RESOLVING FINANCIAL FIRMS IN INDIA:
THE WAY FORWARD

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The ongoing financial distress among some banks, Non-Banking Finance Companies (‘NBFCs’) and Housing Finance Companies (‘HFCs’) has once again drawn attention to the fragmented legal framework on resolution of Financial Service Providers (‘FSPs’) in India. The government was quick to extend the Insolvency and Bankruptcy Code, 2016 to the relatively bigger NBFCs and HFCs. This has renewed interest about the fate of the Financial Resolution and Deposit Insurance Bill, 2017 as well as the future of FSP resolution in India. Yet, barring a few media pieces, the broader Indian academic legal literature has hardly attempted to contextualise these major developments within a conceptual framework. This paper attempts to address this lacuna. It analyses the recent Indian legal developments around FSP resolution within a conceptual framework and highlights relevant issues that may have a bearing on the future of FSP resolution in India.

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I. INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (‘IBC’) initially excluded Financial Service Providers (‘FSPs’) from its scope.\(^1\) However, §227 of the IBC empowered the Central Government, in consultation with the appropriate financial regulator, to bring FSPs, or categories thereof, within the purview of the IBC.\(^2\) On November 15, 2019, the Central Government exercised this statutory power and issued the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 (‘The Rules’).\(^3\) The Rules enable such FSPs or categories of FSPs, as may be notified by the Central Government under §227 from time to time, to be resolved under the IBC, \(\textit{albeit}\) with certain procedural modifications under the Rules.\(^4\) Immediately afterwards, the Ministry of Corporate Affairs extended the Rules to Non-Banking Finance Companies (‘NBFCs’) including Housing Finance Companies (‘HFCs’) with asset size of INR 500 crore or more.\(^5\)

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\(^1\) Insolvency and Bankruptcy Code, 2016, §3(7).

\(^2\) Insolvency and Bankruptcy Code, 2016, §227. Moreover, §239(2)(\(zk\)) empowered the Central Government to make rules regarding the manner of conducting insolvency and liquidation proceedings under §227.

\(^3\) The Rules have been issued under §227 read with §239(2)(\(zk\)) of the Insolvency and Bankruptcy Code, 2016.

\(^4\) Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019, G.S.R. 852(E) (Notified on November 15, 2019).

\(^5\) Ministry of Corporate Affairs, Category of Financial Service Provider whose Insolvency Resolution and Liquidation Proceedings shall be undertaken as per IBC, S.O. 4139(E) (Notified on November 18, 2019).
In parallel, the Reserve Bank of India (‘RBI’) superseded the board of Dewan Housing Finance Corporation Ltd. (‘DHFL’), appointed an Administrator as well as an Advisory Committee. The RBI then initiated an insolvency proceeding under the IBC against DHFL. Subsequently, the National Company Law Tribunal (‘NCLT’) admitted the insolvency application filed against DHFL making it the first FSP to be brought under the ambit of the Rules. These developments come at a time when several other FSPs such as Yes Bank Ltd., Punjab and Maharashtra Co-operative Bank Ltd. (‘PMC’), and Infrastructure Leasing and Financial Services Ltd. (‘IL&FS’) have also experienced acute financial distress.

Initially, Indian policymakers had envisaged that a separate law, the Financial Resolution and Deposit Insurance Bill, 2017 (‘FRDI Bill’), would deal with resolution of FSPs. It was expected that the IBC and FRDI law together would provide a comprehensive resolution mechanism for the economy. The FRDI Bill was introduced in the Parliament on August 10, 2017 and was referred to a Joint Parliamentary Committee. However, there was considerable controversy in the public domain about the bail-in clause in the Bill. Apprehensions were raised that this clause would essentially permit use of depositors’ money to bail out banks. Moreover, there were concerns regarding the adequacy of deposit insurance cover as well as the application of the resolution framework to public sector banks. Due to these controversies surrounding the Bill, the government withdrew the FRDI Bill in July 2018.

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6 Reserve Bank of India, *Supersession of Board of Directors and Appointment of Administrator—Dewan Housing Finance Corporation Ltd.* (November 20, 2019); Reserve Bank of India, *Reserve Bank of India appoints an advisory committee to advise the administrator of Dewan Housing Finance Corporation Ltd.* (November 22, 2019).


12 *Lok Sabha Secretariat,* supra note 10, 3.
In February 2020, the Indian Finance Minister suggested that the government is revising the Bill internally.\textsuperscript{13} Later that month, the RBI governor in a public speech mentioned that an integrated framework for resolution of financial firms is expected in the near future.\textsuperscript{14} Evidently, top policymakers are conscious of the acute need for a holistic legal framework for resolving stressed FSPs in India.

In the meantime, the lack of an appropriate legal framework for resolution of FSPs has resulted in some anomalous outcomes. For instance, the NCLT in \textit{Apeejay Trust v. Aviva Life Insurance Co. India Ltd.}, held that an operational creditor who has a claim in respect of license fees and service tax amounts could trigger the IBC against an insurance company since the claim of the operational creditor did not arise from any financial service (contract of insurance) provided by the FSP.\textsuperscript{15} Such \textit{ad hoc} judicial innovation runs the risk of rendering the Indian insolvency jurisprudence unpredictable in its application to FSPs.

