

THE FINANCIAL RESOLUTION AND DEPOSIT INSURANCE BILL, 2017: A STEP AHEAD

Written by *Yash Vithlani** & *C. H. Anvita***

* 4th Year BA LLB Student, School of Law, Christ (Deemed to be) University

** 3rd Year BA LLB Student, School of Law, Christ (Deemed to be) University

India has seen unprecedented economic growth ever since it opened up its economy in a series of measures beginning in the early 1990's. The country has been able to sustain any major economic slowdown and was largely one of the few countries which was able to come out of the recession of 2008 unscathed.¹ The country though has been slow to react to the causes of the global meltdown itself. A layman inspection of the slowdown cleared showed that the bursting of the housing bubble and the subsequent failure of the financial institutions in the United States of America, due to lack of regulation led to the recession. In events succeeding the financial crisis of 2008, countries across the world took steps and set up regulatory mechanisms to ensure that there is no financial meltdown of a similar nature again².

India's only effort comes at a time when the Non Performing Assets of India's financial situation are at an all time high and there is an urgent need for regulation of the financial institutions³ and only after there was scares of a similar financial meltdown, thus making the move reactive and proactive. the Financial Resolution and Deposit Insurance Bill, 2017 aims was set up to fill in the void that existed in the regulatory framework in regard to the financial institutions.

Financial institutions are corporations which provide services as intermediaries of financial markets⁴. Broadly speaking, there are three major types of financial institutions, namely:

¹ Shashi Tharoor, *How India Survived The Financial Crisis*, (Feb. 8, 2018, 10:05 AM), <https://www.project-syndicate.org/commentary/how-india-survived-the-financial-crisis?barrier=accessreg>

² (Feb. 8, 2018, 10:17 AM), https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/RWG020514_FL.pdf

³ *India in 5th position in High NPA Ratio Across The Globe*, (Feb. 8, 2018, 10:47 AM), <https://www.moneylife.in/article/india-at-5th-position-in-high-npa-ratio-across-the-globe/52603.html>

⁴ Pierre Siklos, *Money, Banking, and Financial Institutions: Canada in the Global Environment* 40 (2001)

- Depository institutions – deposit-taking institutions that accept and manage deposits and make loans, including banks, building societies, credit unions, trust companies, and mortgage loan companies;
- Contractual institutions – insurance companies and pension funds
- Investment institutions – investment banks, underwriters, brokerage firms⁵.

In the working of financial markets, there is often a situation wherein there is intra-borrowing between financial institutions and thus, making them inter-dependent on each other. A failure of one, would lead to a domino effect, thereby leading to a financial meltdown. There is no specialized legislation in India that deals with the regulation of financial institutions. The scrutiny and regulation of financial firms and institutions is in the hands of multiple regulators. This continues to be a limitation and hindrance in case of any crisis. It is therefore envisaged by way of the Financial Resolution and Deposit Insurance Bill, 2017 (Hereinafter ‘Bill’) that a Resolution Corporation be set up to overlook the working of financial institutions and firms.

The introduction of the Bill in House of the People saw a huge uproar among the public as it was seen that there was an attempt being made to allow financial institutions and firms use public funds which have been deposited in these funds to resolve any crisis the said institution or firm may be in. Another concern that loomed over the public is that there was an attempt made to repeal the law which provided for deposit insurance. An analysis of the bill dispels both these concerns. Firstly, all the bill proposes to do is to allow the Resolution Corporation reduce or modify the liabilities of the institution from within, only to the extent that may be necessary for the recapitalization of the said firm or institution. This is known as the bail in option and it is one not without safeguards. It does not imply this tool can be used at the government’s whim and fancy to arbitrarily use depositors’ money without their consent to save failed banks. It also provides various safeguards such as the need for consultation with the regulator of the respective regulator and approval from the central government. There is also a requirement for consultation with the various stakeholders involved.

