

Recovery of Debts Due to Banks - Debt recovery mechanism in Selected Developed Countries in the World

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ABSTRACT

The financial health of a developing country depends upon financial sectors as well as the allocation of financial resources. The wellbeing of a financial sector like Banks is a matter of policy concern for a developing country like India. The COVID-19 pandemic and lockdown has mounted Non-performing Assets problem for Governments around the world. Reserve Bank of India (RBI) in its financial stability report in July had indicated that due to COVID-19 Pandemic the asset quality of Indian Banks would worsen.

The major focus of the paper is to analyse legal trends in various developed countries having effective debt recovery mechanism.

The World Bank report 2019, on Doing Business ranked India at 108th of 190 countries on resolving insolvency which has improved from 16th in 2017. It is also noted by World Bank that insolvency procedure takes 4 to 3 years and costs about 9 percent of the sale proceeds of debtor's estate. The meter of insolvency index has increased from 6 in 2017 to 8.5 in 2018.

An Analysis of Insolvency regime in practice in various developed countries to promote economic stability and maximization of asset value, equitable distribution of proceeds, ensure transparency and predictability, recognition of existing creditor rights and establishment of clear rules for priority of ranking. The developed countries like Australia, Canada, U.K, and USA are having less than 2 per cent of NPA ratio (2015- 2019) whereas India's NPA ratio is more than 8 per cent. These countries are having an effective debt recovery mechanism to tackle the Non-performing Assets. Indian economy falls under top economy category but it's NPA ratio is more.

Keywords: *NPA/NPL; Debt Recovery Mechanism; Developed countries; Insolvency; Bankruptcy; liquidation reorganization.*

1.0 Introduction

The Primary goal of a country for health economic growth is stability of Banking Industry. Economic development of a country is directly connected with entrepreneurship through various dimensions of lending. Both Public Sector and Private Sector are involved in lending process as per the norms laid down by regulating authorities. Now in modern times, for both the Public and Private Banks lending and recovery through various instruments for resolving the disputes is a major barrier.

The Indian Insolvency and Bankruptcy Code 2016(IBC), was enacted to refurbish the complex debt recovery laws in respect of corporate and personal debtors. After the enactment of IBC, India has jumped to 77th rank from 155th rank on ease of doing the business after the enactment of IBC . More than Rs.2lakh crores worth of NPA's are recovered. It is reported that most corporate borrowers (1/3rd of the total borrowers) are facing substantial balance sheet distress, leading the banking industry to dissipate good money after bad lending, hampering the credit cycle adversely.

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There are no research papers on comparative study of in the field of analysis of Debt recovery laws in various countries. The major focus of the paper is to analyse legal trends in various developing countries whose recovery rate is high and recovery rate of Non-performing Loans(NPL) is high.

This Research paper mainly to compare the Insolvency and Bankruptcy laws and procedure of India with other countries such as Australia, USA, UK, and The study of these developed countries would bring more insights to improve the Insolvency and Bankruptcy regime in India.

2.0 Review of Literature

The recovery of NPA is a major problem faced by financial sector. Before 1991, creditors used to file debt recovery cases before the Civil Court of Competent jurisdiction¹. There after various laws like RDDBFI Act, 1993, SARFAESI Act 2002 and IBC 2016 were enacted with the recommendations of various committees, to ease debt recovery for particular class of creditors and empowering the Banks to recover their debts through enforcement of their secured interest².

The bankruptcy framework prevailing in India can be traced back from colonial rule. The legal framework has seen number of amendments over the last 200 years, which created a plethora of overlapping of legislations. Various laws were enacted to resolve the NPA problem through liquidation and reorganization of assets(Ben Branch, 2016). ³The Insolvency timelines in various countries have changed drastically to tackle the delay in settlement of cases. The International Insolvency and Bankruptcy laws have been successful for a long time and taking insights from these laws bring more insights for improving the Insolvency regime in India⁴.

3.0 Comparative Study of Insolvency Laws

An Analysis of Insolvency regime in practice in various developed countries to promote economic stability and maximization of asset value, equitable distribution of proceeds, ensure transparency and predictability, recognition of existing creditor rights and establishment of clear rules for priority of ranking.

Developed countries have a sound legal system or Debt recovery Laws for addressing the resolution of Corporate as well as Personal insolvencies. Most of the countries have laid down a comprehensive legal mechanism to deal with Corporate and Personal Insolvencies.

