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Designing a Personal Insolvency Regime
A Baseline Framework

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In December 2019, the Insolvency and Bankruptcy Board of India (IBBI) notified provisions for personal insolvencies under the Insolvency and Bankruptcy Code,2016 (Code) for personal guarantors (PGs) to corporate debtors (CDs). The IBBI has released regulations for cases involving guarantors and has indicated that it is moving toward notification of the provisions for other personal debtors.[1] As of now, it appears that a small number of applications have been filed under these provisions but none have yet been admitted. It is not clear if the financial and economic effects of the COVID-19 pandemic will accelerate or decelerate progress toward notifying the IBC for other personal debtors. It is certainly possible, however, that the current crisis will hasten notification, and therefore it is particularly important for scholars and policymakers to address some critical questions of policy and design that the Code and the current regulations leave open. This essay identifies one of the most critical questions about the personal insolvency regime that still needs to be fully specified – the design of debtors' repayment plans – and argues for some baseline standardisation.

The Code includes three general chapters or pathways for personal debtors: fresh start, insolvency, and bankruptcy. The Code's fresh start process is available for debtors with very modest financial profiles who are 'unable to pay [their] debt;' who do not have more than Rs. 60,000 in annual income, Rs. 20,000 in assets, Rs. 35,000 in qualifying debts; and who do not own a dwelling unit. It does not provide for any distribution to creditors. The Code's insolvency regime requires debtors to propose and complete a repayment plan. Eligibility for insolvency extends to debtors who have defaulted on debt of at least Rs. 1,000 and who are not otherwise eligible for the fresh start process. Bankruptcy, which provides a discharge of many unsecured debts in exchange for any non-exempt assets the debtor has, is only available if a debtor's insolvency case fails or when a debtor's repayment plan ends before completion. This article only addresses the insolvency pathway, which is presumably the first-order chapter for most debtors who are likely to utilise the system.

While the Code sets out the broad framework of the personal insolvency regime, it is still unclear whether there will be limits, requirements, or guidance, for various aspects of repayment plans. The Code itself only requires that the plan must provide a justification for the plan and state any fee given under the plan to a resolution professional (RP). The regulations for personal guarantors mandate that repayment plans set forth a budget that provides for a debtor's 'reasonable expenses' and give at least 10 percent of the debtor's income to creditors. The Code appears to envision that other unspecified aspects of plans will be subject to debtors' proposals and negotiations with creditors.

In this article, we proposed that repayment plans and other aspects of the insolvency process should be standardised enough to ensure a baseline treatment of both debtors and creditors, subject to some flexibility for unique or exceptional circumstances. While a generally negotiated process may be appropriate for commercial debtors under the Code, we believe that the process for personal debtors should be significantly more rule bound. This is consistent with global trends in insolvency and bankruptcy law and is driven by our recognition of some structural differences between personal and commercial debtors and our concerns about institutional capacity, predictability, and fairness.

Unlike regimes for commercial debtors, personal insolvency and bankruptcy regimes serve a crucial social insurance function and directly impact the well-being of individuals and their households. And often the amount of money at stake for creditors in any particular case is not enough to motivate attentive engagement. Both of these structural differences between personal and commercial debtors provide good reasons to specify basic aspects of the personal insolvency process. In terms of institutional capacity, as we explain in more detail below, we seriously doubt that the system of Debt Recovery Tribunals (DRTs) and RPs can effectively tailor outcomes for the number of cases that will likely be admitted if even a small percentage of eligible debtors end up in the system. We are also concerned about the ability of the Board to effectively monitor the performance of RPs throughout a system that relies heavily on their coordination of a negotiated process. Furthermore, even if the system could feasibly tailor outcomes, the *ad hoc* nature of that approach would not likely ensure fair or equal treatment of similarly situated debtors and creditors. Any of these factors could threaten the effectiveness, predictability, and perceived legitimacy of the system and prove unsettling to developing credit markets.

This article focuses on five aspects of repayment plans that we believe are the most important to regulate or standardise: the amount of income that debtors are expected to repay during the plan period; the amount and types of assets that debtors are expected to relinquish; the duration of repayment plans; the treatment of secured claims under the plans; and the amount of debt that is to be discharged under plans. Specifying a baseline approach to each of these aspects of repayment plans can be done through formal regulation by the Board or through the promulgation of a model plan or protocol by the IBBI.[2]

We further propose that, if an approach to those aspects of plans can be adopted, the system might also dispense with the need for creditors to vote to approve plans, except perhaps to approve plans with more generous relief to debtors. This would presumably require an amendment of the Code. Finally, we propose that the Board or the Tribunals adopt an approach to 'fast-track' debtors to bankruptcy who cannot repay any significant amount in insolvency.

