



**JOURNAL OF INTERNATIONAL LAW, POLITICS AND SOCIETY**

*An International Open Access Double Blind Peer Reviewed*

ISSN No.: 3108-0464

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Volume 2 | Issue 3 (Jul.-Sep.) | 2026

Art. 8

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## A Critical Study on the Role of IBC in Reforming India's Banking and Corporate Debt Resolution Regime

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### **Recommended Citation**

Swetha Josco and Dr. Jyotirmoy Banerjee, *A Critical Study on the Role of IBC in Reforming India's Banking and Corporate Debt Resolution Regime*, 2 JILPS 145-155 (2026).

Available at [www.jilps.in/current-issue/](http://www.jilps.in/current-issue/)

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# A Critical Study on the Role of IBC in Reforming India's Banking and Corporate Debt Resolution Regime

## ABSTRACT

*The Insolvency and Bankruptcy Code, 2016 (IBC) is one of the most important legal and economic reforms in India since liberalisation of the Indian economy. Before the enactment of this Act, there was no single statute to address the issues of insolvency, with various laws being enacted to address the issue, such as the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), the Recovery of Debts Due to Banks and Financial Institutions Act 1993 (RDDBFI) and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SARFAESI). The debtor-centric procedural delays, conflicts among the regimes, low recovery rates, and overall inefficiency of the regimes resulted in the building up of non-performing assets (NPAs) in the banking sector. The Code created an institutional mechanism comprising of the National Company Law Tribunal (NCLT), the Insolvency and Bankruptcy Board of India (IBBI), Insolvency Professionals and Information Utilities. The IBC has effectively changed the debt resolution landscape in India by moving away from defaulting promoters and towards the creditors where the Committee of Creditors (CoC) stands. The IBC has fundamentally redefined the debt resolution landscape in India by shifting the control of debt resolution from the defaulting promoters to the creditors under the Committee of Creditors (CoC). The article also outlines the continuing issues with the effectiveness of the IBC, especially regarding the substantial haircuts that financial creditors are willing to accept, delays stemming from litigation and institutions' capacity limitations, poorly developed distressed assets markets, and the lack of an extensive cross-border insolvency regime. Besides, it also reviews the pending reforms in the Code, including the Pre-Packaged Insolvency Resolution Process (PPIRP) for Micro, Small and Medium Enterprises (MSMEs), and the incomplete implementation of the individual insolvency scheme provisions in the Code. The study finds that the IBC has hugely streamlined and made the insolvency regime more credible in India, but it will be important for the system to continue to be refined through further legislation, increased judicial capabilities, the better working of the cross-border mechanisms and a further strengthening of the distressed asset resolution system as a whole.*

## KEYWORDS

*Insolvency and Bankruptcy Code (IBC), Corporate Insolvency Resolution Process (CIRP), Non-Performing Assets (NPAs), Corporate Debt Resolution, Banking Sector Reforms.*

### I. INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (IBC) is a turning point in the development of the commercial and financial laws of India. Before the Act, there were several laws governing insolvency in India such as Companies Act, 1956, Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI), and Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI). These laws functioned autonomously, with sometimes one law applying to another and many laws taking too long to be litigated.<sup>1</sup> This resulted in the slow and inefficient resolution of insolvency proceedings, with the average debt resolution taking more than four years, and the recovery rate being among the lowest worldwide.

In view of the need for a far-reaching reform, Government of India set up Bankruptcy Law Reforms Committee (BLRC), headed by Dr. T.K. Viswanathan. The Committee made a recommendation to establish a single insolvency regime, which will bring together laws in place, ensure timely resolution and enhance creditor confidence. In compliance with these recommendations, Parliament passed the Insolvency and Bankruptcy Code, 2016 and received Presidential assent on 28th May 2016. The Code abolished SICA<sup>2</sup>, made changes in various existing legislations and created a unified framework for insolvency resolution and liquidation.<sup>3</sup> The IBC has brought in the concept of creditor-in-control, a strict time bound resolution process and a special institutional mechanism comprising the National Company Law Tribunal (NCLT), Insolvency and Bankruptcy Board of India (IBBI) and Insolvency Professionals. It is primarily aimed at maximising asset value, encouraging entrepreneurship, increasing credit availability and ensuring the interests of all stakeholders.<sup>4</sup>

This article critically assesses the mandate of the IBC to transform the banking and corporate debt resolution framework in India, looks at some of the positive and negative outcomes so far and dissects some major

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<sup>1</sup> Insolvency and Bankruptcy Code, No. 31 of 2016, § 1 (India).

