

Unveiling Key Challenges In The IBC: A Critical Study Of Loopholes And Structural Issues In India's Insolvency Framework

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Abstract

The Insolvency and Bankruptcy Code (IBC) has been a landmark reform in India's insolvency framework, aiming to streamline corporate distress resolution and promote a creditor-friendly approach. However, despite its achievements, the IBC is not without significant challenges. This paper critically examines the grave issues and loopholes in the Code, focusing on two major concerns: delays in the resolution process and suboptimal recovery rates for creditors. It explores the root causes of these issues, including overburdened tribunals, procedural inefficiencies, and misinterpretation of legal provisions. Furthermore, the paper highlights related challenges such as the misuse of provisions, valuation disputes, and the lack of a comprehensive cross-border insolvency framework. By analysing these structural and procedural gaps, the study provides recommendations to strengthen the IBC and enhance its effectiveness in resolving financial distress while ensuring equitable stakeholder outcomes.

Key Words: Insolvency and Bankruptcy Code (IBC), insolvency resolution, recovery rates, delays, loopholes, challenges, creditor rights, NCLT backlog, structural issues, cross-border insolvency, procedural inefficiencies.

INTRODUCTION: -

The Insolvency and Bankruptcy Code, 2016 (the Code), implemented in India, signifies a substantial change designed to optimise the resolution of troubled assets and enhance their value. This document offers an in-depth examination of the efficacy and difficulties associated with several insolvency procedures under the Code. The analysis, derived from the Insolvency and Bankruptcy Board of India's (IBBI) Quarterly Newsletter for March 2024, examines the Corporate Insolvency Resolution Process (CIRP), the Liquidation Process, Personal Insolvency, Avoidance Transactions, and the Pre-Packaged Insolvency Resolution Process (PPIRP). This analysis identifies systemic inefficiencies, investigates their root causes, and provides pragmatic recommendations for optimising the current processes to improve the efficacy and efficiency of India's insolvency framework.

ISSUES IN THE INSOLVENCY PROCESS

Prolonged processing of insolvency application admissions

The Code stipulates 14 days for the submission of insolvency applications. The admission process typically requires a significantly longer duration than that. A consultation paper published by the IBBI on April 13, 2022, indicates that the average duration for the admission of an insolvency application by an OC has risen from 468 days in 2020-21 to 650 days in 2021-22. This exceeds the prescribed deadline for completing a CIRP under the Code. Numerous petitions submitted to the National Company Law Tribunal (NCLT) have been delayed at the admission stage for as long as two years. The principal reason for this delay is inadequate human resources, as the NCLT frequently operates at below 50% of its authorized capacity. Such delays impair the efficiency of the process.¹

One of the most significant obstacles in insolvency and debt resolution in India is the time required to

inish the procedure. The IBC was designed to speed up resolution, but delays at the National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) have been a recurring concern. Long litigation and appeals can drag the process out for years, which is bad for both creditors and debtors. Streamlining the legal procedure and minimizing the backlog in these tribunals are critical.²

Resolution Time:

One of the key issues with CIRP is the prolonged resolution time. The average time to complete a CIRP is 683 days, which means the procedure normally takes at least two years. This lengthy period can reduce asset value and hurt stakeholders such as creditors and employees. Delays are frequently caused by procedural difficulties, court backlogs, and inefficiencies in the adjudication process, as well as non-stakeholders filing unregulated and uncontrollable interim applications (IAs) that disrupt the process. It has been observed that such IAs take significant judicial time, leaving very little time for crucial necessities such as approval and disposition of resolution plans and liquidation applications.

