

# The need for an Insolvency and Bankruptcy Fund



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*Insolvency and Bankruptcy Code, 2016 (IBC), since its inception, has a provision in Section 224 under Part V for constitution of the Insolvency and Bankruptcy Fund (I&B Fund). However, little progress has been made on this front in the past over eight years. The objective for creation of the said fund is to support the insolvency resolution, liquidation, and bankruptcy of individuals and businesses under the IBC. In the present article, the author analyses the relevance of this provision in strengthening the insolvency ecosystem in the country by empowering the insolvency professionals and rescuing them in situations of financial crisis such as interim finance, delays in payment of CIRP cost/ liquidation cost, audit costs prior to the Insolvency Commencement Date etc. **Read on to know more...***

## 1. Overview

Part V, Section 224 of the Insolvency and Bankruptcy Code, 2016 (IBC or the Code) provides for formation of a fund to be called the Insolvency and Bankruptcy Fund (I&B Fund). The objective for creation of the said fund is to support the insolvency resolution, liquidation, and bankruptcy of individuals and businesses under the IBC. The extant provision of Section 224 of the Code is as below:

### **224. Insolvency and Bankruptcy Fund. –**

- (1) *There shall be formed a Fund to be called the Insolvency and Bankruptcy Fund (hereafter in this section referred to as the “Fund”) for the purposes of insolvency resolution, liquidation and bankruptcy of persons under the Code.*
- (2) *There shall be credited to the Fund the following amounts, namely –*

- (a) *the grants made by the Central Government for the purposes of the Fund;*
  - (b) *the amount deposited by persons as contribution to the Fund;*
  - (c) *the amount received in the Fund from any other source; and*
  - (d) *the interest or other income received out of the investment made from the Fund.*
- (3) *A person who has contributed any amount to the Fund may, in the event of proceedings initiated in respect of such person under this Code before an Adjudicating Authority, make an application to such Adjudicating Authority for withdrawal of funds not exceeding the amount contributed by it, for making payment to workmen, protecting the assets of such persons, meeting the incidental cost during the proceedings or such purposes as may be prescribed.*
- (4) *The Central Government shall, by notification, appoint an administrator to administer the fund in such manner as may be prescribed.*

The word “prescribed” is defined under Section 3(26) of the Code as “prescribed” means prescribed by rules made by the Central Government. Till now the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 neither provides any information on the Insolvency and Bankruptcy Fund nor it is made operational.

## 2. Report by the Insolvency Law Committee

A high-powered committee called the Insolvency Law Committee (ILC) was constituted by the MCA on November 16, 2017 (reconstituted on March 06, 2019, as a Standing Committee) to make recommendations to the Government on issues arising from the implementation of the IBC, as well as on the recommendations received from its various stakeholders. The ILC has also delved into the issue of the I&B Fund, the brief view and findings of the ILC on the I&B Fund are stated below:

- (a) **First Insolvency Law Committee report dated March 26, 2018:** The Committee discussed that the I&B Fund has been created to allow provision of

additional funds in cases of insolvency when there are no assets for conduct of insolvency proceedings and for any other reasons mentioned in section 224(3) of the Code. Utilization and effective allocation of this fund may be developed over time.

(b) **Fifth Insolvency Law Committee report dated May 20, 2022:**

- (i) The I&B Fund must be used for the purposes of insolvency, liquidation and bankruptcy processes under the Code.
- (ii) The Committee noted that the current design of the IBC Fund does not incentivize contributions to I&B Fund and provides very limited ways of utilizing the amounts contributed. Firstly, a contribution to the I&B Fund is voluntary and may be made by the Central Government in the form of grants and by any person who voluntarily wants to make such a contribution. The Committee discussed that incentives may need to be built, or mandates may be required for contributions to the I&B Fund, as it may not be feasible to expect voluntary contributions otherwise. Secondly, the purposes for which the I&B Fund will be utilized are limited. Section 224(3) allows persons who have contributed to the Fund to withdraw it, to the extent of their contribution. (Para 2.98 of the ILC report dated 20th May 2022)