This article describes basic global trends in personal insolvency and bankruptcy law, which reflect the various aims of these systems, and situates the fundamental design choices of the Code in relation to these trends. It then analyses some of the critical features of repayment plans under the Code, explains and justifies the proposal for standardisation of each, and explains the rationales for reducing creditors' role in the process and for adopting a fast track to bankruptcy for some debtors. It is important to acknowledge that many personal insolvencies in India will inevitably be related to failures of medium and small businesses owned by the insolvent debtors. It is entirely possible that the personal or corporate insolvency provisions of the Code might be reformed to deal with the hybrid nature of small business failures. This thorny set of policy questions is beyond the scope of this article. Rather, it evaluates design options for purely personal insolvencies, recognising that these might be adjusted to account for the role of the personal insolvency system for MSME's in the future.

THE CODE'S PERSONAL INSOLVENCY REGIME IN GLOBAL CONTEXT

Global Trends

A personal insolvency or bankruptcy regime can serve different and, ideally, related functions. Most generally, such a regime provides for the repayment and/or discharge of debt owed by an individual or household to their various creditors. In some circumstances, it can help creditors recover a greater portion of debts owed by individuals and households than they would absent the regime, or, more commonly, make any recoveries more predictable and timelier. It can also provide debtors with temporary protection from debt collection and some degree of debt relief. In many jurisdictions, this protection and relief for debtors predominates, with the policy aim of reducing the social costs of financial distress and to restore debtors to economic productivity. By allocating losses *ex post*, an insolvency or bankruptcy regime may influence private decisions about lending and borrowing *ex ante*.

In describing global trends in personal insolvency and bankruptcy law, this article draws heavily on the World Bank's 2014 Report on the Treatment of the Insolvency of Natural Persons.[3] As the World Bank Report describes in great detail, most jurisdictions with personal insolvency or bankruptcy regimes have adopted some combination of two different approaches: repayment from future income over time or liquidation of the debtor's non-exempt assets, often described as straight bankruptcy. Unsecured obligations are paid from available income and/or assets; and, generally, at least some of the remaining unpaid debts are discharged. While most countries have court- or tribunal-based systems, *'[p]ublic agencies play a significant role in several countries.'* [4]

Most insolvency and bankruptcy systems have basic threshold eligibility requirements that generally aim to limit access to the system to those debtors who are in acute or protracted financial distress. Such eligibility requirements include "a minimum level of debt; a future oriented test of 'permanent insolvency'; 'good faith'; or a requirement that debts are caused by events beyond a debtor's control such as illness or unemployment."[5] Some systems also require that debtors seek financial counseling or attempt to negotiate with creditors to be eligible for insolvency or bankruptcy relief. As a practical matter, access to personal insolvency or bankruptcy is often also affected by threshold costs of the process itself, including administrative fees, fees to professionals, and direct costs of gathering necessary information and documents.

Some insolvency and bankruptcy systems allow both creditors and debtors to initiate cases for debtors, while other systems only allow debtors to initiate cases. This is a potentially significant difference. As the World Bank Report notes,

> [A]lmost all countries that have introduced distinct systems of insolvency of natural persons in recent decades only accept filings by debtors for admission into these proceedings. [C]reditors' insolvency petitions against individual debtors are uncommon even in most of the countries where such petitions are possible. There are some systems, however, where personal bankruptcy is used as a threat in the collection efforts of creditors, and the threat is more intense where the stigma attached to bankruptcy is greater.[6]

Debates over the scope of eligibility and relief available to debtors in insolvency or bankruptcy often revolve around concerns about moral hazard or outright abuse. It turns out that there is little evidence of such moral hazard, even in regimes with generous relief and relatively easy eligibility.[7] Potential moral hazard is offset by a combination of social factors, the direct costs of obtaining relief, and limits on subsequent access to the system. Debtor abuse is addressed in some regimes by investigations of information provided by debtors, substantive limits on relief based on debtor behavior before or after seeking relief, auditing and sanctions during the pendency of cases, or some combination of these approaches.

Some jurisdictions allow or require debtors to select among different types of legal pathways or substantive frameworks. In such systems, professional intermediaries generally play a crucial role in helping debtors make this choice, and this role can create potential conflicts for those professionals if they stand to earn more under one option than another. Some of these intermediaries are official actors, while others are independent and selected by private parties. Many regimes, however, do not let debtors choose among options but pre-determine what process, or sequence of processes, is available to debtors. The most common approach among jurisdictions is some combination of repayment and liquidation regimes that requires debtors to give creditors a portion of their future income as well as some portion of their existing non-exempt assets.

