

**WILL THE RESOLUTION CORPORATION RESOLVE
COMPLICATIONS?**

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ABSTRACT

The Financial Resolution and Deposit Insurance Bill, 2017, or FRDI Bill was aimed at providing a mechanism and framework for resolution of certain categories of financial service providers that might be in distress, and for resolving bankruptcy in banks, insurance companies and other financial establishments.¹ Since, there is no comprehensive and integrated legal framework for resolution and liquidation of financial firms in India presently, in order to have a systematic resolution of all financial firms — banks, insurance companies and other financial intermediaries— this Bill had been introduced.

It was introduced in the Lok Sabha on August 10, 2017, and was under the consideration of the Joint Committee of the Parliament which had been asked to submit its Report to the Parliament by the last day of the Budget Session, 2018, during which it was withdrawn by the government. But, now, that the Bill has been withdrawn by the government, it is imperative to understand the nature and characteristics of the said Bill in order to

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¹ *The FRDI Bill and Concerns of The Depositor*, THE HINDU, <http://www.thehindu.com/business/Industry/the-frdi-bill-and-concerns-of-the-depositor/article21081902.ece> (last visited Dec. 1, 2017); *FRDI Bill 2017*, BUSINESS TODAY, <https://www.businesstoday.in/current/economy-politics/frdi-bill-2017-govt-protect-public-deposits-banks-arun-jaitley/story/265792.html> (last visited Dec. 12, 2017).

determine the reasons behind such withdrawal and the present scenario. Although, the drafters of the Bill suggested that the Bill will promote ease of doing business in the country, improve financial inclusion, increase access to credit, and encourage discipline among the financial service providers by putting a limit on the use of public money to bail-out distressed entities, there are many questions that have arisen regarding its functioning. The key issues in the Bill were the establishment of the uniform body called Resolution Corporation, its powers, the Deposit Insurance Coverage Limit, the provision of bail-in, and the lack of autonomy of the Systematically Important Financial Institutions (SIFI). All these issues oblige us towards answering the question as to whether the Resolution Corporation will resolve complications or not.

1. INTRODUCTION

The Financial Resolution and Deposit Insurance Bill, 2017, or FRDI Bill, was under the consideration of the Joint Committee of the Parliament when it was withdrawn by the Government. It was aimed at promoting ease of doing business in the country, improving financial inclusion, and increasing access to credit. This ultimately may have also reduced the cost of obtaining credit. The Bill was to encourage discipline among the financial service providers by putting a limit on the use of public money to bail-out distressed entities.² The Bill had come together with the

² *What Is FRDI Bill? Here Is All You Need to Know in 10 Points*, THE FINANCIAL EXPRESS, <https://www.financialexpress.com/economy/what-is-frdi-bill-all-you-need-to-know-about-financial-resolution-and-deposit-insurance-bill-2017-in-just-10-points/964461/> (last visited Dec. 7, 2017).

Insolvency and Bankruptcy Code to spell out the procedure for the winding up or revival of an ailing company.³

As pointed out by the Ministry of Finance, there was no comprehensive and integrated legal framework for resolution, including liquidation, of financial firms in India and therefore, this Bill was introduced.⁴ It was introduced in the Lok Sabha on August 10, 2017, and was under the consideration of the Joint Committee of the Parliament which had been asked to submit its Report to the Parliament by the last day of the Budget Session, 2018.

2. SALIENT FEATURES OF THE BILL

1. Establishment of a Resolution Corporation (RC): The Bill provides for the establishment of an RC to monitor financial firms, anticipate their risk of failure, help them in their resolution, and take corrective measures. The Corporation is supposed to replace the already existing Deposit Insurance and Credit Guarantee Corporation (DICGC) that takes care of the deposit insurance which at present is Rs. 1 lakh rupees.
2. Deposit Insurance: The DICGC will be nullified and replaced by the RC. The DICGC insures deposits and guarantees credit facilities. Under the proposed FRDI Bill, the RC has the right to fix the threshold for deposit insurance which is not yet decided.

³ T.C.A. Sharad Raghavan, *What does the FRDI Bill do for you?*, THE HINDU, <http://www.thehindu.com/business/Economy/what-does-the-frdi-bill-do-for-you/article21386264.ece> (last visited Dec. 10, 2017).

