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Abstract

In India, we have paid more attention to the restructuring and winding up processes for companies. In contrast, the legal framework for insolvency in India is rooted in century old laws. In this paper, we motivate the need for a personal bankruptcy law, and study the existing Indian legal framework in the form of the Presidency Towns Insolvency Act, 1909 for Calcutta, Bombay and Madras and the Provincial Insolvency Act, 1920. We also study the systems in the UK and Australia, and draw lessons for reform for India.

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In India, we have paid more attention to the restructuring and winding up processes for companies. In contrast, the legal framework for insolvency in India is rooted in century old laws. In this paper, we motivate the need for a personal bankruptcy law, and study the existing Indian legal framework in the form of the Presidency Towns Insolvency Act, 1909 (PTIA) for Calcutta, Bombay and Madras and the Provincial Insolvency Act, 1920 (PIA). We also study the system in the UK and Australia, and draw lessons for reform for India.

Contents

1 Why is personal bankruptcy important? 3

2 The design of good bankruptcy law 5
2.1 Developments in the Commonwealth 6

3 The UK 8
3.1 Court initiated bankruptcy 8
3.2 IVA 9
3.3 DRO 10
3.4 Insolvency Practitioners 11

4 Australia 11
4.1 Declaration Of Intention option 12
4.2 Debt agreement 13
4.3 Personal insolvency agreement 13
4.4 Bankruptcy 14

5 How does the Indian law fare? 15

6 The way forward 19
6.1 The overall process 19
6.2 Class of insolvency professionals 20
6.3 Design of the discharge 21
6.4 How will this process play out? 22

1 Why is personal bankruptcy important?

The causal effect of financial deepening on economic growth has been a subject of study over the past few decades (Rajan and Zingales, 1996). Credit to individuals, as opposed to firms, has also come to play an increasingly important role in promoting growth. In all countries, credit to individuals is a mechanism for small business financing, thus promoting a culture of entrepreneurship. Another reason for personal credit is consumption smoothing, through which households shift consumption through time. Low-income households, especially, require credit as their incomes are reliant on seasonal cycles such as agricultural harvest, but their consumption patterns require liquidity over the entire year. In the event of shocks like bad harvests, or illnesses, credit allows for stability of consumption.

India has been no exception to the increasing role played by credit. For example, in 2014, Rs.62 trillion were disbursed by the banking sector. This is up from Rs.5 trillion of total bank credit in 2001.[1] Domestic credit to private sector as a percent of GDP stood at 52%.[2]

Of the total credit deployed by banks, Rs.10 trillion, were outstanding as "personal loans". Credit card debt outstanding was Rs.248 billion, while housing loans stood at Rs.5 trillion. Credit outstanding to micro-finance stood at Rs.174 billion.[3] In the category of loans disbursed for agriculture, trade, transport operators, and professional services, it is likely that a large proportion of loans were made to small (often single-owner) firms. In fact, debt outstanding with miro and small enterprises under priority sector lending was Rs.7 trillion as of March 2014, up from Rs.2.5 trillion in 2008.[4]

While these numbers may seem impressive, several problems remain. The biggest concern is that of financial exclusion. The CMIE household survey data shows that only 14% of households had credit outstanding in March 2014. What credit there is, is collateral constrained. For example, a survey of small and medium enterprises (SMEs) found that 80 percent of respondents placed "complex collaterals required to obtain term loans" as the most important hurdle in obtaining financing.[5] India currently has more than

[1] Source: Credit Disbursed by Economic Activity, State of India, CMIE, 2001, 2014.

[2] Domestic credit to private sector (% of GDP), World Development Indicators, The World Bank. `http://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS/countries`

[3] Table 48: Sectoral Deployment of Non-Food Gross Bank Credit (Outstanding), Handbook of Statistics on Indian Economy, 2013-14.

[4] Table 48: Sectoral Deployment of Non-Food Gross Bank Credit (Outstanding), Handbook of Statistics on Indian Economy, 2013-14.

[5] http://firstbiz.firstpost.com/sme-report/pdf/Analysing-Indian-SME-perceptions-

48 million SMEs. These SMEs contribute more than 45 percent of India's industrial output, 40 percent of the countrys total exports and create 1.3 million jobs every year. Indian SMEs employ close to 40 percent of Indias workforce.[6] Financing constraints have led to stagnation of SMEs, affecting GDP growth, and employment. The lack of availability of adequate and timely credit is the biggest problem affecting the growth of the small scale enterprises (Banerjee and Duflo, 2014). This has large adverse consequences for an devlopment of an economy like India (Feibelman, 2011).

The predominance of collateral based lending is directly linked to problems in recovery.[7] If a creditor is unlikely to be able to enforce an individuals promise to repay, then the creditor is likely to ration credit supply, by only giving loans on collateral. The extant legal framework for insolvency in India is rooted in century old laws.[8] and India's record on credit recovery is weak. Either recovery does not happen leading to creditors incurring losses, or recovery happens through co-ercive practices, leading to debtors incurring losses.

