LAW MANTRA THINK BEYOND OTHERS

(I.S.S.N 2321- 6417 (Online)

Ph: +919310053923 Website: journal.lawmantra.co.in

E-mail: info@lawmantra.co.in contact@lawmantra.co.in

REDEFINING THE FINANCIAL RESOLUTION DEPOSIT INSURANCE BILL, 2017*

ABSTRACT

Amidst the rising financial crisis in India, Government of India has proposed to bring in a new legislation for financial sector reforms. Financial Resolution and Deposit Insurance (FRDI) bill is the talk of the town with many political parties terming the bill as barbaric. The paper is a detailed analysis of every important aspect of the bill and is divided into 4 parts with each part covering the pivotal facet of the bill. The first part of the research paper concerns itself with the working of resolution corporation and the scope of possible conflict between Specific Regulator and the resolution corporation. The second part consists of FRDI bill-like legislations in other countries and the root- cause of FRDI bill which was the financial crisis of 2008. The third part deals with bail-in which is arguably the most controversial clause in the bill. The research paper also gives a brief account of Bail-in used in Cyprus. Fourth part focuses on the Viability of FRDI bill in India. The paper concludes with the belief that FRDI bill should be implemented in order to address the problem of non-performing assets (NPAs) and unemployment.

INTRODUCTION

Financial resolution development and Insurance bill, 2017 is a proposed legislation for financial sector reforms which aims to amend and consolidate laws regarding resolution of financial service providers. In light of recent events like Vijay Malya and Nirav Modi- Mehul Choski scams, the bill will prove to be a deterrent against such scams and provide resilience to financial service providers.

The bill was first brought to attention by Finance Minister in his budget speech of 2016-17. He said that there exists a "Systematic vacuum" with regard to bankruptcy in financial firms and stressed the need to bring an Insolvency and Bankruptcy kind of bill for financial service providers as well. A

***Mr. Nikhil Sukhija & Mr. Paras Mithal, Student, Amity Law School, Noida.**

committee headed by Ajay Tyagi, additional secretary, Department of Economics, Ministry of finance was set up to draft the bill. The Union cabinet approved the bill to be introduced in parliament. It was tabled in Lok Sabha by Hon'ble Finance Minister Mr. Arun Jaitley on August 10, 2017. Since then shadows have cast on the bill as the bill has been referred to the joint committee of parliament after protests from opposition parties. The report on the bill is yet to be submitted.

The research paper focuses on debunking the common myths around FRDI bill and proposes some amendments to the bill. Most importantly the paper seeks to answer the concerns regarding the controversial "Bail-in" clause in the bill. This kind of legislation in the light of recent events is necessary

1. REDEFINING THE ROLE OF RESOLUTION CORPORATION

Resolution Corporation (hereinafter referred to as RC) is a body corporate established by the central government under clause 3[1] of financial resolution development and insurance (FRDI) bill, 2017. A body corporate is defined under section 2(11) of the Companies Act, 2013 which has relatively wide powers than a Company. Powers and functions of RC has been defined under clause 13[2] of the FRDI bill which includes providing deposit insurance to banking institutions, specify the criteria for classification of specified service provider into one of the categories of risk to viability, act as an administrator for the specified service provider which has been categorized as under critical risk to

LAW MANTRA
www.lawmantra.co.in

[1]Clause 3- The Central Government shall, by notification, establish for the purposes of this Act, a Corporation by the name of the RC. (2) The Corporation shall be a body corporate, by the name aforesaid, having perpetual succession and a common seal with power, subject to the provisions of this Act, to acquire, hold or dispose of property, both movable and immovable, and to contract, and shall, by the said name sue or be sued.

[2] Clause13- (1) Subject to the provisions of this Act, the Corporation shall have the following powers and functions, namely:— (a) provide deposit insurance to banking institutions; (b) specify the criteria for classification of a specified service provider into one of the categories of risk to viability; (c) act as an administrator for the specified service provider which has been classified in the category of critical risk to viability; (d) exercise powers in relation to certain termination rights in respect of specified service providers; (e) resolve a specified service provider which has been classified in the category of critical risk to viability; (f) act as a liquidator for a specified service provider against which an order of liquidation has been made; (g) any other powers and functions as may be prescribed. (2) Notwithstanding anything in any other law for the time being in force, while exercising the powers under this Act, the Corporation shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:— (a) the discovery and production of books of account and other documents, at such place and such time as may be specified by regulations made by the Corporation; (b) summoning and enforcing the attendance of persons related to the specified service provider and examining them on oath; (c) inspection of any books, registers and other documents of any person related to the specified service provider at any place; (d) issuing of commissions for the examination of witnesses or documents; (e) sharing of information or ordering disclosures as may be specified by regulations made by the Corporation; and (f) any other matter as may be prescribed

viability, certain termination rights in respect of specified service provider, resolve a specified service provider which has been categorized under critical risk to viability, act as a liquidator for specified service provider.

1.1 Areas requiring enhancement:

While the idea of introducing resolution body corporate is fairly good enough but the roles and functions of it assigned requires clarity. Following are the areas that require immediate attention to be redressed:

- Liability of Corporation to insured depositors of insured service providers [Clause 29(1)[3]].
- Relationship between Appropriate Regulator and RC.

Currently, Rs.1 lakh of the depositor's money is insured under Deposit Insurance and Credit Guarantee Corporation Act, 1961[4]. The FRDI bill seeks to repeal this act and government has assured that they will provide more than what has been currently insured in case the financial firm is liquidated. However, the amount has not been specified under the clause 29 which says that RC shall pay the "specified amount" as will be decided in consultation with appropriate regulator. However, it will be easier for the depositors to trust the government if the insured amount to be specified is specified prior to the introduction of the said enactment. After the widespread changes in the financial sector around the globe, United States has insured the amount of $250,000[5] while the United Kingdom has insured the amount of $111,143 for its depositors. While taking into account, the average income in a country, emerging countries like Brazil have insured the limit at 7.4times the per capita income[6]whereas the current Rs.1 lakh is actually less than the per capita income of India. It is therefore, advisable to introduce a revised insured amount which should be more than the current un-reviewed amount of Rs.1lac since 1991 and the proposed amount shall be reviewed every 5 years as is being

[3] Clause 29(1)- The Corporation shall, in consultation with the appropriate regulator, specify the total amount payable by the Corporation with respect to any one depositor, as to his deposit insured under this Act, in the same capacity and in the same right.
[4] Deposit Insurance and Credit Guarantee Corporation Act, 1961, Act No. 47, Acts of Parliament, 1961(India).
[5] Deposit Insurance FAQs, Federal deposit Insurance Corporation (Apr. 23, 2018, 10:00 PM), https://www.fdic.gov/deposit/deposits/faq.html.
[6]Saloni Shukla & Joel Rebello, FRDI bill: Why India needs a new legal framework to prevent bank failures, ET(Apr. 23, 2018, 10:00 PM), https://economictimes.indiatimes.com/industry/banking/finance/banking/frdi-bill-why-india-needs-a-new-legal-framework-to-prevent-failures/articleshow/62141722.cms.