Secondly, the concerns over the removal of deposit insurance also does not hold good as the Bill does not repeal the Deposit Insurance and Credit Guarantee Corporation Act, 1961 but

⁵ Robert E. Wright and Vincenzo Quadrini, *Financial Intermediaries*, (Feb. 8, 2018, 12:05 PM), <https://www.saylor.org/site/wp-content/uploads/2012/06/ECON302-1.2-1st.pdf>

merely subsumes it, with the whole of Chapter IV of the Bill dealing with the issue of Deposit Insurance. The law in this regard largely remains the same⁶.

The Bill sets up the Resolution Corporation to screen monetary and financial firms, (for example, banks, insurance agencies, stock trades, and storehouses), anticipate any crisis, and resolve or sell them if there should be an occurrence of financial crisis. A crisis within these firms may affect money related dependability as they hold purchaser stores, expand credit, encourage interest in the economy, and furthermore acquire from each other. Along these lines, the Resolution Corporation may need to practice its powers with urgency so as to tend to the issue and protect the budgetary framework. The bill does not allow for any mechanism whereby the decision as such may be looked into again, or a higher authority can be approached.

A reason for the same maybe said to be due to the presence of the crisis and the need for a quick reaction, but this leaves a stakeholder in the process no recourse to authority if there is any concern with the decision or any person is not catered to properly by the authorities in charge. This, after the judicial process has been recused from the decision of the Resolution Corporation⁷, leaves scope for unnecessary litigation in the courts as aggrieved parties may still approach the High Courts and the Supreme Court by means of the provisions of the Constitution.⁸ There should be hence a dispute resolution mechanism in place for the decisions of the resolution corporation within the provisions of the statute itself so as to ensure that there is a specialized forum which disposes of matters in a quick and efficient manner.

As per Clause 58 of the Bill, the Resolution Corporation assumes control and administration of the financial firm as soon as the it is classified as ‘critical’. In such a situation, by virtue of the Act, the Resolution Corporation has to govern and run financial firm, and exercise the powers of the board of directors, among others. However, Clause 62 (1) of the Bill gives the power to the Resolution Corporation to supersede the board of directors of the financial firm if it is classified as ‘critical’. As already seen, that the powers of the board of directors of the financial firm are given to the Resolution Corporation when it is classified as ‘critical’, a

⁶ Joyjayanti Chatterjee, *Expert’s view: Contentious Bill doesn’t allow depositors’ money to be arbitrarily used to save banks*, (Feb. 8, 2018, 1:45 PM), <https://scroll.in/article/861270/new-financial-resolution-bill-does-not-allow-depositors-money-to-be-arbitrarily-used-to-save-banks>

⁷ The Financial Resolution and Deposit Insurance Bill, 2017, Clause 133

⁸ INDIA CONST. art 226, art 32

separate provision allowing the Corporation to supersede the board of Directors of a firm when it is classified as 'critical' is of no use.

BAIL IN PROVISION

In rising economies, banks assume an essential part in monetary intermediation. Truth be told, in perspective of immature monetary markets, banks are the principle backbone for industry and business, particularly small and medium ventures. India, being among the countries which are categorized as an emerging market, has to keep up with the changing times and as such, the Bail-In provision has been introduced.

A Bail In, in layman's terms is a situation when there is a restructuring of the internal debt of the firm. As per the Bail In Provision, the Resolution Corporation can internally restructure the firm's debt by: (i) cancelling liabilities that the firm owes to its creditors, or (ii) converting its liabilities into any other instrument⁹ Bail-in may be used in cases where it is necessary to continue the services of the firm, but the option of selling it is not feasible.¹⁰ The government though has said that the option will be used sparingly and as a matter of last resort¹¹

The safeguard in administration has been utilized as a part of a few nations. Especially in the G-20 alliance, it is viewed as a practical alternative for settling worry in banks where non-performing resources are rising. On account of the US, there is a point by point and sound lawful structure for safeguard in determination under the Dodd-Frank Act, 2010. So also, on account of Switzerland, an authoritative safeguard in administration is completely settled, including the evaluation of loss absorbing limit of banks and monetary establishments.