In this contemporary context, this paper analyses the potential implications of these policy developments on resolution of FSPs in India within a conceptual framework. It is structured into the following parts. Part II captures the evolution of the law and institutions dealing with resolution of FSPs globally and in India. Part III provides the theoretical rationale for a special law for resolving FSPs like banks and Systemically Important Financial Institutions (‘SIFIs’). It highlights the unique features of such FSPs, the potential limitations of the IBC in addressing these unique features, and the applicability of a special resolution law on different types of FSPs. Part IV explains the critical features of a special resolution regime, the functions of a resolution authority and the powers of the resolution authority before and during resolution. It also addresses issues related to cross-border resolutions and the resolution of public sector banks and cooperative banks. Part V discusses some of the controversial provisions in the FRDI Bill, 2017, which led to its withdrawal. Part VI summarises the conclusions arrived at from the study.

\section*{II. EVOLUTION}

\subsection*{A. GLOBAL DEVELOPMENTS}

During the Great Depression from 1929 to 1933, nearly 9000 banks suspended operations or failed in the U.S. In response to the crisis, the U.S. Congress created the Federal Deposit Insurance Corporation (‘FDIC’) through


\textsuperscript{14} Shaktikanta Das, Governor, Reserve Bank of India, Banking Landscape in the 21st century at the Mint’s Annual Banking Conclave (February 24, 2020).

\textsuperscript{15} Apeejay Trust v. Aviva Life Insurance Co. India Ltd. 2019 SCC OnLine NCLT 628.
Banking Act, 1933. The FDIC’s primary purpose is to insure deposits, protect depositors of insured banks through its bank supervision and examination function, and to resolve failed banks. Since 1933, the FDIC has faced two episodes of massive financial institution failures. The first period was the Savings and Loan (‘S&L’) crisis from 1986 to 1994, when 1617 banks and 1295 S&L institutions failed or required financial assistance. The second period was the subprime mortgage crisis from 2008-2011.\textsuperscript{16} Figure 1 highlights the resolution activity of FDIC across these two crisis periods.\textsuperscript{17}

\textbf{Figure 1: FDIC Resolution Activity 1980-2016}

Initially, FDIC’s resolution regime was confined to deposit-taking institutions covered by its insurance fund.\textsuperscript{18} Lehman Brothers, being a pure investment bank, was therefore, not under FDIC’s resolution regime. Moreover, there were serious doubts about how effectively a FDIC-type procedure would work in relation to large and complex banks.\textsuperscript{19} Subsequently, the Dodd-Frank Act, 2010 extended the resolution regime to include even non-bank entities designated as systemically risky.\textsuperscript{20} The Orderly Liquidation Authority (‘OLA’) has been established for this purpose. Essentially, OLA is an extension of FDIC’s resolution regime to non-bank financial institutions which are systemically risky.\textsuperscript{21} The OLA is handled by FDIC.\textsuperscript{22}

In contrast, the resolution regime for FSPs in the United Kingdom (‘U.K.’) was relatively underdeveloped. The failure of the Northern Rock Plc in 2007 was a wake-up call for U.K.\textsuperscript{23} The Banking Act, 2009 introduced a Special Resolution Regime (‘SRR’) for banks, modelled quite closely on FDIC

\begin{footnotesize}
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\item \textsuperscript{16} Federal Deposit Insurance Corporation, Resolutions Handbook (2019).
\item \textsuperscript{17} Id.
\item \textsuperscript{18} John Armour, Making Bank Resolution Credible, ECGI Working Paper Series in Law (February 12, 2014).
\item \textsuperscript{19} John Armour et al., Principles of Financial Regulation (2016).
\item \textsuperscript{20} Id.
\item \textsuperscript{21} Id.
\item \textsuperscript{22} Id.
\item \textsuperscript{23} Id.
\end{itemize}
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receivership. Similarly, the EU has adopted the Bank Recovery and Resolution Directive, 2014 (‘BRRD’) to provide authorities with powers to deal with failing financial institutions at national level and cooperate in case of cross-border banking failures. The Single Resolution Board (‘SRB’) is the central resolution authority within the Banking Union. Together with the National Resolution Authorities of participating member states it forms the Single Resolution Mechanism (‘SRM’). The purpose of the SRM is to ensure orderly resolution of failing financial institutions with minimal costs for taxpayers and to the real economy.

B. EXISTING INDIAN FRAMEWORK

In stark contrast to these global developments, India lacks an omnibus regulatory framework governing the resolution of FSPs. The resolution of FSPs such as banks, insurance companies, pension funds, etc. is dealt with by sectoral regulators under the aegis of their respective sectoral legislations, as explained below in some detail.

1. Banking Institutions

Resolution of scheduled commercial banks and co-operative banks is governed by different legal frameworks. The RBI enjoys powers to wind-up or amalgamate a scheduled commercial bank (except those public-sector banks whose statutes prohibit such actions by any agency other than the Central Government) under provisions of the Banking Regulation Act, 1949 (‘BR Act’). The RBI also enjoys similar powers over cooperative banks.

a. Scheduled commercial banks

The BR Act provides three potential methods of resolving a banking company: compulsory merger, winding-up and voluntary merger. In practice, RBI has often used the compulsory merger route. In such mergers, RBI applies to Central Government for a moratorium on the banking company, then prepares