In the early 2000s some lending institutions resorted to intimidating tactics to recover their secured/unsecured loans leading to intervention by the RBI.[9] Such incidents resurfaced during the recession caused by the 2008 global financial crisis. Persons were hit by loss of jobs that resulted in EMI defaults on credit cards, housing mortgages, consumer and personal loans. Financial Institutions, banks and NBFCs resorted to recovery of loans through muscle men, who even carried out physical assault. Reports of suicide by defaulters surfaced forcing the RBI to intervene. Court Orders were passed to stop banks using muscle men.[10] Similar incidents on borrower distress and

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around-Union-Budget-2014-15_Final-new.pdf

[6]Reports by the SMB Chamber of Commerce and the Ministry of Micro, Small and Medium Enterprises

[7]Fan and White (2003) suggest that the fact that 20 percent of personal bankruptcy filings list business debts suggests how important personal bankruptcy procedures are for entrepreneurs.

[8]Individuals are geographically divided across the respective Acts, Presidency Towns Insolvency Act, 1909 (PTIA) for Calcutta, Bombay and Madras and the Provincial Insolvency Act, 1920 (PIA) for the rest of India, respectively. The terms bankruptcy and insolvency are listed at Article 9 of the Concurrent list as per the allocation of subjects in the 7th Schedule, read with Art.246 of the Constitution and the law is vulnerable to amendment by every state in the country.

[9]This incident led the RBI to issue a circular on Guidelines on Fair Practices Code for Lenders, dated May 5, 2003 that dealt with matters of recovery of loans and directed that lenders should not resort to undue harassment viz. persistently bothering the borrowers at odd hours, use of muscle power for recovery of loans, etc.

[10]http://taxguru.in/corporate-law/preview-on-insolvency-and-bankruptcy-with-

creditor excess have been seen in the context of micro-finance. In 2010, several suicides in the state of Andhra Pradesh were caused by alleged coercive recovery practices of micro-finance institutions (MFIs) (Sane and Thomas, 2013).

The problems in recovery have not led to any calls for reform. Several countries placed higher than India[11] in the World Bank ranking of ease of doing business[12] have replaced or regularly updated their laws in tune with significant events in their economies such as the dotcom crash in the early 2000s and the global financial crisis in 2007. Countries that share attributes of common law or a federal structure, like Australia or the UK, have overhauled their legal framework for individual insolvency in order to deliver a quick and uniform procedure that balances interests of the debtor and its creditors.

Against this background of the importance of credit, and problems of recovery, this paper evaluates the personal insolvency frameworks in jurisdictions such as the UK and Australia, and suggests measures for reform. The paper proceeds as follows. Section 2 discusses the broad design of good bankruptcy law. The UK and Australian examples are discused in Sectiom 3 and 4 respectively. Section 5 compares the present Indian law to the UK, while Section 6 discusses the way forward for India.

2 The design of good bankruptcy law

The goals of bankruptcy law for individuals overlap considerably with goals of corporate bankruptcy[13]. A key element of a credit contract is predictability around what happens if the borrower cannot repay. It may be possible for debtors to restructure payments. This requires a conversation between the creditors and the debtor. The mechanism has to be designed such that the debtor can renegotiate payment, and the creditor can enforce payment. At the same time, the creditor needs to be prohibited from coercive collection. Both creditors and debtors need to know that decisions will be taken swiftly. The following elements are thus important in the design of the insolvency process:

reference-to-individuals-and-corporates.html

[11] India is placed at a low 142 of 189 countries ranked and insolvency procedures are ranked at 137.

[12] (http://www.doingbusiness.org/data/exploreeconomies/india)

[13] Warren, 1987; Warren, 1993.

Participation of both the creditors and debtor When the debtor is facing financial difficulties, it may in the interest of both the creditors and the debtor to re-negotiate the terms of repayment, and come to a new agreement. Voluntary decisions by both sides are best in terms of obtaining flexibility and maximising the recovery rate. This allows the debtor to reorganise payments in line with expected cashflows. A good insolvency process should aim to bring together all the creditors with the distressed debtor, and facilitate this re-negotiation.

Fair and orderly process The process of re-negotiation needs to be fair and orderly for everyone to participate. It has to be timely as delays can be costly. If the re-negotiation fails, then there has to clarity on what follows, and in what time period the actions follow.

Release from financial liabilities The debtor will only meaningfully participate in the process if there is the certainty that participation in the process will lead to a clean slate and the possibility of starting all over again. If the process allows the debtor to keep certain crucial assets such as tools of trade, then the debtor has a better chance at a restart.

Ex-ante incentives The participants in the process will naturally want to maximise their own value first. In this process it is likely that either the creditors or the debtor will game the system to their own advantage at the cost of the others. This can skew incentives and lead to a poor credit market. For example, if the debtor knows that debt forgiveness can be had easily, it will encourage the debtor to be reckless with credit, while discourage creditors from lending. The outcome will be credit constraints.

