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A Study of Impact of Insolvency and Bankruptcy Code on Non-Performing Assets of Banks

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Abstract:

In 2016 Government of India introduced Insolvency and Bankruptcy Code to improve credit availability and growth rate of economy by resolving NPA's of banks. It has improved credit supply and reduced the cost of debts and nudge the firms for long term loans. An inefficient insolvency and bankruptcy regime acts as a hindrance to the development and progress of banks credit. With IBC, reforms like the setting up of the National Company Law Tribunal (NCLT) and the Insolvency and Bankruptcy Board of India (IBBI) has given a fair and transparent process. Though there are some issues in the implementation of the Code, IBC has become the pillar of the Indian financial system and has helped in creating better banking environment. And helped in continuous economic growth by improving banks financial stability and lending. In this paper we will try to understand the reasons for implementation of the Insolvency and bankruptcy code 2016 and how it has helped banks in recovery of NPAs..

Keywords: Insolvency and Bankruptcy Code (IBC), Non-Performing Assets (NPA's), Banking Sector, Financial Stability.

Objectives of the Study:

Following are the main objectives of this paper:

1. To understand the concept of Non-performing assets.
2. To study the need for introduction of the Insolvency and Bankruptcy Code 2016.
3. To assess the impact of the IBC code on the banks NPAs recovery.

Data and Methodology

The study is based on secondary data sources from various government sources like Annual Financial Statement, Economic Survey, RBI, research papers and newspaper reports. Descriptive research method is used for analysis of data.

Introduction:

A country's growth and development are determined by its economy. It receives contributions from a variety of sectors. The banking sector makes a significant contribution to the country's economic growth. No country can have a thriving economy unless its banking system is functioning properly. India, being developing country, uses its banking system for both social and economic welfare. Banks are the driving force behind a number of signature projects launched by the central and state governments to promote industrial growth, agriculture, and people's social welfare. Banks invest a significant portion of their deposits in these social programs and even sponsor certain of them.

Sometimes the government's overly ambitious ideas and programs fail, resulting in the sinking of invested assets. Apart from governments, private enterprises rely on banks for loans and advances to invest in profitable ventures. When it comes to repaying the borrowed loans, these borrowers occasionally default. These variables, as described above, are significant contributors to the NPA load of banks.

A non-performing asset (NPA) is a loan or advance whose principle or interest payment has been past due for 90 days. A loan is considered an asset by banks because the interest paid on these loans is one of the bank's most important sources of income. When customers, whether retail or corporate, are unable to pay the interest, the asset becomes 'non-performing' for the bank since it generates no revenue. As a result, the RBI defines non-performing assets (NPAs) as assets that no longer generate income for banks.

Meaning And Clssification Of NPA:

As per the RBI guideline, banks are required to classify NPAs into -

Substandard assets: Assets which have remained NPA for a period less than or equal to
12 months.

Doubtful assets: An asset that has remained in the substandard category for a period of
12 months.

Loss assets: It is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted, although there may be some recovery value.

Reasons for Non Performing Assests:

Defective Lending Process: Improper borrower selection and a lack of periodic credit profile reviews to ensure repayment capabilities can lead to NPAs in PSBs. Borrowers default on several loans due to a lack of collaboration with financial institutions.

Industrial Sickness: Ineffective management, a lack of necessary resources and technical advancements, as well as changing government policy. As a result, banks that finance these companies have a poor loan recovery rate, lowering their profit and liquidity.

Wilful Defaults: An increasing number of borrowers have access to finances to repay their debts but choose not to do so, resulting in loan default.

Regulatory: Public Sector Banks (PSBs) that flout RBI norms and do not comply with regulatory recommendations regarding banking operations may commit fraud and increase NPAs.

According to the Economic Survey 2016–17, companies' decisions to start new projects worth billions of rupees in the middle of the 2000s, especially in infrastructure-related sectors like telecom, steel, and power generation, set off the largest investment boom in Indian history and are the root cause of the non-performing asset (NPA) problem facing Indian lenders. The survey goes on to say that increased financing costs, lower revenue, and higher than anticipated costs all reduced business cash flow and hastened debt servicing issues.