Trends in Filing the cases-

The volume of cases submitted for CIRP has shown significant variability. Starting with a mere 37 instances in 2016-17, filings escalated to 1989 in 2019-20. Nonetheless, the exclusions resulting from the epidemic caused a decline to 536 instances in 2020-21. Submissions increased once more, totalling 987 in the 2022-23 period. This pattern reflects an initial robust acceptance of the CIRP procedure, subsequently followed by a notable deceleration attributable to external causes, including Covid and the resolution of longstanding legacy cases.³The IBC seeks to resolve insolvencies efficiently while increasing asset value. By September 2024, there have been over 40,000 insolvency cases filed under the IBC. Creditors recovered 3.55 lakh crore. This exceeded the expected liquidation value, but fell short of the total number of claims. As of September 30, 2024, 40,943 cases had been filed with the National Company Law Tribunal under the Insolvency and Bankruptcy Code, 2016. Creditors have recovered 3.55 lakh crore through resolution plans, representing 161.11% of the liquidation value and 86.13% of the asset's fair value. According to the quarterly reports, the number of approved liquidation orders is 2.5 times that of approved resolution plans, indicating a shift in corporate bankruptcy resolution trends. A total of 40,943 cases have been filed in the National Company Law Tribunal (NCLT) under the Insolvency and Bankruptcy Code, 2016 (IBC) as of September 30, 2024.⁴

The details of cases that have been resolved till September 2024		
Process	No. of Cases	Amount realized (Rs. In Cr.)
Corporate Insolvency Resolution Process	1068	333371.74
Liquidation Process	769	7608.82
Voluntary Liquidation Process	1571	1106.00
Insolvency Resolution Process of Personal Guarantors	26	102.78

As on 30th Sept,2024, 40,943 cases had been filed in the NCLT under the IBC.

Corporate insolvency proceedings can be commenced against the corporate debtor under Sections 7, 8, and 10 of the Insolvency Bankruptcy Code, 2016. Section 6 of the code addresses the individuals who may commence the corporate insolvency resolution process.

Number of Cases filed in NCLT under IBC		
S.No.	Financial Year	Filing
1	April 2018 to March 2019	9,243
2	April 2019 to March 2020	12,373
3	April 2020 to March 2021	3,392
4	April 2021 to March 2022	4,853
5	April 2022 to March 2023	4,730
6	April 2023 to March 2024	4,014
7	April 2024 to Sept 2024	2,736

Until September 2024, creditors have received 3.55 lakh crore under the resolution plans. When these corporate debtors entered the CIRP, their assets were estimated to be worth 3.38 lakh crore and 2.20 lakh crore, respectively, compared to creditors' total claims of 11.44 lakh crore. According to the quarterly newsletter, creditors have realized 161.11% of the liquidation value and 86.13% of the fair value (based on 964 cases where fair value has been estimated), with creditors receiving a haircut of around 14% relative to the fair value of assets and 69% relative to their admitted claims. The major goal of the Insolvency Bankruptcy Code, 2016 is to resuscitate and sustain the Corporate Debtor. In various cases, the Supreme Court has ruled that the goal of IBC is to rehabilitate the Corporate Debtor, with liquidation as a last resort. The quarterly data provided during the second quarter of this year indicate otherwise, with the Liquidation order approved being 2.5 times the Resolution plan approved. The same pattern can be found in both the overall and quarterly analyses. ⁵Notably, delays in approving resolution plans and making decisions on liquidation applications severely impact all stakeholders. Each day of delay reduces the possibility of CDs being revived efficiently and on schedule, decreases the likelihood of workers being retained, and raises costs and expenses. Creditors are the worst affected since each day of delay deprives them of the lawful worth of their claim, which is frozen on the date of admission of the application. Delays in approval of resolution plans are thus detrimental to the entire concept of resurrection.

Recovery rates:

The CIRP recovery figures reveal that Financial Creditors recover an average of 32% of their claims, while Operational Creditors recover approximately 25%. Interestingly, Operational Creditors filed more cases (3667) than Financial Creditors (3440), and a significant number of these cases (756) were settled and withdrawn under Section 12A of the Code, compared to 306 cases for Financial Creditors, indicating that OC are more proactive in settling and recovering their dues before the admission of insolvency applications. According to the numbers, 40% of the CIPRs that resulted in resolution plans were previously with BIFR and/or defunct. Understandably, recovery in such circumstances was restricted to approximately 9% of the claim value of creditors. Similarly, more than 77% of liquidation cases were

either BIFR or defunct, with a recovery of approximately 6%. There were around 200 cases with admitted claims of more than INR 1,000 crore, resulting in an aggregate claim amount of INR 8.84 lakh crore against an asset value of just about INR 0.44 lakh crore. The foregoing could be a primary explanation for the mismatch in the number of claims made and realized by creditors.⁶

Section 12A Withdrawal:

A notable trend is the high number of cases withdrawn under Section 12A of the Code. Section 12A allows for the removal of insolvency cases due to settlements before and after admission. Approximately 14% of the claims filed were withdrawn under section 12A, likely owing to settlements with creditors. This demonstrates a strong preference among stakeholders for resolving insolvency situations outside the formal resolution procedure.