Care about frictions The institutional design needs to be mindful that for most individuals, as with most small firms, the magnitude of the debt at stake does not justify substantial expenditures on negotiation, payments for insolvency professionals, and processes at a judicial forum.

2.1 Developments in the Commonwealth

In the UK, the Cork Committee undertook a comprehensive review of the insolvency law, publishing its report in 1982 (the Cork Report). This led to the enactment of the UK Insolvency Act 1986 (the UK Insolvency Act), an omnibus bill which combined the personal and corporate insolvency regimes. Substantial refinements were again made to the UKs insolvency regime by way of the Enterprise Act 2002 (the UK Enterprise Act) (which amended the

UK Insolvency Act) and the Cross-Border Regulations 2006, which adopted the UNCITRAL Model Law on Cross-Border Insolvency into the UK regime. Amendments were introduced through the Tribunals, Courts and Enforcement Act 2007, that brought in Part 7A for quick resolutions to debtor-creditor disputes (DRO).

A similar review of insolvency laws was conducted in Australia, which led to the publication by the General Insolvency Inquiry of the Australian Law Commission of its report in 1988. The Corporate Law Reform Act passed in 1993 incorporated major revisions to the corporate insolvency regime, including the introduction of voluntary arrangement, and a re-write of the procedures for claw back provisions such as voidable preferences and insolvent trading. Since then, both the Australian Corporations Act 2001 and Bankruptcy Act 1966, which govern corporate and personal insolvency respectively, have from time to time undergone further significant amendments.

Similar to Australia a number of major common law jurisdictions continue to house their corporate insolvency and personal bankruptcy regimes in separate pieces of legislation. For instance, the Companies Act 1993 and the Insolvency Act 2003 of New Zealand, and the Companies Ordinance and the Bankruptcy Ordinance of Hong Kong.

In Singapore, a committee report of 2013 had the following comments on the need for overhaul of the laws pertaining to insolvency and to keep it separate from the law for companies. First the report suggested that insolvency law has developed and is considered as a discrete area of commercial law that is underpinned by a set of concepts, principles and policies. For instance, much of the judicial management regime bears a closer relationship with the bankruptcy and liquidation regimes than general company law. This reflects the reality that, when individuals and companies are in financial distress, substantially different concerns, tensions, and stakeholder interests and objectives emerge, which have to be addressed outside general commercial and corporate law. Second, the report commented that having the insolvency statutory law untidily dispersed in fragmented and disparate pieces of legislation is not in keeping with Singapore's goal of establishing itself as a main commercial, financial and legal hub within the region. The consolidation of our various insolvency regimes into a single piece of legislation enhances clarity and access to laws by members of the commercial sector. It also assists insolvency practitioners who currently have to navigate the mass of primary and subsidiary legislation in order to advise their clients and carry out their functions.

In what follows, we describe the laws of Insolvency for individuals and firms

(non-corporate) in the UK and Australia in more detail.

3 The UK

The UK legal framework for individual insolvency is governed by the Insolvency Act, 1986 which repealed the Insolvency Act, 1985 and the Bankruptcy Act, 1914. The 1986 Act was further amended by the Enterprise Act, 2002 and then 2007. There are three kinds of relief possible in the UK law:

1. Court initiated bankruptcy
2. Individual Voluntary Agreement (IVA)
3. Debt Relief Order (DRO)

In the first two cases debtors in bankruptcy can be subject to Income Payment Orders, requiring payment of all future income beyond "reasonable domestic needs", generally for a term of three years. An important feature of the UK process is that the house or dwelling of bankrupt is excluded from estate available for distribution only after 3 years of adjudication of debtor as insolvent by the Court. Discharge in the UK has also become faster. Debtors are now discharged automatically after one year. As a result they can return to professional and financial life (at least legally) in a year.

3.1 Court initiated bankruptcy

Bankruptcy proceedings before the court are process intensive. If the debtor files for bankruptcy, the court appoints an Insolvency Professional to either prepare a report stating whether the debtor is willing to make a proposal for a voluntary arrangement. The estate is administered by the Trustee in bankruptcy: either an Insolvency Practitioner (IP) or a Government official, the Official Receiver (OR). Such a process could continue for a long period and discharge to the debtor is a decision of the Court with no a priori certainty. In the UK, discharge is normally granted in a year. Specific triggers are available for creditor and debtor petitions or by an IVA supervisor or on account of criminal prosecution. This remains on credit history for six years from the date of the order.