Basic Design of the Code

Personal insolvency and bankruptcy were not a primary focus of policymakers who drafted and enacted the Code, and they have received significantly less public attention than the provisions for commercial debtors. Regarding personal insolvency and bankruptcy, the Code opts for an approach that combines a repayment plan regime with a straight bankruptcy one, but debtors do not choose between them. Rather, they must try the repayment option first. As noted above, eligibility for insolvency extends to debtors who have defaulted on debt of at least Rs. 1,000 and who are not otherwise eligible for the fresh start process.

Contrary to global trends noted above, the Code allows both debtors and creditors to initiate a personal insolvency. Whoever files can select an RP, who serves various important functions in any case. For example, the RP is charged with assisting debtors in preparing and submitting their repayment plans. Their creditors then vote to approve or reject the plan or modify it with the debtor's consent. Approval of a repayment plan by creditors requires the vote of more than three-fourths of the value of the claims of creditors. The RP thereafter implements the plan and applies for the debtor's discharge at the appropriate time. Some additional aspects of the regime have been set forth in regulations and draft regulations. Other aspects remain unspecified, including whether and how creditors' claims will be verified, what income a debtor may keep under a plan, and the precise scope of some excluded assets.

STANDARDISING REPAYMENT PLANS AND MANAGING IMPERFECT INFORMATION

The default approach of Code's personal insolvency regime is to leave the contents of repayment plans that are not specified by the Code itself or regulation to negotiation between debtors and their creditors. The Code presumably gives the Tribunals authority to review plans for compliance with the relevant rules and regulations, but it is uncertain whether Tribunals have authority to review the terms of repayment plans and police for any egregious substantive unfairness to debtors or dissenting creditors.[8]

The Code's personal insolvency regime will apply to hundreds of millions of individuals. The DRTs that are the adjudicating authorities for the regime are already taxed with their caseloads. Even if rates of utilization of the Code are low, the absolute numbers could quickly and easily overwhelm the existing capacity of the Tribunals.[9] And even if the capacity of the Tribunals increases, anything that streamlines the process of cases they must adjudicate will likely help improve the timeliness and effectiveness of the regime.

Debtors' rates of literacy, social views of indebtedness and government assistance, as well as practical challenges for citizens in navigating physical distances may also pose fundamental challenges to the operation of the regime. Added to which, the availability of relevant information about debtors' personal and financial affairs and creditors' claims will be imperfect at best.

In additional to these concerns about institutional capacity, it is important to consider the likely motivations and incentives of debtors and creditors who might use the system. Around the globe, significant numbers of debtors in most regimes do not actually distribute payments to unsecured creditors because they have no surplus income under the applicable framework, and most debtors would not have meaningful surplus income under modestly more restrictive approaches. Furthermore, repayment plans have nearly universally low rates of completion. Among other things, this suggests that many creditors will have little or no motivation to invest time or attention in particular personal insolvency cases.

On the debtor side, unless the system is simply going to operate as a threat that creditors can employ to collect from debtors outside of the system, a regime that requires payments over a period of time must inevitably adopt a balance between austerity and generosity. This balance is necessary to increase the likelihood that repayment plans will not end in failure, to encourage debtors to voluntarily utilise the system when they really need to, and to maintain the perceived legitimacy of and public support for the regime.

With the foregoing factors in mind, the key design challenges for the regime are to steer those debtors who can plausibly repay some amount over the life of a plan into the system, to steer other debtors away from it, and to provide for plans that give debtors a feasible chance to complete them. To do so, it is necessary to determine how much debtors must repay, which is a function of the amount of future income that debtors are allowed to keep, the duration of plans, the treatment of secured creditors, and the amount of debtor's assets that are exempt.

We believe that the core terms of repayment plans should be specified by the Board either in rules and regulations or through a model plan or protocol. A baseline degree of specificity will improve predictability and fairness of the system for both debtors and creditors. To begin with, this will help parties decide whether to employ the system to begin with. It will also reduce potentially significant transaction costs of negotiations and institutional and supervisory costs for judicial officers, RPs, and the Board. We appreciate that specifying rules could lead to ossification or could be over- or under-inclusive in particular cases. Yet such rules could provide for some degree of flexibility to address the unique or exceptional circumstances of particular debtors where appropriate. We acknowledge and anticipate that some routine practice among repeat players in the system would likely emerge in the absence of institutional specification to reduce costs and unpredictability to some extent. But we are concerned that such a process of organic standardization may not be an efficient or reliable pathway to predictability or fairness. This Part also proposes a liberal approach to the treatment of information provided by the parties. All of these proposals are generally consistent with global trends in personal insolvency and bankruptcy. The sections below provide a dynamic menu of institutional approaches to various aspects of repayment plan regimes in other jurisdictions as well as approaches to verifying creditors' claims and supervising the plans.