The question many have raised is that what the need for provision of such an option is when no such situation where it's need has arisen has come up in the past. In the past though, the Reserve Bank of India, which regulates the banking system in country, has used the provisions of the Banking Regulation Act, 1949 effectively to cater to the failure of any bank which may pose a risk to the to the safety of public deposits in the said bank. The answer to this concern

⁹ The Financial Resolution and Deposit Insurance Bill, 2017, Clause 52

¹⁰ *Report of the Committee to Draft Code on Resolution of Financial Firms*, (Feb. 9, 2018, 6:11 AM), <http://www.prsindia.org/uploads/media/Financial%20Resolution%20Bill.%202017/FRDI%20Bill%2>

¹¹ Remya Nair, *Bail-in Clause in FRDI Bill Will Only Be Used Sparingly: Finance Ministry*, (Feb. 9, 2018, 6:46 AM), <http://www.livemint.com/Politics/pjdh4jTHpJA1vYbswGOVzJ/Misgivings-about-FRDI-Bill-entirely-misplaced-says-financ.html>

is that firstly, the reason India did not face such situations is that by living in a closed economy and with restricted financial and economic growth in the country, chances of failure of financial markets were largely based on domestic issues. But with the onset of globalization and increasing dependence of world economies on each other, there is a need for a specialized institution to be in place which would be able to take the adequate steps to combat new dangers which may arise, and with the increase in the number of possibilities of economic slowdown or market failure one cannot any longer be dependent on traditional tools and hence, the insertion of the Bail-In provision. It is merely one of the tools in the belt of the Resolution Corporation and not the only tool.

DEPOSIT INSURANCE

For a country's banking system to run smoothly and be successful, it is vital that people have confidence in it. One way to instill such confidence is by protecting the deposits made by people in banks. One of the most common forms of ensuring safety to depositors is deposit insurance. Deposit insurance is providing insurance protection to the depositor's money by receiving a premium. If and when the banks fail, the depositors will get back their money. However, insurance to deposits will be provided only up to a limit and to get deposit insurance protection, it is necessary that depositors pay an insurance premium.

The first deposit insurance scheme was launched in the US. The period of great depression witnessed failure of many banks, as a result of which the depositors lost their money. In order to gain the confidence of the public in the US financial system along with protecting small depositors, the Federal Deposit Insurance Corporation was launched.

The period after 1960s saw many banks setting up their own deposit insurance institutions.

DEPOSIT INSURANCE IN INDIA

The launch of Deposit Insurance and Credit Guarantee Corporation (DICGC) Act, 1961 started the concept of deposit insurance in India. DICGI is fully owned by the RBI and it mandates deposit insurance for all banks.

The banks insured by DICGC are¹²:

Commercial Banks : All commercial banks including branches of foreign banks functioning in India, local area banks and regional rural banks are insured by the DICGC.

Cooperative Banks : All State, Central and Primary cooperative banks, also called urban cooperative banks, functioning in States / Union Territories which have amended the local Cooperative Societies Act empowering the Reserve Bank of India (RBI) to order the Registrar of Cooperative Societies of the State / Union Territory to wind up a cooperative bank or to supersede its committee of management and requiring the Registrar not to take any action regarding winding up, amalgamation or reconstruction of a co-operative bank without prior sanction in writing from the RBI are covered under the Deposit Insurance Scheme. At present all co-operative banks are covered by the DICGC.

Primary cooperative societies are not insured by the DICGC.

The DICGC insures¹³:

all deposits such as savings, fixed, current, recurring, etc. deposits except the following types of deposits:

- Deposits of foreign Governments;
- Deposits of Central/State Governments;
- Inter-bank deposits;
- Deposits of the State Land Development Banks with the State co-operative bank;
- Any amount due on account of and deposit received outside India
- Any amount, which has been specifically exempted by the corporation with the previous approval of Reserve Bank of India.