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24 Id.
28 Id.
29 Deposit Insurance and Credit Guarantee Corporation Act, 1961, §§2(gg), 13D (providing that the Reserve Bank may initiate the winding-up of cooperative banks).
30 Banking Regulation Act, 1949, §45 (for compulsory merger), §38 (for winding-up), §44A (for voluntary merger).
31 For an account of Indian banking resolution experience, see Prashant Saran & Tulasi Gopinath, Resolution of Weak Banks: The Indian Experience, 45(2) ECONOMIC & POLITICAL WEEKLY 54 (2010); Prashant Saran & Tulasi Gopinath, Weak Bank Resolution Framework in India: Thumbs Up or Down, 46(50) ECONOMIC & POLITICAL WEEKLY 104 (2011).
a scheme for merger with another healthy bank, and finally gets the scheme sanctioned by the Central Government. Alternatively, the Central Government could also order acquisition of the undertaking of a banking company under certain circumstances, upon receipt of a report from the RBI.\(^{32}\) Under the winding-up route, the RBI may apply to the High Court to wind-up a banking company in specific circumstances.\(^{33}\) Under voluntary merger route, a scheme for amalgamation approved by two-third majority of shareholders and sanctioned by the RBI could be used to merge two banking companies.\(^{34}\)

\textit{b. Co-operative banks}

Co-operative banks pose a peculiar problem. Under the Indian Constitution, Entry 43 of List I empowers the Union Parliament to legislate on ‘incorporation, regulation and winding up of trading corporations, including banking, insurance and financial corporations, but not including co-operative societies’. Entry 32 of List II empowers the States to legislate on ‘incorporation, regulation and winding-up’ of co-operative societies. Moreover, ‘bankruptcy and insolvency’ is under Entry 9 of List III.

As a consequence of this constitutional construct, a co-operative bank located in a single state is regulated by the RBI and the Registrar of Co-operative Societies (‘RCS’) of that state.\(^{35}\) A co-operative bank operating in multiple states is registered under the Multi-State Co-operative Act, 2002, and regulated by the RBI and the Central Registrar of Co-operative Societies (‘CRCS’). Multi-state co-operative banks are wound up under the direction of the Central Registrar, and state co-operative banks under the respective state’s RCS.\(^{36}\) However, the Multi-State Co-operative Societies Act, 2002 states that the Central Registrar shall make an order for the winding up of a co-operative bank if so required by the RBI.\(^{37}\) Similar provisions have been included, through amendments in co-operative society statutes of different states.\(^{38}\) The Banking Regulation (Amendment) Bill, 2020 seeks to resolve some of the issues with regulation of co-operative banks.

\textbf{2. Insurance Companies}

The resolution of insurance companies is governed by the Insurance Act, 1938. If it is found by the Insurance Regulatory and Development Authority of India (‘IRDAI’) that a life insurer is acting in a manner prejudicial to the interests of policyholders, it may, after giving the insurer an opportunity to be heard,
appoint an administrator to manage the insurer’s affairs.\textsuperscript{39} There are two possible outcomes for an insurer: winding up or amalgamation. Winding up could be done at the behest of IRDAI,\textsuperscript{40} and is to be carried out in accordance with provisions of the Companies Act, 2013.\textsuperscript{41} Amalgamation could either be initiated by the parties,\textsuperscript{42} or could be at the behest of the IRDAI itself.\textsuperscript{43}

3. NBFCs

Under the Reserve Bank of India Act, 1934 (‘RBI Act’), the RBI may file an application under the Companies Act, 2013 for winding up an NBFC if it determines that it is unable to pay its debt, has become disqualified to carry on the business of an NBFC, if its continuance is detrimental to public interest or to depositors, or if it has been prohibited by the RBI from receiving deposit.\textsuperscript{44} All the provisions of the Companies Act, 2013 relating to winding up of a company apply to a winding up of an NBFC initiated on an application by the RBI.\textsuperscript{45} The RBI was recently given statutory powers to supersede the board of an NBFC, appoint an Administrator and Advisory Committee.\textsuperscript{46}

4. Pension funds

The Pension Fund Regulatory and Development Authority (‘PFRDA’) may make a report to the Central Government if it has reason to believe that a Central Recordkeeping Agency (‘CRA’) or Pension fund is acting in a manner that is prejudicial to the interest of the subscribers and the Central Government may, if it deems fit, appoint an administrator to manage the affairs of the Pension fund or the CRA under the direction and control of the PFRDA.\textsuperscript{47} The PFRDA further has powers to make orders for attachment, retention, preservation, interim custody and sale of any asset or property which is regulated by the PFRDA Act;\textsuperscript{48} supersede the governing board or board of directors or management of the intermediary and appoint an administrator to manage the affairs of the intermediary,\textsuperscript{49} and direct the pension funds to transfer the assets, records, documents and information to another pension fund at its own cost.\textsuperscript{50}

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\textsuperscript{39} Insurance Act, 1938, §52A.
\textsuperscript{40} Id., §33(6)(c).
\textsuperscript{41} Id., §53.
\textsuperscript{42} Id., §35.
\textsuperscript{43} Id., §37A.
\textsuperscript{44} Reserve Bank of India Act, 1934, §45MC.
\textsuperscript{45} Id.
\textsuperscript{46} Id., §45-IE. The Rules also provide a framework for appointment of Administrator and Advisory Committee. Please refer to Part IIID.
\textsuperscript{47} Pension Fund Regulatory and Development Authority Act, 2013, §19.
\textsuperscript{48} Id., §31.
\textsuperscript{49} Id., §31.
\textsuperscript{50} Id., §13.
5. Public Sector Financial Institutions