Sector Analysis:

Another notable element of the rise in the insolvency process is the proportion of the industrial sector. The manufacturing sector accounts for the majority of insolvency cases, approximately 37%, followed by real estate (21%), and construction (12%). This tendency is also reflected in the resolution outcomes, with the manufacturing sector receiving 48% of the resolution plans, followed by real estate (15%) and construction (11%). Overall, the manufacturing sector has dominated the number of claims filed, resolved, and liquidated.⁷

Personal Insolvency

Personal insolvency cases have increased, with 2800 applications filed totalling INR 188155 crores. Guarantors began 401 of these claims. However, the resolution rate has been dismal, with only four cases resulting in a resolution plan over four years and an overall recovery rate of about 2%.

Challenges of Recovery:

Several factors contribute to low recovery rates in personal insolvency cases:

I. **Inadequate Asset Information:** One key hurdle is the difficulty in obtaining accurate and comprehensive information about the guarantors' assets. Many assets are protected from creditors.

II. **Interim Moratorium:** Section 96 of the Code establishes an interim moratorium, allowing guarantors to delay recovery actions by simply applying. Guarantors use this clause to postpone the recovery procedure.

III. **Look-back time:** In personal insolvency, the look-back time for avoidance transactions begins with the filing of the bankruptcy petition, as opposed to CIRP, which begins with the application admission date. Because of this mismatch, numerous transactions are excluded from the scope due to delays in commencing the bankruptcy procedure.

IV. **Creditors prefer SARFAESI** procedures for secured debts and use the IBC largely for unsecured debts, which have lesser recovery chances. This predilection complicates the picture of personal insolvency resolution, as cases with the lowest odds of recovery are often brought before the NCLT.

V. This method is also being used to compel promoters to pay dues through One-Time Settlements (OTS). However, delays in application admission and the detrimental impact on current recovery actions, such as those under the SARFAESI Act, enable promoters to evade and delay IBC actions. Furthermore, banks are frequently found wanting to recognize settlement amounts due to a lack of clear policy rules on the subject, particularly in cases involving high-net-worth guarantors.

Lack of a clear pre-packaged insolvency framework.

Pre-packaged insolvency settlements have gained popularity worldwide as a faster and more efficient option to resolve financial problems. India lacks a robust framework for pre-packaged insolvency, resulting in delays and risks. Establishing clear norms and laws for pre-packaged insolvency will assist address this issue and speed up debt resolution.⁸

Complex group structures and cross-border insolvency

In today's corporate environment, organizations frequently operate under complex group structures, making it difficult to identify genuine beneficiaries and assets. Cross-border insolvencies add an extra layer of complication because different jurisdictions may have conflicting laws and regulations. To overcome these problems, insolvency laws and procedures must be aligned with worldwide standards, as well as cooperation with foreign authorities.

5. Creditor Hierarchy and Haircuts.

The IBC established a creditor hierarchy, with financial creditors receiving priority over operational creditors. While this was meant to establish a clear payment schedule, it has resulted in disagreements and litigation among several kinds of creditors. Balancing the interests of all stakeholders while ensuring equitable asset allocation can be difficult. Amendments to the IBC may be required to resolve these problems.⁹

Behavioral Issues and Lack of Cooperation

Another issue with insolvency and debt settlement in India is the behavior of numerous stakeholders. Some debtors use delaying tactics, and creditors may not always act in good faith. The absence of cooperation among parties might stymie the resolution process. Transparency, accountability, and a collaborative attitude among all stakeholders are critical for overcoming these obstacles.

Ineffective liquidation process.