Available income, budget

Determining how much a debtor should be required to pay creditors over the life of a repayment plan is probably the most significant question for policymakers designing such a regime. This question often depends on how much income debtors are allowed to retain for their reasonable or necessary expenses, which inevitably raises fraught questions of fairness and about what constitutes adequate baseline support for individuals and families.

Not surprisingly, there are various approaches for determining how much income a debtor should be able to retain for personal and family requirements over the life of a plan. Some regimes employ a relatively fixed standard amount, often relying on general rules that limit the amount that creditors can garnish wages outside of the insolvency or bankruptcy system. Others provide a rule-based scheme for determining necessary expenses that depend on a debtor's specific circumstances. Still others provide for a relatively discretionary determination of expenses by an authorized decision-maker, often a judicial officer. According to the World Bank Report,

> One lesson that seems to have emerged most clearly from the last three decades of experience is that a flexible, discretionary approach, while theoretically attractive, is practically quite problematic.[10]

Such an approach leaves the system susceptible to errors in both directions, either allocating more or less income to debtors than they truly need for basic expenses. Allocating less than necessary appears to be a much more common, and is certainly a more consequential, error. The report observes that,

> [m]any examples of constructing a basic consumer budget … are available to policymakers interested in developing a sensitive and livable approach to payment plans.[11]

Most jurisdictions set a pre-determined amount of income that the debtor must pay to creditors periodically over the life of a plan, while other jurisdictions require payments to creditors based on the actual income per payment period. A flexible approach may be better matched to a debtor's actual circumstances, but it may also entail greater costs in monitoring and supervision. It may also have a negative effect on a debtor's motivation to earn more income during the term of a repayment plan. Regimes that do not adopt a flexible approach nonetheless often allow modification of repayment plans if a debtor's circumstance changes significantly. But this imposes monitoring and administrative costs on debtors and creditors alike.

In addition to differences in the process of determining how much debtors should repay in their plans, systems differ in the degree of austerity they expect from debtors. Systems that err on the side of more austerity may make too many debtors reluctant to seek relief when it is needed. They may also increase the number of plans that fail before completion and impose additional stress on debtors without significantly increasing the amount of distributions to creditors. Systems that require less austerity may generate moral hazard, although, again, there is little evidence of personal insolvency or bankruptcy regimes actually creating moral hazard.

The regulations for personal guarantors promulgated by the Board provide that repayment plans must provide for

> a minimum budget for the duration of the repayment plan, to cover the reasonable expenses of the guarantor and members of his immediate family to the extent they are dependent on him, provided that at least ten percent of the realisable income of the guarantor shall be utilised for repayment of debts.[12]

We applaud the specification of a concrete minimum requirement, but this regulation still leaves a significant amount of room for heterogeneous approaches and uncertainty. It appears to require a unique determination of reasonable expenses and a debtor's budget in each case, which might yield a debtor's allowed budget to be anything between ten percent of income and all disposable income. If guidance is not forthcoming, this approach would likely impose costs of tailoring and negotiation between debtors, creditors, and RP in every case.

We believe it would preferable for policymakers to adopt a semi-mandatory framework for determining debtors' budgets in repayment plans. Experience in other jurisdictions has shown that such a framework could yet include some limited flexibility. Some jurisdictions, for example, have established formulae for attributing budgets to debtors based on factors like family size and homeownership, all of which can be adjusted by region. This imposes some predictability and rough equality of treatment. Tribunals could be authorized to consider deviations from the framework if the amount generated by the formula turned out to be more or less than would be reasonable in a particular case. This approach could be adopted by regulation or by the Tribunals and should not require a formal amendment to the Code.

We are also concerned that in many cases, the amount necessary for reasonable expenses will be more than ninety percent of a debtor's income, in which case the debtor would not be able to propose a feasible repayment plan. This minimum requirement may not be suitable for the general population of personal debtors, who are much less likely than personal guarantors to have meaningful amounts of disposable income. These concerns would be assuaged if debtors who do not have enough disposable income to pay ten percent to creditors are thereby eligible for bankruptcy, as we discuss in more detail below.

Assets, exemptions

Rules that exempt assets from creditors' recoveries are central components of both 'straight bankruptcy' regimes and for repayment regimes that require debtors to offer creditors both future income and existing assets. Common examples of such exemptions include homes, cars, basic household goods, pensions, and property used in a debtor's trade. The scope of these exemptions is also relevant.

