30th September 2024

Impact of IBC on India's Credit Culture and Private Credit Growth

Until the first introduction of the Insolvency and Bankruptcy Code (IBC) in 2016, there was no one single law in Indian context which dealt with stressed borrowers/creditors and ensured an orderly bankruptcy/insolvency process. The existing laws and schemes such as Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI); The Recovery of Debts and Bankruptcy Act, 1993 (RDB Act which operated through Debt Resolution Tribunals); Sick Industrial Companies Act, 1985 (SICA); Scheme for Sustainable Structuring of Stressed Assets (S4A); Strategic Debt Restructuring (SDR) etc. dealt only with a limited or specific aspect of debt resolution. These frameworks neither enabled a wholistic plan towards recovery and resolution nor provisioned for requisite deterrents for the owners of the business. The introduction of IBC has however, tilted the balance in favour of lenders providing for a time bound resolution process including the threat of change in control over the business.

Some of the existing laws/schemes/forums have been found lacking because of the reasons enumerated below –

Act/Code/Legal Recourse	Drawbacks
SARFAESI	Primarily focused on recovery of specific assets by banks and financial institutions covered under the Act without addressing the broader insolvency scenario
RDB Act which operated through Debt Resolution Tribunals	Primarily focused on establishment of tribunals as an efficient alternative to civil courts for expeditious adjudication and recovery of debts due to banks and financial institutions. However, the main problem for effective implementation of RDB Act was a dispute of jurisdiction between the civil courts and the Debt Recovery Tribunals (DRTs). The debtors have often taken advantage of the same and deliberately delayed the resolution process.
SICA	SICA dealt with cases of industrial sickness and revival was lengthy and often plagued with uncertainties. SICA was not harmonised with other regulations and often there were contravening matters pending under different statutes such as SICA and the Companies Act pertaining to the same company. Moreover, SICA was limited by its focus on the concept of a sick company or an industrial undertaking. Hence the act was repealed in 2016 with the introduction of IBC.
S4A	In order to strengthen the lenders' ability to deal with stressed assets, Reserve Bank of India (RBI) has been issuing, from time to time, guidelines and prudential norms on stressed assets resolution by regulated lenders. S4A was one such scheme made available by RBI in 2016 to the Banks and NBFCs for resolution of large accounts (> Rs. 500 cr). The scheme provides framework for the lenders to implement a resolution plan to ensure sustainability of the debt but falls short of providing comprehensive insolvency resolution including sale of assets.

By establishing a clear and time-bound process for resolving distressed assets, Insolvency and Bankruptcy Code has strengthened the enforcement of creditor rights, improved recovery rates, and fostered a culture of accountability among borrowers. Even RBI Governor Shaktikanta Das admitted to the superiority of IBC as a stress resolution mechanism and quoted *"so far as the recoveries are concerned under IBC, it is far better than Securitisation and Reconstruction of Financial Assets and*

Enforcement of Security Interest (Sarfaesi) Act and DRT" which was reported in an article by Mint in August 2021.

Some of the key achievements of the Insolvency and Bankruptcy Code, which according to us have been significant game changers include the following:

1. Credible fear of losing control over the business: IBC has empowered the creditors to transfer the asset to a willing buyer in case the existing business owners are unable revive the business and repay the debt to the satisfaction of the lenders. This fear of losing control over the business has been the single biggest deterrent for the existing promoters of the business thereby shifting power in favour of creditors.

2. Single overarching regulation to deal with bankruptcy unlike in the past: IBC has been designed as a single overarching regulation to deal with bankruptcy with National Company Law Tribunal (NCLT) or the National Company Law Appellate Tribunal (NCLAT) as the forums for dealing with corporate insolvency cases. No civil court or authority has any jurisdiction to entertain any suit or proceedings in respect of any matter on which NCLT or NCLAT has jurisdiction under IBC. The same has brought clarity to the judicial process. Further, IBC clearly defines the waterfall for distribution of recovery proceedings thereby reducing unnecessary litigations by various stakeholders.

3. Better accountability through Personal Guarantees: The IBC allows creditors to pursue promoters' personal assets in the event of corporate defaults, especially through the enforcement of personal guarantees. Promoters are held more accountable for the company's debt obligations, leading to improved governance and reducing instances of wilful default. This accountability has strengthened the overall credit culture in India.