Several Indian public sector-owned FSPs have a statutory basis. Their respective statutes often provide for a resolution mechanism. For instance, the State Bank of India Act, 1955 exempts the State Bank of India (‘SBI’) from any laws relating to winding up of companies. The SBI can be placed in liquidation only by order of the Central Government, and the liquidation would happen in such manner as the Government directs. Similarly, the Regional Rural Banks Act, 1976 exempts the Regional Rural Banks (‘RRBs’) from any laws relating to winding up of companies. Instead, RRBs can be placed in liquidation only by order of the Central Government, and the liquidation would happen in such manner as the Government directs. The Central Government can also direct the amalgamation of two or more RRBS. The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980 also provides for exemption from laws on winding up of companies, and states that only an order of Central Government can lead to winding up of the banks nationalised under those Act. The Central Government may also supersede the board of a bank under any of the two laws. Similarly, the Life Insurance Corporation Act, 1956 (‘LIC Act’) provides a similar exemption from winding up and liquidation of the Life Insurance Corporation (‘LIC’). Policies issued by LIC are also backed by sovereign guarantees.

Thus, the present framework for resolving distressed financial institutions is dispersed and non-uniform in its application across different FSPs. Moreover, the Deposit Insurance Scheme (‘DIS’) is presently managed by a separate institution called the Deposit Insurance and Credit Guarantee Corporation (‘DICGC’) under the DICGC Act, 1961. This DIS covers depositors of all commercial banks and eligible co-operative banks. Under the provisions of the DICGC Act, 1961, the original deposit insurance cover was INR 1,500 per depositor for deposits across all the branches of a bank taken together. This limit was subsequently increased to INR 1,00,000 in 1993, and finally to INR 5,00,000 in

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51 State Bank of India Act, 1955, §45.
52 Id., §35(9).
54 Id., §23D.
55 Id., §23A.
57 Id., §18A.
58 Life Insurance Corporation Act, 1956, §38
59 Id., §37.
60 Deposit Insurance and Credit Guarantee Corporation Act, 1961, §21A(2).
61 Eligible co-operative banks refer to those co-operative banks which are functioning in States which have amended their respective Co-operative Society Acts, as required by the DICGC Act, 1961 empowering the RBI to take regulatory and supervisory actions by directing the Registrar of Co-operative Societies accordingly; See Deposit Insurance and Credit Guarantee Corporation Act, 1961, §2(gg).
62 Deposit Insurance and Credit Guarantee Corporation Act, 1961, §16(1), Second Proviso.
63 Deposit Insurance and Credit Guarantee Corporation, Annual Report 2017-18.
Given this state of the law, Indian policymakers have been deliberating on reforming the legal framework on resolution of FSPs for nearly a decade.

C. PRIOR POLICY DEVELOPMENTS

In 2013, the Financial Sector Legislative Reforms Commission (‘FSLRC’) for the first time made detailed recommendations suggesting a complete overhaul of this fragmented resolution regime, with a modern comprehensive law on resolution. The first version of the draft Indian Financial Code (‘IFC V1’) provided detailed provisions for setting up a Resolution Corporation.\(^{65}\) Subsequently, the second version of the draft Indian Financial Code (‘IFC V2’) updated the provisions.\(^{66}\) In parallel, a RBI Working Group recommended the setting up of a single Financial Resolution Authority (‘FRA’) for resolving all financial institutions and FMIIs in coordination with the respective financial regulators.\(^{67}\) In 2016, the Ministry of Finance released another report recommending setting up of an independent Financial Resolution and Deposit Insurance Corporation (‘FRDIC’) that would perform resolution functions for a wide range of financial firms and also provide deposit insurance to banks.\(^{68}\) Finally, the Financial Resolution and Deposit Insurance Bill, 2017 was introduced in the Parliament. It was referred to a Joint Committee of the Parliament. However, due to wide-ranging concerns about the implications of the law, the bill was withdrawn by the Finance Minister on July 23, 2018.\(^{69}\) Evidently, the policy thinking in India regarding deeper structural reforms in this area has evolved and matured over time.

III. RATIONALE FOR A SPECIAL RESOLUTION LAW

A corporate bankruptcy law is well suited for real sector companies, such as manufacturing companies. However, certain FSPs including SIFIs merit a different treatment. Globally, different standards for resolution of certain FSPs have been laid down. In the absence of a special legislation, the Rules serve as an interim arrangement for FSP resolution. However, the long term solution to this problem is a dedicated legislation like the FRDI Bill.

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\(^{66}\) Department of Economic Affairs, Indian Financial Code, 2015, Cl. 286-310 (2014).


\(^{68}\) Department of Economic Affairs, Report of the Committee to Draft Code on Resolution of Financial Firms (September 2016).

A. TYPES OF FSPS

FSPs could broadly be classified into three categories.70

First, some FSPs use their balance-sheet to engage in liquidity transformation, maturity transformation, credit transformation or risk transformation. These FSPs could again be broadly sub-divided into two categories. The first category is comprised of banks, which typically have extremely liquid short-term liabilities and hold long-term assets. Liquidity is a major concern for banks, since they are open to the risk of a run. Lack of liquidity alone may push them into financial distress. Consequently, banks are the most fragile FSPs and need special treatment. On the other hand, NBFCs depend largely on bank borrowings, debentures and commercial papers. Liquidity risk may arise from over-reliance on commercial papers.