**“The 5<sup>th</sup> ILC recommended that the Government may consider building incentives or mandates in order to enable regular contributions to the I&B Fund.”**

- (iii) The Committee agreed that suitable amendments may be made to Section 224 to allow the Central Government to prescribe a detailed framework for contribution to and utilization of the IBC Fund. For this purpose, the Government may undertake a review of the design of funds in other statutes like the Investor Protection and Education Fund under Section 11(5) of the Securities and Exchange Board of India Act, 1992 and the Investor Education and Protection Fund under Section 125 of the CA, 2013. (Para 2.99 of the ILC report dated 20th May 2022)

(iv) The Government may consider building incentives or mandates in order to enable regular contributions. Sources for contributions to the I&B Fund may also be expanded. Additionally, the utilization of the I&B Fund may be bolstered, and wider uses may be identified. For instance, the I&B Fund may be used to meet the expenses of resource-strapped insolvency proceedings, including payment of workmen's dues, pursuing avoidance action proceedings, etc. *(Para 2.100 of the ILC report dated 20th May 2022)*

From the observations of the ILC, it is evident that ILC was aware of the challenges faced by the insolvency professionals in meeting the expenses of resource-strapped insolvency proceedings, hence it is critical that the I&B fund as envisaged under the Code is operationalized at the earliest.

The following issues need immediate consideration as per the observations of the 5<sup>th</sup> Insolvency Law Committee report:

- (a) Augmenting the sources of funds for contribution to I&B Fund
- (b) Detailed framework for utilizing the purposes for which the I&B Fund can be used.

### 3. Augmenting the sources of funds for contribution to I&B Fund

The following may be considered for augmenting the sources of funds for contribution to I&B Fund:

- (i) About 0.25% to 0.50% of the resolution plan amount may be contributed to the I&B Fund by the Successful Resolution Applicant (SRA). This step will create sufficient amount. This amendment may also entail amending Regulation 31A(1) of the CIRP Regulations which presently requires 0.25 per cent of the realizable value to creditors under the resolution plan approved under Section 31, to be paid to the IBBI. Under the present framework of Regulation 31A, the contribution to IBBI is a cost to creditors. Ideally this contribution should be a cost to the SRA which must go into the I&B Fund.
- (ii) About 0.25% to 0.50% of the sale proceeds under liquidation may be contributed by the successful bidder to the I&B Fund.

- (iii) The I&B Fund can also earn interest by contributing to interim finance during the CIRP process.

The above sources can contribute and create a significant corpus for the I&B Fund.

**“About 0.25% to 0.50% of the Resolution Plan amount may be contributed to the I&B Fund by the Successful Resolution Applicant (SRA).”**

### 4. Purposes for which the I&B Fund can be utilized

It is suggested that the I&B Fund should be utilized in a way which yields better outcomes from a Corporate Insolvency Resolution Process (CIRP) and liquidation processes, protects the interest of insolvency professionals (IPs) and the service providers engaged by the IPs during the CIRP/ liquidation process by assuring timely payment of their fees and expenses.

The following are the suggested purposes for which the I&B Fund may be utilized:

- (i) Payment of fees and expenses to the IPs where there are no assets with the Corporate Debtor (CD) or where there has been inordinate delay in payment of the same to the IPs.
- (ii) Interim finance for running the CD as a going concern.
- (iii) Litigation funding for CDs for realizing claims receivable by the CD.
- (iv) Any other funding towards a CIRP process which can enhance or maximize the resolution value from a CD.

### 5. Administration of I&B Fund

As per Section 224(4) of the Code, the Central Government shall, by notification, appoint an administrator to administer the I&B Fund in such manner as may be prescribed. It is suggested that a committee for the administration of the fund may be constituted. This committee must have fair representation from IPs to advise on the utilization of the fund based on the facts of each case.