LAW MANTRA
www.lawmantra.co.in

followed in the United States to keep the trust of depositors in banking system. Appropriate regulator is defined in Clause 2(2)[7] and the first schedule of FRDI Act, it includes the Reserve bank of India, The Insurance Regulatory and Development Authority of India, The Securities and Exchange Board of India, The Pension Fund Regulatory Development Authority and any other regulator as may be notified by the Central Government. RC is defined in Clause 3 of the Financial resolution deposit insurance bill[8], which is a body corporate having perpetual succession and a common seal with powers provided in the Act, to acquire or dispose of property, both movable and immovable and to sue and sued.

The area for improvement in the proposed bill is the conflicting clauses which are leaving room for being redressed between the defined roles and working of RC and the appropriate regulator. Chapter 6 of the FRDI bill talks about the resolution of a special service provider. Proviso of Clause 36(1) states "the corporation shall have no power to classify a specified service provider into the category of low or moderate risk to viability" while clause 36(5)[9] states that RC in consultation may classify special service providers into any of the 5 stated categories, namely, low, moderate, material, imminent and critical. Therefore, a clear conflict between the abovementioned clauses is noticeable. Furthermore, Clause 37 of the FRDI bill explains the procedure in case of difference of opinion while classifying a specific service provider. The proviso of section 37(2)[10] states that in case appropriate regulator and RC continues to hold different opinions, RC may decide to conduct inspection to

LAW MANTRA
www.lawmantra.co.in

[7] "appropriate regulator" means a financial sector regulator specified under Definitions. As INTRODUCED IN LOK SABHA Bill No. 165 of 2017 5 10 2 the First Schedule, and includes financial sector regulators where the specified service provider is regulated by more than one financial sector regulator; and in that case such regulators shall, from amongst them, designate a lead regulator by entering into a memorandum of understanding, and in case of any disagreement, the Central Government may designate a lead regulator.

[8] Supra 1.

[9] The Corporation shall, in consultation with the appropriate regulator, specify by regulations, objective criteria for classification of a specified service provider into any one of the following categories of risk to viability, namely:— (a) low, where the probability of failure of a specified service provider is substantially below the acceptable probability of failure; (b) moderate, where the probability of failure of a specified service provider is marginally below or equal to acceptable probability of failure; (c) material, where the probability of failure of a specified service provider is marginally above acceptable probability of failure; (d) imminent, where the probability of failure of a specified service provider is substantially above the acceptable probability of failure; (e) critical, where the probability of failure of a specified service provider is substantially above the acceptable probability of failure, and the specified service provider is on the verge of failing to meet its obligations to its consumers: Provided that the Corporation may specify different criteria for different categories of specified service provider.

[10] Where the Corporation has conveyed a contrary opinion over the assessment under sub-section (1), there shall be a consultation of not more than fifteen days between the Corporation and the appropriate regulator with a view to arriving at a consensus over the assessment. Provided that if after such consultation, the Corporation continues to hold a different view regarding the assessment, it may decide to conduct an independent inspection to confirm its own view regarding the risk to viability, and the appropriate regulator may be present during such inspection, if it deems necessary.

confirm its own view regarding the risk to viability. Thus, the apparent conflict in powers delegated to both the bodies is highlighted in the bill which needs to be addressed before being introduced as an Act all over the country.

Amongst the appropriate regulators, Reserve bank of India (RBI) expressed is view in the "Report of the Committee to Draft Code on Resolution of Financial Firms" that the RC should have the powers to intervene only when a firm enters imminent risk to viability[11]. This proposal of the RBI was backed by the Indian Banks Association. Concerns were also raised by the RBI on the potential conflict between its own supervisory risk classification and that of the RC and the power given to the central government to designate the systematically important financial insititutions in India, rather than the RBI[12]. The Insurance Regulatory and Development Authority of India (IRDAI) flagged clause 14(1)[13] of the Bill that gives the RC the power of investigation. It said that RC has been given power to investigate even before an entity is classified as a critical or imminent risk to viability[14]. Each appropriate regulator has specialisation in their own domain. Membership of RC includes 1 chairperson, 1 officer of Ministry of Finance, 1 member of RBI, 1 member nominated by SEBI, 1 member nominated by pension reserve fund and development authority of India, 3 whole time members decided by central government and 2 independent members while the membership of each appropriate regulator is full of members who are specialised in their fields. Undoubtedly, there is a need for RC in our country but it should not be given powers such that it can overpower the decisions of appropriate regulator. As far as the decision for classification of any specific service provider under the heads given under clause 36(5) is concerned, final decision of appropriate regulator should prevail over the decision of RC because the corporation is already entitled to the powers in the bill which includes, resolving a specified service provider which has been classified in the category of critical risk to viability. The said section specifies the categories in which RC can classify specific service provider based on risk. The categories are- low, moderate, material, imminent and critical.

[11]Report of Committee to Draft Code on Resolution of Financial Firms, Department of economic affairs (Apr. 23, 2018, 10:05 PM) https://dea.gov.in/sites/default/files/report_rc_sept21_1.pdf.
[12]Prasenjit Bose, FRDI Bill, 2017: Inducing Financial Instability, Engage (Apr. 23, 2018, 10:05 PM) http://www.epw.in/engage/article/frdi-bill-2017-issues-and-concerns#.
[13] Clause 14(1) Where the Corporation has reasonable grounds to believe that— (a) the activities of a specified service provider are being conducted in a manner detrimental to the interest of the consumers; or (b) any person or entity related to the specified service provider has violated any of the provisions of this Act or the rules or regulations made or any directions issued thereunder, it may, by order in writing, direct any person (hereafter in this section referred to as the Investigating Authority) mentioned in the order, to investigate the affairs of such specified service provider or persons or entity related to the specified service provider and to report its finding thereon to the Corporation.
[14] AM Jigeesh, Stakeholders seek clarity on role of Resolution Corpn, The Hindu , Jan 11, 2018.