4.0 Legal Framework of Debt recovery Laws in India

At present Insolvency in India is governed by various Recovery of Debts due to Banks and Financial Institutions Act 1993, SARFAESI Act 2002, and Insolvency and Bankruptcy Code 2016. The main aim of Insolvency laws is to address the recovery of debts through easy resolution system,

¹ Ravi, A., (2015). Indian Insolvency Regime in Practice. Economic & Political Weekly, 50(51), p.47

² Singh, C. and Brar, J., (2016). Stressed assets and banking in India. IIM Bangalore Research Paper, (507).

³ Branch, B. and Khizer, A., (2016) Bankruptcy practice in India. International Review of Financial Analysis, 47, pp.1-6.

⁴ Binoy J. Kattadiyil (2020) Corporate Insolvency in India and other countries – a comparative Study, International Journal of Multidisciplinary Education Research, ISSN: 2277-7881, Pg.no. 149-162

reorganization and liquidation⁵.

The Insolvency and Bankruptcy Code, 2016 ('IBC'), has brought into reality the long awaited expectation of industries, corporates, banks and financial institutions on a self-contained legal framework to deal with the insolvency and bankruptcy process. It is to be noted that IBC is enacted after the enactment of the new Companies Act, 2013. Justice V Balakrishna Eradi committee gave recommendations 16 years back on 'Law Relating to Insolvency and Winding up of Companies'. The new law has been enacted on the basis of Report of the Bankruptcy Law Reforms Committee⁶.

The IBC is enacted to provide expert professional forum to improve all insolvency and liquidation framework. It is enacted with the objective of improving the "ease of doing business" in India, a country alleged to have a weak insolvency framework and where the law is abused by defaulting debtors. Its main objective is refurbishment of laws in respect of reorganization of insolvency resolution of corporate persons, part Limited Liability Partnership Act 2008, companies governed by any Special Act, Partnership firm and Individuals insolvency, liquidation or bankruptcy⁷.

5.0 International Trends in respect of Debt Recovery Laws relating to Debt Recovery

An Analysis of Insolvency regime in practice in various developed countries to promote economic stability and maximization of asset value, equitable distribution of proceeds, ensure transparency and predictability, recognition of existing creditor rights and establishment of clear rules for priority of ranking.

Table 1: Work Rank of Selected countries on Resolving Insolvency⁸

Country	Ease of Doing Business Rank In 2019	Time Taken to Resolve Insolvency in 2019	Resolving Insolvency Rank in 2019	NPA Ratio				
				2015	2016	2017	2018	2019
India	63	4.3	52	5.9	9.2	10.0	9.5	9.2
Australia	14	1.0	21	0.9	1.0	0.9	0.9	1.0
Canada	23	0.8	14	0.5	0.6	0.4		
United Kingdom	8	1.0	15	1.0	0.9	0.7	1.1	-----
United States	6	1.0	3	1.5	1.3	1.1	0.9	0.9

Source: Compiled from World Bank's reports

The above Table No. 1 signifies, countries Rank on Ease of Doing business, Resolving Insolvency Rank, time taken to resolve Insolvency and NPA Ratio (2015 – 2019). Indian NPA ratio is more compared to other countries. The NPA Ratio of these countries is consistently stable during this period. The stable NPA ratio is the result of an effective Insolvency and Bankruptcy regime in these

⁵ [Aparna Ravi](#) "Indian Insolvency Regime in Practice An Analysis of Insolvency and Debt Recovery Proceedings" Economic and Political Weekly [Vol. 50, Issue No. 51, 19 Dec, 2015](#) ISSN (Print) - 0012-9976 ISSN (Online) - 2349-8846

⁶ Baldev Bhinder, "Fastest Fingers First", 36 International Finance Law Review 31 (2017). ISSN No.0262-6969

⁷ ANKEETA GUPTA "Insolvency and Bankruptcy Code, 2016: A Paradigm Shift within Insolvency Laws in India, "The Copenhagen Journal of Asian Studies" 36(2) – 2018, ISSN No. 1395-4199

⁸ <https://www.ceicdata.com/en/indicator>

countries. The Ease of doing business Rank of India is far away from that of the other countries. The time taken to resolve Insolvency in 2019 of India is at an average of 4.3 years whereas in other countries it is at an average of less than an year.