## 6. The Need for an I&B Fund

IPs are one of the most important pillars of the IBC ecosystem, and the entire CIRP process revolves around resolution professional of the CD. Hence protecting the interest of IPs is of paramount importance to strengthen the IBC ecosystem. One of the biggest challenges faced by the IPs is the timely payment of the CIRP cost incurred by the IPs. Despite several amendments to the CIRP Regulations, the issue of timely payment of CIRP cost is yet to be addressed. It is felt that the creation of an I&B Fund can go a long way to alleviate some of the challenges faced by the IPs and to achieve better outcomes from a CIRP/ liquidation process as detailed below:

- (a) **CIRP process/ Liquidation process against a CD with no realizable assets:** There are multiple instances where the CIRP process has been initiated against a CD having no assets or the realisable value of its assets are nil. It is observed that in most of the said cases, the Committee of Creditors (CoC) is reluctant to fund the CIRP cost. A resolution of such cases is almost impossible and the CIRP cost & liquidation cost of such cases remain outstanding for payment due to resource crunch. It is imperative that the Code provides protection to IPs, i.e. the fees and cost incurred by IPs must be paid within a reasonable period. The I&B Fund can come to the rescue of the IPs under the said circumstances and the cost duly approved by the CoC/ SCC can be paid from the I&B Fund.

**“ The I&B Fund may be used to pay CoC/ SCC approved CIRP cost/ liquidation cost to IPs if the CD lacks resources. ”**

- (b) **Liquidation is completed, but liquidation orders are pending due to pending litigation/ investigations:** There are instances where the liquidators have duly completed the liquidation process and assets have been sold and proceeds have been distributed to the stakeholders as per Section 53 of the IBC. However, the liquidators have not been relieved from their duties due to pending investigations into the corporate debtor as a result of



which the winding up orders have not been passed by the Adjudicating Authority. In such circumstances the liquidators are compelled to carry on their responsibilities without any remuneration due to a resource crunch. The I&B Fund can come to the rescue of the liquidators under said circumstances and a certain minimum fee can be paid to the liquidators from the I&B Fund.

- (c) **When CoC is reluctant to fund certain critical costs necessary for a CIRP Process:**
- (i) It is often seen in the case of companies under CIRP that the accounts of the said companies are not updated to the Insolvency Commencement Date. It is therefore critical of the Resolution Professional to update the books of accounts of the CD under CIRP. However, the CoC are sometimes very reluctant to incur costs to be incurred towards updating the books of accounts for the period prior to the Insolvency Commencement Date. The I&B Fund can come to the rescue of the resolution professionals under said circumstances.
- (ii) A forensic/ transaction audit is to be conducted by the resolution professionals, however in some of the CIRPs, it has been observed that the CoC is reluctant to approve the cost to be incurred to carry out a forensic/ transaction audit. Without carrying out a forensic/ transaction audit, the application for PUF transactions cannot be filed by the Resolution Professional. Resolution professionals have onerous responsibilities with very little freedom to take independent decisions. The I&B Fund can come to the rescue of the resolution professionals under said circumstances.



(iii) **Statutory compliances to be done on behalf of the CD in compliance with Section 17(2)(e) of the Code:** There are several instances where the CoC does not approve the appointment of professionals to carry out statutory compliances to be done on behalf of the CD. Under such circumstances, the resolution professional finds it very difficult to carry out his statutory responsibilities without the support of professionals required to assist him in the process. The I&B Fund can come to the rescue of the resolution professionals under said circumstances.

(d) **Inordinate delay in funding the CIRP/ Liquidation cost by the CoC /SCC:** An inordinate delay in funding the CIRP cost by the CoC has had a significant impact on conduct of the CIRP process, the only option available with the Resolution Professional is to keep on persuading the CoC for timely payment with very little outcome or to file an application before the Adjudicating Authority seeking direction against the CoC for payment of CIRP cost. The I&B Fund can come to the rescue of the resolution professionals and bridge the gap for delay under said circumstances.