While the IBC primarily focuses on resolution, the liquidation process is frequently viewed as a last resort. However, the liquidation procedure in India is inefficient and delayed, resulting in reduced recovery rates for creditors. Streamlining the liquidation process and increasing the value realized from distressed assets are critical to improve the overall efficacy of the insolvency system.¹⁰

Avoidance Transactions -Case and Recovery:

A large sum of INR 370942 crores is involved in 1237 incidents of avoidance transactions. However, just 293 cases have been resolved, with a pitiful return of INR 6599 crores. Notably, INR 5500 crores of the recovered sum are from a single case involving Jaypee Infra, in which a mortgage of land in favour of the banks was set aside. This suggests that, outside of big cases, recovery is low, showing inefficiencies in addressing avoidance transactions. Furthermore, in cases (947) that have been handled through CIRP, around 233 applications for avoidance transactions totalling INR 1.24 lakh crore are waiting. Despite the enormous financial investment, many applications receive little attention from stakeholders and judicial authorities. Furthermore, many petitions are submitted without appropriate support and documentation. It is also clear that banks are hesitant to pursue disputes in foreign courts. With an emphasis on activities rather than results, banks are robbed of recoveries that they could have obtained by pushing and pursuing cases in other jurisdictions where promoters are located or assets are diverted off. It is also evident that, while litigation finance has benefited several jurisdictions, banks in India either lack expertise or initiative to investigate such opportunities

In 2023, the Reserve Bank of India (RBI) released a financial stability report (FSR) indicating that the resolution plan approval process typically requires only a 15% payment from the purchaser, and repayment can take years with no further interest collected by banks. This has prompted concerns about the effectiveness of the repayment process.

Settlement & Recovery:

Recent settlements and resolutions, such as the Reliance Communications Infrastructure Ltd. (RCIL) case, have sparked concerns due to low settlement sums and lengthy resolution times. For example, the settlement for RCIL amounted to only 0.92% of the debt, and the resolution plan took four years to execute, greatly exceeding the 330-day limit. Financial creditors (FCs) should ideally receive principal and interest. Time-consuming processes for recognizing and acknowledging defaults help to reduce recovery rates. It impedes the timely beginning of settlement proceedings, leading to lower recovery rates.

Haircut and Recovery Rates: The concept of "haircuts," or writing off loans and accrued interest, has gained popularity.



Promoters take advantage by taking the firm to the cleaners and receiving a significant haircut from bankers/the National Company Law Tribunal (NCLT). Borrowers and Insolvency Professionals (IPs) benefit from resolutions, but lenders suffer and banks are relieved of accountability because only corporations, not their owners, are declared insolvent, resulting in depositors losing out. This has resulted in low recovery rates for financial creditors, with some receiving as little as 5% of the loan balance.¹¹ In NCLT-settled cases involving significant corporations, banks or financial creditors often get about 10-15% of the realizable value, according to the RBI's 2023 FSR. However, the RBI reports that creditors receive 168.5% of the liquidation value and 86.3% of the fair value. According to the FSR, the amount realized from 597 liquidations out of a claim of Rs 1,32,888 crore represented 3% of the allowed claims.¹²

Banks collect current interest on loans to farmers, students, MSMEs, and housing, as well as penalty interest for late payments, but corporations are not treated the same.

The proceeds from liquidations have also been modest, increasing concerns about the recovery process.

Regulatory concerns and reports:

The FSR has expressed many concerns about the Corporate Insolvency Process (CIRP). According to the research, acknowledged claims are fewer than dues, and banks or financial creditors only receive a fraction of the liquidation and fair value. The 32nd report of the Parliamentary Standing Committee on Finance highlights concerns about low recovery rates, including haircuts of up to 95%, as well as delays in the resolution process, with over 71% of cases pending for more than 180 days. The report also highlights issues with Resolution Professionals (RPs) and Insolvency Professionals (IPs). It also advises establishing a professional code of conduct for the Committee of Creditors (COCs) and limiting haircuts. Due to a lack of judges, the IBC resolution process slows down. This, in turn, leads to longer resolution times.

Steps for reducing delays in India:

A] Streamline hearing processes:

- I. **Single Continuous Hearing:** Encourage continuous hearings to ensure that matters are heard in one sitting rather than repeated adjournments, which can speed up the decision-making process.
- II. **Clear Hearing Schedules:** Establish and adhere to stringent hearing timetables, decreasing the number of adjournments and ensuring that cases move forward on time.¹³

B] Limit interim applications:

- I. **Screening method:** Use a preliminary screening method to eliminate frivolous and non-essential interim applications, avoiding unnecessary delays.
- II. **Penalty for Frivolous petitions:** Penalties should be imposed on parties who file frivolous or vexatious petitions in order to deter such behavior and streamline the process.
- III. **Limit Inherent Powers:** Review the scope of the NCLT's inherent powers under Rule 11 and Section 60(5) to ensure they are not utilized to unreasonably interfere with or delay the insolvency process.