LAW MANTRA
www.lawmantra.co.in

2. ANALYSIS OF THE FINANCIAL REFORMS INTRODUCED AROUND THE GLOBE

2.1. Roots of FRDI Bill:

To understand the need of Financial Resolution and development insurance act, it is imperative to understand the root cause of the bill. The need for financial reforms arose around the world when America experienced the financial crisis in the year 2008 and the effect of which was seen in almost all of the world economy. It all started with the abolition of Glass Steagall Act, 1933[15] which separated the functions of investment banks and commercial banks. The functions of investment banks and commercial banks were merged into commercial bank in 1999 with introduction of Gramm-Leach-Bliley Act. Banks started issuing housing loans by taking mortgage and the other part of the same bank (investment sector) started offering the insured bonds to the people. Bonds were insured by the insurance companies which were backed up by the mortgage received from the borrowers. The scheme of bonds was seen as an opportunity by the people thereby the demand for bonds increased. Investment sector looking at the growth of bonds, encouraged commercial sector to give more housing loans so that more mortgage can be received by the bank to provide the bonds with adequate insurance. Commercial sector after offering the loans to prime lenders, started extending loans to the sub-prime lenders, which at the time of issuance seemed that they will repay the loan but it was where all got wrong and the housing bubble got burst as the sub-prime lenders in thousands stopped repaying the interest and principal amount. This led banks to sell the house mortgages in the market. As the number was in thousands, the supply of mortgaged house was way above than its demand thereby reducing the price of houses which ultimately became problem in 2007 when the default rate on sub-prime mortgage reached 8.05%[16], fall in the value of houses led the prime borrowers to stop repaying their relatively low interest rate borrowings, thereby increasing the supply of the houses to be sold. Investors that purchased the mortgaged backed bonds from banks, noticing the trend tried to sell their bonds in open market. They also failed to get enough buyers for the bonds which are redeemable after certain specific period of time from the banks. The banks were also losing the capacity to repay the bonds and neither had they the capacity to issue fresh housing loans leading to American recession, 2008. As the banks have various branches and they operate overseas, following the introduction of

[15] Julia Maues, Banking Act of 1933 (Glass-Steagall), Federal Reserve History (Apr. 23, 2018, 10: 15 PM), https://www.federalreservehistory.org/essays/glass_steagall_act.
[16] Vikas Bajaj, Default rate on U.S. subprime mortgages continues to rise, NY times, Oct 16, 2007.

globalization, the effect was widely felt around the globe and its tremors can be felt even now in the world economy.

The Crisis of 2008 gave the idea of forming a RC which can act as a shock absorber in the event of a single organization (Lehman brothers) going bust. Lehman brothers was a global financial service provider which had the greatest exposure to the housing loan in 2007 and the financial crisis of 2008 was because of the bank going bankrupt. Since the impact of American recession was widespread over the nations of the world, interconnectivity between the nations increased with the acceptance of globalization worldwide. Every decision has its characteristics, its pros and cons. After the experience of world war II, the need and importance of being together was felt around the world. Now, that we have an interconnected world with the benefits of economies are shared but it also invites the sharing of losses. To minimize the losses and for maximizing the profit in economies, various steps have been taken to setup the international authorities. The Group of twenty (G20) is a premier forum for its members' international economic cooperation and decision-making. It comprises a mix of the world's largest advanced and emerging economies, representing about two-third of the world's population, 85% of global gross domestic product and over 75% of global trade.[17]The Group of twenty (G20), after the G20 London summit in April 2009 established an international body that monitors and makes recommendation about the global financial system called Financial Stability Board (FSB).

2.2. Major reforms on the International platform:

The financial crisis of 2008 prompted the international authorities to introduce an effective international framework for the resolution of cross-border financial institutions as the absence of such framework led the national authorities to respond to the crisis by offering public resources to support the relevant institutions. Since the beginning of the crisis, the G-20 leaders called for such a framework which includes the report of the cross-border resolution group of the Basel Committee on Banking Supervision[18] and the Financial Stability Board's Key Attributes of Effective Resolution Regimes for financial Institutions (key attributes). Key attributes were endorsed as the new standard by the G-20

[17]G20 Members, G20 Org. (Apr. 23, 2018, 10: 15 PM), http://g20.org.tr/about-g20/g20-members/.
[18]Report and recommendations of the Cross-border Bank Resolution Group*,* BIS Org. (Apr. 23, 2018, 10:30 PM), https://www.bis.org/publ/bcbs169.htm.

LAW MANTRA
www.lawmantra.co.in

leaders on 2011 at their summit in Cannes in November 2011. The resolution powers envisaged under the Key attributes can be broadly grouped into three categories, namely, (i) powers to intervene and assume control prior to insolvency from existing owners and managers. (ii) powers to effect a resolution (iii) powers to support the resolution.

General Resolution Powers under the key attributes are as follows:-

- Assume control – Replacing the management, clawback remuneration, appointing an administrator to take control of the firm.
- Tools to effect resolution- transfer assets and liabilities to an existing entity or a bridge bank or an asset management company, bail-in creditors to captitalize the failed bank or successor, merge, sale, capital injection by overriding stakeholders rights.
- Support the resolution- suspending payments to unsecured creditors and temporarily stay early termination rights[19].

2.3. Analysis of Financial Stability Board's "key attributes" over its member jurisdictions:

Financial Stability Board (FSB) member jurisdictions have committed, under the FSB charter and in the FSB Framework for strengthening Adherence to international standards, to undergo peer reviews[20].

United States response to the 2008 crisis by the final written testimony of the chairman of US treasury secretary Timothy F. Geithner which broadly includes 5 points[21]:

- Orderly resolution of failing financial institution, which means that the losses are to be absorbed by equity holders, unsecured creditors and not taxpayers.

---

[19] Mmes. Pazarbasioglu et al. Erbenova, Moretti, Nedelescu & Messrs. Dobler and Verkoren (MCM) & Messrs. Leckow, Bossu, & Milford, and Mmes. Rutledge & Chew, The Key Attributes of Effective Resolution Regimes for Financial Institutions— Progress to Date and Next Steps, IMF (Apr. 23, 2018, 10:35 PM) https://www.imf.org/external/np/pp/eng/2012/082712.pdf.