<sup>2</sup> Sick Industrial Companies (Special Provisions) Act, No. 1 of 1986 (India) (repealed 2016).

<sup>3</sup> M.P. Ram Mohan & Vishakha Raj, Evolution of Insolvency Regime in India, 10 J. Fin. Reg. 215, 217 (2019).

<sup>4</sup> T.T. Ram Mohan, Bankruptcy Law Reform in India, 51 Econ. & Pol. Wkly. 18, 19 (2016).

judicial developments, and discusses the kind of reforms that are needed to make the IBC more effective in the coming years.

## II. ARCHITECTURAL FRAMEWORK OF THE IBC

### *A. Institutional Infrastructure*

The IBC gives the NCLT (national company law tribunal) the power to adjudicate on corporate insolvency, and the DRT (debt recovery tribunal) the power to adjudicate over individual and partnership insolvency. The Insolvency and Bankruptcy Board of India ("IBBI") is the sector regulator and lays down the standards for the Insolvency Professionals ("IPs"), Information Utilities ("IUs") and Insolvency Professional Agencies ("IPAs"). It has introduced a tripartite institutional framework with the judiciary as an adjudicator, the regulator as a regulator and the market intermediary as a market intermediary, intentionally designed to emulate the sectoral regulators like SEBI, in order to ensure an insulation of insolvency administration from executive influence and to create a professional ecosystem of specialists.

The Code provides for distinction between the Corporate Insolvency Resolution Process ("CIRP"), and the Fast Track CIRP for smaller entities, and the liquidation. The corporate debtor, a financial creditor or an operational creditor may file an application for CIRP<sup>5</sup>. On admission, a moratorium under Section 14 puts all legal proceedings and transfers to a halt, and an Interim Resolution Professional ("IRP") replaces the board of directors. A Committee of Creditors ("CoC") consisting of financial creditors by value, superintends the resolution process and approves resolution plans.<sup>6</sup> If a plan is not approved within the time limits, the debtor is liquidated.

### *B. The 330-Day Timeline and its significance*

One of IBC's most revolutionary changes to previous law is the strict time limit. The original Code laid 180 days for CIRP, which can be extended by 180 days by CoC's approval, to make maximum 270 days. The Insolvency and Bankruptcy Code (Amendment) Act, 2019 had inserted a mandatory time limit of 330 days (360 days + litigation time) for the resolution plan. The Insolvency and Bankruptcy Code (Amendment) Act, 2019 had set a time limit of 330 days for the resolution plan. It was held by the Supreme Court in *Swiss Ribbons Pvt. Ltd. v Union of India* that this process is constitutionally valid and the time bound process shall serve to preserve enterprise value for all stakeholders.<sup>7</sup> The Code's

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<sup>5</sup> Id. § 7.

<sup>6</sup> Id. § 33.

<sup>7</sup> *Swiss Ribbons Pvt. Ltd. v. Union of India*, (2019) 4 SCC 17 (India).

use of the concept of time discipline indicates a policy shift on the normative side, in favour of a resolution over rehabilitation, and a preference for credit over debtor protection, a conscious turnaround of the SICA paradigm.

### III. A GAME-CHANGING EFFECT ON THE INDIAN BANKING SYSTEM.

#### *A. The following statistics are provided by NPA Resolution and Recovery*

IBC's effect on the banking industry has been significant though not uniform. So far, 6,315 CIRPs have been admitted since the operationalization<sup>8</sup> of the Code in March 2023. Amongst these, 808 resulted in approved resolution plans and 2289 resulted in a liquidation order. The difference there is important "going-concern value" is the value of the enterprise, while "scrap value" is usually the value of the assets.

