

Various Committee Reports on Insolvency

Dr. A. Sridhar

NALSAR University of Law, Hyderabad

Week 02

Lecture 07

Welcome to all.

Today as a part of the course on insolvency and bankruptcy law in India today we are going to discuss various committee reports on the insolvency. So, in the previous class we have discussed about overview of SICA that is, Sick Industrial Company Special Provisions Act 1985 then establishment of Board, BIFR then we have discussed about constitution of appellate authority then problems with the SICA. So, in the previous class we have discussed the overview of SICA so today we are going to start the concept of various committees related to insolvency law in India. As a part of that, today we are going to start with the committee of Tiwari committee report 1981.

Let us discuss the background and context of Tiwari committee. So, during the 1970s and 1980s, okay, India witnessed a rise in industrial sickness. Okay, so we have adopted the industrial policies, various industrial policies were adopted and industries were encouraged. But the fact is that because of so many reasons in 1970s and 1980s. okay, so industrial sickness was there. We have witnessed the industrial sickness particularly in case of large and medium-sized companies. Okay, so which were operating in the core sectors and they were all becoming the sick industries.

Okay, so that is one of the basic problems that we are facing in 1970s and 1980s. So, what is the impact of this sickness so the impact of this sickness is lock up of large investment? Please remember, First, we have concentrated, after our independence, we have concentrated on the large-scale industries. So, government started investing in large scale industries and all these industries were established by 1960s. And by 1960s only they have established. So, because of the management issues and other things by 90s by 70s 1970s and 1980s. So, majority of these industries becomes, it I cannot say all the industries, but there are problems are there. ok. So, lock up of large investments. So, we have made large investment in these industries or now that is locked up. Okay, and wastage of natural resources, national resources. Okay, so all the factors of production that is land, okay, capital, everything is wasted and loss of employment.

Then stressed financial institutions due to raising of NPAs, even because of the sickness in the industries, it also caused NPAs, non-performing assets. in the balance sheet of banking institutions also. Okay, So, which adversely impacted the banking institutions also. Then the existing legal framework if you observe, that is I am talking about 1980s ok. So, at that point of time the existing legal framework was only in companies act 1956.

Okay, so at that point of time we don't have much provisions. Okay, which are exclusively dealing with restructuring or revival of such companies. Okay, so now under the companies act 2013 we are having provisions relating to arrangements. Okay, whereby you can go for any kind of arrangements. But, we don't have such provisions for the restructuring and revival of such companies during that period. This was a problem at that point of time. So, in this background Okay, so they they were having this committee. Okay, so, to address these problems the government of India they have constituted a committee called as Tiwari committee under the R G Tiwari, secretary of the department of heavy industries. So, under the chairmanship of R G Tiwari this committee was formed.

Now, what is the mandate of this committee the mandate of this committee is to examine the causes of industrial sickness. Okay, and they are expected to recommend preventive, corrective and curative measures. So, how can you prevent that means before an industry is becoming sick? How can you prevent how can you correct that means already done ok so already sickness is there so how can you correct how can you cure ok so the loss is there how can you cure ok.

So, they are supposed to recommend preventive corrective and curative measures ok then suggest institutional framework for revival or closure of sick industrial companies. So, government gave the mandate that you have to give the suggestions for institutional framework and develop mechanism for coordination between banks, financial institutions and the government. Okay, so because at that point of time banking institutions are regulated by RBI and there is no comprehensive mechanism, where because central government or the state government they were concentrating on industrialization and banks were working separately. So, that's why, there is no coordination between the banks and other financial institutions. So, NBFCs and other financial institutions and the government, there was no coordination.

So, that's why, we should have a mechanism to have the coordination between these banks, financial institutions and the government. So, this is the basic object of this committee. Now, they have recommended based on the mandate given by the government they gave the recommendations. Now, let us discuss various recommendations of the committee. Subsequently, how these recommendations were incorporated in the legislation or policy framework and what are all the changes that happened or that took place based on these recommendations?