[20] FSB Framework for Strengthening Adherence to International Standards, Financial Stability Board (Apr. 23, 2018, 10:45 PM), http://www.fsb.org/wp-content/uploads/r_100109a.pdf.

[21] Secretary Timothy F. Geithner, Final Written Testimony, House Financial Service (Apr. 23, 2018, 10:50 PM), https://financialservices.house.gov/media/file/hearings/111/geithner_-_treasury.pdf.

LAW MANTRA
www.lawmantra.co.in

- No assistance by the government in the form Bail out. Therefore, defeating the notion of "too big to fail".
- Limiting the functions of Federal Reserves and Federal Deposit Insurance Corporation (FDIC) so that they can focus on checks and balances.
- Giving more powers to federal government and regulatory authority over major financial firms to make sure that they have enough to absorb losses in period financial stress.
- The duty of council (Foreign Service Officer) to identify and manage the financial firms.

The Dodd-Frank Act, which was enacted in July 2010, is Unites States federal law that places regulation of the financial industry in the hands of the government. The act introduced various aspects, important amongst them are Financial Stability Oversight Council, Federal insurance office, Consumer Financial Protection Board and Volcker rule[22].

Major reforms in the United Kingdom have been made in the banking industry since the financial crisis. As many as 80 pieces of legislations has been passed in order to make the financial system more stable and secure. To make a much safer financial system, the banks hold more capital, the concept of Ring fencing and Bail-in has been introduced. Ring fencing is when a public utility business separates itself financially from its parent company to protect its consumers from financial instability in the parent company. The changes to the remuneration of highly paid bank employees have been introduced via the concepts of bonuses deferred and clawback. For increasing the competition, the government has introduced the scheme of switching of the accounts by current account switch services (CASS). The guidance to customers for bank related transactions and provisions for covering their risks has been introduced schemes like banking for all (BBA), Customers' money protection whereby the Financial services compensation scheme up to 85,000 GBP of each customer's deposits are now 100% protected up from 2000 GBP in 2007. The major regulatory reforms introduced are as follows Banking Conduct of Business Sourcebook (BCOBS), Banking Act 2009, Banking Reform Act and Single Resolution Mechanism[23].

---

[22] Dodd-Frank Wall Street Reform and Consumer Protection Act, Investopedia (Apr.23, 2018, 10:55 PM), https://www.investopedia.com/terms/d/dodd-frank-financial-regulatory-reform-bill.asp.
[23] BBA Briefing – Reforms since the Financial Crisis, BBA Org. (Apr. 23, 2018, 11:00 PM), https://www.bba.org.uk/news/reports/bba-briefing-reforms-since-the-financial-crisis/#.WrffTmaB0UQ.

LAW MANTRA
www.lawmantra.co.in

Formation of G-SIBs was the regulatory response to the revealed vulnerability of banking sector in the financial crisis of 2008 to solve "too big to fail" interconnectedness of G-SIBs.

According to the Peer Review Report[24], the home jurisdictions of global systemically important banks (G-SIBs)[25] have implemented broadly all the powers specified in the FSB key attributes of effective resolution regimes for financial institutions. According to the report, six jurisdictions that are European Union member states and Switzerland have implemented all the powers conferred in the Key Attributes. The United States has all the resolution powers apart from the single resolution authority which is given a wide range of powers to exercise those powers. Six other countries, namely, Australia, Canada, Japan, Korea, Mexico, Singapore have all implemented all the powers except continuity powers and bail-in provision. The remaining ten member countries of G-20 (including India) have four or fewer resolutions powers. According to the peer review report, in the large majority of FSB jurisdictions, resolution regimes apply broadly to all types of commercial banks except Brazil, where the regime does not apply to federal government-owned banks and India, where state-owned banks are governed by special acts.

Thus, according to the peer review report and after understanding the financial framework of U.S. and U.K. it is clear that countries have implemented the key attributes according to the suitability and financial demand of the economy.

2.4. World economy since the implementation of Financial reforms:

What started in the U.S financial sector (sub-prime crisis in 2008) infected the world economy in such a manner that the recovery from the crisis took years and still have a long way to match the speed to had it not taken place. Several countries have grown continuously since the end of between the fourth quarter of 2008 and the fourth quarter of 2014 for example, U.S. and China grew by 12 percent and 65 percent respectively. While the economies of Italy and Greece have grown and then shrink again with their GDP declining by 6% and 24% between the same span of period[26]. According to the data of IMFs world economic outlook (2015), the largest decline in aggregate GDP in the period of

[24] Second Thematic Review on Resolution Regimes, Financial Stability Board (Apr. 23, 2018, 11:00 PM), http://www.fsb.org/wp-content/uploads/Second-peer-review-report-on-resolution-regimes.pdf.
[25] 2017 list of global systemically important banks (G-SIBs*)*, Financial Stability Board (Apr. 23, 2018, 11:03 PM), http://www.fsb.org/wp-content/uploads/P211117-1.pdf.
[26] Maria A. Arias and Yi Wen, Recovery from the Great Recession Has Varied around the World*,* The regional economist (Apr. 23, 2018, 11:24 PM), https://www.stlouisfed.org/~/media/Publications/Regional-Economist/2015/October/recession.pdf.

recession was in Europe and the Middle East where the decline ranged from 10-20 percent, following this was Latin America, the GDP of which fell by almost 8 percent, the growth rate did not decline in Asia, while it slowed at average of 5%, despite a sharp drop in exports[27]. It is amply clear from the information that the crisis that started from U.S and infected the world economy affected those nations the most which had an advanced and open financial system whereas the countries with less connected international framework were less affected, moreover countries like India where 77 percent banks are public, they were least affected as against the countries being run on private banking financial framework.

3. INTRODUCTION OF UNEXAMPLED BAIL-IN

After the global financial crisis in 2008, the Financial stability board (FSB), an international body comprising G20 countries (including India), recommended that countries should allow resolution of firms by bail-in under their jurisdiction[28].It is a new concept which is on the verge of being introduced in the Indian economy and there are a lot of questions being raised regarding the need of its implementation. It is one of the key attributes of effective resolution regimes for financial institutions. Provision of bail-in is mentioned under clause 52(1)[29] of the FRDI bill, 2017 which means rescuing the failing financial firms by canceling out its liabilities and making its creditors and depositors take a loss on their holdings.

