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IBC vs SARFAESI: An avoidable comparison

RECOVERY TOOL. Both Acts need proper perspectives around objectives, recognition of inter-linkages and equivalent policy focus for credit market effectiveness

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With much focus on improving the Insolvency & Bankruptcy Code's (IBC's) effectiveness/efficiency, there remains relatively lesser discussion on the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI). IBC is also frequently pitted against the latter in relative comparison (however using arguable yardsticks). It will hence be useful to take stock of their comparative positioning and the road ahead.

ESTABLISHING PERSPECTIVE

At the outset the SARFAESI in research parlance is a 'Collateral Law' and, among other things, a tool for secured lenders to enforce their security interest without court/tribunal intervention. Such laws are crucial for credit markets. This is evident even in some World Bank measures (strength of legal rights) which predominantly relied on collateral law indicators while assessing quality of law (from a credit market perspective).

The IBC, on the other hand, often described as one of the most important economic legislation since GST (Standing Committee on Finance [SCF], 2024) is a collective mechanism (unlike SARFAESI's secured creditor focus) with broader objectives of resolutions, value maximisation, promoting entrepreneurship, facilitating credit and balancing interests. It can result in resolutions or liquidations with a thrust on the former.

The SARFAESI is thus a standalone law, not meant to be replaced by IBC but meant to coexist (although referred to as a 'conventional' channel of recovery; Economic Survey, 2024). However, it is important to recognise their linkages. Scholarly research has argued collateral and bankruptcy laws are complementary with the former important for bankruptcy laws' effectiveness.

SOME ASSESSMENT ISSUES

Yet popular debate tends to assess these laws in terms of their relative positioning (while not recognising their inter-linkages, complementary nature, or subtle differences in objectives). While SARFARSI has been long criticised as ineffective (low recoveries /liquidation bias, etc), IBC is often shown in a relatively positive light using recoveries as a yardstick.

It is, however, well-established through jurisprudence (Swiss Ribbons judgment [SC], 2019) that resolutions and not recoveries are IBC's objectives. The Supreme Court has also repeatedly differentiated IBC as a collective mechanism (interestingly stressing no recovery guarantee) from ordinary recovery tools. In this context, it observed 'that while both proceedings no doubt contemplate an aspect of debt recovery, in insolvency proceedings recovery is a consequence of rehabilitation /resolution of the corporate debtor and not the main relief' (*HPC Bio-fuels Ltd Vs Shahaji Bhanudas Bhad*, 2024).

However, recoveries continue to be often used in relative comparisons (or even in standalone IBC assessments). This is evident even in some important reports. For instance, the RBI's recent trends and progress report highlights: 'IBC remained the dominant mode of recovery with a 48.1 per cent in total amount recovered in 2023-24'. In similar vein, the Economic Survey (2024) while noting IBC's resolution objectives largely emphasised: 'In the six years since FY18, the IBC has enabled over ₹3 lakh crore recovery for SCBs, more than what they have recovered through the Lok Adalats, DRTs, and the SARFAESI Act' (similar arguments in previous survey). The SCF observed that IBC's low recoveries (25-30 per cent), haircuts, and delays point to deviations from its original objectives.

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Further, such assessments often do not consider their *inter-se* interactions /restrictions. IBC imposes a strict moratorium upon which no secured lender (including those unwillingly dragged into IBC) may initiate /continue SARFAESI action. This has ramifications for secured creditors considering delays /extended IBC period. Thus, IBC has curtailed SARFAESI's usage from this perspective.

NEED FOR EQUIVALENT FOCUS

Leaving aside the inconsistencies in relative comparisons, SARFAESI has in absolute terms yielded around ₹0.30 lakh crore (24.7 per cent of amount involved) in 2023-24 against, IBC's ₹0.46 lakh crore (28.3 per cent) during the period (RBI). This is sizeable on a standalone basis itself (leaving aside relative percentages) hinting at its importance. However, while SARFAESI's usage increased in 2024, it was primarily due to the low base effect (RBI).

The narrative that IBC is a more viable recovery tool than SARFAESI is, however, avoidable given their differing (yet interrelated) objectives. It is not a competition. Both need to coexist for effective credit markets. While the IBC preamble states it is an Act to consolidate laws, it does not imply substituting SARFAESI. Often, while resolution objective is used to defend IBC's haircuts, recoveries are used (in relative assessments). More considered comparison is needed to avoid narratives that can influence the *ex-ante* selection of remedies (which should otherwise be case specific).

While amendments are reportedly on the anvil to improve IBC's effectiveness/efficiency, similar policy attention for SARFAESI will be helpful towards a composite package. As per reports, while SARFAESI was last amended in 2016, some changes are reportedly being expected (although not noted in recent Budget documents) including lowering the threshold amount for NBFCs and including ships in assets that can be forfeited. SARFAESI however remains an option for secured creditors to recover dues.

In sum, it is important to establish sound perspectives for gauging laws (standalone/relative) while ensuring equivalent policy focus. Both Acts need proper perspectives (around objectives), considered assessment, recognition of inter-linkages, and effective co-existence for credit market effectiveness (while avoiding unconsidered comparisons). A more consolidated perspective of laws while providing equivalent policy impetus will be useful for the credit ecosystem.

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