Okay, now let us look at the recommendations. So, they have defined and they have given the definition for an identification of sickness. So, they suggested objective financial criteria for identifying the sickness. So, this committee suggested that we need to have an objective criteria. So, that means maybe based on the erosion of net worth or if any company is getting continuously losses. Okay, or if any defaults are there continuously to the financial institutions. Okay, so these are a few examples. Okay, so one company is unable to make the payment to the financial institutions. That is they borrowed the money, but they were unable to pay non-performing assets. Okay, so your net worth is eroded over a period of time, or continuously you are getting the losses. Okay, so, In these cases Particular company can be considered to be sick company.

Okay, so they try to define what is the meaning of sick company? Okay, then they recommended a watch list system for early detection of potential sickness. Okay, so It's better instead of reacting after the sickness, if you can react in advance, if you can prevent the sickness, okay, which will help the economy as a whole. Why? Because if any company went or if any industry becomes sick, then lot of employment and other things, economic activities will be stalled. So that's why, it's better if we can detect the potential sickness in advance. Then, it helps us in reducing the sickness and it helps us in protecting the economy as a whole. So that's why, this committee recommended a watch list system for early detection of potential sickness.

Then, creation of quasi judicial body so this committee recommended for creation of quasi judicial body okay so like which is centralized which is independent and which is exclusively dealing with sick companies okay. So, the body would assess viability and recommend either rehabilitation or winding up. Okay, so, whenever there is a possibility, the quasi-judicial body should concentrate on rehabilitation of the industry. So, in case if the rehabilitation failed then in such cases you can go for winding up of the company or winding up of the entity, okay. So, that is the recommendation given by the committee, okay.

Then based on these recommendations, okay, so they have created central government has created BIFR, Board for Industrial and financial reconstruction. Then, AAIFRS ok, so, Appellate authority for industrial and financial reconstruction AAIFR. Ok, so, as we have discussed ok so there is a centralized authority must to be there and there should be appellate authority must to be there ok so if you are not satisfied with the BIFR then it should be there should be mechanism ok. So, that's why, based on the recommendations given by this committee now we are having this. Ok, now they recommended for time bound rehabilitation framework ok so suggested strict timeline for preparing and implementation of revival schemes. But, whether it happened really or not, we will discuss this later. Okay, So, but this committee recommended that, okay, whenever if you are going for rehabilitation of any sick industry, this should happen within the time framework, okay.

Then, emphasize that delays defeats the purpose of revival as the financial and operational conditions worsen over the tax. So, this committee also warned the government that if there is a delay is there. Okay, so if there is a delay is there then automatically the assets value will reduce in any company. Okay, so, that's why, the basic purpose of these legislations is to arrive or I can say maximization of the assets, early detection of the sickness, then, ensured that. Subsequently, when rehabilitation process implemented you are going to realize the assets. Ok, even in case of winding up also you are going to realize assets quickly so that the loss can be minimized. But, if there is a delay is there then automatically it is going to impact the entire process. ok, so.

that's, why this committee strongly recommended that there should not be any delay. Then, they insisted on the financial and institutional coordination. Ok, so, recommended coordination actions among banks and financial institutions, central and state governments, then industry regulators and proposed debt restructuring, interest concessions and capital infusion for viable units. So, this committee also recommended that there should be coordination as already we have discussed in the mandates. Okay, one of the mandate given by the central government to the committee is that, okay, so, can we have any coordination among the institutions? So, this committee recommended the coordination among the banks and financial institutions central and state government because central government is framing some policy state government is framing some policy. there should be, okay some uniformity among the central government and state government and industrial regulators industry regulators will be there. So, these people should coordinate with each other. Okay, and they they also propose suppose if any industry is viable now it is running into the losses, but if you can provide a debt restructuring or if you can provide some additional capital then in such cases or if you can give some flexibility in repayment of the debts in such cases you can revive the company okay.

So, in case of viable units. Okay, this committee also recommended that there should be debt restructuring mechanism or as interest concession. So, you are reducing the interest even that is also possible then exit strategy for non-viable suppose after rehabilitation after considering the company. If, the BIFR is of the opinion that okay it is not viable to revive the company then in such cases there should be exit strategy. Okay, so if the revival is not possible speedy liquidation was advised to prevent the wastage of resources. Okay, so, instead of wasting the resources if you can speedily if you can quickly dispose of the assets. And if you can liquidate the company quickly, then in such cases, you are going to save the resources.