3.1. Current scenario and proposed FRDI provisions:

LAW MANTRA
www.lawmantra.co.in

Before 1969, many banks failed and many people lost their life savings after which the concept of nationalization was adopted in our country. There are two sectors of banks in India, public sector banks and private sector banks. Public sector banks are those banks whose majority stake (i.e. more

[27] World Economic Outlook, International Monetary Fund (Apr. 23, 2018, 11:35 PM), http://www.imf.org/en/publications/weo.

[28]Gayatri Mann & Vatsal Khullar, The FRDI Bill: Bail-In provisions explained*,* PRS (Apr. 23, 2018, 11:10 PM), http://www.prsindia.org/theprsblog/?p=3932.

[29] Clause 52(1)- Notwithstanding anything in section 49, the Corporation may, in consultation with the appropriate regulator, if it is satisfied that it necessary to bail-in a specified service provider to absorb the losses incurred, or reasonably expected to be incurred, by the specified service provider and to provide a measure of capital so as to enable it to carry on business for a reasonable period and maintain market confidence, take an action under this section by a bail-in instrument or a scheme to be made under section 48.

than 50%) is held by a government and private sector banks are those banks whose majority stakes are held by private persons, they are under close supervision of Reserve Bank of India. RBI passes guidelines periodically which are to be strictly adhered by both the sectors of the banks. In case a bank fails, RBI passes moratorium (mentioned in section 14[30] of the Insolvency bankruptcy code, 2016) and ensures merger with any other solvent bank. We have seen 22 mergers since the implementation of New Economic Policy, 1991 out of which 12 mergers were forced mergers owing to the financial sickness of the firms while 8 were voluntary and 2 were in lines of consolidation. According to the current legal system, if a bank reaches a stage at which it cannot be merged due to its uncertain and undependable position, it is bound to get liquidated where the creditors will be paid as creditors after the other statutory obligations, like staff dues, government dues etc., of the bank is met with[31]. In case of liquidation today, if the bank is liquidated the amount insured by Deposit Insurance and Credit Guarantee Corporation (DICGC) is Rs.1 lakh of each depositor. So, even in present scenario, on a failure of a bank, depositors may have to forego their deposits. Given the present scenario, bail-in can help the financial firm to continue its operation while the funds of already indebted government can be utilized in a more productive manner. Thus bail-in is nothing but a transparent tool to save taxpayers money as against bail-out which is currently being widely practiced.

3.2. Privatisation of banks and bail-in:

Bail in as explained above is a tool whereby the liabilities of banks are cancelled out and the money so recovered is used in restructuring the bank. Bail-ins may appear to be cruelat the first instance since the depositor's money is being used to save the bank from becoming insolvent but after going into the merits of the proposed clause in the FRDI bill one may have a changed view. Firstly, the bail-in clause is only applicable on private banks and not on public banks. This statement has been made by the government of India[32]. The scope of using bail-in has already been limited as the majority of banking sector in India is controlled by public sector banks. Now the concern is whether it would be

---

[30] Section 14- Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following, namely:—
(a) the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority; (b) transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein; (c) any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
[31] S Kalyanasundaram, The 'bail-in' clause in FRDI Bill is no big deal, The Hindu, Jan 8, 2018.
[32] T.C.A. Sharad Raghavan, FRDI Bill: clearing the air on the bail-in clause, The Hindu , Jan 4, 2018.

beneficial if bail-in is only applicable on private banks? To answer this concern we must look at the following points:

- Before the advent of bail-in the most common technique to save a bank from going insolvent was Bail-out or the infusion of money by the government. This money is ultimately the hard-earned taxpayer's money. This practice is not feasible since the Indian government is rolling under huge debt and the fiscal deficit crosses the decided threshold during every financial year. Putting a burden on government to bail out stressed banks will increase the fiscal deficit and burden on government exchequer.
- Secondly, it is important to save the bank rolling under debt because the failure of any bank has wide implications. A failure of a bank not only affects its customers but also the whole economy.
- Thirdly, the trust that people hold in banks has to be rebuilt if a bank fails be it a private bank.

Following the recent trend of developments in Indian Banking System, it is amply clear that the banking system is moving towards privatization. Since the bill is made keeping in mind the needs of private banks, this would help set a stage for fore coming increasing number of the private bank. The recent Nirav Modi scam has reignited the debate on privatization of banks reason being that there is a lot of corruption in public banks and privatization would further reduce fiscal deficit.

3.3. Invocation of bail-in:

Having analyzed the meaning and need of bail in we must now come to the consequences which the depositors might face in case of a bank failure. Straightaway coming to the point that RC has recommended the usage of bail in, in case of a bank failure. Now as understood by most that in this contingency all of the depositor's money would be used to repay the debts of bank is not the case rather under FRDI bill there is a clause for insured amount. A careful perusal of clause 29(1)[33] of the bill clears the doubt regarding insured amount which states that the RC shall specify the amount payable to any one depositor in consultation with appropriate regulator. One backdrop of this clause is that the insured amount is yet not specified however, every country using bail in clause has a set

---

[33] The Corporation shall, in consultation with the appropriate regulator, specify the total amount payable by the Corporation with respect to any one depositor, as to his deposit insured under this Act, in the same capacity and in the same right.

LAW MANTRA
www.lawmantra.co.in

insured amount. In the USA the insured amount is 250000 US dollars which are guaranteed by Federal Deposit Insurance Corporation. In the United Kingdom bank deposits unto 85000 pounds are insured by Financial Services Compensation Scheme. In Australia, the insured amount is 250000 Australian Dollars payable by Australian Prudential Regulation Authority[34]. In India the insured amount under DICGC was 100000 rupees, however, initially, the amount reserved was mere 1500 rupees. This amount was last revised in the year 1993. Now going by the trend this amount is required to go up under the proposed legislation. Therefore, it is in the interest of depositors as the insurance limit is going to be raised.

Amendment**:** Clause 29 should make specific the amount insured. In the year 1993 the amount set was 1 Lac rupees insured under DICGC. Keeping in mind the inflation that has taken place since then and various other factors like cost of living the amount set should be increased manifold and should be specified under clause 29of the bill.

One thing that many need to understand is that bail in is only one of the tools of resolving a Financial institution. Further, there are many safeguards in bill regarding the use of Bail-in. These safeguards are i.) Anything done by the RC has to be done in consultation with the appropriate regulator, ii.) RC shall forward a report regarding the proposed bail in to the central government which shall be laid before the parliament. Therefore, there are ample safeguards and the above analysis only shows that the proposed bill is more transparent and better than the current regime.