The second category consists of insurance companies, which engage in risk transformation by spreading individual idiosyncratic risks across a group of similarly placed persons. They usually have long-term liabilities and medium term assets. Even if they may have sufficient solvency to meet immediate claims, it may be necessary to regulate them to ensure that they are able to meet future liabilities due to the high intensity promises underlying insurance contracts. Overall, liquidity and solvency risks are very critical for this type of FSPs. The law may therefore need to provide special treatment to such FSPs in insolvency.

Second, certain FSPs are only service providers such as payment systems and Financial Market Infrastructure (‘FMIs’). Some of them could be exposed to credit risk due to counter-party default. Such risks are usually contained through pre-funding measures (such as settlement guarantee fund, core settlement fund, etc.). In exceptional cases, if such pre-funding proves insufficient, the credit risk could actually impact the balance-sheet of these FSPs. Another critical concern for these FSPs is operational risk (including risk of fraud), which could in exceptional cases impact the balance-sheet of these FSPs. Overall, it is important to recognise that some such FSPs may be critical in facilitating the functioning of the financial markets. Their failure, due to any reason, may raise unique systemic concerns. The law should consider such issues when providing for resolution of such FSPs. Third, some FSPs are pass-through entities. These FSPs are mostly asset managers like mutual funds, brokers, pension funds, etc. Their client accounts are usually segregated from their proprietary account. Consequently, they are not usually not exposed to the balance-sheet risks as explained above. Instead, they

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only face operational risks (such as fat finger trades\(^71\) and frauds). Therefore, these FSPs usually do not raise any unique issue during insolvency.

While thinking about resolution of FSPs, it is important to bear in mind this classification to better appreciate the need for a special legal regime.

**B. FSPS ARE DIFFERENT FROM REAL SECTOR FIRMS**

There are four basic differences between FSPs and real sector companies.

First, many FSPs provide financial intermediation services. They help channel capital from savers to entrepreneurs for productive use. For instance, banking helps convert short and medium term deposits of savers to long term credit for entrepreneurs. Insurance mitigates individual risks of economic actors by pooling of similar risks, providing a safety net to entrepreneurs against events that are beyond their control. Such FSPs are critical to the working of the entire real economy. Failure of such FSPs may vastly reduce the aggregate capital available for productive uses by entrepreneurs in an economy, seriously impairing economic growth. In contrast, failure of any real sector company is unlikely to vastly reduce the aggregate capital available for allocation for productive uses in the economy. This is a fundamental difference between generic FSPs and other real sector companies.

Second, some critical FSPs are structurally fragile. The fragility is particularly extreme for FSPs like banks that promise to pay a fixed return at short notice (that is, immediate liquidity). This exposes banks to the risk of a ‘run’ by depositors following actual or perceived threat to the bank’s solvency or liquidity. In the event of a run, the bank has to convert its assets, most of which are long-term like loans, into cash. Since long-term assets are typically illiquid, the bank will have to sell these at a discount. Thus a distressed bank could quickly be pushed into insolvency. Traditionally, insurance companies did not share these features of a bank since they were largely exposed to idiosyncratic risks. However, modern insurance companies often offer products that expose them to non-diversifiable market risks. For example, before the global financial crisis, some life insurers wrote investment oriented life insurance policies with minimum guarantees and other features that exposed them to risk from movements in equity and other investment markets. Similarly, investments made by insurers could also expose them to market movements, making their business model fragile.\(^72\) Similar fragil-

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ity exists in the business model of some other FSPs too, unlike most real sector companies.

Third, severe negative externalities are associated with failure of such FSPs. A critical source of such externality is the high degree of interconnectedness among FSPs’ balance-sheets and correlated investments. For instance, if FSP 1 holds debt issued by FSP 2, FSP 2’s insolvency would affect the balance sheet of FSP 1, provoking investors to run on the latter. Similarly, if both FSPs 1 and 2 hold the same assets, a fire sale of such assets during FSP 2’s liquidation could depress the asset value on FSP 1’s balance sheet and push it into distress. Such myriad interconnections among FSPs raise systemic risk concerns, which are very different from most real sector companies.

Fourth, failure of some large FSPs poses a moral hazard problem. Given their systemic importance in the broader macro-economy, an expectation could be created among various stakeholders that such FSPs will not be allowed to fail. In case of their failure, the state will intervene and use taxpayers’ money for their ‘bail-out’. This sense and comfort of an implicit state guarantee, encourages risky behaviour which may further lower incentives for market discipline among certain systemically important FSPs. This moral hazard problem may not be as relevant for real sector companies.

It is important to note that these unique concerns may not apply to every FSP. Therefore, it is important to analyse each category of FSP separately when thinking about their resolution.

C. LIMITATIONS OF THE IBC

1. Value Maximisation may not promote financial stability

A general corporate insolvency law like the IBC is aimed at preserving the assets of the insolvent corporate debtor for the purposes of value maximisation of the stakeholders. This legislative scheme of the IBC was never intended to promote financial stability, which ought to be the primary objective while resolving many FSPs. For instance, a judicially supervised public marketing process under the IBC may facilitate price discovery in the sale of an insolvent real sector business, maximising its value. However, price discovery may not the most important objective while resolving certain FSPs. Instead, promotion of financial stability may require that the resolution be achieved quickly, even if the process is less transparent and administrative. In this context, it may be useful to note here that while the Rules provide that provisions of the IBC will apply to the notified

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FSPs (with modifications proposed in the Rules) it is evident that these FSPs for the time being will continue to be governed by the same process which is used for resolution of real sector firms.  