Then, emphasize on released logged assets for re-employment in productive sector. So, once if you can recover the assets, that is capital, then the same capital can be reinvested somewhere else. then prevention of sickness, call for better corporate governance early warning system and management accountability, so corporate governance norms were

introduced. I mean I cannot say introduced okay so they are they were modified and early warning systems must also be there in a company and suggest a regulated monitoring of the financial health of industries. Okay, then what happened based on these recommendations? Okay, so these are all the various recommendations given by the committee.

Okay, then do we have any impact or whether these recommendations had any impact? Yes. Okay, so first impact is that they have enacted, central government has enacted SICA, Sick Industrial Companies Act, okay, 1985. Then based on the Tiwari committee, okay, Sick Industrial Companies Special Provisions Act was enacted. And they have established BIFR. So, as already I told you committee gave the recommendations to establish quasi judicial body. Okay, there is nothing but BIFR. Okay, then they have also established AAIFR. Okay, served as an appellate body. Then, what are the powers of BIFR under SICA?

Under SICA, BIFR is going to determine the sickness of the company and appoint the operating agencies to prevent, to prepare the revival plan. Okay, so is there any possibility of revival? Then they are expected to prepare the revival plan, then sanction, modify or reject the rehabilitation plan. So, these are all the powers of BIFR and SICA. So, even in the previous classes also, we have discussed about the powers of BIFR and SICA.

That is session number 6. Then, recommend winding up of the unviable companies so after the process is completed if the BIFR is of the opinion that the revival of the company is practically impossible then in such cases they can recommend the winding up of unviable companies. Okay, what is the criticism? so though the committee recommended that we need to have speedy disposal of the cases but practically speaking even BIFR also was following the basic court procedures only. Okay, procedural aspects. So, the case is dragged for five years actually. Okay, few years. Okay, with no effective resolution.

So, they were unable to come to the resolution and few years, okay so sometimes 5 to 6 years 10 years the cases used to run okay so there is a problem with the BIFR. Okay, then, companies use BIFR process to avoid the creditor action and delay enforcement so even the corporate debtor that is the board of directors or companies, also even they started using this BIFR as a mode where they can circumvent or bypass the provisions of other legislations. Okay, then lack of credit control so this system was debtor friendly. Okay, so with limited say for the banks and financial institutions, so they don't have any control over the corporate debtor. Okay, then poor coordination financial institution though the committee recommended that they should be coordination between financial institution government departments, but the fact is that there is no coordination among the departments. Okay, financial institution government departments and BIFR often lack

synergy in implementation of revival plans. Okay, so they don't implement the proper plannings okay.

Then, abuse of process so many promoters use BIFR to award the liquidation while continuing to erode the values so these are all the various criticism okay so against the SICA act okay. Now, let us conclude.

Okay how the Tiwari committee report is important to the Indian economy. Okay so the Tiwari committee report of 1981 was a milestone Indian corporate rescue framework, while its implementation through SICA & BIFR may not be successful. Okay, so it's not successful but fact is there, okay, the idea of early detection institutional investor intervention and revival versus liquidation. Okay, so these are all became foundations for insolvency law. Okay, So in the subsequent lessons we are going to discuss about IBC insolvency bankruptcy code. Okay, so where this concept of revival of the company that is they they have used the word CIRP process okay. So, the concept of revival of the company in case of a failure let us go for liquidation so all this basic ideology is developed okay so based on the Tiwari committee report.

Now, let us look at the other committee. Okay, today we will discuss another committee report also Narasimhan committee report 1991-1998. Okay, So, please remember when you are talking about the narasimham committee, narasimham committee report 1991, even you have to consider the economic scenarios or economic position of the economy as a whole, okay. So, you have to understand, okay. So, India was in the middle of the severe balance of payment crisis. So, at that point of time, when you observe the balance of payment is I mean, it is a very problematic scenario that we had, ok. So, the balance of payment crisis and the verge of economic collapse, ok, that is where actually we came up with the LPG policy, liberalization, privatization, globalization, where the entire economy, the structure of the economy has been shifted, ok.