3.2 IVA

The main goal of the IVA is allow a private negotiation between debtors and creditors so that debtors avoid the stigma of bankruptcy. While negotiations are outside of the court, they are supported by legal provisions embedded in the law. If debtors and creditors can come up with an agreement on composition of debts, then the court only plays a role in sanctioning the agreement. There is no bankruptcy in the case of an IVA, as a plan of repayment is agreed upon before the debtor can be called a "bankrupt". In order to facilitate this process the amended law includes the following steps

- The debtor initiates the IVA by approaching an intermediary known as the Insolvency Practioner (IP). The IP is the nominee of the debtor in negotiating the payment plan with the creditors. The IVA can also be initiated by creditors.
- This process allows the debtor a moratorium of 14 days from adverse actions of creditors, within which the IVA is offered.
- The terms of the IVA are unregulated.
- An IVA can be implemented only with a vote of acceptance by 75% in value of unsecured creditors, and less than 50% by value of non-associated creditors vote against the proposal. The rights of secured creditors cannot be affected without the consent of the creditor.
- Once an IVA is agreed between debtors and creditors, it is overseen by an Official Receiver (OR) and taken to court only for a stamp of approval.
- The debtor then makes the repayments according to the agreement. It usually takes 5 to 6 years for completion of scheduled payments. The IVA is supervised by the IP.
- As the IVA occurs prior to a bankruptcy, there is no "discharge". The IVA remains on the credit history of the debtor for six years.
- In case any party is aggrieved, they can take the other to court.

From an institutional perspective, this has required clarity of laws on a) the role of the IP b) the rules of the negotiations and c) costs and charges d) rules for fresh start.

In 2002, a fast-track version of the IVA (Sections 263 A to G) procedure for composition of debts or arrangements further distanced the in-court

bankruptcy process by allowing the undischarged insolvent and creditors to negotiate and close out before the OR itself, save cases of failure of implementation of order of OR. However, unlike the IVA which allows the debtor to avoid the stigma of bankruptcy, the fast-track IVA process commences after an order of bankruptcy is passed. The OR exercises judgment and powers to speed up the process.

3.3 DRO

While the IVA works for larger debts, insolvency (or difficulty of debt repayment) continued to be problem for low-income households. The costs of doing an IVA often exceeded the debts of these households. This motivated the setting up of the DRO mechanism. The DRO is only applicable to those with maximum debts of pound 15,000, and maximum assets of pounds 300.[14]

The DRO works as follows:

- An application is made to the OR through the IP (or an approved intermediary).
- The OR either refuses the application (only by provisions of the law), or accepts the application and makes a DRO in a prescribed form.
- The Order includes a list of the debts which the OR is satisfied were qualifying debts of the debtor at the application date, specifying the amount of the debt at that time and the creditor to whom it was then owed.
- There is no distribution to creditors.
- The debtor emerges debt-free after a 12 month term. Certain debts such as student loans, child support payments, fines and debts incurred through fraud still need to get paid.
- The DRO remains on credit history for six years from the date of the order.

The emergence of the DRO was concurrent with the global financial crisis that witnessed several individual insolvencies. It indicates a much desired flexibility and agility in the law to address situations arising in a dynamic business environment.

[14]There are some exclusions such as car upto pounds 1000, approved pensions and some basic domestic belongings.

3.4 Insolvency Practitioners

The development of the institution of the IP and its pivotal role in individual or firm insolvency is an important feature of the developments in the UK. The UK law empowers the Secretary of State to recognise professional bodies of IPs as a competent authority that regulates the practice of a profession and maintains and enforces rules for securing that such of its members, as are permitted by or under the rules to act as insolvency practitioners-

- Are fit and proper persons so to act, and
- Meet acceptable requirements as to education and practical training and experience.

The ICAEW is the largest single regulator of IPs in the UK. A person acts as an IP in relation to an individual by acting as

- his trustee in bankruptcy or
- interim receiver of his property or
- as permanent or interim trustee in the sequestration of his estate or
- as trustee under a deed which is deed of arrangement made for the benefit of his creditors or
- as supervisor of a voluntary arrangement proposed by him and approved or
- in the case of a deceased individual in the administration of his estate

4 Australia

The Commonwealth legislation, the Bankruptcy Act 1966, covers personal insolvency, including bankruptcy, Part IX (debt agreements) and Part X (personal insolvency agreements) in Australia. Corporate entities are covered by the Corporations Law administered by the Australian Securities and Investments Commission.