2. Administrative supervision better than creditor in control

The IBC provides for a creditor in control regime based on collective action. A committee of financial creditors is constituted, which then decides on the future of the insolvent company—resolution or liquidation—by super-majority vote (66%). The IBC gives primacy to the Committee of Creditors’ (‘CoC’) commercial judgment and limits the discretion of the Adjudicating Authority to interfere with this commercial judgement. The financial creditors are in charge of deciding the fate of the firm. This arrangement may be problematic in case of resolution if applied to certain FSPs. For instance, in the case of banks, the depositor base will typically be large and be replete with retail depositors, and fewer institutional investors.

Coordination costs for them are likely to be very high. In the case of insurance companies, most policy holders are contingent creditors—they could become creditors in the future as and when the insurable event happens. Excluding them from the CoC would be problematic. It is unclear how a CoC will be constituted with such creditors or even function effectively with them. Moreover, accommodating contingent creditors in the CoC may also prove tricky. Therefore, the collective action mechanism through a creditor-in-control regime under IBC may not lend itself to a smooth application to many FSPs. In the case of NBFCs, the CoC may comprise of banks and other NBFCs, who are often competitors of the distressed NBFC. Leaving the future of a distressed NBFC at the hands of its competitors may create perverse incentives at the time of voting, which may also damage financial stability.

3. Triggered only upon ‘default’

Under the IBC, the Corporate Insolvency Resolution Process (‘CIRP’) is triggered against a company only when a ‘default’ has occurred. While using ‘default’ as a criterion for resolution of real sector companies is justified, it may not be ideal for certain FSPs. For certain FSPs, pre-emptive measures would be more

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75 Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019, Rule 6.
76 Insolvency and Bankruptcy Code, 2016, §30(4)
79 A default under the IBC means non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable.
appropriate to avoid distress in one such FSP from spreading across the financial system.\textsuperscript{80} It would therefore, be important to take suitable measures before such FSPs get into financial distress and default to their claimants, raising systemic risk concerns. It may be useful to note here that the Rules allow initiation of the CIRP against a FSP by the appropriate financial regulator only if such FSP has committed a default under section 4 of the IBC.\textsuperscript{81}

4. Blanket moratorium may be problematic

Under the IBC, once a corporate debtor enters into the CIRP, a blanket moratorium prevents creditors of the corporate debtor from taking away its assets till the end of the CIRP period.\textsuperscript{82} This moratorium helps create a calm period during which the resolution process could be successfully completed to enable value maximisation. However, such moratorium could be disastrous for certain FSPs. For instance, certain FSPs like banks, HFCs etc. often rely on short-term borrowings from the repo and call money markets.\textsuperscript{83}

Lending in such markets is for extremely short periods of time, typically less than a week. If a FSP, which has borrowed from such markets, becomes insolvent and a moratorium is imposed on any recovery from the FSP, it could hamper settlement and wreak havoc in such markets. Other FSPs which rely on those markets could suddenly be hit by a liquidity freeze, raising systemic risk concerns. Therefore, the blanket moratorium may be problematic if applied to certain FSPs. It may be useful to note here that under the IBC, the Central Government has the power to issue notifications to exclude certain transactions from the moratorium.\textsuperscript{84}

However, under the Rules, an interim moratorium immediately commences on and from the date of filing of the application to the Adjudicating Authority till admission or rejection.\textsuperscript{85} This interim moratorium will not extend to any third-party assets or properties in custody or possession of the FSP, including any funds, securities and other assets required to be held in trust for the benefit of third parties.\textsuperscript{86} However, the coverage of the term ‘third party assets or properties’ is undefined. Therefore, the implications of this exclusion are currently not quite evident. It is relevant to note that the BR Act also imposes a moratorium upon an


\textsuperscript{81} Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019, Rule 5(a)(i).

\textsuperscript{82} Insolvency and Bankruptcy Code, 2016, §14.

\textsuperscript{83} Reserve Bank of India, Repurchase Transactions (Repo) (Reserve Bank) Directions, 2018, Cl. 4.

\textsuperscript{84} Insolvency and Bankruptcy Code, 2016, §14(3)(a).

\textsuperscript{85} Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019, Rule 5(b)(i).

\textsuperscript{86} \textit{Id.}, Rule 10. A similar exclusion can be found in the Insolvency and Bankruptcy Code, 2016, §§18, Explanation A, 36(4)(a)(i).
application made by the RBI to the Central Government.\textsuperscript{87} The nature of power vested with the Central Government is such that the terms of moratorium may be altered. This power may be exercised to allow a certain class of depositors to withdraw money or allow the banks to meet certain kind of obligations. \textsuperscript{88}

5. Early termination rights may be problematic

Under the IBC, the supply of essential goods or services cannot be terminated or suspended or interrupted during moratorium.\textsuperscript{89} In other words, the IBC permits \textit{ipso facto} clauses permitting a counterparty to terminate any financial contract (other than a contract for essential goods or services) on entry of the corporate debtor into moratorium under the IBC. Applied to certain FSPs, when a debtor FSP defaults on any contract, its counterparties would be wary of the IBC being triggered. Consequently, they may quickly terminate financial contracts like swaps, repos, etc. in which such defaulting FSP is a party. Such termination could immediately destroy the business of the debtor FSP, pushing it into premature liquidation. This may not only destroy value of the debtor FSP but could potentially lead to a system wide contagion. It may be useful to note here that under the IBC, the Insolvency and Bankruptcy Board of India (‘IBBI’) has the power to issue regulations to prevent termination of any class of financial contracts.\textsuperscript{90} However, the rules enhance the risk of early termination by imposing interim moratorium from the date of filing of the application by the appropriate regulator to the Adjudicating Authority.\textsuperscript{91}