The recovery rate from the counterfactual (longer litigation under RDDBFI or DRT) was less than 10% and the time span was greater than 10 years. The recovery percentage of the IBC shows a significantly better result compared to a liquidation valuation, in the landmark resolution of Essar Steel, the financial creditors got around 92%. The overall recovery to the liquidation value ratio under the IBC has been over 168% as on 2022-23, reflecting the true spirit of value maximization.<sup>9</sup>

#### *B. Empower creditors, discipline promoters*

The behavioral Shift of IBC has also, however, inspired a fundamental shift in credit market behaviour, beyond statistics. Fear of a loss of control over the management has pushed promoters to negotiate out-of-court settlements prior to admission. This is reflected in the RBI's Stressed Assets Framework of 2019, which mandates that banks have to put in resolution plans for large borrowers within stipulated time before the IBC is invoked.<sup>10</sup> This "shadow of the IBC" has proved to be a potent deterrent: pre-admission settlements have risen significantly in the years after the Code was operational, and lenders seem to have been deterred from lending by the prospect of CIRP proceedings without any formal action taken.

The CoC policy has also given financial creditors more power, thus changing the negotiating equation in the banking system. Previously, the

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<sup>8</sup> Insolvency and Bankruptcy Board of India, Annual Report 2022-23, at 27 (2023) [hereinafter IBBI Annual Report 2023].

<sup>9</sup> Essar Steel India Ltd. v. Satish Kumar Gupta, (2019) 2 SCC 1 (India).

<sup>10</sup> Arcelormittal India Pvt. Ltd. v. Satish Kumar Gupta, (2019) 2 SCC 1 (India).

solution was to coordinate inter-creditors between dozens of lenders under non-binding Joint Lenders' Forum arrangements. The voting majority rule and statutory override in the CoC have eliminated collective action problems faced by its predecessor. This inter-creditor agreement ("ICA") mechanism was also specified in the Reserve Bank of India's Circular on Prudential Framework for Resolution of Stressed Assets, which requires lenders to be signed up within specific timelines.<sup>11</sup>

#### IV. JUDICIAL INTERPRETATION AND DEVELOPMENT OF JURISPRUDENCE UNDER THE IBC

##### A. Landmark Decisions

Many landmark decisions shape the Code. The Supreme Court of India has been influential in resolving the ambiguities surrounding the interpretation and has been a decisive in the test of the constitutional principles of the Code.

In *Swiss Ribbons Pvt. Ltd. v. Union of India* (2019), the Court recognized the differential treatment of financial and operational creditors in the CoC structure, holding that financial creditors' greater interest in the underlying long-term debt instruments of the company warrants their special rights of governance. This judgment resolved early constitutional issues and gave a "seal of approval" to the creditor-friendly approach of the Code.<sup>12</sup>

In *Arcelormittal India Pvt. Ltd. v. Satish Kumar Gupta* (2019), the Court interpreted the eligibility criterion of Section 29A very strictly, excluding resolution applicants who were associated with the defaulting promoter. This decision further strengthened the Code's anti-abuse policy but created uncertainty in commercial transactions as financially able bidders were disenfranchised, leading to legislative changes.<sup>13</sup> Later, in the case of *Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta* (2020), a Constitution Bench upheld the business judgment of the CoC and ruled that even the judicial review of resolution plans will be confined to the legality of the proceedings and will not be used to substitute business judgment.

In *Lalit Kumar Jain v. Union of India* (2021), the Court upheld the extension of the provisions in the IBC in relation to the personal guarantor, allowing banks to be able to pursue both the corporate debtors and their personal guarantors, which was an important extension of creditor

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<sup>11</sup> Reserve Bank of India, Circular on Prudential Framework for Resolution of Stressed Assets (June 7, 2019).

<sup>12</sup> *Swiss Ribbons Pvt. Ltd. v. Union of India* case is (2019) 4 SCC 17.