> Historically, most systems set exempt property levels at very low levels .... There is a growing trend to liberalize property exemptions. When countries modernize their property exemptions, they generally increase the levels and scope of exempt property.[13]

In most jurisdictions, exemptions are 'waivable' to the extent that creditors can generally enforce secured claims against exempt property, although some jurisdictions provide that security interests in basic necessities are not enforceable. There is a variety of approaches to determining what property is subject to exemption, but almost all require valuing property that might be exempt. And valuation is itself time-consuming and imposes some costs on stakeholders and on the system. Thus, for example, raising levels of exemptions has the collateral effect of reducing the likelihood of uncertainty about whether particular assets are exempt, in turn eliminating the cost and burden of determining value.

Regarding assets, the Board's regulations for personal guarantors only provide that a repayment plan '*must provide the details of excluded assets … of the guarantor*' and '*may provide for the … transfer or sale of all or part of the assets of the guarantor.*'[14] Taken together, these provisions appear to envision that that repayment plans will not include exempt assets and may provide for the liquidation of all non-exempt assets. But somewhat confusingly, the regulations do not expressly state that non-exempt assets cannot be included in a plan. Nor do they require that debtors must relinquish all of their non-exempt assets, suggesting that debtors might propose to keep some non-exempt assets under a repayment plan.

We propose, first, that the Board clarify both that excluded assets cannot be included in a plan. We also propose that the Board should specify an amount of non-exempt assets to be liquidated under a plan, perhaps all non-exempt assets or a set percentage of the debtors' indebtedness. If a standardised approach to assets and income is not adopted, it will be necessary to rely on ad hoc tailoring and negotiation between debtors, creditors, and the RP in every case. The easiest approach to administer would be to provide that debtors include all non-exempt assets in their plans. Yet, depending on the austerity of debtors' budgets and the scope of exempt assets, this approach may significantly reduce the amount of debt relief available to some debtors, which may cause those debtors to avoid the system when it would be broadly efficient for them to employ it.

Regarding debtors' non-exempt assets, much will depend on definitions of those exemptions. As with the income and budgets allowed to debtors, if exemptions are too austere, then debtors will be reluctant to seek relief when it is needed, and there will be a greater likelihood that approved repayment plans will end in failure. Furthermore, if exemptions require careful and elaborate valuations, then the time and cost of valuation itself can eat away at whatever recovery creditors might otherwise enjoy and limit the benefits of relief to debtors. This suggests that, where feasible, policymakers consider exempting categories of assets rather than an amount of value thereof. Where that is not feasible, policymakers might set the exempt value high enough so that most assets that fall within the relevant categories are obviously within the limit and do not require valuation.

The Code provides that excluded assets include:

> (a) unencumbered tools, books, vehicles and other equipment as are necessary to the debtor or bankrupt for his personal use or for the purpose of his employment, business or vocation; (b) unencumbered furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankrupt and his immediate family; (c) any unencumbered personal ornaments of such value, as may be prescribed, of the debtor or his immediate family which cannot be parted with, in accordance with religious usage; (d) any unencumbered life insurance policy or pension plan taken in the name of debtor or his immediate family; and (e) an unencumbered single dwelling unit owned by the debtor of such value as may be prescribed....[15]

The Central Government has also promulgated Rules[16] regarding these definitions specifying that the limit for the exemption for unencumbered personal ornaments is Rs. one lakh and that the limit on the exemption for dwelling units in urban areas is Rs. 20 lakh and for dwelling units in rural areas is Rs. 10 lakh.

We applaud the specification of the amount of value of homes and jewelry that are exempt from creditors' recoveries. But for two reasons, we are concerned that the limits may be set too low, especially for debtors other than personal guarantors. First, it is possible that these amounts are simply too austere, which might discourage debtors from using the insolvency system or might cause repayment plans to fail. Second, if the limits are somewhat higher, they may require valuation of assets less frequently. We encourage the Board to reevaluate these limits for personal guarantors regularly and to consider adopting higher limits for other debtors if the personal insolvency provisions are notified for them. For these same reasons, we do not believe the Board should adopt limits on the value of tools of the trade and household items that are exempt. Instead, the Board might consider specifying certain household and trade-related items that are exempt or adopting broad definitions for each that are designed to avoid the need for valuation.