IV. **Intervention Guidelines:** Establish explicit protocols for the application of inherent powers to avert superfluous court interference and guarantee prompt case resolution.¹⁴

C] Fast-track Liquidation Approvals:

- I. **Streamlined Procedures:** The National Company Law Tribunal (NCLT) should establish more streamlined procedures for approving liquidation applications. This is an evaluation of the decision-making process to avoid delays.
- II. **Priority Handling:** Cases that have exhausted all resolution options should be prioritized for liquidation approval. This will avoid additional value depreciation and minimize the backlog of long-term cases.

D) Simplify Routine Matters:

- I. **Expedited Procedures for Routine Applications:** Implement fast-track procedures for routine concerns such as time extensions, resolution professional replacements, and applications under Section 19 of the Code, among others, to ensure that they do not cause unnecessary delays.
- II. **Simplify the procedural procedures under CIRP and PPIRP to decrease complications and increase efficiency.** Standardize templates and processes for typical filings and activities to decrease variation and procedural delays. Reduce the number of processes and rules, as well as the frequency of revisions, which adds complexity rather than fixing problems.

III. Increase Judicial Capacity: Strengthen the National Company Law Tribunal (NCLT) by selecting more judges with relevant experience in business disputes.

E] Use pre-packaged solutions:

I. Encourage genuine pre-packaged insolvency schemes in which debtors and creditors agree on a resolution plan before contacting the NCLT, thereby reducing court participation.

II. Make sure that PPIRP has demonstrable advantages over CIRP, such as shorter schedules and cheaper costs, to make it an appealing alternative for stakeholders.

F] Encourage Alternative Dispute Resolution (ADR).

I. Incorporate mediation and arbitration into the bankruptcy resolution process to resolve conflicts swiftly and lessen the strain on the courts. Make ADR mandatory for IAs by non-stakeholders.

II. Create specific ADR centers for insolvency cases to expedite outcomes.

III. Implement Technology Solutions: Use technology to streamline case management and shorten administrative delays. Introduce electronic case management solutions to allow for real-time changes and effective case handling.

IV. Establish rigorous timeframes: Enforce rigorous timeframes for each stage of the insolvency process, and penalize any unwarranted delays. Regularly monitor and analyze case progress to ensure deadline adherence and early identification of obstacles.¹⁵

G] Other measurements:

I. **Address Interim Moratorium Exploitation:** Amend Section 96 to prevent guarantors from using the interim moratorium to prolong recovery efforts.

II. **Reconsider. Look-back Period:** Align the look-back period for avoidance transactions in personal insolvency with the CIRP to ensure that transactions are not lost owing to delays.

III. **Improve Asset Information Access:** Improve processes for gathering and verifying information regarding guarantors' assets to aid in recovery.

IV. **Prioritize faster approval of resolution plans.** Encourage the development and approval of resolution strategies in a quicker timeframe to optimize asset value and recoveries. Similarly, applications for liquidation should be decided within 30 days, as court scrutiny is limited at this point.

V. **Revise PPIRP Framework:** Simplify PPIRP by removing unnecessary processes and limits. Ensure that it provides actual benefits over traditional CIRP, such as faster resolution and cheaper expenses.

VI. **Encourage true pre-packaged resolutions** with limited involvement by RPs and NCLTs, with a focus on pre-agreed plans approved by financial creditors.

VII. **Stakeholder Engagement:** Instead of implementing new processes, engage with genuine stakeholders to understand their concerns and requirements and devise realistic solutions.