3.4. Example of Cyprus:

In 2013 Cypriot banking system came to a halt. This halt was because of the poor investments made by Cypriot banks in Greece. Cyprus was rolling under financial crisis therefore on June 25, 2012, it formally requested a bail out from European Union. Cyprus was in need of an estimated amount of €17.5 billion. No European nation came to the help of Cyprus and Germany forced Cyprus to have the money arranged on its own. A 6.75% confiscation of accounts under €100,000 and 9.9% for

[34] Annexure: Comparison of international laws with the proposed framework, Legislative Brief The Financial Resolution and Deposit Insurance Bill, 2017, (Apr. 23, 2018, 11:30 PM), http://www.prsindia.org/uploads/media/Financial%20Resolution%20Bill,%202017/Legislative%20Brief%20Financial%20Resolution%20Bill%202017.pdf.

accounts larger than €100,000 was proposed to help the banking system[35]. After proposing the bail in terms everyone came running to withdraw their money from banks so the government notified bank holidays for a couple of days. Finally, a cash limit of €100 for withdrawals was put on the largest bank in Cyprus. The net result of the bail in was disastrous with people losing up to 40% of their money.

This example of Cyprus shows how disastrous bail in can be? However, before reaching to any conclusion we must consider some facts that the situation in Cyprus was different then it would ever be in India. Firstly, the Cypriot banks have assets equal to roughly eight times the economy and this is because Cyprus was a tax heaven therefore, most of the deposits were made by foreign nationals, Russians in particular[36]. Secondly, these banks made huge bad investments in Greece which was the major reason for their downfall. Finally, these banks were dependent on the central bank to stay alive. Therefore, these banks were too big to be saved by the small economy of Cyprus.

3.5. Addressing the encumbering problems of NPA and unemployment:

Every passing minute is demanding a strong and stable financial policy in our country given the ever increasing non-performing assets and never declining unemployment and the new trend of the economic offender being witnessed by our country from past decade. Although against the economic offender, a new bill is proposed namely Fugitive Economic Offender Bill, 2017.

Non-performing asset is a loan or an advance where interest and/or installment of principle remain overdue for a period of more than 90 days. NPAs affect the economy adversely as bank credit acts as a catalyst for economic growth. Banks have an obligation towards its depositors and other lenders to repay the money and when loans advanced by banks are not repaid, the cycle of lending-repaying-borrowing is adversely affected. In absence of the funds with banks, they have to borrow funds from external agencies to repay depositors and creditors. This leads to a situation where banks get reluctant to advance money in the form of the loan while they are bailed out by external agency mostly government which gives the money of taxpayers. According to government report, NPAs in public sector banks have been increasing and stood at 6.83 lakh crore as of March 2017[37] while total NPA

LAW MANTRA
www.lawmantra.co.in

---

[35]We've All Been Warned (the Cyprus "Bail-In" Model is coming to a Country Near You), ZeroHedge (Apr. 23, 2018, 11:30 PM), https://www.zerohedge.com/news/2015-10-28/weve-all-been-warned-cyprus-bail-model-coming-country-near-you.

[36]Matthew O'brien, Everything You Need to Know About the Cyprus Bank Disaster, TheAtlantic (Apr. 23, 2018, 11:50 PM), https://www.theatlantic.com/business/archive/2013/03/everything-you-need-to-know-about-the-cyprus-bank-disaster/274096/.

[37]Report of the Comptroller and Auditor General of India on Recapitalisation of Public Sector Banks, CAG (Apr. 23, 2018, 11:56 PM), https://www.cag.gov.in/sites/default/files/audit_report_files/Report_No.28_of_2017_-

are expected to rise to Rs9.5 lakh crore as on 31st march 2018 i.e. about 10.5% of total advances, while stressed assets are expected to be at Rs11.5 lakh crore[38].

Currently, banks lend loan easily to the unqualified borrowers also in some cases because they have a notion that even in the worst case scenario, they will be bailed out because they know that they are too big to fail. If bail-in provision comes into play, which means the banks will not be bailed out by the government as a result of which they will be cautious as to whom they are lending money because in the event of non-payment, they will not be advanced help from taxpayers. Even in the case where the bail-in provision is applied which is the last resort to liquidation, in such scenario too, the banks would know that such case would be one case scenario after which, although they will stay in operation but the depositors will cautious before investing thus their reputation would be adversely affected. Secondly, if the government abstains from bailing out, taxpayer's money would be saved, they will not have to suffer directly and indirectly thereby the chain of lending-repaying-borrowing will come to an end giving relief to the society as a whole.

One of the most important and highly demanding problems of our country is and has been for decades, the unemployment status of our country. According to a report, unemployment in India projected in 2018 is 18.0 million people as against 17.8 million being unemployed in the year of 2017[39]. Unemployment is of various types, each hampering the country adversely. Unemployment is the reason why our country being full of competency in terms of personnel is not able to perform as per its potential. While there are various reasons of unemployment in our country, few of them are slow growth of industrialization, slow economic growth, fall of small and cottage industries, expansion of universities, inadequacy of irrigation facilities, etc. While these are the widely accepted reasons of unemployment in our country and all these are connected with infusion of money. We all, blame our government for not being able to increase the employment rate but government itself is so indebted that it does not have funds to invest because major chunk, nowadays, is being invested in reviving banks which can be revived with simple implementation of bail-in thereby, giving government time and resources to invest in other areas which are very important.

_Performance_audit_Union_Government_Recapitalisation_of_Public_Sector_Banks_Reports_of_Ministry_of_Finance.pdf.

[38] Study forecasts gross NPAs to rise to Rs 9.5 lakh crore by March '18, ASSOCHAM (Apr. 23, 2018, 11:55PM), http://assocham.org/newsdetail.php?id=6696.

[39] World employment social outlook, International Labour Org. (Apr. 23, 2018, 12:00 AM), http://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/publ/documents/publication/wcms_541211.pdf.

FRDI bill is the outcome of the aftermath faced by United States and other countries due to global financial crisis in 2008. US had to bail out its big banks which had the notion of too big to fail. Following the bail-out process, in the year 2008 the unemployment rate rose to 7.2% in December from 6.7% in November alone while the number of people who lost jobs in that month was 5,24,000. In the months after recession, unemployment rate peaked at 10.0 percent in October 2009[40]. While haemorrhaging of Indian job is consistent from past 3 years showing no signs of improvement, if not getting adverse. In such scenario, to provide government with adequate resources is the need of the hour, so that they can serve according to their plans timely and efficiently.

