, as designed, improve the position of creditors in relation to their debtors?

Probably yes:

- Fresh start provision may not have a significant impact, at least for a while
- Can force debtors (even poor ones?) into insolvency chapter upon a default and unmet demand
- Debtor to propose a repayment plan to be approved by a majority of creditors
- Quicker outcomes/resolutions, perhaps in many cases
- Threat of filing may provide some leverage
- BUT: Not clear how inter-creditor conflicts will affect overall impact on creditors' recoveries (individual creds might benefit over others); plans might not be predictable

Does the new regime, as designed, increase the protections for borrowers against the risk of financial distress?

In sum: **Yes, at least on paper**

- easier, clearer standard for eligibility
- much faster relief, considerably more limited role for court
- automatic moratorium of debt collections efforts, may reduce coercive collection
- non-discretionary discharge of unsecured debt, and
- relatively generous exclusion of some assets from distribution to creditors.

Will individual debtors actually employ the new regime **as intended**?

Two different questions:

1. Will debtors in genuine financial distress **utilize** the regime?
2. Will some debtors use the law **opportunistically** to escape debts they shouldn't have incurred or can actually repay?

Will individual debtors in genuine financial distress actually employ the new regime?

- how many individuals have significant amounts of **unsecured debt** to discharge?
- maybe leverage/time to renegotiate with secured creditors?
- social, cultural factors – e.g., **stigma**
- practical **hurdles** – e.g., costs, distance, lack of information
- **institutional capacity** (heavy reliance on effective r.p.s, burden on DRTs, possibility of delay by dispute) – if institutions work imperfectly, may affect all parties' willingness to file

Will individual debtors in genuine financial distress actually employ the new regime?

If not, the regime might become primarily a creditor's remedy, not really insurance.

- might reduce the cost of credit make it more available, especially unsecured
- but also might reduce individuals' willingness to borrowing for useful purposes
- limited safety valve for ex post allocation of losses (potential macro consequences)

If so, may lead to some increase in the cost of credit – the insurance premium

Will Debtors Use the Law Opportunistically?

- background widespread mistrust of debtors?
- regime could create “moral hazard”
- can be constrained – through fees, substantive law, credit reporting
- if not constrained, could significantly increase the cost or reduce the availability of consumer credit

Again, the important questions:

1. Will the new regime **improve the position/recoveries** of creditors
2. Does the new regime, as designed, **increase the protections** for borrowers against the risk of financial distress;
2. Will individual debtors **actually employ** the new regime **as intended**;
3. Does the legal system have **capacity** to operate the regime; and
4. If utilized, how will it **affect** Indian society, especially the cost and availability of **(unsecured) consumer credit**, and individuals' **willingness to borrow**?

Concluding thoughts:

Promises:

- As designed, an expansion of available debt relief and streamlining of the process of obtaining it.
- Quicker and perhaps more predictable recoveries for creditors.
- If so, might help expand availability of unsecured credit
- It's plausible that a large number of debtors in genuine financial distress will be inclined to employ it when they would benefit from doing so.
- If so, would significantly expand the insurance function of insolvency/bankruptcy law in India

Concluding thoughts:

Perils:

- Institutional incapacity (systemic costs $>$ social benefits)
- Becomes a creditor's remedy
- Significant numbers of debtors utilize the regime opportunistically

Any of which would impede development of a productive, stable, and equitable consumer financial market

Concluding thought, on the timing of legal development:

- The law was not adopted in reaction to a looming macro crisis in household debt.
- **In theory, this is ideal** -- the social insurance function will be built into the financial system that emerges and, hopefully, this will cause consumer credit to expand with protections in place to limit the negative effects of over-indebtedness and financial distress and to price those protections accordingly.
- India will provide a test of this theory
- Finally, a plea for data