The Australian system departs from the UK in having a separate institution, knows as the Australian Financial Security Authority (AFSA), responsible for the administration and regulation of the personal insolvency system. The AFSA[15]:

[15] For more details, see https://www.afsa.gov.au/

- Operates the bankruptcy registry, where debtors petitions are lodged, debt agreement proposals are processed and public records on insolvency are maintained
- Exercises Official Receiver powers to assist trustees to obtain information and recover property
- Investigates possible offences under the Bankruptcy Act and prepares briefs of evidence for prosecution
- Regulates the administrations and activity of the Official Trustee and private registered trustees, and licenses private trustees
- Advises Government on appropriate legislative reform to the Bankruptcy Act 1966 and related legislation, and acts as a special trustee for government agencies, pursuant to court orders, particularly by locating, controlling and selling property under the Proceeds of Crime Act 1987 and the Customs Act 1901

There are four forms of relief available in Australia:

1. Suspension of creditor enforcement by presenting a declaration of intention (DOI) to present a debtors petition.
2. Debt agreement
3. Personal insolvency agreement
4. Bankruptcy

If debtors income and assets are under specified thresholds, the debtor is free to choose either agreement. If they exceed these amounts, the debtor becomes ineligible for a Debt Agreement and can only then consider a Personal Insolvency Agreement

4.1 Declaration Of Intention option

In a Declaration of Intention (DOI) option the debtor does not file for either insolvency or bankruptcy. This is just a period of 21 days of relief from unsecured creditor action provided to the debtor to be able to choose the future course of action. A DOI is not recorded on the National Personal Insolvency Index (NPII). However, some unsecured creditors and secured creditors not bound during this stay period. Also, A creditor can petition the court to make the debtor bankrupt during the 21 days, or after the end of the period if an arrangement has not been reached.

4.2 Debt agreement

A Debt Agreement (DA) is similar to the IVA in the UK. It is essentially a binding agreement between debtors and creditors where creditors agree to accept a sum of money that the debtor can afford. During the voting period, creditors cannot take debt recovery action or enforce action against the debtor or his property. Unsecured creditors are bound by the debt agreement and paid in proportion to their debts. Secured creditors may seize and sell any assets mortgaged to them. The DA process is as follows:

- Debtor appoints a debt administrator (either registered or non registered)
- Debtor lodges the following with AFSA
  - A debt agreement proposal
  - An explanatory statement (informing creditors about income and assets)
  - A statement of affairs (detailed explanation of personal information and circumstances not sent to creditors and not put out in public)
- AFSA sends proposal to creditors to assess and vote on. Creditors to send their vote (with a yes or no) to AFSA in five weeks
- If majority of creditors accept, then it is registered on the NPII as a debt agreement and the debtor begins to comply. If a majority of creditors do not accept, then this voting outcome is recorded on the NPII. Creditors can commence or continue with action to recover the debts.

4.3 Personal insolvency agreement

A Personal insolvency agreement (PIA) is also similar to the IVA, especially because the process is more formal than the DA described earlier. Like the IVA it allows the debtor to come to an agreement with creditors to settle debts without the stigma of bankruptcy. The debtor however has to be insolvent to propose a PIA. The broad process is as follows:

- Debtor appoints a controlling trustee to take control of the property

and put forward a proposal to creditors.[16]

- The controlling trustee examines the proposal, makes inquiries into debtors financial affairs and reports to creditors
- The report will advise creditors of the amount they can expect from the proposal compared to the amount they could expect if the debtor became bankrupt, and make a recommendation whether it is in creditors' interests to accept the proposal.
- Creditors consider and vote on the proposal. Acceptance requires a yes vote from a majority of creditors who represent at least 75 percent of the dollar value of the voting creditors debts (referred to as a special resolution).
- Secured creditors' rights in relation to dealing with their security are not affected by a PIA.
- If proposal is rejected, creditors can vote in favour of debtor becoming bankrupt.

4.4 Bankruptcy

There are two ways of becoming bankrupt. The first is when the debtor presents a petition (referred to as voluntary bankruptcy), while the second is a creditor petition (referred to as involuntary bankruptcy). If it is a voluntary bankruptcy, then debtor will need to complete and lodge a debtor's petition and a statement of affairs with AFSA within 28 days of signing the form that declares voluntary bankruptcy. When the forms are accepted by AFSA, generally within 24-48 hour period, the debtor becomes bankrupt. The debtor becomes due for discharge three years and one day after the debtor filed that petition and statement of affairs with AFSA.

A creditor to whom the debtor owes $5,000 or more can file for involuntary bankruptcy. The creditor applies for a bankruptcy notice, and serves it on the debtor demanding that the debtor pay the money owed to the creditor within 21 days. If the debtor does not pay the creditor by the time given in the notice, the debtor commits an "act of bankruptcy". A creditor can then apply to the court (called a creditors petition) to have the debtor made bankrupt. If after hearing the creditor's case and any submissions the debtor makes,

[16] Only a registered trustee, AFSA or a suitably qualified solicitor can act as a controlling trustee

the court is satisfied that the debtor has not paid the creditor, the court makes an order (called a sequestration order) making the debtor bankrupt. A trustee is appointed and the debtor is then required to file a statement of affairs with AFSA within 14 days of being notified of the order. The debtor becomes due for discharge three years and one day after AFSA accepted the completed statement of affairs.

After discharge, the name of the debtor appears on the NPII forever as a discharged bankrupt. Credit reporting organisations also keep records of bankruptcies for seven years.