Table 2: Resolving Insolvency Index⁹

Location	Resolving Insolvency rank	Resolving Insolvency score (per cent)	Recovery rate (cents on the dollar)	Time (years)	Strength of insolvency framework index (0-16)
India	52	62	71.6	1.6	7.6 (2016)
Australia	20	78.9	82.7	1	11
Canada	13	81.0	86.7	0.8	11.0
United Kingdom	14	80.3	85.4	1.0	8.5
United States	2	90.5	81.0	1.0	13.0

Source compiled from world Bank report on ease of doing business

According to World Bank Report, 2019, Table No. 2 shows that India rank on resolving insolvency is 52 whereas United States is 2, Germany is 4, Canada is 13, UK is 14. Indian rank on resolving Insolvency needs more improvement. The score of resolving insolvency of India is 62 whereas that of other countries is more than 80 per cent. The recovery rate of India is at 71.6 per cent which is comparatively less than other countries. The average time taken for resolving Insolvency is 1.6 years in India whereas in other countries it is at an average of less than an year. The strength of Insolvency framework far less than other countries.

The strength of insolvency framework index measures the legal framework applicable to judicial liquidation and reorganization proceedings and the extent to which best insolvency practices have been implemented in each country covered by Doing Business¹⁰.

Basing on the above data it is pertinent to examine the legal regime of these countries in spite Indian rank is improving but still Indian Insolvency regime needs more reforms.

The key features of Insolvency Indicators of Corporate and Personal Insolvency regime

Treatment of failed entrepreneurs:	1. Time of discharge 2. Exemptions
Prevention and streamlining:	1. Early warning mechanism 3. Pre-Insolvency regime 4. Special Insolvency procedures for SMEs
Restructuring Tools:	1. Creditor ability to initiate restructuring 2. Availability and length of stay on assets 3. Possibility and priority of new financing 4. Possibility to cram-down on dissenting creditors 5. Treatment of management during restructuring
Other Factors:	1. Degree of Court Involvement 2. Distinction between honest and fraudulent bankrupt 3. Rights of creditors

⁹ <https://www.doingbusiness.org/en/data/exploretopics/resolving-insolvency>

¹⁰ <https://datacatalog.worldbank.org/resolving-insolvency-strength-insolvency-framework-index-0-16>

The debt recovery is characterized by recovery rate, time taken and cost of insolvency proceedings¹¹. The data on Insolvency proceedings in many countries basing on economic efficiency of Banks Non-performing Assets/Loans (NPA) and enforcement of debt recovery law. The parameters for assessment of efficiency of Insolvency system are NPA recovery rate¹², time taken (duration of insolvency proceedings), and costs of proceedings¹³.

6.0 Australia

Statutory Framework of insolvency and reorganization in Australia¹⁴

The Australian government in order to align the Corporation Act 2001 and the Bankruptcy Act 1966 with common rules for both corporate and personal debt recovery process has introduced new legislative reforms through the Insolvency Law Reforms Act 2016. The Australian legal regime of Debt recovery focuses more on punitive measures than on rehabilitation of corporate debtors¹⁵.

7.0 Debt Recovery in Australia

Corporation Act 2001: The Debt recovery from Corporate Debtors is dealt under the Australian primary legislative framework of Corporation Act 2001 (the Corporation Act) deals with registration, insolvency and reorganization of companies incorporated in Australia. Debt recovery deals under insolvency under the Corporations Act recommends the way in which an Australian Company can enter into conventional insolvency process and how its assets are finally distributed to creditors.

The main aim of the Australian insolvency law is to maintain balance of interest of the primary stake holders in an insolvent estate, who include debtors and creditors. In the event of insolvency, a number of prescribed procedures are available under the Corporation Act. The Corporate insolvency procedure include receivership(private and court-ordered), voluntary administration, deeds of company agreements, provisional liquidation, liquidation (voluntary and involuntary and solvent and insolvent) and scheme of arrangement (court-sanction).¹⁶

In order to promote better restructuring, innovative reorganizations the Corporations Act introduced Section 588GA which provides that, a director will not be liable for debts incurred by a company while it is insolvent if ‘at a particular time after the director starts to suspect that the company may become or be insolvent, the director starts developing one or more courses of action that are reasonably likely to lead to a better outcome for the company’ than the immediate appointment of an administrator or liquidator to the company’.¹⁷

The Corporation Amendment(Strengthening Protections for Employee Entitlement) Act 2019 (the SPE Act) introduced new amendments to Corporation Act 2001 Criminal offence for the employers using “Sharp corporate practices” to avoid employee entitlements during winding up of company¹⁸.