VIII. **Committee to analyze the impact of meaningless IA'S :** Establish a committee to investigate the issue of the filing of meaningless interim applications and the judicial time required to resolve such applications, as well as to propose a mechanism to decrease such IA's.¹⁶

The code must be resilient, decentralized, economical, inclusive, and efficient. This would facilitate earlier corporate exits and expedite the redeployment of capital to productive firms, ultimately enhancing economic output and employment levels. The code ought to promote decentralization, diminish the influence of courts or insolvency specialists, and facilitate a more prominent role for a market-oriented strategy.¹⁷

Steps for Improving Asset Information:

One of the most difficult issues in boosting recovery rates in personal insolvency is gathering and verifying detailed information about the guarantors' assets. This problem is exacerbated by the lack of statutory registration for the transfer of moveable and liquid assets, as well as the danger that such assets will be iphoned off or stored in foreign countries. To overcome these difficulties, the Insolvency and Bankruptcy Board of India (IBBI) and other stakeholders might take the following steps:

1. Strengthen regulatory requirements.

Mandatory Asset Disclosure:

I.Enhanced Disclosure Norms: Guarantors must meet more severe asset disclosure standards when qualifying for credit. This should include a full disclosure of movable and immovable assets and information about any assets held abroad. Solid and verifiable credentials must substantiate the net worth.

II.Periodic Updates: Ensure that guarantors provide lenders with periodic updates on their asset status.¹⁸

2. Utilize technology and data analytics.

I. Interconnected Systems: Create an interconnected system linking databases from financial institutions, tax authorities, and other relevant agencies to cross-verify asset declarations made by guarantors.

II. Advanced Analytics: Use data analytics tools to identify patterns and discrepancies in asset declarations, helping to detect potential fraudulent transfers or hidden assets.

III. Immutable Records: Utilize blockchain technology to create tamper-proof records of asset ownership and transactions. This can provide a transparent and verifiable trail of asset movements, making it harder to hide or transfer assets without detection.

3. International Cooperation and Legal Frameworks

International Treaties: Strengthen international cooperation by entering into treaties and agreements with other countries to facilitate the identification, freezing, and repatriation of assets located abroad.

Mutual Legal Assistance: Enhance mechanisms for mutual legal assistance in cross-border insolvency cases, allowing for the seamless sharing of information and execution of recovery actions across jurisdictions.

Collaborative Platforms: Participate in global platforms and networks dedicated to tracking and recovering assets. Collaboration with international agencies like Interpol and the Financial Action Task Force (FATF) can provide access to crucial information and resources.

4. Legal and Institutional Reforms

Asset Freezing and Forfeiture:

Pre-emptive Measures: Implement interim moratorium under section 96 for pre-emptive freezing of assets once insolvency proceedings are initiated, preventing the guarantor from transferring or concealing assets.

Increased Authority for RPs: Grant more authority to Resolution Professionals (RPs) to investigate and track guarantor assets. This could include access to confidential financial records and the power to conduct forensic audits.

5. Stakeholder Collaboration and Education

Awareness: As of now, all the efforts are concentrated on CIRP and Liquidation process it is now time

to shift the gear to make the system more effective and efficient. It is seen that Banks especially Public Sector Banks, are slow in adopting new practices that have proven effective in other jurisdictions therefore, there is need to.

Stakeholder Workshops: Conduct regular workshops and training programs for banks, financial institutions, and RPs to educate them on best practices for asset tracking and recovery.

Joint Task Forces: To form joint task forces comprising representatives from banks, financial institutions, and regulatory bodies to develop and implement strategies for effective asset recovery.

Information Sharing Protocols: Establish protocols for real-time information sharing between banks and regulatory authorities to promptly identify and act on suspicious asset movements. The Insolvency and Bankruptcy Code, of 2016, has significantly improved India's insolvency landscape. However, several areas require urgent attention to enhance its effectiveness. Drawing from international best practices and implementing targeted measures to reduce delays can help streamline the process, improve recovery rates, and ensure the overall success of insolvency processes under the Code. Implementing the measures mentioned above can significantly enhance the effectiveness of the IBC framework, leading to quicker resolutions, better recovery rates, and a more robust insolvency ecosystem. The focus should be on improving the existing mechanism through practical, stakeholder-driven solutions.

- The code must be robust, decentralised, less costly, inclusive and speedy.
- This would help businesses exit sooner and capital to be redeployed faster to productive firms, thereby improving economic output and employment.
- The code should encourage decentralization, reduce the role of courts or insolvency professionals and allow for a greater role for a market-friendly approach.