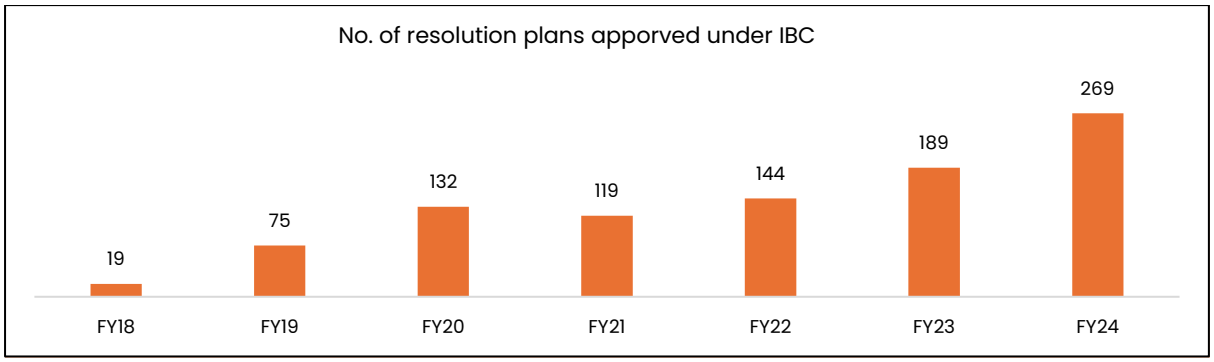
4. Increased Recovery Rates: One of the other significant achievements of the IBC has been the improvement in the recovery rate of distressed assets. The creditors have realised ~161% of the liquidation value, ~86% of the fair value and ~31% of the claim value (since inception of IBC till Sep-24). The realisation levels outside of IBC (i.e. DRTs, Lok Adalats, SARFAESI) have been much lower ranging from 2% to 25% during various years. It is remarkable to see that since the launch of IBC, over 1,068 resolution plans have been approved, allowing creditors to recover ~Rs. 3.55 trillion.

5. Greater Price Discovery for stressed assets: Prior to IBC it was difficult to sell/trade stressed assets. With better certainty around asset value discovery (which has been close to the fair value in the resolved cases) and time bound resolution process, there is increased appetite for secondary transactions in stressed assets. Accordingly, many global firms specializing in purchase of stressed assets have been active in Indian market over the last few years acquiring stressed assets from domestic banks/financial institutions (who do not want to wait through the completion of resolution process).

6. Discouraging wilful defaulters: The IBC has deterred wilful defaulters by barring promoters from bidding for their own companies if they are responsible for the default.

What cannot be measured, cannot be evaluated. Hence, here's some data and statistics around effectiveness of IBC as sourced from Insolvency and Bankruptcy Board of India (IBBI).

Consistent increase in resolutions under IBC



Recovery rates (as % of admitted claims) consistently reduce with delay in resolution

Resolution in (Days)	No. of Cases #	Recovery
0-330	140	49.2%
330-599	354	36.0%
600 or more	453	26.1%

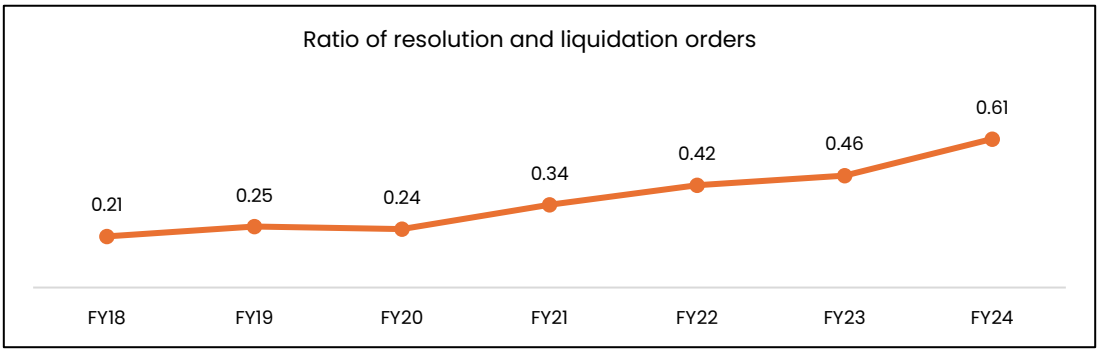
 # data of all the cases resolved till the end of FY24

Of the cases admitted under Corporate Insolvency Resolution Process (CIRP) a large proportion gets settled/withdrawn; however, almost 1/3rd cases have also ended in liquidation

Status	No of cases	%
Admitted	8,002	100.0%
Withdrawn under section 12A (i.e. by lender consent)	1,120	14.0%
Closed on appeal or review or settled	1,221	15.3%
Resolution plans approved	1,068	13.3%
Liquidation orders passed	2,630	32.9%
Ongoing CIRP cases	1,963	24.5%

 # data of all the cases outstanding as on 30-Sep-24

However, the ratio of resolution vs liquidation order is improving year on year...



As gauged from some of the data points above, IBC is still far from perfect and remains work in progress. One of the biggest challenges around effectiveness of the Code has been the time taken for the resolutions. As observed from recovery rates stipulated above, delay in resolution leads to suboptimal recovery outcome. Hence various stakeholders (including government) have been constantly working on strengthening the Code, which continues to evolve with periodic amendments to remove shortcomings based on actual experience.

Nevertheless, IBC has transformed India's insolvency landscape, establishing a powerful framework for corporate resolution. For the first time, creditors hold decisive power, with numerous promoters losing control of their companies. This shift has aided growth of Indian private credit space, instilling investor confidence and strengthening the financial ecosystem. So much so that even the RBI governor remarked in January 2024 that *"The credible 'threat of insolvency' ignited by the Code has strengthened the negotiating powers of the creditors, in the absence of which it is most likely that those defaults would have lingered for much longer, resulting in value destruction".*