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Avinash Kumar



Avinash Kumar has completed his Ph.D. in International Investment Law from the Dept. of Law & Governance, Central University of South Bihar. His research work is on "International Investment Agreement and State's right to regulate Foreign Investment." He qualified UGC-NET and has been selected for the prestigious ICSSR Doctoral Fellowship. He is an alumnus of the Faculty of Law, University of Delhi. Formerly he has been elected as Students Union President of Law Centre-1, University of Delhi. Moreover, he completed his LL.M. from the University of Delhi (2014-16), dissertation on "Cross-border Merger & Acquisition"; LL.B. from the University of Delhi (2011-14), and B.A. (Hons.) from Maharaja Agrasen College, University of Delhi. He has also obtained P.G. Diploma in IPR from the Indian Society of International Law, New Delhi. He has qualified UGC – NET examination and has been awarded ICSSR – Doctoral Fellowship. He has published six-plus articles and presented 9 plus papers in national and international seminars/conferences. He participated in several workshops on research methodology and teaching and learning.

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IBC AND ITS IMPACT ON CREDIT MARKET: A STUDY OF INVESTOR CONFIDENCE IN INDIA

AUTHORED BY - TARINI KALRA

Abstract

A revolutionary change in India's approach to bankruptcy resolution was brought about by the Insolvency and Bankruptcy Code (IBC), 2016, which sought to combine diverse regulations into a single, time-bound framework. This study examines how the Code affects investor confidence and the credit market, emphasizing how it might improve recovery rates, predictability, and legal enforcement. The paper highlights the ways in which IBC has enhanced the banking industry's asset quality, enhanced the lending market, and reinforced creditor rights. This study also examines whether the IBC has positively impacted investor confidence and credit flow in India, by analyzing legal developments, market trends, resolution outcomes.

Keywords: Insolvency and Bankruptcy Code (IBC) 2016, Investor Confidence, Credit Market, Credit Discipline, Corporate Insolvency Resolution Processes (CIRPs), Draft Z

Introduction

The Insolvency and Bankruptcy Code is a comprehensive framework established to deal with the insolvency of corporate, individuals, Limited Liability Partnerships (LLPs) and partnership firms while also striving to unify the insolvency and bankruptcy laws in India. The concept of 'Insolvency and Bankruptcy' is outlined in Entry 9 of the Concurrent List of the Constitution of India, granting both the Central and State Governments the authority to create rules and laws. Earlier, the laws were fragmented into multiple laws such as Chapter XIX and Chapter XX of Companies Act, 2013, Part VIA, Part VII and Section 391 of Companies Act, 1956, RDDBFI Act, 1993, SARFAESI Act, 2002, SICA Act, 1985, The Presidency Towns Insolvency Act, 1909, The Provincial Insolvency Act, 1920 and Chapter XIII of LLP Act, 2008¹ which did not facilitate effective and timely recovery, thereby alleviating distressed credit markets and raised the need of all the laws under one code.

¹ SUPPLEMENTARY INSOLVENCY AND BANKRUPTCY CODE, 2016 available at <https://icmai.in/upload/Students/Supplementary/IBC-2016.pdf>

The need for a unified and efficient insolvency framework was recognized resulting in the formulation of the Insolvency and Bankruptcy Code (IBC) which was the result of various process involving a committee's recommendations, public feedback, and parliamentary debate. In 2014, the Ministry of Finance established the Bankruptcy Legislative Reforms Committee (BLRC) to draft a new bankruptcy law which was headed by T.K. Viswanathan. The committee submitted its report titled "*The report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design*"² with a draft bill in November 2015. The draft bill was modified after incorporating public comments, and then introduced in the Lok Sabha as the Insolvency and Bankruptcy Code, 2015, by the then Finance Minister, Mr. Arun Jaitley. A Joint Parliamentary Committee (JPC) was set up to analyze the bill, and they submitted their report with a revised draft in April 2016. The bill was passed by both the Lok Sabha and the Rajya Sabha in May 2016 and received presidential assent and was officially notified in The Gazette of India on May 28, 2016.

The Code has emerged as a successful economic reform to revive corporate entities facing liquidation. It marks a significant milestone from previous policies by shifting the focus from mere recovery to holistic revival.³ The code has rebalanced the insolvency framework by enhancing creditor rights over debtor control as a pivotal economic reform. It has greatly strengthened financial and credit discipline, helping to safeguard economic value more effectively.⁴

Since its establishment, the IBC has signified a fundamental shift in India's bankruptcy process. Steering away from the conventional emphasis on asset recovery, the Code stresses the revival and continuance of viable companies. It has also significantly shifted the power dynamic between creditors and debtors, strengthening financial creditors and establishing a more disciplined and transparent settlement procedure. IBC as a fundamental economic reform, has enhanced recovery rates and decreased resolution times while also increasing investor confidence in India's credit market. By providing a predictable and time-bound bankruptcy procedure, the Code helps to create a more stable financial environment, promoting both local and international investment.