**“ In the case of inordinate delay in funding the CIRP/ Liquidation cost by the CoC /SCC, the I&B Fund can be utilized to bridge the gap for delay. ”**

It is also commonly noticed that, where there are multiple financial creditors in a CIRP process, it is observed that a few of the financial creditors don't contribute to the CIRP cost thereby jeopardizing the CIRP process. The I&B Fund can come to the rescue of the resolution professionals under said circumstances.

(e) **Stay granted by a higher court to the CIRP process:** In several CIRP cases post initiation of CIRP, stay is granted by a higher court like NCLAT/ Supreme Court. Post stay of the CIRP process, it is normally observed that the CoC stops payment of CIRP cost and fees to the Resolution Professional during the period of stay. It is significant to note that

the duties of the RP are not paused during the period of stay by a higher court. It therefore becomes very onerous for the resolution professionals to carry out their duties without the necessary resources. The I&B Fund can come to the rescue of the resolution professionals under said circumstances.

(f) **Judicial delays in disposal of applications pending before the adjudicating authorities:** There are significant delays in disposal of applications filed by the resolution professionals or other stakeholders in the process by the Adjudicating Authorities. The I&B Fund can come to the rescue of the resolution professionals under said circumstances.

(g) **Fees payable to the resolution professionals for conducting the Personal Insolvency Resolution Process (PIRP) under Part-III of the IBC:**

(i) Under Part-III of the IBC, the IPs are required to act as resolution professionals for the Insolvency Resolution Process of Personal Guarantors to the corporate debtors (“PIRP process”).

The resolution professional is appointed by the Adjudicating Authority under Section 97 of the IBC and immediately after his appointment the resolution professional is mandated to issue a report within 10 days of his appointment under Section 99 either recommending for approval or rejection of the application filed under Section 94 or 95 of the Code. However, there is no provision enshrined under the Code and Regulations framed thereunder with respect to the fees payable to the resolution professional for issuing the said report under Section 99. Resolution professionals are required to file the said report under Section 99 by way of an interlocutory application before the Adjudicating Authority. This normally requires the resolution professionals to engage a legal counsel. The lack of clarity for payment of fees and cost incurred by the resolution professionals during the process of PIRP has created immense difficulties for the resolution professionals. The I&B Fund can come to the rescue of the resolution professionals under the circumstances where the resolution professional is unable to realize his fees and costs.

(ii) The application for a PIRP process under Part-III of the Code is admitted or rejected by the Adjudicating Authority under Section 100 of the Code. Prior to the process of admission or rejection of the application for PIRP, there are multiple hearings before the Adjudicating Authority. In several instances, the applications are settled between the creditor and debtor and as a result the PIRP gets terminated on their settlement. Under the said circumstances, there is a lack of clarity in the Code and Regulations framed thereunder on who shall fund the fees and costs incurred by the resolution professionals. There are several instances where the resolution professionals have not been paid any fees and have paid the cost incurred by them from their own pocket. The I&B Fund can come to the rescue of the resolution professionals under the circumstances where the resolution professional is unable to realize his fees and costs.

With amendments to the IBC and Regulations framed thereunder, some of the expenses as stated above can gradually be managed with the use of an I&B Fund.

**“The I&B Fund can play a big role in achieving better outcomes from a CIRP and a liquidation process.”**

## 7. Conclusion

With the experience gained during the last eight years of the implementation of the IBC, there are sufficient reasons for operationalizing the I&B Fund as enshrined under Part V, Section 224 of the Code. Effective implementation of the I&B Fund can alleviate several challenges faced by IPs. The I&B Fund can play a big role in achieving better outcomes from a CIRP and a liquidation process.