¹¹ Arltová M., Smrčka L., Louda L., Mateos-Planas X. (2016), An attempt to compare the efficiency of insolvency proceedings in various countries in the world, Journal of International Studies, Vol. 9, No 2, pp. 25-47. DOI: 10.14254/2071-8330.2016/9-2/2

¹² Recovery Rate means the return on investment in percent in case insolvency proceedings take place.

¹³ Costs of proceedings means the price creditors pay for the collection of debt.

¹⁴ The Insolvency Review - The Law Reviews

¹⁵ Ali, P., O'Brien, L. and Ramsay, I., 2016. Bankruptcy and debtor rehabilitation: An Australian empirical study. Melb. UL Rev., 40, p.688.

¹⁶ Edelman, J., Meehan, H. and Cheung, G., 2019. The evolution of bankruptcy and insolvency laws and the case of the deed of company arrangement. Lloyd's maritime and commercial law quarterly, (4), pp.571-602.

¹⁷ Section 588A of the Corporations Act 2001

¹⁸ Section 596AB of the Corporation Act 2001

Australian Courts accords with the foreign courts decisions and insolvency practitioners. The Australian Law on Cross-border Insolvency (the Model Law) was codified through the Cross-Border Insolvency Act 2008 (the Cross-Border Act). The main objective of the UNCITRAL Model Law is to Recognize and enforce of Insolvency Related Judgments of 2018 and to clarify uncertainties arising from the Model Law¹⁹.

8.0 Personal Debt Recovery framework

The Debt recovery of individual/personal insolvency is dealt under the Bankruptcy Act 1966 (the Bankruptcy Act) which recommends the manner in which an individual may enter into a personal insolvency agreement or a prescribed bankruptcy procedure.

The formal procedure of restructuring are²⁰:

- a. Receivership (both private and court appointment)
- b. Voluntary administration
- c. Deeds of company arrangement;
- d. Provisional liquidation;
- e. Liquidation;
- f. Court-sanctioned schemes of arrangement between creditors and the company

9.0 United States of America

Statutory Framework of insolvency and reorganization in USA²¹:

The United States Constitution has placed bankruptcy under federal jurisdiction, empowering congress to enact uniform laws throughout USA in respect of Bankruptcy and Insolvency Laws.

In August 2019, the USA adopted many changes to the Bankruptcy Code. Most notable was the Small Business Restructuring Act of 2019(SBRA), which came into effect from February 2020. It was enacted to expedite and reduce Bankruptcy cost for small business debtors with a debt of approximately \$2.7 million.

Debt Recovery in USA²²:

Bankruptcy helps a person for discharging debt or making a repayment plan. In USA bankruptcy case is filed by the debtor with the Bankruptcy Court. The Petition may be either filed by an individual or spouses together or by a corporation or other entity.

Federal Courts has the Jurisdiction to Bankruptcy cases under the rules outlined in the U.S. Bankruptcy Code²³.

Different types of bankruptcies under the U.S. Bankruptcy Code are²⁴:

Chapter 7: A corporation may voluntarily be liquidated by a trustee for the administration of estate

¹⁹ <https://www.legislation.gov.au/Details/C2017C00063>

²⁰ https://thelawreviews.co.uk/digital_assets/707e3adc-4263-4aad-84a6-0a59125e2013/The-Restructuring-Review---13th-Edition.pdf

²¹ [United States - The Insolvency Review - The Law Reviews](#)

²² <http://restructuring.bakermckenzie.com/wp-content/uploads/sites/23/2016/12/Global-Restructuring-Insolvency-Guide-New-Logo-United-States.pdf>

²³ <https://www.uscourts.gov/services-forms/bankruptcy#:~:text=A%20bankruptcy%20case%20normally%20begins,in%20the%20U.S.%20Bankruptcy%20Code.>

²⁴ *ibid*

comprised of estates of the company. The trustee shall be responsible for liquidation and distribution of proceeds to creditors holding claims against the estate. It is the most common form of Bankruptcy in USA.

Chapter 11: The company may choose to be restructured and reorganized by filling a voluntary petition. The need not be insolvent in order to file petition under Chapter 11. It allows reorganization plan to help repay loan over a time used by small and large corporations

Chapter 13 :Individual Insolvency plan or reorganization of loan and propose a repayment plan over three or five years. The payment is made to creditors through court trustee. It helps to protect the assets of debtor by giving time to repay over a period of time.

