The Applicability of the Insolvency and Bankruptcy Code (2016) to Insurance Companies - NCLT Order in the matter of Aviva Life - An Analysis

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Recently, the National Company Law Tribunal (NCLT) admitted an insolvency petition under the Insolvency and Bankruptcy Code, 2016 (IBC) against Aviva Life Insurance Company India Ltd. In this article, we analyse the NCLT decision from the perspective of the Expert Committee recommendations that led to the enactment of IBC, legislative intent, text of IBC, the rule of harmonious construction and case law. We argue that, as of now, no insolvency application against an insurance company is maintainable under IBC. Therefore, it is respectfully submitted that the NCLT decision in Aviva requires reconsideration. Insurance companies can be brought under the ambit of IBC only through a notification under Section 227 of IBC. Moreover, the article also points out certain implementation challenges to applying IBC framework to insurance companies. Thus, if the Central Govt., at a future point of time, intends to bring insurance companies under the ambit of IBC, these challenges need to be addressed.

Keywords: Insolvency and Bankruptcy Code (IBC), 2016; Systemic Risk, Financial & Operational Creditors, NCLT, Judicial Interpretation

On 4th November, 2019, New Delhi Bench – V of the National Company Law Tribunal (NCLT) delivered an order in the matter of Apeejay Trust (Apeejay) v. Aviva Life Insurance Company India Ltd. (Aviva). The Honourable NCLT, by way of this order, admitted the petition of Apeejay against Aviva under Section 9 of the Insolvency and Bankruptcy Code, 2016 (IBC). Apeejay initiated insolvency proceedings against Aviva on the ground that the later defaulted in paying the licence fees for the use of office premises and other services as well as service tax dues amounting to approximately Rs. 28 lakh.

The Learned Counsel for Aviva raised a preliminary objection that Aviva is a "financial service provider" within the meaning of IBC. Therefore, as per the provisions of IBC, no such petition can lie against it and the same deserves to be dismissed. On the other hand, the Learned Councel for Apeejay contended that Aviva did not provide any insurance cover or financial assistance to Apeejay. The purported default by Aviva is in respect of lease rentals and other service charges. Therefore, the status of Apeejay is that of an operational creditor and thus is within its rights to

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initiate insolvency proceedings against Aviva. NCLT accepted this contention and admitted the petition.

This article attempts to analyse the order on the basis of Expert Committee recommendations, legislative intent, textual analysis of IBC provisions, the rule of harmonious interpretation and case law. Further, it identifies certain implementation challenges inherent in applying the provisions of IBC in the context of insurance companies.

A) Analysis of Aviva

Expert Committee Recommendations

Much of the architecture of IBC has its origins in the recommendations of the Bankruptcy Law Reforms Committee (BLRC) headed by Dr T. K. Viswanathan. The Committee submitted its Report in November 2015. As the Report explains, the need for an overhaul of the bankruptcy law framework was felt due to the fact that despite considerable policy efforts, the credit markets continued to malfunction. One key factor that held back the credit market is the mechanism for resolving insolvency, or the failure of a borrower (debtor) to make good on repayment promises to the lender (creditor). The then existing laws had several problems and were enforced poorly.

The Report gave a detailed framework for creating a robust institutional infrastructure such as an insolvency regulator, adjudicatory tribunals, information utilities and qualified, expert resolution professionals. It also suggested a time bound process for resolution of corporate insolvencies under the rubric of a single Code and dealt with implementation issues as well as the impact of the proposed framework on the rest of the legal framework.

Significantly, in its Problem Statement, BLRC specifically mentioned that the draft “Indian Financial Code (IFC)”, by Justice Srikrishna’s Financial Sector Legislative Reforms Commission (FSLRC) covered the failure of financial firms. Therefore, the BLRC Report categorically states that it has taken up the task of drafting a single unified framework which deals with bankruptcy and insolvency by persons other than financial firms.