<sup>13</sup> *Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta*, (2020) 8 SCC 531, 563 (India).

remedies under the Code.<sup>14</sup>

### ***B. Commercial Efficiency and Judicial Supervision***

One of the recurring jurisprudential issues in IBC adjudication has been the demarcation of the supervisory jurisdiction of NCLT and its commercial independence of CoC. In the early stages of NCLT proceedings, it was a pattern for the NCLT to question the resolution plan payouts made to operational creditors and the dissenting financial creditors, which led to delays and disputes on appeal. The Supreme Court's Essar Steel judgment tried to rein in this facet by setting out the specific grounds for judicial intervention. However, at times, the National Company Law Appellate Tribunal ("NCLAT") has been seen as tilting at the windmill, unsettling the status quo and introducing a few clouds into the doctrinal sky.

The resulting appellate backlog has severely affected the temporal discipline of the Code; currently, more than 67% of the pending CIRPs are past the 270-day mark and several are more than five years old.<sup>15</sup> This path, if left to run, could lead to the very diseases that the IBC has been designed to treat.

## **V. CRITICAL ANALYSIS: STRUCTURAL GAPS AND REFORM IMPERATIVES**

### ***A. The Haircut Problem and Creditor Recovery***

The extent of a face value bail-in that creditors would accept in resolution plans continues to be a key question. The first hundred resolutions to the Code were analysed, and an average realisation rate of around 43% was seen for admitted claims, with significant differences between the various sectors.<sup>16</sup> The infrastructure and real estate case had the lowest recovery rates, likely due to the specific nature of the assets, which made the collateral highly asset-specific, and the relatively small pool of bidders in this segment.

The World Bank's Doing Business 2020 survey attributed this improvement to the IBC, which had raised the recovery rate from insolvent companies from 26 cents to 71 cents per dollar, but this overall figure hides the distribution effect, as large, visible cases drive the mean up, and the median gives poor value.<sup>17</sup>

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<sup>14</sup> Lalit Kumar Jain v. Union of India, (2021) 9 SCC 321 (India).

<sup>15</sup> IBBI Annual Report 2023, supra note 16, at 42.

<sup>16</sup> Jayant Kumar Sinha & Nikhil Gupta, Haircuts and Recovery under IBC: Evidence from the First 100 Cases, 55 Econ. & Pol. Wkly. 12, 14 (2020).

<sup>17</sup> World Bank Group, Resolving Insolvency – Doing Business 2020, at 78 (2020).

The fact that bidder markets are illiquid makes the solution of the haircut problem more difficult. When there are fewer strategic investors in the Sector, the resolution professionals are unable to get sufficient expressions of interest and are compelled to either settle for a sub-standard resolution plan or go for a liquidation. Improving bidder market depth would help to boost competitive pressure and reinforce creditor recovery.

### ***B. Judicial and Institutional Capacity Constraints***

The NCLT adjudicates a huge load of cases on sixteen benches. Acute bottlenecks have been created due to the shortage of staff, judges and infrastructure. At present (2022-23), there are more than 18000 cases pending before the NCLT for all the matters, a significant number of which are from the IBC.<sup>18</sup> The resulting delays, however, create economic costs that are higher than the institutional savings that the Code was intended to provide. The Government's pledge of more NCLT benches and digital court facilities has to be matched with the number of judicial appointments and professional training.

The quality of insolvency professionals is also of key importance. While the role of IPs as an operational nerve centre to each CIRP is well established, regulation of their competence and ethics is in its infancy. IBBI has released performance indicators, and has initiated disciplinary action against misbehaving IPs, but there is a need for more fine-tuning in the professional ecosystem: creating standardized fee arrangements, insurance and compulsory continuation courses to maintain the institutional credibility.

### ***C. Cross-Border Insolvency***

Indian corporates having operations across the border thus make the IBC's silence on cross-border insolvency significant and of growing magnitude. The BLRC had recommended the adoption of the UNCITRAL Model Law on Cross-Border Insolvency and IBBI had released draft rules but no legislative action has been taken.<sup>19</sup>

The lack of a clear cross-border mechanism leads to asymmetries in that foreign creditors might have to wait to see if the NCLT orders are enforceable against foreign assets, whereas foreign courts could refuse comity if the Indian process is seen as lacking transparency. Cross-border insolvency laws are crucial for India to become a commercial hub in the international community.