So, the government initiated economic liberalization. and financial sector reforms were deemed critical. So, the committee on finance system chaired by M. Narasimhan was constituted in the year of 1991 in the month of August ok. So, Narasimhan committee was constituted ok. So, Narasimhan committee please remember it is not totally for the purpose of insolvency law ok. So, it is generally.

Then, what is the basic objective of this committee so strengthening the banking system in a liberalized economy so now 1991 they decided to go for liberalization policy okay so in the liberalization policy or in the liberalized economy you are expected to have a strong banking system So that is the basic objective of this committee. Then improve the efficiency and profitability of financial institution. How to improve the efficiency and profitability? You have to identify, reduce the role of director credits, then address the growing concern about bad loans and insolvency in the banking system.

So, bad loans are increasing and also insolvency is also increasing. So, you have to address the growing these concerns. Now let us look at the recommendations made by this committee. So, reduction of statutory pre-emptions, so SLR CRR, okay, so capital SLR statutory liquid ratio, okay, so CRR cash reserve ratios were observing a large share of banks fund because you are expected to maintain the SLR and CRR funds.

So, the money is blocked already. So, that's why, they thought of reducing the statutory pre-emptions. Okay, then suggested reducing SLR from 38.5% to 25% and CRR in a phased manner because your CRR is directly going to impact the credit availability. Okay, so you have to reduce the CRR. So, then the availability of the credit with the banking institution tends to increase.

Okay, then free up resources for productive lending. these are all the various recommendations okay then recognition and classification of NPAs so introduce the concept of non-performing assets for the first time. Previously, there is no there was no concept of NPA previously then recommended classification of advances into standard substandard doubtful and losses so these assets with the banking institution okay whenever you are doing auditing. The assets of the banking institutions must be categorized into this, standard, substandard, doubtful and loss assets. So, according to the standard, according to the classification, you are going to take the action accordingly, ok. Then, proposed provisioning norms for NPAs to ensure transparency and prudential management.

Then, capital adequacy norms, suggested capital adequacy ratio, CAR for 8 percent in line with Basel 1 norms. then stressed on capital infusion for public sector banks by the government so they insisted that government has to invest more on the public banks public sector banks. Then autonomy of public sector banks recommended reducing government interference in daily operations. So, this committee recommended that previously in banking operations government used to interfere because they were having nominee directors. So, they used to interfere, but this committee recommended that government should not interfere.

It is a business activity, let it happen like that. So, recommended reducing the government interference in daily operations and proposed setting up banking bureau board of bureau BBB bank board bureau for appointments and governance. then suggested listing of banks and stock exchanges for market discipline so even they suggested that these banks should go for listing also so that is how we are having so many companies, banking institution now now where is they are listed. Okay, then direct credit director credit and priority sector lending so recommended gradual phasing out of priority sector lending so previously they used to lend to only priority sector only so you have to phase out.

Then, proposed limit it to 10% of total credit focusing on truly need so instead of going for priority sector so previously when the government decides so and so is priority sector whether the project is viable or not banks used to give the loans So instead of that limit 10% of total credit, generally remaining 90% you are expected to concentrate on the need actually.

Wherever there is a need is there, so you have to give the loan. So, then you can grow as a banking institution. Then they suggested certain recommendations for strengthening the financial institutions also. Like encourage professional governance in development financial institution. Then, promoted competition among the financial institution to improve service delivery.

So, these are all the various recommendations made by the committee. Now, what happened? So, whether the committee recommendations had any impact on the policy framework? Yes, okay, so NPA concept was institutionalized. RBI notified that subsequently NPA concept. Then gradual deduction of SLR and CRR even that also happened so that the credit availability in the market is also increased. Okay, then basis for enacting prudential banking regulations by RBI.

So, these recommendations acted as a basis for RBI also to frame the regulations accordingly. Then led to restructuring and recapitalisation of banks in the late 90s. Then influenced the creation of debt recovery tribunal DRT system under the RDD BFI Act 1993. Okay, so these are all the various recommendations and the implementation of the Narsimhan committee report one. Then in the year of 1998, again central government, they formed another committee with the same person as the chairman Narshimhan committee report.