Duration

For repayment plan regimes, an obviously crucial policy choice is how long to make the period of repayment, and yet this is a highly under-theorised and under-examined issue. There are two basic approaches among jurisdictions in this regard: first, to set one or more particular time periods in the law or rules of the regime or, second, to allow stakeholders, administrative officials, or judges to determine the length of individual debtors' plans. For jurisdictions that adopt a rule on duration, there is general tendency to opt for three to five years, tending toward five. The World Bank Report observes that *'existing evidence and widespread anecdotal reporting … consistently indicate an inverse relationship between plan length and plan success.'* [17]

We believe that it will be important for India's personal insolvency system to adopt a common duration for repayment plans one way or another. This might be done by regulation, by the Tribunals, or by parties through conventions in practice. If the Board does not adopt a standard duration for repayment plans, however, then even if a standard duration is settled upon by Tribunals or the parties, that will require an unnecessary period of uncertainty and unpredictability.

Assuming that a standard duration is adopted, three to five years seems like a sensible range for a standard given the clear trend in global practice to specify a term for repayment plans within that range. As the duration of plans tends to be directly related to the rate of plan failures around the globe, a duration on the shorter end of that range may be advisable.

Treatment of secured creditors

Insolvency and bankruptcy regimes for both consumer and corporate debtors generally respect the rights of secured creditors, reflecting a widely-shared view of the financial and economic importance of secured lending both as a source of credit and an important stabilizing facet of the banking system. That said, many jurisdictions do provide for some involuntary adjustments to rights of secured creditors, such as staying foreclosure or repossession and allowing debtors to cure defaults, alter maturities, adjust the amount of secured claim, and override some security arrangements altogether, especially in the case of claims secured by basic necessities. In the recent global financial crisis, policymakers around the globe came to appreciate the potentially systemic utility of a regime that allows for adjusting secured claims to expeditiously allocate losses in a crisis situation.

The Code does not specify much about the treatment of secured creditors in personal insolvency cases. Presumably, secured creditors are stayed from enforcing their security during the moratoria that apply upon an insolvency application and admission of the application and last until the Tribunal approves a repayment plan.[18] It also appears that a creditor's secured claim is limited to the value of the collateral.[19] Secured creditors can choose to retain their right to enforce their secured claims during the repayment plan period or to participate in the voting on the repayment plan.[20] This appears to mean that if secured creditors do not participate in voting, then their claims are not adjusted at all; and if secured creditors do participate in voting, then there is no formal limit on treatment of such claims.

We are concerned that this arrangement will lead to significant unpredictability about the treatment of secured claims in particular cases and across the system. Currently, most formal consumer debt in India is secured. For debtors, the amount of claims, payment terms, and interest rates for secured claims will, in the short run, often be the most consequential aspects of their repayment plans; the need to adjust these aspects of such claims may be a primary reason for seeking relief or a primary barrier to successful financial recovery. While, in most cases, secured creditors may be able to control the outcome of voting among creditors, this may not always be the case. And in many cases, the costs of negotiating among creditors regarding the treatment of secured claims may be more than the overall value of the repayment plan to creditors. Finally, for secured creditors and markets for secured credit, uncertainty about the treatment of secured claims may have a more unsettling effect than certainty about a reasonable amount of adjustment of claims. We therefore propose that the Board consider adopting a standard framework for determining the amount of secured claims, the rate of interest allowed on those claims, the rights of debtors to cure defaults or missed payments over the life of a plan, and other similar matters.

Discharge of unsecured debt

A key feature of most consumer insolvency and bankruptcy regimes is the discharge of at least some unsecured debt. It is the primary way that these regimes reduce the personal and social costs of financial distress and aim to motivate debtors to return to economic productivity. The availability of discharge is limited in various ways under regimes around the globe. Most exclude certain types of debts from discharge, especially debt owed to the government or for family support and maintenance. Regimes that require debtors to submit repayment plans generally limit the availability of a discharge to those debtors who complete their plans, and some straight bankruptcy regimes require a minimum payment amount to obtain a discharge. In many regimes, discharge of debt is also premised on a debtor's good faith in incurring debts and in performing obligations under the insolvency or bankruptcy regime. Some jurisdictions allow debtors to voluntarily agree to pay discharged debts, but those jurisdictions tend to police such agreements for egregious terms or uninformed bargaining.

The Code provides that some debts are non-dischargeable, including court-ordered fines or damages, maintenance obligations, and student loans.[21] Beyond that, it does not specify that all dischargeable debts that are unpaid under a repayment plan will be discharged at the end of the plan; rather it appears to leave open the possibility that a plan could provide that some or all dischargeable debts that are not paid in full under a plan are not discharged. We believe that it is important for the Board to clarify that this is not permissible, and that dischargeable debts not repaid under a plan are discharged. Otherwise, a primary benefit of insolvency relief will be denied to debtors, which may discourage many from seeking relief or may undermine an underlying rationale of the regime. The government has the ability to specify additional categories of non-dischargeable debts if that is desirable. Furthermore, we propose that policymakers consider creating a formal and monitored process by which debtors can voluntarily agree to reaffirm discharge debts if they believe it is in their best interest to do so. That may require an amendment to the Code.