Chapter 15: The United Nation Commission on International Trade Law (UNCITRAL) Model Law on Cross border Insolvency is adopted in 2005 under Chapter 15 of the Bankruptcy Code. It allows recognition of foreign proceedings in US

10.0 Canada

Statutory Framework of insolvency and reorganization in Canada:

Debt recovery Laws are classified under Insolvency Laws in Canada. Debt recovery Laws are governed by the Bankruptcy and Insolvency Act. The bankruptcies are supervised by the office of the Superintendent of bankruptcy for fair and efficient administration²⁵.

Debt Recovery in Canada²⁶ :

Insolvency and Bankruptcy is governed under three federal statutes.

1. The Bankruptcy and Insolvency Act 1985(BIA):

The Act deals with restructuring and liquidation of assets of Individuals, partnership, corporations (exclude certain types of corporations) and other business entities that meet residency and nominal debt requirements. The act provides for receiverships in which an insolvent's assets and rights are given for custody and care of third party called receiver. The receiver though continues operation, but in certain cases the assets are liquidated.

The BIA is the complete code which provides substantive provisions scope and breadth of stays of proceedings, distributional priorities, fraudulent transfers, the sale of assets, the contract treatments, interim financings, cross-border proceedings and penalties and sanctions against debtors and their directors for violations under the act. It also deals with appointment of receivers and the rules related to their conduct. Restructuring procedure is by way of proposal to creditors. These proposals bind all affected creditors, if approved by the requisite double majority and subsequently by the court.

2. The Companies Creditors Arrangement Act 1985(CCAA):

The act deals with the only restructuring of the debts of corporations and income that meet certain residency requirements and meet higher minimum debt requirements than those found under the Bankruptcy and Insolvency Act 1985. It is a more better statute than the BIA, which gives more discretionary powers to court in respect of restructuring corporations.

3. The Winding-up and Restructuring Act 1985 (WURA):

The Act deals with liquidation and restructuring of certain definite entities like banks and trust

²⁵ <https://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br01467.html>

²⁶ Insolvency- Law Review 7th Edition- Canada pg no.50, 51

companies, those excluded under The Bankruptcy and Insolvency Act 1985 and The Companies Creditors Arrangement Act 1985.

11.0 United Kingdom

Statutory Framework of insolvency and reorganization in UK:

Debt Recovery in United Kingdom:

The legal framework of in most of the countries is based on English Common Law. Further the IBC is close mirror of UK Insolvency regime, but customized to Indian scenario.

The UK Insolvency Laws are:

1. The Insolvency Act 1986:
2. The Insolvency Rules 2016

The UK Insolvency Act 1986²⁷ deals with personal and corporate insolvency. The act deals with winding up of company, appointment of receiver, insolvency proceedings etc.

The Insolvency provisions adopted from UK are:

- The doctrine of debtor in possession is shifted to Debtor in possession.
- Appointment of Insolvency Resolution Professionals.
- Moratorium period
- The waterfall mechanism in distribution of proceeds after the completion of liquidation.
- UNCITRAL Model of Cross-border insolvency is subject to Government of India agreement with any country. But Cross-border insolvency has not yet been adopted.

12.0 Conclusions and Suggestions

- ✓ India needs a proper legal framework in the aspect of cross border insolvency in order to tackle foreign investors to invest in India.
- ✓ Pre-packaged insolvency process is successfully implemented in USA and UK. Amendment has to be made to the IBC as and when need arises or felt necessary, for better and cost effective recovery process.
- ✓ The debt recovery rate in India is very less as compared to Australia, Canada, USA and UK countries which is more than 80 per cent whereas Indian recovery rate is less than 70 per cent.
- ✓ The turnaround time taken to recover the debts needs to be considerably improved.
- ✓ Liquidation is most resorted option in India wherein assets are sold in a piecemeal and not as going concern. Whereas in other countries reorganization is given more importance.
- ✓ After the introduction of IBC India's ability to resolve insolvency on par with the International trends
- ✓ UNCITRAL Model Law on Cross border Insolvency but not adopted under IBC.

Australia, Canada, USA and UK are having a sound Insolvency Resolution system for addressing the resolution of Corporate as well as Personal insolvencies. They have laid down a comprehensive legal mechanism to deal with Corporate and Personal Insolvencies.

²⁷ <https://www.lexisnexis.co.uk/legal/legislation/uk-parliament-acts/insolvency-act-1986-c45#:~:text=An%20Act%20to%20consolidate%20the,two%20subject%20matters%2C%20including%20the>