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IBC reform: Let us also consider preventive insolvency processes

The idea of creditor-led resolution is well meaning but we need newer options for value protection

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The introduction of a creditor-led insolvency resolution process (CLRP) in India's Insolvency and Bankruptcy Code (IBC) Amendment bill, 2025, is well meaning, but its focus on creditor-only initiations, default as the operative trigger and the court's role in key stages may make value protection a challenge.

Unlike the IBC's usual corporate insolvency resolution process (CIRP), the CLRP is a proposed option under which the corporate debtor keeps management control while creditors work towards a time-bound resolution (150 days extendable by 45 days) under limited court oversight, which is helpful given today's adjudicatory level delays. The bill also aligns with the World Bank's 'B-ready' insolvency model that encourages countries to have an out-of-court mechanism, although the CLRP is a hybrid. A CLRP may be initiated with the approval of 51% of creditors (by debt value), with the corporate debtor given time to respond. Then, an insolvency professional (IP) is appointed. The board stays in place, but the IP can attend meetings and veto resolutions. For a moratorium, an application must be made to the adjudicating authority, which approves the final resolution plan. A CLRP can be converted to a CIRP under certain circumstances.

It is also important to understand what the CLRP is not. It is not strictly out-of-court; it is a hybrid mechanism that combines out-of-court and formal reorganization methods (for legal sanctity). The CLRP is not 'pre-packaged insolvency' either. It is also not an early-stage preventive device that applies formal resolution processes (with a limited court role) to an enterprise that is not yet technically insolvent. Notably, it kicks in only in case of a default and cannot be self-applied by a corporate debtor on the verge of insolvency.

This reform, while aiming for quicker resolution, raises some concerns over how much value recovery it will enable.

First, a CLRP can only be initiated by creditors (and not corporate debtors themselves), who will require the implicit cooperation of the debtor, which could prove challenging in many cases, especially as the initiation of this process means the debtor risks it being converted into a regular CIRP (through a vote among creditors or court order). So, while the corporate debtor gets a breather, a CIRP may loom. This route may end up delaying an inevitable CIRP, causing further value loss.

Next, the CLRP's initiation criterion is a default by the corporate debtor (also the CIRP's insolvency test). However, from a value recovery perspective, it is often quite late by then. The Reserve Bank of India's (RBI) prudential guidelines for lenders acknowledge that "default is a lagging indicator." While defaults determine reclassifications of loan quality, the regulator encourages banks to manage accounts proactively.

Lastly, on account of the court's role, limited though it us, the new process would be just as vulnerable to delays as the CIRP, which tends to erode value, as the longer resolution takes, the less can be expected out of it. The court has a role in some important phases (if a CD objects to initiation, for example, and resolution plan approval). While the bill prescribes an adjudication timeline and criteria, the process may face prolonged appeals. Similar concerns exist for other adjudicating-authority approvals.

Extant mechanisms do not provide corporate debtors many avenues to initiate pre-default solutions without losing control of operations (or risking it). Value erosion typically begins well before technical insolvency, and information asymmetry implies that debtors may be best placed to assess their solvency status. However, since formal processes entail a high risk of losing control (and of an associated stigma), companies often do not seek timely resolution. Extant mechanisms have not seen much success either. The IBC does let corporate debtors initiate a CIRP (upon default), but it has been invoked only in 522 cases so far. The pre-pack device for MSMEs is underused. Among non-IBC solutions, the 'scheme of arrangement' (under the Companies Act) is considered too complex for debt restructuring. The RBI framework, also default-based, has seen moderate success. Although it recommends early action on warning signals, it is meant for the banking sector and excludes non-financial creditors.

While the CLRP introduces an alternative rescue device, India should also consider preventive insolvency mechanisms for enhanced value protection. Specifically, it will help if we let debtors initiate hybrid processes (without the fear of immediate control loss) as soon as they foresee insolvency. It will encourage debtors to try resolving debts well before technical insolvency. Many countries in the Global South have put in place such mechanisms (for instance, Ethiopia, Morocco, Tunisia). India could consider them too. The Supreme Court has also recently voiced a need for preventive restructuring mechanisms (*Mansi Brar Fernandes vs Shuba Sharma*). While we do not need to reopen a discussion on the default test, greater flexibility can be explored for hybrid mechanisms.

An over-emphasis on creditor-led and default-triggered processes may work against value preservation.

These are the author's personal views.