In the short term, because most debt owed to financial institutions in India is secured, this may seem like a minor issue. Yet the insolvency process will affect 'informal' debts, and the amount of institutional unsecured debt in India is growing. It is important for the development of unsecured consumer credit markets that the treatment of such claims in the insolvency and bankruptcy system is predictable. Expanding the availability of formal debt relief may seem antithetical to the growth of credit markets, but the availability of debt relief for individuals under insolvency and bankruptcy laws has, around the globe, expanded along with developing consumer credit markets. For one thing, individuals who qualify for such relief generally would not be able to repay much more, if any, outside of the regime. And secondly, the insurance effect of a reliable debt relief regime may make some debtors more willing to borrow in the first place, expanding demand. And once again, the potential moral hazard of making debt relief available and somewhat more generous is offset by many factors working against such hazard, including stigma.

Information veracity

Historically, many jurisdictions have provided a mechanism for verifying creditors' claims against debtors in their insolvency or bankruptcy system. It appears that the contemporary trend is away from this, instead relying on the submission of information by private stakeholders, allowing other parties to challenge the information provided by others, and imposing a variety of consequences and sanctions for providing inaccurate information.

As noted above, there are reasons to anticipate pervasive problems in ensuring the accuracy of information provided by all private stakeholders in India's personal insolvency system. Yet the costs of systematically addressing this problem will be large, especially compared to the value at stake in the discrepancies. Given that the accuracy of debtors' income disclosures will often be difficult to verify, a system that requires threshold verification will be relatively costly to employ effectively. The error costs (up and down) of relying on debtors' disclosures and putting the burden on creditors to challenge debtors' assertions may be lower than the costs of up-front verification or of requiring creditors or IPs to monitor debtors' actual income. If creditors are allowed to challenge information provided by their debtors, and if there are meaningful sanctions for deliberate – and perhaps negligent – errors, these error costs can be limited even further. Allowing for modifications to the terms of repayment plans in exceptional cases can further reduce the relative costs of a backward-looking approach.

A similar approach could be adopted for creditors' claims – i.e., that they not require threshold verification but can be challenged by debtors or other stakeholders. The regulations for personal insolvencies involving guarantors require creditors to provide some proof of their claims, *'on the basis of … records available in an information utility, or …any other documentary evidence which substantiates the existence of claim.'* [22] RPs are charged with verifying these claims and can make estimates; they are also authorized to request additional information or clarification.[23] We propose that the Board or RPs should specify these requirements somewhat further. They could clarify, for example, whether certain types of claims must be submitted with written documentation. Requiring that certain types of claims be submitted with written documentation might have the beneficial effect of motivating creditors to adopt written agreements where they are currently not doing so. For claims not required to be submitted with written documentation, policymakers might take a liberal approach to creditor claims, allowing them subject to objection by the debtor or some other party with an interest in the case.

In addition to reducing administrative costs, we believe that this approach would enhance the potentially beneficial role of information utilities, perhaps increasing pressure for the development of such entities.

RECONSIDERING CREDITORS' ROLE AND THE PATHWAY TO BANKRUPTCY

Who decides?

If policymakers specify baseline requirements for personal debtors' repayments plans under the Code, there would then be good reasons to consider reforming the role of creditors in the personal insolvency process, perhaps eliminating the requirement of their approval. While some jurisdictions do require that creditors vote to approve a debtor's repayment plan, in most jurisdictions the terms of repayment plans, including what assets and income the debtor must give to creditors and what the debtor may keep for basic maintenance, are determined by courts or administrators or proposed by debtors pursuant to legal rules. Among other reasons for this, as noted above, creditors tend to recover little or nothing from most consumer insolvency or bankruptcy cases, so they have limited general motivation to participate in the process. In some jurisdictions that require a vote by creditors, some of those also provide that debtors can proceed to a straight bankruptcy if their plans are not accepted, perhaps increasing creditors' motivation to approve the plans. In some systems that provide a state-determined repayment and discharge plan, a majority of creditors can agree to accept a debtor's alternative offer, binding the minority of creditors.