⁴ THE HINDU, <http://www.thehindu.com/business/Economy/what-does-the-frdi-bill-do-for-you/article21386264.ece>.

3. Risk based classification: Based on their risk of failure, the RC or the appropriate financial sector regulator may classify financial firms under five categories. These categories in the order of increasing risk are: (i) low, (ii) moderate, (iii) material, (iv) imminent, and (v) critical. The RC shall also take over the financial firm as soon as it is classified as “critical” and shall resolve the same within a resolution period of two years which can be extended.
4. If the Board of the RC, in its opinion, is of the view that the risk to viability is at critical level, it will have sweeping powers and various methods of resolution can be undertaken by the RC, including: i) merger or acquisition; (ii) transfer of the assets, liabilities, and management to a temporary firm; and (iii) liquidation.

3. KEY ISSUES

3.1. ESTABLISHMENT OF RC

Chapter 2 of the Bill seeks to establish a corporation called the ‘RC’ which will replace the ‘Deposit Insurance and Credit Guarantee Corporation’ (DICGC) as the principal agency to monitor financial firms; provide for the resolution of specified service providers (SSP), which under FRDI covers the entire gamut of financial service providers and their holding companies, if any; act as an administrator for the SSPs classified as ‘critical’; provide deposit insurance; classify banks based on risk to viability; anticipate risk of failure; take corrective action; and

resolve them in case of such failure.⁵ The corporation will be more powerful than any other corporations and institutions in the field.⁶ The unfettered powers to merge or acquire shares and assets of a company raise few competition concerns as to whether the decision taken by the RC would supersede the decision taken by the Competition Commission, in cases of finding that there is an effect on the relevant market.

While analysing the effectiveness of creating a single authority, i.e., the RC, it is imperative to look at both the sides of the issue. On one side, it has been proposed by many authors and writers that the creation of RC for the purpose of resolution of the financial sector can create common regulatory standards and make the resolution process speedier and more efficient. While on the other hand, the critical analysis of the corporation can be witnessed like vast possibility of conflicts between the regulators such as the RBI and the RC over the classification of risk to viability of a financial firm as well as over its restoration or resolution plans.⁷

The Bill provides for risk to viability determination of ‘Covered Service Providers’ (CSPs) differently for different stages. It specifies the determination by RBI up to the first two stages of moderate risk to viability, and by the RC for the last two stages of imminent risk to

⁵ *Wrong Diagnosis, Harmful Prescription: A Critique of Financial Resolution and Deposit Insurance (FRDI) Bill, 2017*, CENTRE FOR FINANCIAL ACCOUNTABILITY, <http://www.cenfa.org/publications/a-critique-of-frdi-bill-2017/>; *The Financial Resolution and Deposit Insurance Bill, 2017*, PRS LEGISLATIVE RESEARCH <http://www.prsindia.org/billtrack/the-financial-resolution-and-deposit-insurance-bill-2017-4871>.

⁶ *Id.*

⁷ *Id.*

viability and critical risk to viability.⁸ The RBI in the report of the Committee to Draft Code on Resolution of Financial Firms,⁹ has expressed that the RC should add value to the financial sector stability rather than acting as an additional watchdog. The RBI is of the view that the RC should intervene only when classification done by the regulators is ‘imminent risk to viability’ as it would allow the Corporation sufficient time to prepare for the resolution.¹⁰ The RBI justifies its stand by specifying that the Corporation’s intervention at ‘material risk to viability’ stage may not be necessary as the resolution would start only in the ‘critical risk to viability’ stage.¹¹ Further, there is a certain amount of trust among the people with regard to the public sector banks as they are in the hands of the government. If the government, through this Bill, begins to handover its responsibility and that of the RBI to an RC, it would be breaking this trust.¹²

3.2. DEPOSIT INSURANCE COVERAGE LIMIT

The Bill envisages that there will be an RC which will replace the existing Deposit Insurance and Credit Guarantee Corporation for the purpose of monitoring the financial companies, classifying them in accordance with their risk profiles, and determining the steps to be taken for resolution in case of their failure. The DICGC is an RBI subsidiary,

⁸ MINISTRY OF FINANCE: DEPARTMENT OF ECON. AFFAIRS, REPORT OF COMM. TO DRAFT CODE ON RESOLUTION OF FINANCIAL FIRMS (2016).