6. Involvement of judiciary could be time-consuming

The IBC process requires involvement of the Adjudicating Authority at various levels.\textsuperscript{92} The issue with bringing a case before the Adjudicating Authority is that information on the firm’s default becomes available publicly. After an application under the IBC is filed with the Adjudicating Authority but before the case is admitted by the Adjudicating Authority (which is when moratorium is imposed), the availability of such information in the public domain can cause a run on certain FSPs, exacerbating its distress.

\textsuperscript{87} This is part of the RBI’s power to do a compulsory merger under the Banking Regulation Act, 1949, §45.
\textsuperscript{88} Banking Regulation Act, 1949, §45(3).
\textsuperscript{89} Insolvency and Bankruptcy Code, 2016, §14(2); Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Reg. 32 (Essential goods and services refer to electricity, water, telecommunication services, and information technology services).
\textsuperscript{90} Insolvency and Bankruptcy Code, 2016, §14(3)(a).
\textsuperscript{91} Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019, Rule 5(b)(i).
\textsuperscript{92} Broadly, the Adjudicating Authority is involved at three stages: (1) When an insolvency application is to be admitted or rejected; (2) When any dispute arises during the insolvency resolution process; and (3) At the stage of submission of a resolution plan or filing of a liquidation application.
While the financial sector is heavily reliant on continued public confidence, the ability of the public to correctly assess the firm’s financial position is limited. Consequently, loss of public confidence in a financial firm may lead to its premature destruction which, in the case of a SIFI, could lead to contagion and wider systemic consequences. As observed earlier, while the Rules require the appropriate regulator to trigger the CIRP for FSPs, the CIRP will still happen under the aegis of the Adjudicating Authority.\footnote{Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019, Rule 6.}

**D. POTENTIAL CONCERNS WITH THE RULES**

\$227 of the IBC allows the Central Government to notify FSPs or categories of FSPs for their insolvency and liquidation proceedings under the IBC. Using this power, the Rules were framed as an interim measure to deal with “any exigency pending introduction of a full-fledged enactment to deal with financial resolution of Banks and other systemically important financial service providers”. The Rules create a parallel framework for resolution of FSPs, which is slightly different from the one envisaged under the IBC. However, the Rules state that the provision of IBC relating to CIRP shall, \textit{mutatis mutandis} apply, to insolvency resolution process of FSPs subject to the exceptions provided therein.\footnote{Id., Rule 5.}

1. **Role of Administrator vis-à-vis Committee of Creditors**

The Rules provide for the appointment of an Administrator.\footnote{Id., Rule 5.} The Rules define the Administrator as an individual appointed under the Rules to exercise the powers and functions of the resolution professional or the liquidator.\footnote{Id., Rule 5(a)(iii).} In the context of NBFCs, it could be that the Administrator appointed under the Rules will be the same person that is appointed by the RBI under provisions of the RBI Act.\footnote{Id., Rule 3(a).} This assumption is not merely theoretical, as is evident from the DHFL case in the Box 1 below. At the same time, it also appears that the Advisory Committee under the Rules could be the same as the one appointed under the RBI Act.\footnote{Reserve Bank of India Act, 1934, §45-IE(2).} However, this again raises questions about the role of the Administrator in the whole process. Under the scheme of the IBC, the Resolution Professional (in this case the Administrator) acts as a \textit{de facto} agent of the CoC. However, under the Rules, the Administrator is appointed by the RBI and serves at the pleasure of the RBI. This may give rise to considerable confusion as to the role and accountability the Administrator vis-à-vis the CoC.

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Box 1: DHFL Case

\footnote{Id., §45-IE(5).}
In the case of DHFL, the RBI has issued two notifications under §45-IE of the RBI Act. The first one is for the appointment of an Administrator and the second one is for the appointment of the Advisory Committee. Both these notifications were issued before any application has been filed before the NCLT. This reinforces the expectation that the Administrator under the Rules will in fact be the one appointed under the RBI Act.

2. Potential extension to banks

The Rules empower the Central Government to extend the IBC framework to any class of FSPs.\textsuperscript{99} Currently, the Rules apply only to NBFCs and HFCs with asset size worth more than INR 500 crore.\textsuperscript{100} However, there is no prohibition on the Central Government’s powers to extend the Rules to other FSPs including banks. If the current framework under the Rules is extended to banks, additional concerns may arise.

For instance, the moratorium under the BR Act during compulsory merger is similar to the moratorium under IBC. The key difference lies in the fact that its enforcement (under BR Act) is done without any judicial supervision, which allows the RBI a lot more flexibility during the moratorium. In the event banks were to be brought under the ambit of the Rules, the introduction of the Adjudicating Authority in the process (which the Rules envisage) could restrain RBI’s flexibility during the moratorium period and delay urgent regulatory actions needed to sustain the banking company’s business during the moratorium. Such concerns need to be addressed by policymakers before the Rules are extended to banks.