Of course, the draft IFC, as recommended by FSLRC has not been enacted till date. However, it is clear that while making its recommendations, BLRC was mindful of the fact that the framework for corporate insolvencies that it suggested would be applicable only in the context of corporate persons other than those operating in the financial sector. As such, the peculiarities of dealing with insolvencies of financial firms have arguably not been considered in its recommendations.

Legislative Intent

Following BLRC Report, the Govt. introduced the Insolvency and Bankruptcy Code Bill, 2015 (Bill) in the Lok Sabha. Part II of the Bill deals with the insolvency and liquidation of corporate persons. The term “corporate persons” takes within its ambit companies, limited liability partnerships, or any other person incorporated with limited liability under any law for the time being in force (subject to the provisions of any special act under which such person is incorporated).

The Notes on Clauses in the Bill explicitly state that Insolvency resolution and liquidation of financial service providers is excluded from the scope of proposed Code. The Notes acknowledge that such entities require a specialized insolvency regime in tune with the requirements of such entities. The Notes also recognise that given the inter connectedness between such entities and the systemic risk implications for the economy the insolvency resolution and liquidation process of such entities must take into account the interest of the financial system and the economy as a whole.

Thus, the Notes on Clauses clearly spell out the legislative intent and determination that the sector agnostic framework laid down in the Code would be ill-suited to the specific needs of financial sector firms. To give effect to this intent, the Bill defines the terms "corporate person", "financial service", "financial service provider" and "financial regulator". These definitions appear in IBC, as enacted by Parliament and are textually identical to those proposed in the Bill. Therefore, while interpreting these provisions, the legislative intent, as set out in the Bill ought to be kept in mind. It is these provisions that we now turn to.

Textual Analysis of IBC Provisions

Part II of IBC deals with the insolvency resolution and liquidation for corporate persons. Section 3(7) defines a corporate person as a company as defined in clause (20) of section 2 of the Companies Act, 2013, a limited liability partnership, as defined in clause (n) of sub-section (1) of section 2 of the Limited Liability Partnership Act, 2008, or any other person incorporated with limited liability under any other law for the time being in force but shall not include any financial service provider.

Section 3(17) defines a financial service provider as a person engaged in the business of providing financial services in terms of authorisation issued or registration granted by a financial sector regulator.

As per Section 3(18), "financial sector regulator" means an authority or body constituted under any law for the time being in force to regulate services or transactions of financial sector and includes the Reserve Bank of India, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority of India (IRDAI), the Pension Fund Regulatory Authority and such other regulatory authorities as may be notified by the Central Government.

Finally, Section 3(16) provides an inclusive definition of "financial service". In particular, clause (c) of this provision brings effecting contracts of insurance within its ambit.

With this background, we analyse the interplay of these provisions and their relevance for determining whether the text of IBC supports the proposition that an insolvency petition under IBC is maintainable against Aviva in particular or an insurance company in general.

To begin, we note that Section 2(9) of the Insurance Act, 1938 defines "insurer" as an Indian Insurance Company, a cooperative insurance society, a statutory body established by an Act of Parliament to carry on insurance business or a foreign company engaged in reinsurance business

through a branch established in India. Aviva is an Indian Insurance Company, a fact that is not under dispute.

Further, as per Section 2(7A) of the Insurance Act, 1938; as amended by the Insurance Laws (Amendment) Act, 2015 that came into effect from 26th December, 2014; one of the defining features of an Indian Insurance Company is that it is formed and registered under the Companies Act, 2013 as a public company or is converted into such a company within one year of the commencement of the Insurance Laws (Amendment) Act, 2015. Thus, as a matter of first impression, Aviva would come within the definition of "corporate person", modulo the question whether it is a financial service provider, as such persons are specifically excluded from the definition of "corporate person".

As mentioned above, the definition of "financial service" includes effecting contracts of insurance. Significantly, another limb of the definition of "Indian insurance company" stipulates that the sole purpose of such company is to carry on life insurance or general insurance or reinsurance or health insurance business. Thus, it is clear that not only Aviva is in the business of effecting contracts of insurance, but by definition, it cannot carry on any business other than effecting contracts of life insurance.