⁹ *Id.*

¹⁰ *Id.*; Prasenjit Bose, *FRDI Bill, 2017: Inducing Financial Instability*, EPW ENGAGE, <https://www.epw.in/engage/article/frdi-bill-2017-issues-and-concerns>.

¹¹ *Id.*

¹² *Id.*

established on July 15, 1978, and presently offers an insurance coverage of up to Rs. 1 lakh to all kinds of bank deposits.¹³ In case of winding up or liquidation of an insured bank, such deposits up to Rs. 1 lakh is to be provided to the depositors, and within 3 months a list of all the deposits have to be submitted by the liquidator to the DICGC. After receiving such list, the DICGC is obligated to pay such amounts within two months from receiving the list. In other cases like amalgamation, the DICGC pays the difference between the amount due to the depositors and the amount actually received under the scheme, or Rs. one lakh, whichever is less.¹⁴ However, the Bill seeks to replace this subsidiary with the RC.¹⁵

3.3. BAIL-IN

The Bill mentions in Section 48(1) (c) that the RC is empowered to resolve an SSP classified as a critical risk to viability through bail-in.¹⁶

...48. (1) The Corporation may resolve a specified service provider classified in the category of critical risk to viability under section 45 through a scheme or a bail-in instrument, in such form and manner as may be specified by regulations made by it, by—

¹³ *The FRDI Bill And Concerns Of The Depositor*, THE HINDU, <http://www.thehindu.com/business/Industry/the-frdi-bill-and-concerns-of-the-depositor/article21081902.ece> (last visited Dec. 1, 2017); Tamal Bandyopadhyay, *Much Ado About 'Bail-In' And FRDI Bill*, Livemint, <https://www.livemint.com/Opinion/4AYBWrd3m9RukcEGik53mL/Much-ado-about-bailin-and-FRDI-Bill.html> (last visited Dec. 18, 2017).

¹⁴ *supra* note 8.

¹⁵ *Bail-In Doubts — On Financial Resolution Legislation*, THE HINDU (Dec. 5, 2017); *supra* note 8.

¹⁶ *supra* note 5; Financial Resolution & Deposit Insurance Bill, 2017, available at http://164.100.47.4/BillsTexts/LSBillTexts/Asintroduced/165_2017_LS_Eng.pdf.

(c) *bail-in in accordance with the provisions of section 52...*

The said Bill contains a bail-in clause which has been highly debated upon. It is one of the resolution tools in case of insolvency in a bank or in the event a financial firm is sought to be sustained by resolution. The depositors, in such cases, will have to bear a part of the cost by a corresponding reduction. A bail-in clause is different from a bail-out clause where the public funds are used to inject capital into an ailing company.¹⁷ A bail-in clause gives the bank the authority to refuse repayment of a customer's money or to issue securities such as preference shares to a customer instead of giving money. These funds are then used for recapitalization of the bank.¹⁸ The amount covered by the deposit insurance is the only money owed that cannot be used for bail-in. Presently, the DICGC insures 1 lakh rupees but the Bill empowers the RC to decide such amount. This clause has been opposed by many including trade unions, terming it as anti-people.¹⁹ The Ministry of Finance by a press release²⁰ attempted to clarify its stand. The excerpt from the press release is reproduced below:

¹⁷ *supra* note 3.

¹⁸ Meera Nangia, *Banking On Legislation*, THE HINDU, <http://www.thehindu.com/opinion/op-ed/banking-on-legislation/article20005363.ece> (last visited Nov. 9, 2017); Shohini Sengupta, *FRDI Bill: Dispelling Some Myths About Bail-In And Other Issues To Allay Depositors' Concerns*, FIRST POST, <https://www.firstpost.com/business/frdi-bill-dispelling-some-myths-about-bail-in-and-other-issues-to-allay-depositors-concerns-4258241.html> (last visited Dec. 14, 2017).