5 How does the Indian law fare?

As stated earlier, the law of Insolvency in India exempts incorporated bodies from its ambit and individuals are geographically divided across the respective Acts of PTIA, 1909 for Calcutta, Bombay and Madras and the PIA, 1920 for the rest of India, respectively. Firms and other non-corporate bodies are governed only under PTIA, 1909 and therefore suits by and against firms are possible only if states under PIA have adopted provisions for firms.

The origin of the law of Insolvency is found in the British laws of the 19th century and the extant law is also closely modeled on the UK law prior to its overhaul in 1986. The term "Bankruptcy" is found neither in Insolvency Laws or the Companies Act, save the one occurrence in section 125 of the PTIA where reference is to a Bankruptcy Act, 1883 - a British Act that has been long invalidated in the UK. A unified version of the existing laws was submitted to the government of the day by the 26th Law Commission in 1964 but it remained abortive.

The two extant acts are very similar as concluded by the Law Commission and its exercise of unifying the two laws into a single draft law was completed without recommendations for substantive changes. An understanding of the substantive and procedural aspects of the extant law is essential in the process of revamping or replacing it. The process in India for filing for personal bankruptcy (quoted from practitioners) and its salient features are presented below:

1. The triggers for insolvency are events that are measurable and are described in section 9 of PTIA, eg. "makes a transfer of his property or of any part thereof with intent to defeat or delay his creditors" or "departs from his dwelling-house or usual place of business or otherwise absents

himself" or "fails to comply with the demand notice accompanying the decree of the Court for recovery as given by creditors".

2. The time limit for creditor to petition is 3 months from trigger or act of insolvency and the debtor's petition itself constitutes an act of insolvency. These petitions are submitted in the district court.

3. Rules provide options available for secured creditors to exclude themselves or join in the claim.

4. Admission to court is a process of law that requires the petition to adhere to the conditions laid down including the jurisdiction of the particular court. The registrar of the Court checks for the satisfaction of the conditions.

5. A "Statement of Affairs" is filed by the debtor. This is a declaration of his assets and the income that he may be receiving from this occupation or business. It is here that misrepresentation happens by the debtor and non-disclosure of assets is a common occurrence.

6. Once this has been submitted, further proofs are offered and the determination of insolvency upon evidence offered is made. The Court makes a proclamation at the end of the adjudication process. This is delivered by an Order of the Court.

7. Once the proclamation of Insolvency in public domain is made, the property of debtor vests in the Official Receiver with a Court-prescribed date before which discharge is not permissible.

8. An officer is responsible for inspecting all the assets and collecting all of them except for the ones that are exempted by law. Assets that do not comprise the property of insolvent and therefore cannot be alienated include the home of the insolvent.[17].

9. Distribution has to conclude in 1 year. This includes handling of unclaimed dividends.

10. Powers are vested with the Committee of Creditors to oversee the negotiation and distribution process.

11. For smaller cases, there is a provision for Summary Administration, where the procedures of the court do not kick in and the flexibility rests with the OR.

[17] Other provisions are provided in section 60 of CPC

We next compare the unified Law Commission text or 'draft Bill with the law as prevalent in the UK since it had once served as the mother act for the Indian law. A comparison of the draft Bill, which is largely a unification of the two extant acts, with the substantive Act of 1986 found only a few differences in the provisions.

The institutional changes made in the UK law include the Insolvency Practitioner, the Trustee, the supervisor, the nominee all of whom assist the debtor or the Official Receiver in its role as a mediator between debtor and creditors. The specific provisions in the 2007 amendments on time-lines for completion of negotiations strengthened the hands of creditors and also fixed discharge at the end of one year without an adverse credit history bringing relief to debtors. A comparison of the two laws allows for cherry-picking of the best provisions of the UK law in order to overhaul and modernize the Indian law in keeping with the shared common law traditions of the two countries. The following are some lacunae in the Indian law that could be directly filled up by borrowing provisions or modifying concepts from the UK law:

1. Moratorium (interim) order to halt remedy against property of a debtor or other legal proceedings does not exist, though an Adjudication Order after a court procedure has the effect of placing a debtor in the same position.

2. The disadvantage of an adjudication order is the status of debtor converts to that of an insolvent while the debtor could still be in a position to offer a scheme of arrangement and return to normalcy without stigma of being an insolvent. The DRO of UK law allows composition by a debtor.

3. There are no provisions laying down the duties of a nominee or an IP or supervisor.

4. OR may seek trustee to be appointed for protection of the estate and to summon meeting of creditors. The role of Trustee is not made formal, and the Trustee is not registered. The appointment of the Trustee is also not widely advertised.

5. Reasonable prospect of failure to pay as assessed by the creditor is a unique clause in the UK law that helps early detection. This should be preferred over the current arduous prerequisite for a petition by creditor to be preceded by failure to comply to a statutory demand or notice that must include a decree or order from a Court.

6. The time period for discharge (in one year) is fixed in the UK law.

In contrast, under Indian law it is the Courts decision to determine discharge. This introduces uncertainty and delays.