¹² (Feb. 9, 2018, 7:07 AM), https://www.dicgc.org.in/FD_A-GuideToDepositInsurance.html#q1

¹³ (Feb. 9, 2018, 7:14 AM), https://www.dicgc.org.in/FD_A-GuideToDepositInsurance.html#q1

Each depositor in a bank is insured upto a maximum of ₹1,00,000 (Rupees One Lakh) for both principal and interest amount held by him in the same right and same capacity as on the date of liquidation/cancellation of bank's licence or the date on which the scheme of amalgamation/merger/reconstruction comes into force.¹⁴

There was a growing concern though that the existing regulatory regime will not suffice and that there is a need for a change and enhancement of the same. Furthermore, there was also the perception that there was no longer any need for a separate corporation to deal with deposit insurance and that it should be combined with other aspects of the regulatory regime. Therefore the Financial Resolution and Deposit Insurance Bill, 2017 absorbs the current deposit insurance legislative framework.

There is additionally hypothesis that the Bill accommodates pulling back existing protection for bank deposits. To scatter these questions, one needs look no more distant than the title of the Bill, which explicitly incorporates the expression "deposit insurance". The prelude expresses that "deposit insurance to consumers of certain categories of financial services" is one of the reasons for the Bill to be introduced.

The Bill does not repeal the Deposit Insurance and Credit Guarantee Corporation Act, 1961, however just subsumes its working in the Resolution Corporation. Chapter 4 of the Bill is altogether about deposit insurance and the Resolution Corporation's rliability to safeguarded investors. The Bill generally keeps up the arrangements of the 1961 law, while fortifying a few provisos, for example, accommodating speedier system of installment of deposit insurance. To the extent the deposit insurance limit is concerned, even now the Rs 1 lakh scope does not emerge out of the core law, which is the Deposit Insurance and Credit Guarantee Corporation Act.

Initially under this law, the protection cover was restricted to Rs 1,500. It was raised every once in a while, in the end achieving the present Rs one lakh. As of March 31, 2017, more than 92 % of accounts were completely safeguarded as they were beneath Rs one lakh. Past this aggregate, the investors are thought to be "unsecured loan bosses". The Bill not just holds the

¹⁴ (Feb. 9, 2018, 7:20 AM), https://www.dicgc.org.in/FD_A-GuideToDepositInsurance.html#q1

assurance given to protected investors, yet additionally agrees substantially more prominent security to unsecured banks than the current law. Fears about deposit insurance cover being pulled back are subsequently totally unwarranted.¹⁵

CONCLUSION

India in the twenty first century aims at at being an economic superpower, which if it has to be needs to be back by hard measures and a certain amount of simplicity in the manner in which the systems work. The presence of multiple regulators in individual sectors has led to a scenario where there is a clash every time there may be an overlap between the jurisdictions of various regulators. The Resolution Corporation, as envisaged by this Bill solves this problem as it will be the sole authority of last resort, irrespective of the sector. If a financial institution is in a situation where the depositors' money may be at risk or there is a likely domino effect on the other financial institutions of a financial nature, the Resolution Corporation may step in and take the appropriate steps which may be necessary.

There can be however no doubt about the need for certain changes in the Bill itself. The non presence of a redressal forum would vitiate the entire purpose of the Bill, as the statute would not be able to bar the constitutional right of individuals to move the High Courts or the Supreme Court.

India can't dream of regularly turning into a genuinely developed economy, not to mention a monetary superpower, without building up a strong budgetary framework, one that can fittingly manage possibilities and stuns. In spite of the fact that India developed to a great extent unscathed from the 2008 emergency, India can't stand to be gotten unprepared in case of a potential budgetary emergency like numerous countries were in 2008. Transforming the Bill into law will put India on a standard with the countries that took in their lessons from the 2008 emergency.

¹⁵ *Financial Resolution and Deposit Insurance (FRDI) Bill, 2017 seeks to protect and enhance the depositors' existing rights and bring in a comprehensive and efficient resolution regime for financial firms.*, (Feb. 9, 2018, 9:09 AM), <http://dea.gov.in/sites/default/files/PressRelease02012018.pdf>