¹⁹ *Bail-In Clause in FRDI Bill: Depositors Need Not Have Any Apprehensions, Says Government*, THE INDIAN EXPRESS, <https://indianexpress.com/article/business/banking-and-finance/bail-in-clause-in-frdi-bill-depositors-need-not-have-any-apprehensions-says-government-5010647/> (last visited Jan. 4, 2018).

²⁰ *supra* note 4.

...The Government always stands ready to take care of the capital needs of the public sector banks. Bail-in amounts to liabilities' holders bearing a part of the cost of resolution by reduction in their claims. Bail in provision may not be required to be used in case of any specific resolution. Most certainly, it will not be used in case of a public sector bank as such a contingency is not likely to arise...

Prior to the press release, there had been immense confusion and fear among the citizens regarding the bail-in clause. The need of a bail-in clause had been questioned time and again. With the Press release of January 2, 2018, the Ministry of Finance attempted to clarify the reasons for the same and the safeguards provided under the Bill. It stated that only the RC shall have the option to design an appropriate bail-in instrument, which will be subject to government scrutiny and oversight of the Parliament. It also compared the present scenario where in case of forced mergers of banks under the Banking Regulation Act, 1949, without the consent of depositors, the right of depositors of a merging bank can be reduced, with the proposed bail-in clause, where the cancellation of the depositor's liability beyond the insured amount will be possible only with his or her prior consent. Another safeguard mentioned was the judicious and reasonable use of the bail-in clause by the RC, and where the use is injudicious and unreasonable, the depositors will have the right to get compensation from the RC on an order of the National Company Law

Tribunal.²¹ Furthermore, it has stated that the bail-in clause will not be used for public sector banks (PSBs).²²

There are both positive and negative aspects of this provision. Various columnists have expressed their views regarding the same. Some say that the provision will not be beneficial at all. They compared it to the case of Cyprus, where the depositors lost almost 50 per cent of their savings when a “bail-in”, similar to the one proposed in the Bill, was implemented by the RC.²³ Others are of the view that the provision will provide a necessary safeguard and enable quick restoration of solvency. Some took the example of the Lehman Brothers’ case and explained how a bail-in could have changed the outcome for them. They are of the view that a bail-in during the course of crisis could have allowed Lehman to continue operating and would have forestalled much of the investor panic that froze markets and deepened recession.²⁴ It can only be used in respect of specific liabilities, which are specified in the regulations framed through a consultative process. These liabilities would be known upfront

²¹ *supra* note 4; *Fears Over FRDI Bill Misplaced, Says Government*, THE HINDU, <http://www.thehindu.com/news/national/fears-over-frdi-bill-misplaced-says-government/article22354147.ece> (last visited Jan. 2, 2018).

²² *supra* note 3; *supra* note 4.

²³ Purnima Tripathi, *Dangers in a Bill*, FRONTLINE, <https://www.frontline.in/the-nation/dangers-in-a-bill/article9896821.ece> (last visited Oct. 27, 2017); *Wrong Diagnosis, Harmful Prescription: A Critique of Financial Resolution and Deposit Insurance (FRDI) Bill, 2017*, CENTRE FOR FINANCIAL ACCOUNTABILITY, <http://www.cenfa.org/publications/a-critique-of-frdi-bill-2017/>; *The FRDI Bill And Concerns Of The Depositor*, THE HINDU, <http://www.thehindu.com/business/Industry/the-frdi-bill-and-concerns-of-the-depositor/article21081902.ece> (last visited Dec. 1, 2017).

²⁴ *From bail-out to bail-in*, THE ECONOMIST (Jan. 28, 2010), <https://www.economist.com/node/15392186/all-comments>.

and well before the bail-in tool is exercised.²⁵ Some are also of the view that this tool of bail-in will be most advantageous in cases where the authorities would fail to find a willing buyer for a failed financial institution, and effecting a full or partial transfer of the firm is difficult.²⁶

3.4. SIFI

SIFI stands for Systematically Important Financial Institutions. The central government in consultation with the appropriate regulator has been given the ability to characterize a SIFI. A financial service provider that meets the criteria mentioned by the government will be designated as a SIFI.²⁷ The proviso to Section 25(1) states as follows:

...Provided further that any person designated as Domestic Systemically Important Bank by the Reserve Bank of India shall be deemed to be a systemically important financial institution for the purposes of this Act, for a period of six months with effect from such date as the Central Government may, by notification, specify...