7. UK law gives power to Court to decide fate of debtor through a voluntary arrangement even if not applied for and upon doing so the insolvency practitioner concludes the settlement process as supervisor of the scheme. This is currently not possible in India.
8. The UK law has allowed for exclusion from estate or property the dwelling house of bankrupt only after a period of three years, by way of 2002 amendment. This has not happened in India.
9. There is a gap in the Indian law for dealing with credit given by spouse as also for second or subsequent bankruptcies, both of which are dealt adequately in the UK law.
10. Sections relating to priority of debts are similar in dealing with wages and may require to be updated to cover more instances as done in UK law, e.g. apprenticeship.
11. A review of what may be excluded from the estate of the insolvent needs to be undertaken.[18]
12. A listing of the offences that may be committed by an insolvent should be adopted for the Indian Law.[19]

It appears that the direction the UK law has implicitly accepted is that:

1. Less intervention of the Court is better, except for invoking arrest and seizure orders.
2. The OR can execute a quicker process of negotiation with the debtor and creditor.
3. Intermediaries make the process more effective by verifying submissions of debtors.
4. Recourse to courts should only occur after completion of the negotiation or composition process in the event a party is aggrieved by the order.
5. The procedures should make it easier for a creditor to file a petition since a "reasonable prospect" of inability to pay debts is a valid criterion as a trigger for bankruptcy in the Court.

[18]Section 60 of the CPC.

[19]Sections 352 to 360 of the UK law.

6 The way forward

A review of the personal insolvency principles and practices suggests that a sound framework involves an impartial, efficient and expeditious administration. In this section, we present the rationale for the choices for India.

6.1 The overall process

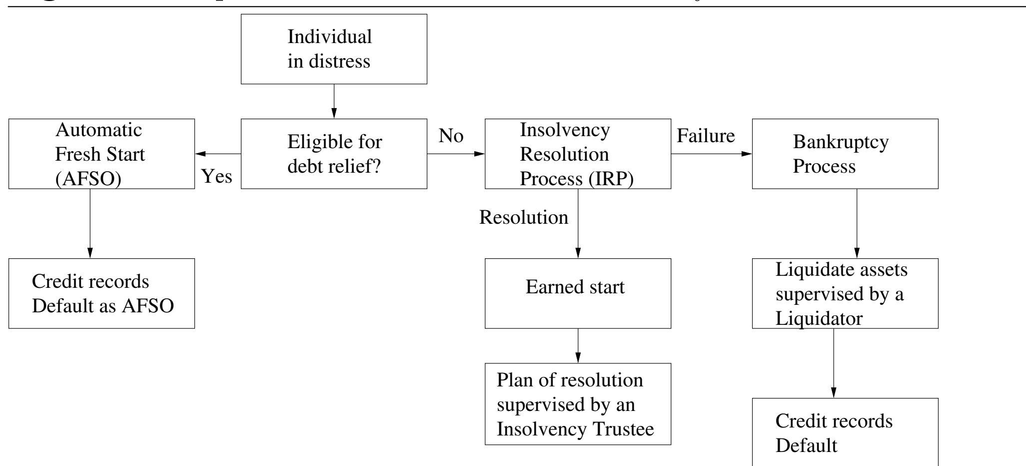
Process design includes questions related to the conditions under which bankruptcy is triggered, the structure of the repayment plan of the debtors, ranking of creditors, execution of the repayment plan. There are two main functions that need to be in place. The first is administrative which includes recording, collection and evaluation of the assets and liabilities and such others. The second is judicial, which includes adjudication of disputes. The central question in the design of procedure is, what functions should be placed outside the court of law, and what should be conducted under the authority of the court of law.

The trend across the world is towards placing administrative proceedings outside of the courts. The rationale for this is that from the perspective of the economy, a repayment plan has to affects the premium of future credit transactions, because this serves as a deterrent to willful default by debtors. If creditors and debtors can settle this out of court, what matters for the system is just a record of this settlement. A negotiated settlement outside of court allows more flexibility in the repayment plans, and the time to execute the plans, that can be acceptable to both parties, as opposed to a court procedure which can constrain the possibilities. Thus, placing administrative proceedings outside of courts seems the natural way forward for India as well.

We, therefore, propose an "Insolvency Resolution Process" (IRP), which will involve a process of negotiation between debtors and creditors supervised by a Resolution Professional. The formal oversight of the process of negotiation by the RP under the shadow of the law with no long term adversarial effects to the debtor is a critical step towards a modern insolvency framework.

Our proposal for a personal bankruptcy law is for the "trigger" of bankruptcy to be recorded in court. Once that is obtained, negotiations between debtors and creditors happen outside the court similar to the IVAs in the UK. This should be in the presence of an approved intermediary. If the negotiation succeeds, it will lead to a repayment plan. If they fail, then a set of rules should apply to the liquidation. We call it the "Bankruptcy resolution process".