4. VIABILITY OF FRDI BILL IN INDIA

4.1. Foreseeable instability of Public Banks:

A lot has been debated about the viability of FRDI Bill, 2017 for India. To start with there are concerns from the intellectual society of India that the bill is not viable for Indian context since India has the presence of more Public Sector Banks than Private banks. Moreover, the epicentre of great depression of 2008 was an American Private bank which led to the downfall of major economies all over the world. The reason why India escaped unhurt was because of the RBI's safeguard policy. At the time when Lehman Brothers filed for bankruptcy protection in 2008, India's largest private bank ICICI had the maximum exposure to Lehman Brothers among other Indian Banks i.e. $83 millions. Other Public Sector banks like State Bank of India, Punjab National Bank and Bank of Baroda shied away from getting involved with foreign entities therefore the 2008 crisis had limited impact on Indian economy[41].

LAW MANTRA
www.lawmantra.co.in

The reason given for opposing the implementation of FRDI bill is that Public banks are infallible. To bust this myth let us look at some statistics.

---

[40] James Marschall Borbely ,U.S. labor market in 2008: economy in recession, BLS (Apr. 23, 2018, 12:07 AM), https://www.bls.gov/opub/mlr/2009/03/art1full.pdf.

[41] Tamal Bandyopadhyay, How India's banking sector weathered the globalstorm, live mint (Apr. 23, 2018, 12:00 AM), https://www.livemint.com/Specials/Jz0STkDuhEehFlOb6kVfoM/How-Indias-banking-sector-weathered-the-global-storm.html.

- Pre-2008, the GNPA (Gross Non-performing asset) only amounted to 53,917 Cr. rupees and in the year 2015 it amounted to 341,641 Cr. rupees[42]. After 2015 many scams have unearthed, the recent one of Jeweler Nirav Modi-Mehul Choski which amounts to approx. 13,000 Crores. By this, one thing is clear that there has been a steep rise in GNPA in the Indian Banking system since 2008.
- Now let us look at the data of how much of this NPA belongs to public Sector banks and the amount which belongs to Private Banks. Up to 2008 surprisingly, major share of NPAs belonged to private banks and mainly to the ICICI bank. By 2014 the majority of NPAs were held by public Sector banks and the list was topped by Indian overseas bank. This data shows that public banks are performing highly inappropriately. For the better understanding of statistics two charts are pasted below referred to as *Image 1* and *Image 2*.

According to Financial Stability Board Peer review report August 2016 ordinary Indians make 63% of their financial investment in banking system and out of which 63% are made in Public Sector banks and 18% in private banks. Having analyzed the shaky condition of Public sector banks the deposits in such banks are at a high risk.[43]

LAW MANTRA
www.lawmantra.co.in

[42]Dinesh Unnikrishnan & Kishor Kadam, Explained in 5 charts: How Indian banks' big NPA problem evolved over years, First Post (Apr. 23, 2018, 12:05 AM), http://www.firstpost.com/business/explained-in-5-charts-how-indian-banks-big-npa-problem-evolved-over-years-2620164.html.

[43] Meera Nangia, Banking on legislation, The Hindu (Apr. 23, 2018, 12:10 PM), http://www.thehindu.com/opinion/op-ed/banking-on-legislation/article20005363.ece.

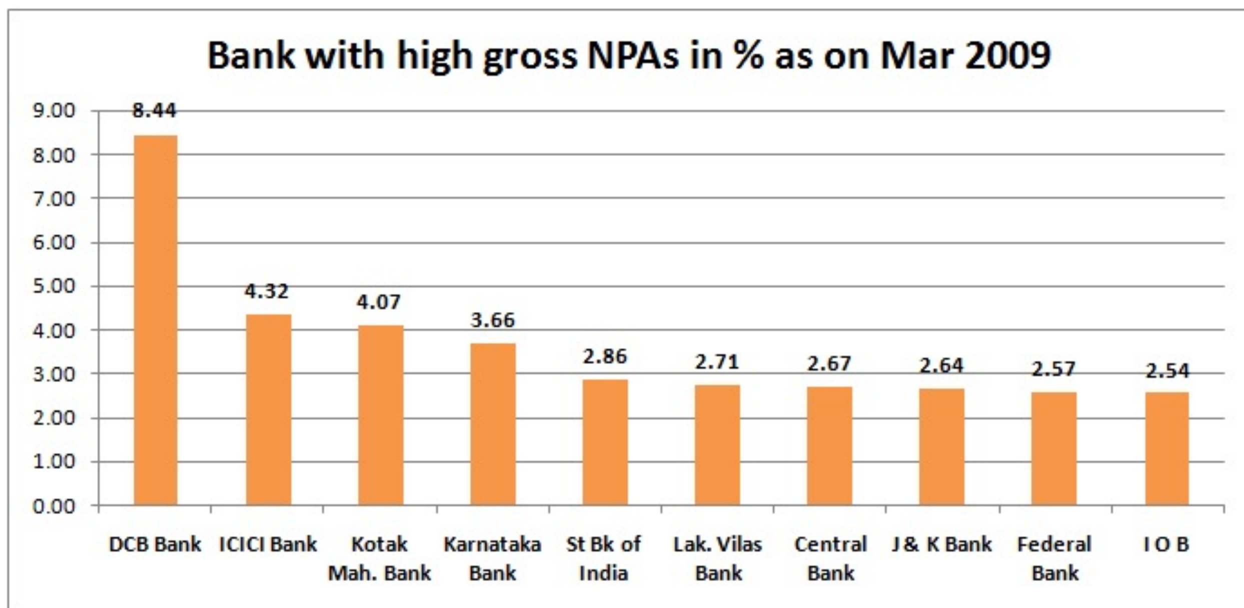

Image 1.[44]