Prior to the FRDI Bill, RBI had already identified certain banks as DSIBs i.e., Domestic Systemically Important Banks. These were: State

²⁵ Smita Aggarwal, *FRDI Bill: An ICU to Take Care of Critically Ill Patients*, LIVE MINT, <https://www.livemint.com/Opinion/rqQXkzRnKQm7sL3IUfY2bI/FRDI-Bill-An-ICU-to-take-care-of-critically-ill-patients.html> (last visited Dec. 20, 2017).

²⁶ Shohini Sengupta, *FRDI Bill: Dispelling Some Myths About Bail-in And Other Issues to Allay Depositors' Concerns*, FIRSTPOST, <https://www.firstpost.com/business/frdi-bill-dispelling-some-myths-about-bail-in-and-other-issues-to-allay-depositors-concerns-4258241.html> (last visited Dec. 14, 2017).

²⁷ Financial Resolution & Deposit Insurance Bill, 2017, § 25(1), available at http://164.100.47.4/BillsTexts/LSBillTexts/Asintroduced/165_2017_LS_Eng.pdf; *Financial Resolution and Deposit Insurance Bill, 2017: Key highlights*, PWC, <https://www.pwc.in/assets/pdfs/publications/2018/financial-resolution-and-deposit-insurance-bill-2017-key-highlights.pdf>.

Bank of India, ICICI Bank, and HDFC Bank.²⁸ The new provisions in the FRDI Bill give the Corporation the ability to control all the financial institutions and this might lead to delay in decision making and response time. The lack of autonomy of SIFI can also serve as a limitation to the growth of the sector.

4. CONCLUSION

The answer to the question as to whether the RC is efficient in resolving the complications or increasing them has to be seen only when those rules on paper start to apply in the world. On the face of it, it is good as people's money is now better protected because of the institutions being classified into categories that are monitored by a single authority which will deal with them for their benefit, subsuming the factor that there is an additional constant monitor that will be on the rear to watch the already heavily scrutinized industry. The scope of extent of RC interfering and determining itself the powers and in certain cases the obligations to pay, though is always under judicial review, there is a need to have guidelines to check it before the judiciary actually draws the border line. A higher accountability for the decisions taken would decrease the load on the ever-stressed judiciary as well. Overall, the law resolves complications by re-assessing corporate status.

Although, the Bill has been withdrawn, understanding its salient features and the consequent issues that led to the withdrawal of the same, was necessary in order to understand the government's actions and the

²⁸ *supra* note 7.

present scenario. The Joint Parliamentary Committee was informed by the Union minister that a “resolution of these issues would require a comprehensive examination and reconsideration”, and that it is “appropriate” to withdraw the Bill.²⁹ The very undoing of the Bill can be blamed on to the bail-in clause of the Bill which was highly criticised by many including the opposition parties who termed this clause as anti-people and anti-poor.³⁰ This withdrawal has come as a relief to the citizens who were afraid of the chances of losing their money through this Bill.

²⁹ *A Welcome Retreat: Withdrawing The FRDI Bill*, THE HINDU, <https://www.thehindu.com/opinion/editorial/a-welcome-retreat-withdrawing-the-frdi-bill/article24646860.ece> (last visited Aug. 10, 2018).

³⁰ *Govt. Withdraws FRDI Bill In Lok Sabha: Framework For Resolution Of Distressed Financial Firms Fails To Go Through*, FIRST POST, <https://www.firstpost.com/business/govt-withdraws-frdi-bill-in-lok-sabha-framework-for-resolution-of-distressed-financial-firms-fails-to-go-through-4908821.html> (last visited Aug. 7, 2018); *Govt. Withdraws FRDI Bill In Parliament Following Backlash*, LIVE MINT, <https://www.livemint.com/Industry/Ff29jhSKgcOxZkkipHY5K/Govt-withdraws-FRDI-Bill-from-Lok-Sabha.html> (last visited Aug. 7, 2018).