² The report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design, November 2015

³ Siddharth Addy, & Mr. Aditya Chakraborty, "Role of IBC in development of Credit Market in India"

⁴ Understanding the IBC KEY JURISPRUDENCE AND PRACTICAL CONSIDERATIONS A HANDBOOK

In the case of *Swiss Ribbons Pvt. Ltd. v. Union of India*⁵, Hon'ble Supreme Court corroborated the IBC's constitutional legitimacy, describing it as economic legislation in the national interest that restored credit discipline and investor trust.

Decoding Credit Market under IBC

The credit market refers to the financial ecosystem in which lenders provide credit to borrowers such as individuals, businesses, and government borrow money through various debt instruments with the expectation of repayment along with interest. A robust credit market is necessary for capital development, economic stability, and maintaining investor trust in any country. India lacked a strong legal framework for handling bankruptcy and insolvency until the Insolvency and Bankruptcy Code (IBC), 2016 was passed. The time-consuming and fragmented nature of the current methods led to a decrease in credit discipline and an increase in non-performing assets. The enactment of the IBC has addressed the long-standing demand for credit market reform which is vital to address the country's economic issues in a rapidly evolving global economy. The legislation allows financial creditors (FCs) to make the final decision on a business's potential for revival or liquidation. India's ranking in World Bank's Ease of Doing Business⁶ ranking has significantly improved from 136 in 2017 to 52 out of 190 economies in 2020 after successful implementation of the code of Insolvency and Bankruptcy. This improvement was largely attributed to the Code's structure and has greatly strengthened financial and credit discipline, helping to safeguard economic value more effectively.

In the case of *Innovative Industries Ltd. v. ICICI Bank*⁷, the Hon'ble Supreme Court reiterated that the Code empowers the financial creditors to initiate insolvency proceedings on the basis of a clear record of default in order to accomplish time-bound resolution and upheld the creditor-in-control principle.

Impact of IBC on Investor Confidence and Credit Discipline

The main objective of IBC was to provide a transparent, organized, and time-bound procedure for handling bankruptcy and insolvency, which had a direct effect on how investors perceived India's credit market. Investor perception is significantly impacted by various aspects that

⁵ AIR 2019 SUPREME COURT 739

⁶ World Bank Group, "Doing Business 2020" available at <https://documents1.worldbank.org/curated/en/688761571934946384/pdf/Doing-Business-2020-Comparing-Business-Regulation-in-190-Economies.pdf>

⁷ AIR 2017 SUPREME COURT 4084

contribute to a market's attractiveness for investment, such as predictability, legal enforceability, and exit possibilities, which all have a direct impact on the risk and return profile of investments. The IBC aimed at improving creditors' legal rights by guaranteeing they have influence over the settlement process. In the case of *Anuj Jain IRP for Jaypee Infratech Ltd. v. Axis Bank Ltd*⁸, the Hon'ble Supreme Court affirms the IBC's determination to promote creditor protection, discouraging preferential transfers and reaffirming investor faith in the integrity of India's bankruptcy regime.

Current Scenario of Investor Confidence and Credit Discipline

The Reserve Bank of India (RBI) supports the financial ecosystem for investors by mandating banks to launch Corporate Insolvency Resolution Processes (CIRPs) against defaulting corporations. Chapter II of the Code deals with CIRP and it is a methodical technique to either restructuring or liquidating a financially challenged firm while safeguarding the interests of all stakeholders. The RBI also calls for a strong Code of Conduct for the Committee of Creditors (CoC), which would ensure that resolution choices are fair, transparent, and consistent with the larger economic interests. Together, these improvements have improved credit discipline and created a more investor-friendly financial climate. Section 29A prohibits defaulting promoters from re-entering as resolution applicants, while the insolvency resolution procedure for financial service providers and pre-packaged processes are also introduced. Special Situation Funds (SSFs) are a subcategory of Category I Alternative Investment Funds, which were officially introduced by the Securities and Exchange Board of India (SEBI) in January 2024. Each SSF is allowed to invest only in stressed assets as defined by SEBI and must have a minimum corpus of ₹100 crore. Buying Security Receipts (SRs) from Asset Reconstruction Companies (ARCs), acting as resolution applicants in Corporate Insolvency Resolution Processes (CIRPs), and acquiring stocks of businesses in financial crisis are a few examples of these investments. SSFs need a minimum investment of ₹10 crore from investors, although qualified investors can deposit as little as ₹5 crore. This regulatory endeavor has the ability to infuse critical funds into the stressed asset ecosystem. Furthermore, by permitting SSFs to purchase loans directly from banks, SEBI has made a significant step toward the creation of a structured market for distressed assets. This strategy not only strengthens the link between asset supply and investor demand, but it also encourages independent, market-driven price

⁸ 2020 INSC 227

discovery. The Reserve Bank of India's Trend and Progress of Banking in India 2023-24⁹ study gives useful information about the impact of the Insolvency and Bankruptcy Code (IBC) on India's lending sector and investor confidence. By September 2023, the Scheduled Commercial Banks' (SCBs') GNPA ratio had dropped from 3.9% in March 2023 to a decadal low of 3.2%. The improved recuperation and upgrading efforts are responsible for this improvement. Additionally, NNPA ratios decreased, suggesting improved asset quality throughout the banking industry. As of September 2024, SCBs' Capital to Risk-Weighted Assets Ratio (CRAR) was 16.8%, far higher than the legal requirement. This suggests a strong capital position, which improves banks' capacity to withstand possible losses.