Insolvency and Bankruptcy Code:

The Need-

A strong insolvency regime fulfils two purposes. It saves businesses that are viable and facilitates the exit of those that are not. The Insolvency and Bankruptcy Code (IBC), 2016, has been designed to create such a regime in India. Before the IBC was passed, a number of laws

pertaining to insolvency and debt settlement, like Companies Act 2013, Sick Industrial Companies Act 2013,Indian Partnership Act 1932,Limited Liability Partnership Act 2008, SARFAESI Act 2002, RDDBFI Act 1993. Before the Insolvency and Bankruptcy Code, 2016 (IBC) As we can see, the performance of the NPA recovery has been significantly impacted and delayed by a number of complex challenges, such as having several legal forums, overlapping rules, and contradicting resolutions. The most crucial necessity was a quick recovery process. There was also a strong need for a single law rather than several laws, as well as for greater coordination and fewer confusion The IBC offers a market-directed, time-bound mechanism to resolve insolvency, wherever possible, or exit, where required. The government passed the Insolvency and Bankruptcy Code Bill in 2016 after introducing it in 2015 to address all of these issues.

By combining and amending the laws pertaining to the timely resolution of corporate entities, partnership firms, and individuals' insolvency and reorganization, as well as the maximization of the value of their assets and matters related or incidental thereto, the new law seeks to encourage entrepreneurship, increase credit availability, and balance the interests of all stakeholders. The new law aims to stimulate business and innovation. Some commercial projects will inevitably fail, but they will be resolved quickly and efficiently. Entrepreneurs and lenders will be able to move ahead without being weighed down by previous decisions.

Four Pillars of IBC-

1. The first pillar of institutional infrastructure consists of regulated individuals known as "Insolvency Professionals". They would play an important role in the smooth operation of the bankruptcy proceedings. They will be controlled by "Insolvency Professional Agencies".
2. The second component of institutional infrastructure is the emerging 'Information Utilities' industry. Electronic databases are used to record information on lenders and loan terms. This would eliminate delays and factual disagreements when a default occurs.
3. The adjudication system serves as the third pillar of institutional infrastructure. The NCLT will hear firm insolvency cases, while DRTs will hear individual insolvencies. These institutions, as well as its Appellate bodies, the NCLAT and DRATs, will be appropriately enhanced to ensure that the bankruptcy process operates at world-class levels.
4. The fourth pillar of institutional infrastructure is a regulator, "The Insolvency and Bankruptcy Board of India". This body will have regulatory authority over the Insolvency Professional, Insolvency Professional agencies, and information services.

Impact of IBC on NPA:

The Insolvency and Bankruptcy Code (IBC) brought about significant changes in India's NPAs in 2016. This Code aims to minimize inefficiencies in the previous legal framework by implementing a more efficient and timely insolvency resolution process. The establishment of the National Company Law Tribunal (NCLT) and the Insolvency and Bankruptcy Board of India (IBBI), which regulate the bankruptcy process to guarantee equity, effectiveness, and transparency, were two of the fundamental reforms under IBC. IBC has instilled discipline in lenders and

borrowers. Defaulting borrowers are more likely to repay because they will lose control of their firm. NPAs have decreased, and credit is available to individuals and enterprises. More lending has occurred as lenders gain confidence, which is critical for entrepreneurship and growth. By December 2023, 138 big stressed enterprises had paid creditors 32.9% of their accepted claims. IBC has decreased gross NPAs from Rs 8.96 lac crore in March 2018 to Rs 5.77 lac crore in December 2020, notwithstanding variances in recovery rates. The financial sector has benefited from large-scale recoveries from corporate defaults, including Bhushan Steel, Essar Steel, and Jaypee Infrastructure.

67% of the 5,893 corporate insolvency resolution processes (CIRPs) that have been started since December 2016 were finished by the end of September 2022, according to the Economic Survey 2022–2023. About 21% of these cases were settled, appealed, or reviewed; 19% were withdrawn; 46% resulted in liquidation orders; and 14% were addressed by the adoption of resolution plans. According to the report, banks' overall recovery through the IBC in 2021–2022 was higher than the total amount recovered through other means, including debt recovery tribunals, Lok Adalats, and the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

Conclusion:

Finally, the Insolvency and Bankruptcy Code (IBC), which went into effect in 2016, is a watershed moment for the Indian banking system, significantly influencing credit availability and stability. The IBC has increased lender trust by establishing a clear and efficient mechanism for resolving bankruptcies within a specific deadline, resulting in enhanced bad debt recovery. The IBC has had a significant impact on lowering nonperforming assets (NPAs) and strengthening the credit culture. The enactment and implementation of this Code has significantly improved the ease of doing business in India.

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