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<sup>18</sup> IBBI Annual Report 2023, supra note 16, at 50.

<sup>19</sup> Deepti M. Karthik, Cross-Border Insolvency and the IBC Framework, 12 Nat'l L. Sch. India Rev. 88, 91 (2021).

### ***D. Pre-Pack Insolvency and MSME Resolution***

The Insolvency and Bankruptcy Code (Amendment) Act, 2021 (PPIRP) has been introduced to provide for a pre-packaged insolvency resolution process for Micro, Small and Medium Enterprises (MSMEs).<sup>20</sup> The PPIRP precludes the imposition of the NCLT process, as the debtor and creditors have to agree on a resolution plan before filing the application, a process akin to pre-packs in Chapter 11 of the United States and equivalents in the UK. The PPIRP has been welcomed by scholars as being suitable to the operational realities of MSMEs which make up a majority of Indian businesses but don't have management bandwidth and reputation on par to be able to sustain long-running CIRP proceedings.<sup>21</sup>

However, the uptake of PPIRP is still low as of March 2023, partly due to lack of awareness and the reluctance of residual creditors.<sup>22</sup> There is a need for targeted outreach, simplified guidance notes by IBBI and capacity building of the DRT to maximise the potential of the mechanism.

### ***E. Individual Insolvency: An Unfinished Reform***

As of 2024, the provisions of the IBC, Part III (on individual insolvency) and Part IV (on partnership insolvency) have not yet been put into effect.<sup>23</sup> The divide is significant because personal guarantors, small proprietorships and individual borrowers continue to be governed by the old Presidential order procedures and the colonial era Presidency-towns Insolvency Acts. Notification of the individual insolvency provisions along with suitable infrastructure in the DRT will bring the universalist vision of the Code, to have a single and coherent insolvency law for all debtors to a close.

## **VI. CONCLUSION**

IBC is a sea change in how commercial distress in India is dealt with. The Code has profoundly changed the commercial law landscape by shifting the focus of the insolvency regime from debtor protection to creditors' value maximisation; by imposing a temporal discipline on proceedings that have historically suffered from the curse of delay; and by introducing a new institutional framework to the insolvency regime.<sup>24</sup>

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<sup>20</sup> Insolvency and Bankruptcy Code (Amendment) Act, No. 9 of 2021 (India) (introducing pre-packaged insolvency for MSMEs).

<sup>21</sup> Sikha Bansal, Decoding Pre-Packaged Insolvency Resolution under IBC, 56 Econ. & Pol. Wkly. 22, 24 (2021).

<sup>22</sup> IBBI Annual Report 2023, supra note 16, at 61.

<sup>23</sup> Insolvency and Bankruptcy Code, No. 31 of 2016, §§ 94-187 (India).

<sup>24</sup> Preamble to Insolvency and Bankruptcy Code, No. 31 of 2016 (India).

The structural logic behind the reform is validated by the macroeconomic evidence of declining NPA ratios, strengthened credit discipline and India's improved position in the Ease of Doing Business index by the World Bank. However, a critical evaluation shows that there remain gaps. Haircut sizes are still high, due to the low number of bidders, the high proportion of distress in some sectors and delays in litigation that impact enterprise value.

The gaps in the NCLT and NCLAT risk to usher in a set of temporal pathologies that are familiar from previous systems. Cross-border insolvency provisions have not yet been adopted, and are not particularly useful in today's world of globalized balance sheets. Measures are to be put in place for individual insolvencies.

The way forward calls for a multi-faceted strategy, including a continued focus on improving judicial and institutional capacities, enactment of legislation incorporating cross-border insolvency provisions consistent with UNCITRAL Model Law, measures for market-deepening in bidder universe in distressed asset acquisition, operationalisation of individual insolvency provisions and promotion of PPIRP for MSMEs. Such reforms, needed to be legislated with emergency speed and institutionalisation, would cement the IBC's gains and realize its potential, making the insolvency system not just a legal reform but a key pillar of a creditworthy, high-growth economy.

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