Thus, Aviva is a (corporate) person providing financial service. Further it carries on its business in terms of registration granted by IRDAI under Section 3 of the Insurance Act, 1938, which again is not disputed. In fact, this Section prohibits any person from carrying on any class of insurance business in India unless he obtains from IRDAI, a certificate of registration for that particular class of business. Further, in terms of Section 103, a person carrying on insurance business in contravention of the provisions of Section 3 is liable to a penalty not exceeding Rs. 25 crore and with imprisonment which may extend to 10 years.

Therefore, Aviva is engaged in the business of providing financial services in terms of authorisation issued or registration granted by a financial sector regulator (IRDAI). Thus, both parts of the definition of "financial service provider" are satisfied. Therefore, Aviva is a financial service provider in terms of Section 3(17).The exclusion from the definition of "corporate person" under Section 3(7) squarely applies to it and the provisions of Part II of the Code do not apply to it, qua its status as corporate debtor. It is submitted that the issue whether the petition was moved by a policyholder, a financial creditor or an operational creditor is not relevant. It is not the nature of debt owed by it but the status of Aviva as an entity that is a financial service provider is the dispositive fact here.

Harmonious Interpretation

As discussed above, IBC excludes financial service providers from the definition of corporate persons. However, Section 227 of the Code empowers the Central Government to notify financial service providers or categories of financial service providers for the purpose of their insolvency and liquidation proceedings, which may be conducted under this Code. There are two caveats here. One, this can be done only in consultation with the appropriate financial sector regulators.

Two, such proceedings shall be conducted in such manner as may be prescribed by rules made by the Central Government in exercise of the powers granted under Section 239(2)(zk) of the Code. Both these provisions are clearly sensitive to the need of tailoring the insolvency regime for such entities, keeping in mind their interconnectedness and implications for managing systemic risk to the economy, as enunciated by the Notes on Clauses to the Bill.

In exercise of these powers, on 15th November 2019, the Central Government notified the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 (Rules). These apply to financial service providers or categories of financial service providers, as may be notified by the Central Government under section 227 of the IBC, from time to time.

On 18th November 2019, a notification was issued bringing the Non-banking finance companies (NBFCs) (which include housing finance companies) with asset size of Rs. 500 crore or more, as per last audited balance sheet, within the purview of the Rules.

The insolvency process, as enunciated in these Rules, departs from the one provided in IBC in several respects. As per the Rules, the corporate insolvency resolution process (CIRP) can commence only on an application made by the relevant financial sector regulator to NCLT. In other words, creditors – whether financial or operational – have no right to commence such proceedings. Further, the concerned financial sector regulator shall appoint an advisory committee to assist the administrator (as the resolution professional is called in this context) during the insolvency process. Also, the resolution plan, as approved by the financial creditors with requisite majority, must contain a statement as to how it satisfies the sectoral requirements of the financial service provider as laid down by the financial service regulator. Finally, the plan must get a no objection certificate from the regulator to the effect that persons who would take over the control and management of the financial service provider under the plan satisfy the "fit and proper" criteria laid down by such regulator. Thus, it is clearly envisaged that the concerned regulator should closely control and monitor the whole process right from filing the application to the implementation of the resolution plan. The whole process is virtually driven by the regulator, unlike in other cases. This seems to have been done in view of the potential economy wide impact of the insolvency of such entities.

As per Section 14 of IBC, there is a moratorium on certain matters such as the institution or continuation of any suit against the corporate debtor, transfer or alienation of any property by the corporate debtor and enforcement of any security interest created by the corporate debtor in respect of its property. The moratorium comes into effect after the admission of the insolvency application. However, the Rules provide that in respect of financial service providers, the moratorium shall come into effect from the date of filing the application until its admission or rejection by NCLT. This provision is clearly aimed at preventing a run on the financial service provider. For example, once the news of RBI filing an application against an NBFC becomes public, there may be a scramble by the depositors to withdraw their money, derailing the whole resolution process. Further, the failure of the resolution process due to this would create a

systemic risk due to the interconnectedness of financial service providers and the potential trust deficit that may be endangered by such failure.