Figure 1 The process flow of individual insolvency



In the case of those class of debtors who have no ability to repay creditors, an Insolvency Resolution Procedure is likely to be expensive for both debtors and creditors, with not much in the way of outcomes. In such instances, it is useful to consider a mechanism of automatic debt relief. The innovative amendment of the DRO in the UK is a process of quick settlement between debtor (not insolvent) and creditors leading to automatic discharge in a year without the label of insolvent attaching to the debtor. A DRO kind of a mechanism will be very useful in the Indian context considering the large number of poor debtors who could benefit from it. Also, it makes the conditions of the DRO predictable which will allow better pricing of credit, as opposed to the current system of unpredictable politically motivated debt-relief.

We, therefore, propose an "Automatic Fresh Start Order" (henceforth referred to as AFSO) by which persons with assets and income lower than specified amounts will have their debts written off. Figure 1 presents the overview of what is envisaged for India.

6.2 Class of insolvency professionals

An important intermediary in insolvency resolution in the UK is the Insolvency Practitioner (IP).[20] Licensed IPs advice, and undertake appointments in all insolvency procedures. They play the role of supervisors of voluntary agreements, trustees, administrators, as well as liquidators. The institution of IP has played a pivotal role in individual or firm insolvency. A recent

[20]http://www.insolvency-practitioners.org.uk

report in the UK estimates that IPs rescued 41% (6,700) of insolvent businesses, and helped individuals repay 5bn of personal debt to creditors within five years.[21]

The institution of an IP is critical if negotitations between debtors and creditors have to take place outside the court. It is thus an important constituent of the UK law to be transplanted into the Indian law. We propose the setting up a new class of intermediaries similar to the IP in the UK. This should be accompanied by a regulatory body to monitor the performance of IPs and discipline them as necessary.

6.3 Design of the discharge

Discharge relates to the relief offered to the debtor. The world has adopted one of two measures - an “earned” start where the duration of the repayment plan lasts for between 3-7 years. This is the system prevalent in most European countries. The other is that of a “fresh” start where debt relief is granted with a year. In the US, fresh start underlies the policy of small-business insolvency legislation. The UK has also moved towards a system of discharge within twelve months.[22]

Within the system of fresh start are three choices. Debt forgiveness is given for business loans (but not consumer loans).[23] In other parts, consumers can apply for debt forgiveness, but there is no guarantee that will be granted. A judge, exercising discretion and guided by statutory guidelines, decides whether, and under what circumstances, that individual’s debts should be forgiven.[24] The most extreme example is where discharge is automatic, and is offered with a high degree of certainty.[25] Another aspect closely related to discharge is the recording of the insolvency. While a debtor may be granted discharge, the record can continue to appear on credit history for a period of time.

The choice for India seems to be a combination of automatic and earned relief. A DRO equivalent is worth introducing for the marginal persons who fall within the threshold since debt write-offs will occur according to laid down rules. A system of earned start will be in place for those who can pay

[21] https://www.r3.org.uk

[22] Efrat (2002) describes the global trends in the fresh start policy

[23] An example of this is Brazil

[24] This is the case in India at present.

[25] This is the case in the US

off some debts. The IRP should give the debtor an "earned start", while the AFSO should make the debtor eligible for an "fresh start". In the event of a bankruptcy, the debtor will be eligible for a "bankruptcy discharge".

6.4 How will this process play out?

In our proposal, a debtor or a creditor will approach the Court to file for initiating an IRP. Debtors below certain specific thresholds will be automatically routed to the provisions under the AFSO, where their debts will be written-off.

The application of the IRP will be the trigger of a formal negotiation process between the debtors and creditors. The negotiation period will be accompanied by a period of moratorium in which there is no collection or other action by creditors against debtors. All negotiations between creditors and debtors for a scheme of arrangement will take place outside the court. This will be guided by an IP, under the provisions of the Law. The final arrangement has to have a majority vote both in the number of creditors, and creditors with 75% in value. The process of negotiations will have to be completed within a strict time-line.

Once negotiations conclude, and a plan is approved by creditors, this will be notified to the Court. An IP will be appointed to execute the repayment plan. On successful completion of the plan, the IP will notify the court, and the IRP will conclude.

Our proposal envisages that application for bankruptcy can occur only if the IRP has failed. This may be because the negotiations between the debtors and creditors failed, or because the repayment plan could not be successfully concluded. This ensures that the court-intensive procedure is used sparingly, and that the debtors always have the chance to renegotiate with their creditors. Once an IRP has failed, either the debtor or credit can apply for a bankruptcy. This should lead to the appointment of a Bankruptcy Trustee who then takes up the sale of assets of the debtor as per the provisions of the Law.

The draft of a personal insolvency law requires the infrastructure in the form of resolution professionals, and the adjudication infrastructure. Questions on the interface between these institutions is left for future research.

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