Eliminating the requirement that creditors have to vote to approve debtors' repayment plans would reduce the costs, delays, and uncertainty of debtors' insolvencies. If so, the reduction of administrative costs and delays could, alone, increase the amount and/or likelihood of creditors' recoveries, and it may reduce the chances that creditors will use their leverage to require onerous plans or discourage debtors from employing the system. If plans are subject to relatively clear rules and guidelines, as suggested above, there would be little left for negotiation between a debtor and his or her creditors to begin with. Perhaps a vote of creditors' vote might be utilised to allow creditors to approve plans that are more generous than the rules envision, i.e., to essentially allow creditors to waive their rights when a super-majority believes it is in their interest to do so. Given that debtors will be eligible for potentially far-reaching relief in bankruptcy if their plans fail, it may often be in creditors' individual and collective interest to do this.

Fast-tracking some debtors to bankruptcy

There are good reasons, based largely on experience in other jurisdictions, to believe that many individual debtors in India who would benefit from debt relief or who will enter the insolvency and bankruptcy system involuntarily will not have the capacity to repay anything to their unsecured creditors. For such debtors, the requirement of attempting a repayment plan in an insolvency proceeding will be an unnecessarily costly detour for all affected parties. This may justify providing a pathway by which debtors who are not eligible for a fresh start and who can show that they would not repay much or anything under a repayment plan could skip the insolvency process and go directly to bankruptcy.

We propose that the IBBI or the Tribunals establish a standard process for identifying debtors who are unlikely to be able to make any significant payments to creditors in an insolvency proceeding. These debtors could then be made immediately eligible for bankruptcy. If standard criteria for repayment plans are adopted, then it should be relatively straightforward to identify debtors who do not have meaningful amounts of non-exempt assets or income beyond what is necessary for their budgets. If so, then it would also be relatively easy to identify in advance which debtors are better candidates for bankruptcy than insolvency.

CONCLUSION

We assume that the goals of the personal insolvency system under the Code are to steer debtors into insolvency who can repay some meaningful amount of their obligations, to maximise the amount debtors can actually repay, and to make outcomes as predictable as possible for all parties involved. We propose that, to advance these goals, policymakers should specify significant aspects of the structure and content of repayment plans and that such specifications should be aimed at reducing the need for administrative functions and the impact of information constraints. Specifically, we propose that policymakers develop a baseline framework for repayment plans with regard to debtors' budgets; duration; the amount of non-exempt assets that are to be available to creditors; the treatment of secured claims; and the treatment of dischargeable debts. We also propose that, to avoid administrative costs of verification, information about creditors' claims and debtors' financial affairs be treated as presumptively correct unless challenged. If such approaches to the personal insolvency process are adopted, then we further propose that policymakers reconsider requiring creditor approval of debtors' repayment plans unless, perhaps, creditors might be given the right to vote to approve plans that provide more relief to the debtor than the specified baselines. Finally, we propose that the IBBI or the Tribunals adopt an approach to steer some debtors directly to bankruptcy, perhaps by creating a framework for RPs or Tribunals to assess insolvency cases at the application stage and determine that they be immediately eligible for bankruptcy.

NOTES

[1] IBBI (Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Regulations, 2019.

[2] As an example of such a protocol, see e.g., the United Kingdom's Individuals Voluntary Arrangement (IVA) Protocol, 2016, https://www.gov.uk/government/publications/individual-voluntary-arrangement-iva-protocol.

[3] World Bank (2014), "Insolvency and Creditor/Debtor Regimes Task Force, Working Group on the Treatment of the Insolvency of Natural Persons," Report on the Treatment of the Insolvency of Natural Persons.

[4] *Id.* at 58 (emphasis added).

[5] *Id.* at 66.

[6] *Id.* at 62.

[7] In the U.S., empirical studies have consistently found that most filings are attributable to external shocks, such as a medical event, the loss of a job, or a divorce, and few though some filings appear to be opportunistic. In fact, one prominent study found that, contrariwise, a significant number of debtors who could benefit from bankruptcy relief do not file.

[8] Adam Feibelman, "Legal Shock or False Start: The Uncertain Future of India's New Personal Insolvency and Bankruptcy Regime", p. 37-38, forthcoming American Bankruptcy Law Journal, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3092042.

[9] Renuka Sane, "Estimating the potential number of personal insolvency cases at the DRT", December 1, 2017, https://blog.theleapjournal.org/2017/12/estimating-potential-number-of-personal.html.

[10] Supra Note 4, at 92.

[11] *Id.* at 96-97.

[12] IBBI (Insolvency Resolution Process for Personal Guarantors to Corporate Debtors), Regulations, 2019.

[13] Supra Note 3, at 75.

[14] Supra 12.

[15] Section 79(14), IBC.

[16] IBBI (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019.

[17] *Id.* at 86.

[18] Sections 96 and 101, IBC.

[19] Sections 110(3), (4), IBC.

[20] Section 110, IBC.

[21] Section 79(15), IBC.

[22] Supra note 12.

[23] *Ibid.*