There are two key takeaways from this analysis. One, the legislature has left it to the wisdom of the executive whether any class of financial service providers should be brought under the purview of IBC, and if so, in what manner. Two, the Rules envisage an insolvency regime for such entities that is sensitive to the special characteristics of the financial sector. It is clearly the nature of business of these entities as financial service providers that is relevant, not the nature of debt that they owe. Also, permitting the operational creditors to file an insolvency application under the general provisions of the Code militates against the strong monitoring and oversight role (and indeed the exclusive power to initiate insolvency proceedings in the first place) accorded to the sectoral regulator under the Rules.

Therefore, it is submitted that a harmonious interpretation of Section 227 with the other provisions of the Code implies that a class of financial service providers are subject to insolvency proceedings under IBC only on the basis of a notification issued under Section 227 and the proceedings can be conducted only in the manner laid down in the Rules.

Case Law

The issue whether an application against financial service providers is maintainable came before the National Company Law Appellate Tribunal (NCLAT) in *Randhiraj Thakur - Director, Mayfair Capital Pvt Ltd v. Jindal Saxena Financial Services Pvt Ltd. and ors.* (order dt. 18th September, 2018) *and Housing Development Finance Corporation Ltd v. RHC Holding Private Ltd (order dt. 10th July, 2019).*

In both these cases, it was held that an insolvency application is not maintainable against financial service providers. Of course, in these cases, unlike in case of Aviva, the application was moved by the financial creditors of these entities. However, the NCLAT did not go into the nature of debt (financial / operational) but rather the nature of entities against whom the application was made.

This is borne out by the observation made by NCLAT in Jindal case that an exception had been carved out while enacting the Code that the financial service providers have been kept outside the purview of the Code. Being a consolidating legislation only those acts are permitted which are mentioned in the Code and it cannot be made applicable to financial service providers.

Therefore, it is submitted that NCLAT holding in the above case applies regardless of whether the debt owed by the financial service provider is in the nature of financial debt or operational debt.

B) Implementation Issues in the Context of Insurance Companies

The application of IBC to insurance companies raises another difficulty. Section 21(2) of IBC states that the Committee of Creditors (CoC) shall comprise all financial creditors of the corporate debtor. Further, under Section 31, the resolution plan must first be approved by CoC by requisite majority. Later, such approved plan is submitted to NCLT for its approval. Thus, while

the operational creditors can move an application under the Code, they have no say in the approval of the resolution plan. Rule 5(d) of the Rules also provides for the approval of the resolution plan by the committee of creditors as per section 30(4) of IBC.

According to Section 5(7), "financial creditor" means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to. In turn, under Section 5(8), financial debt is defined as a debt alongwith interest, if any, which is disbursed against the consideration for the time value of money. The definition also incorporates by way of an inclusion clause, several specific categories of debt, such as money borrowed against the payment of interest. Thus, in case of banks and Non-Banking Finance Companies (NBFCs), persons who have placed deposits with these entities are treated as financial creditors. They are represented in the CoC either directly or through an authorised representative.

A perusal of the categories that are enumerated indicates that in case of an insurance company, the policyholders (except possibly credit insurance) would not come under the definition of financial creditors. As a result, they would not have any say in the resolution plan. This is surely an odd result as they are arguably the most prominent stakeholders in insurance companies.

In fact, several insurance companies in India do not have any financial creditors. As per Aviva's Audited Balance Sheet as on 31/3/2019, the company has no financial creditors. In such cases, by definition, the CoC cannot be constituted. As per Section 22, it is the CoC that appoints the Resolution Professional in their first meeting. If there are no financial creditors, this step itself cannot be carried out in accordance with the provisions of IBC and the whole process runs aground.