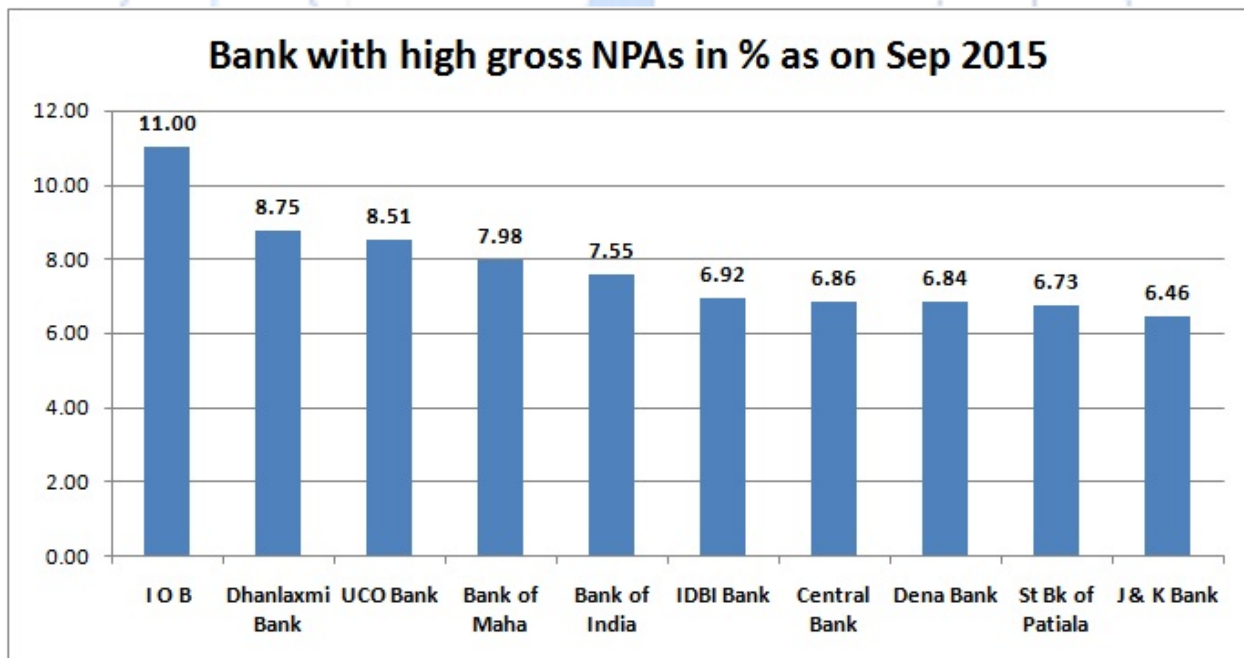

Image 2.[45]

4.2. "Bail in" in public banks

[44]Supra note 23.
[45]Supra note 23.

The tools for resolving a public sector bank includes all the tools mentioned under FRDI bill except the bail in tool. This is so, because the government is the guardian of these banks and taking over the depositor's money is against the welfare nature of the government. Further, it has been time and again clarified by the government that FRDI bill will not reduce the liability of government of infusing cash in public sector banks.

4.3. Should Bail-in precede privatization?

Bail in tool is especially devised to help distressed private banks. Majority of Indian banks are public sector banks therefore the question arises whether bail in should precede privatization? To answer this question we must go by the trend that gradually Indian banking system is moving towards privatization. Further, the government under FRDI bill has accepted all the "key attributes" which are devised for private banks only therefore, clearing the intention of the government to move towards privatization. Having placed a law before privatization would help clear the air around the clause of bail in and set a stage for fore coming private banks. Therefore, it is the perfect time to introduce "bail in" in the Indian Banking system.

4.4. No right to appeal

Another major concern regarding the FRDI bill is that the bill ousts the jurisdiction of courts to try the matter in case a decision is given by the RC set up under the bill and there is **no right to appeal**. Clause 133 of the bill reads as follows:

"Unless otherwise provided in this Act, no court or other tribunal shall have jurisdiction to entertain or adjudicate upon any matter which the Corporation, the appropriate regulator, the Tribunal or the Appellate Tribunal is empowered to decide or determine under this Act and no court or tribunal shall grant any injunction in respect of any actions proposed or reverse any such action."

LAW MANTRA
www.lawmantra.co.in

There can be various instances when the RC gives a decision and it is not appealable. Two of such incidences are discussed below.

- One can be when the RC classifies any Financial Institution into the category of 'material'; 'imminent' and 'critical'. Also, depending on such classification the institution may be subject to various corrective measures depending on the category it has been classified in and the decision of RC will be final in such regards.

- Second can be when the chairperson, director can be asked to return the *performance based incentive* when the financial institution is classified under 'critical' category. This has been given under Clause 51(2)[46] of the bill.

Safeguards: Now the above two may seem arbitrary at once but getting into the bill will answer these issues as there are two safeguards available in both the above cases. They are discussed as follows:

- One is that in each of the above case the aggrieved party is given a reasonable opportunity of being heard and only after the party is heard can a RC take decision against them.
- Second is even though there is no right to appeal available one can always move the high court under **Article 226** of the Constitution.

Furthermore, *the RBI Working Group on Resolution Regime for Financial Institutions (2014)* has recommended that a grievance redressal mechanism shall be put in place. This recommendation is not practical since that would lead to unnecessary delay in resolving the financial institutions which require immediate corrective actions.

CONCLUSION

At a time when most of the Indian banks are reeling under debt pressure the FRDI bill could prove to be a boon for banks. The need for a consolidated bill regarding bankruptcy laws for financial service providers is needed more than ever in the light of recent events. The investigative nature which is established by the help of RC will keep the activities of banks under regular check. The classification as proposed under the bill will make people aware well in advanced regarding the heath of a financial institution. The argument that India has majority of Public Banks and none of the Public bank has ever failed therefore FRDI bill is not suitable for Indian context is flawed in itself as India's Public Sector banks are overburdened with rising NPAs and need resolution mechanisms provided under the bill. The distressed financial institutions require the taking up of immediate corrective action through RC rather than getting stuck in lengthy process of litigation.

Further, the time is ripe for such legislation as the fiscal deficit of India is already high. The regular bail outs by the government forces it to go to even higher levels. Introducing bail in and other

LAW MANTRA
www.lawmantra.co.in

[46] The appropriate regulator shall specify by regulations made by it, the manner in which certain portion of such remuneration may be designated as performance based incentive for such chairperson, director, chief executive officer, (by whatever name called) and such other officer referred to in sub-section (1).

resolution mechanism which reduces the dependency of banks on government is in the public interest. Moreover, when the banks start believing that they are too big to fail and government will help them in times of need the investments are not made with full veracity which leads to bad investments and ultimately the banks losing huge chunk of money. The banking system is inter-dependent that means the fall of one bank has wide implications and will lead to the fall of other banks through which the former dealt directly or indirectly. In the context of above analysis and the merits of the FRDI bill while answering the concerns the opposition and government should unify themselves and help in smooth passage of bill through both the houses of parliament.

LAW MANTRA
www.lawmantra.co.in