So, that is why it is called as nursing home committee report. So, what are the existing problems at that point of time? So, high levels of NPAs though we have liberalized economy, but still we are having high level of NPAs. Ok, and poor recovery of loans the recovery of the loans was very worst actually it is very bad. Ok, So, weak legal system for debt enforcement because they do not have proper system to enforce the debt they used to approach the civil courts only then inadequate capital and inefficient banking structure. Then, in december 1999 so this this is the background actually, okay though 1991 we are having Narshiman committee report then subsequently we made the changes but by 1998 still the problem is continuing. Okay, so that's why, second committee under the chairmanship of m narsima was set up to examine the progress and recommend further reforms. Okay now, let us look at the recommendations What are the recommendations? Legal and institutional reforms.

Emphasize credit empowerment and fast recovery mechanism. Recommended creation of asset reconstruction companies, ARC system. So, there is a new concept at that point of

time, ARC system was introduced. Then strong push for legislation enabling banks to enforce security without court intervention. That is how SARFAESI Act came into picture.

Okay, so that is the basis for SARFAESI Act. Then, strengthening the DRT system also the debt recovery tribunal system suggested reforms in DRT functioning to make them more efficient they suggested some constructive recommendations. Okay, so those recommendations were implemented then emphasize technology adoption so the technology was growing at that time only. Okay, so they encourage the technology and they emphasize the technology adoption must be there and improve staffing and time-bound disposal of the cases. Okay, so these are all the various recommendations given by the committee okay. Then, apart from this uh they have given the recommendations relating to bank capital based on norms also so advocated raising of CAR to 9% and to later 10% over a period of time then recommended risk weightage asset management then called for provision coverage ratio and title asset classification so these are all the various recommendations given in this committee Then propose a three tier banking structure whereby large international banks will be there at one level.

Then national banks with wide presence will be there. Then regional banks for local presence. So large international banks, national banks and regional banks. So, this is what supported. then they recommended voluntary merger of strong banks to create globally competitive okay so if banks want because previously we used to have so many banks if they want to compete with each other they should be strong. So, that's why, they recommended voluntary uh mergers among the banks so that they can globally compete with other players okay so these are all the recommendations.

then governance in banks they advocate a department of independent director so they have introduced the concept of governance system in the banks also okay then they recommended. then called removal of dual control by RBI and finance ministry. So previously, finance minister RBI both used to manage now they said only RBI. okay then asset management companies AMCs. So, asset reconstruction companies and asset management companies, ok. So, they proposed AMC to take over the NPAs.

So, NPAs were in the hands of banking institution. Now, this committee recommended that banking institution should concentrate only on their business. The NPAs must be transferred to asset management companies, AMCs, ok. Then, encourage public-private partnership in bad asset resolution. Okay, so these are all the various recommendations given by this committee.

Now, let us look at the impact of 1998 report. So, it led to SARFAESI Act 2002, there is a major I can say benefit of this committee. Then, strengthen the DRT system through amendments to RDDBFI Act. It helped in conceptualizing the ARCs like ARCIL. Okay,

at that time only we were having ARCIL company. Also, these are all the various I can say changes that took place because based on the recommendations ok push for recapitalization reconsolidation consolidation of banks in a later years so these are all the various things.

Ok, now let us conclude.

These two reports okay so revolution revolutionized india's financial sector and they were instrumental in laying down the foundation for SARFAESI act and DRTs subsequently these will these helped in the IBC in the next years coming years okay.

So, let us recap what we have discussed today. Today we started the concept of various committees relating to insolvency as a part of various committees in today's lesson we have discussed Tiwari committee report. So, in the Tiwari committee report provided for background we I mean while discussing the Tiwari committee report we have discussed the background in which the Tiwari committee came into picture and the context of committee and mandate of the committee then key recommendations given by the Tiwari committee. Then, subsequently, we started with the concept of narshimhan committee report so Narshimhan committee report we have in two parts Narshimhan committee report one 1991 and report two 1998. Okay, then we have discussed about the objectives of this committee then recommendations given by this committee then impact of these committees how it impacted the legal framework in india okay. So, this is what we have discussed today and tomorrow we are going to discuss other committee recommendations and other committees relating to insolvency law in India.

Thank you.