Potential challenges or limitations

1. Delays in Resolution Process

Section 12 of the Insolvency and Bankruptcy Code (IBC) ¹⁰directs the time restriction for completing the Corporate Insolvency Resolution Process (CIRP). The CIRP must be completed within 180 days from the date the application to initiate it is admitted with a maximum extension of 330 days, including any extensions granted by the Adjudicating Authority. However, due to a combination of judicial delays, repeated appeals, and ambiguity or deadlock within the Committee of Creditors (CoC), many cases have actually lasted far longer than this. This deterrent affects the confidence of both domestic and foreign investors, especially when the outcomes are held in legal limbo for years. A classic example of this limitation is the case of *Essar Steel India Ltd. v. Satish Kumar Gupta & Ors*¹¹, which was admitted in 2017 and resolved in 2019, taking almost two years. It sparked investor concerns about the effectiveness of "time-bound" resolution, particularly in high-value or complicated insolvencies.

2. Issues with Asset Valuation

There is lack of standard valuation of asset. The IBC requires two types of valuations: fair value and liquidation value, to be performed by registered valuers. Regulation 35 of the CIRP Regulations prescribes that "the two registered valuers appointed under regulation 27 shall submit to the resolution professional an estimate of the fair value

⁹ Report On Trend And Progress Of Banking In India 2023-24 available at <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/0RTP261220247FFF1F49DFC04C508F300904A90C7439.PDF>

¹⁰ Act 31 of 2016

¹¹ AIR ONLINE 2019 SC 1494

and of the liquidation value computed in accordance with internationally accepted valuation standards. If investors believe the valuation is overstated, they may avoid bidding out of fear of overpaying. If undervalued, it may result in legal objections by operational creditors or promoters, prolonging resolution. Both situations erode trust and transparency, which deters investors from making large investments or actively participating in CIRPs. *Essar Steel India Ltd. v. Satish Kumar Gupta & Ors*¹², disagreements occurred over asset value and profit sharing, culminating in complicated litigation. The Supreme Court supported the CoC's commercial acumen while emphasizing the importance of transparency in evaluation. Such valuation disparities may discourage investors by creating uncertainty in returns.

3. Section 29A and Limited Pool of Resolution Applicants Ineligibility of Promoters

Section 29A of the Insolvency and Bankruptcy Code (IBC) prohibits promoters and connected parties from becoming resolution applicants under specific conditions, significantly limiting the pool of eligible bidders in the Corporate Insolvency Resolution Process (CIRP). This prevents promoters who helped a company's financial troubles from reclaiming control during the settlement process. While Section 29A was designed to keep deliberate defaulters out, it also limits promoter-led revival programs, who may have a better grasp of business turnarounds. It reduces the amount of eligible proposals, potentially impacting competition and resolution values.

Future Outlook and Way Ahead

In order to prevent any overlap of insolvency proceedings while adhering to international standards without compromising the sovereignty of the nation's laws and public policy concerns, India is seeking to propose a cross-border insolvency framework based on the UNCITRAL Model known as "Draft Z." This framework will include cooperation between Indian and foreign courts. Draft Z's salient features in accordance with the UNCITRAL Model Law include:

- **Jurisdictional Access for Cross-Border Insolvency Cases:** Draft Z grants foreign insolvency professionals or representatives direct access to Indian courts, enabling foreign creditors to participate in Indian insolvency proceedings while treating cross-border claims fairly.

¹² Ibid

- **Judicial Recognition and Protection of Cross-Border Insolvency Cases:** Under Draft Z, Indian courts will be able to acknowledge insolvency processes from other countries. Protective measures, such as a ban on debtor assets in India, are therefore allowed in order to prevent them from being depleted while the international insolvency procedures are pending.
- **Cross-Border Cooperation and Coordination Mechanisms:** In order to improve cross-border coordination, prevent duplication, and guarantee equitable treatment of global creditors, Draft Z encourages collaboration between Indian and foreign courts as well as administrators. Indian processes are in line with those in other countries, preventing inconsistent rulings or preventing cases from being handled smoothly.
- **Public Policy Exception and Relief Measures:** Draft Z includes a public policy exception that states that Indian courts have the authority to reject foreign proceedings if they are found to be against Indian public policy. This would safeguard the nation's interests as well as those of the law and the economy.

Conclusion and Suggestions

The IBC has significantly improved India's bankruptcy system by promoting financial discipline, investor trust, and a more efficient lending market. Its technique has resulted in significant improvements in recovery rates and asset quality, but continued delays, valuation anomalies, and legal uncertainty highlight the need for further refining. Strengthening institutional capacity, speeding court procedures, and broadening the pool of resolution applicants will be crucial to retaining investor interest. The anticipated cross-border insolvency framework and regulatory innovations such as SSFs have the potential to increase market participation. To maintain momentum, India must achieve a balance between creditor empowerment and procedural justice, culminating in a strong and globally competitive bankruptcy procedure.