Section 6A of the Insurance Act, 1938; as amended by the Insurance Laws (Amendment) Act, 2015 provides that the capital of any company carrying on insurance business may consist of equity shares and such other form of capital, as may be specified by the regulations made by IRDAI. Pursuant to this, Insurance Regulatory and Development Authority of India (Other Forms of Capital) Regulations, 2015 were notified. As per these Regulations, other forms of capital include preference share capital and subordinated debts. The amount raised through such instruments is treated as Available Solvency Margin, subject to limits, for the purpose of determining the solvency ratio of an insurance companies. A few companies such as National Insurance Company Ltd and ICICI Lombard General Insurance Company Ltd have issued subordinated debt. The purpose of issuing these instruments is to support the solvency position of the company. Therefore, Regulation 3(ii)(b) specifies that the claims of the subordinated debt holders shall be superior to the claims of preference and equity shareholders but subordinated to the claims of the policyholders and all other creditors.

In case of a company that has outstanding subordinated debt, holders of such debt would be the only financial creditors and they would drive the resolution plan. This is contrary to the very rationale of allowing insurance companies to raise solvency capital through the issue of such debt. As providers of solvency capital buffer, their position in this respect is akin to that of the equity shareholders. Thus, exactly as in case of equity shareholders, their role in the resolution

process must be that of "bailing out" the other classes of creditors. It is hard to justify why they should have a role in the resolution process.

Further, Section 53 of IBC specifies the order of priority among the different creditors for the distribution of liquidation assets. This Section begins with a non-obstante clause and overrides the provisions of any law enacted by the Parliament or any State Legislature for the time being in force. Under this Section, financial debts owed to unsecured creditors have a higher priority than the claims of unsecured operational creditors and holders of other debt and dues. Subordinated debt holders of insurance companies would have a superior claim in liquidation over other creditors. This defeats the very purpose of issuing subordinated debt.

In *Col. Vinod Awasthy v. AMR Infrastructures Ltd. [2017]* 80 taxmann.com 268, the Delhi Bench of the NCLT observed that under Section 5(20) of IBC, "operational creditor" means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred. Further, under Section 5(21), "operational debt" means a claim in respect of the provision of goods or services including employment or a debt in respect of the payment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority. The NCLT held that an operational creditor refers to the creditor to whom amount is due from the corporate debtor on account of rendering any service or supply of any goods. Thus, the policyholders are clearly not operational creditors under IBC.

This gives rise to an odd situation. Policyholders of an insurance company are the most importance stakeholders. However, they are neither financial nor operational creditors under the IBC framework. As such, they can neither initiate insolvency proceedings nor have any say in the resolution plan.

Earlier, a similar situation arose wherein it was realized that the provisions of IBC, as originally enacted, did not accommodate the specific needs of the real estate sector. Typically, in a real estate project, people are allotted a house before the project is complete and they pay advance money against such allotment. Under IBC, they were neither financial nor operational creditors and had no say in the resolution process. To address this, in 2018, an Explanation was added to the definition of "financial debt" to the effect that any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing. Thus, through the deeming fiction, such persons are now treated as financial creditors.

Therefore, the application of IBC to insurance companies throws up specific implementation challenges that need to be addressed, if at all the Govt. intends to bring them under the ambit of IBC through a notification under Section 227. For instance, IBC may be amended to provide that policyholders of an insurance company shall be deemed to be financial creditors.

C) Conclusion

Based on the analysis of Expert Committee recommendations, legislative intent, text of IBC, the rule of harmonious construction and case law, this article argues that, as of now, no insolvency application against an insurance company is maintainable under IBC. Therefore, it is respectfully

submitted that the NCLT decision in Aviva requires reconsideration. Insurance companies can be brought under the ambit of IBC only through a notification under Section 227. Moreover, the article also points out certain implementation challenges to applying IBC framework, as modified by the Rules applicable to financial service providers. Thus, if the Central Govt., at a future point of time, intends to bring insurance companies under the ambit of IBC, these challenges need to be addressed.

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