3. Litigation risk

Further, the Rules may be exposed to litigation risk. There are broadly two grounds on which the Rules could potentially be challenged. First, the vires of §227 of the IBC could be challenged for excessive delegation of legislative powers to the executive. Alternatively, if the first ground fails, the Rules could be challenged as \textit{ultra vires} of §227. These risks are elaborated below.

\textit{a. Excessive delegation of powers doctrine}

The doctrine of excessive delegation suggests that a Parliamentary law would be unconstitutional if it excessively delegates core legislative function

\textsuperscript{99} Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019, Rule 2.

\textsuperscript{100} Ministry of Corporate Affairs, \textit{supra} note 5.
to the executive. A seven-judge bench of the Supreme Court explained this doctrine in the following words:  

“[…] the legislature cannot part with its essential legislative function which consists in declaring its policy and making it a binding rule of conduct. A surrender of this essential function would amount to abdication of legislative powers in the eye of law. The policy may be particularised in as few or as many words as the legislature thinks proper and it is enough if an intelligent guidance is given to the subordinate authority.”

The IBC lays down a particular statutory process for resolving a financially distressed company, which is not a FSP. §227 empowered the Central Government to notify FSPs or their categories for resolution under the IBC. The section is reproduced below for convenience:

“Nowithstanding anything to the contrary examined in this Code or any other law for the time being in force, the Central Government may, if it considers necessary, in consultation with the appropriate financial sector regulators, notify financial service providers or categories of financial service providers for the purpose of their insolvency and liquidation proceedings, which may be conducted under this Code, in such manner as may be prescribed.”

The language of this provision appears to be broad enough to allow the executive to notify a resolution process for FSPs, which is completely different from that under the IBC. For instance, the Rules have created a new ‘interim moratorium’ period from the date of filing, which is in addition to the moratorium from the date of admission under IBC. It could potentially be argued that such modifications through the Rules alter substantive rights of creditors of FSPs in the new resolution process under the Rules in contrast to rights of creditors of non-FSP companies undergoing resolution under the statutory procedure in the IBC. Overall, there is a litigation risk on the ground that §227 of the IBC could be held to be unconstitutional by Indian courts due to excessive delegation of powers.

b. Ultra vires doctrine

In the event that §227 is held to be constitutional, the Rules could still be challenged as ultra vires the section. It is a well-established principle that

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delegated legislation can only fill the gaps in the parent legislation and not substitute it.\textsuperscript{102} A three judge bench of the Supreme Court had held that

“a delegated power to legislate by making rules ‘for carrying out the purposes of the Act’ is a general delegation without laying down any guidelines; it cannot be so exercised as to bring into existence substantive rights or obligations or disabilities not contemplated by the provisions of the Act itself.”\textsuperscript{103}

Another three-judge bench of the Supreme Court subsequently held that “rules cannot be made to supplant the provisions of the Act but to supplement it. What is permitted is the delegation of ancillary or subordinate legislative functions, or, what is fictionally called, a power to fill up details”.\textsuperscript{104} In the factual matrix at hand, it could potentially be argued that the Rules alter the substantive rights of parties available under the IBC, which was not envisaged under §227 of the IBC. For instance, under the IBC, a financial creditor, operational creditor or corporate debtor may file to initiate the resolution process. However, under the Rules, it is only the sectoral regulator that can initiate the resolution process. Therefore, the Rules could be challenged for supplanting the statutory provisions in the IBC. Overall, there is a litigation risk on the ground that the Rules could be held to be \textit{ultra vires} §227 of the IBC by Indian courts.

\section*{E. FEATURES OF A SPECIAL RESOLUTION REGIME FOR CERTAIN FSPS}

\subsection*{1. A Resolution Authority

When a FSP makes high intensity promises to unsophisticated consumers (like callable at par deposits, life insurance coverage, etc.), such FSP is usually regulated by a prudential regulator. The job of a prudential regulator is to monitor the failure probability of the FSP and undertake interventions to reduce this failure probability.\textsuperscript{105} Prudential regulations may diminish but can never eliminate the probability of failure of a FSP. Therefore, a specialised resolution capacity is needed to swiftly and efficiently wind-down the distressed FSP, and protect the interests of the unsophisticated consumers.\textsuperscript{106} The resolution authority should act as a receiver for the failing FSP and must choose the most optimal resolution tools. Evidently, there is an inherent tension between prudential supervision

\begin{thebibliography}{99}
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\item \textsuperscript{102} \textit{Raiya Sabha Practice & Procedure Series, Committee on Subordinate Legislation} (February 2005).
\item \textsuperscript{106} \textit{Id.}
\end{thebibliography}
and resolution functions. Resolution is necessary when prudential supervision has failed to resolve the distress. To avoid supervisory forbearance, it is important to separate prudential supervision from the resolution function. Ideally, the resolution function should vest with an independent resolution authority. If that is not possible and the resolution function is situated in the same institution as the prudential supervision function, decisions taken by the prudential supervisory function must not constrain the decisions of the resolution function.\(^\text{107}\)

The objectives of the resolution authority should be to pursue financial stability, protect depositors, avoid unnecessary destruction of value and minimise the overall costs of resolution, and consider the potential impact of its resolution actions on financial stability in other jurisdictions.\(^\text{108}\)

2. Interaction between prudential supervisor and resolution authority

At a policy level, there needs to be a clear delineation of responsibilities between the prudential supervisor and the resolution authority since their roles may often conflict. The prudential supervisor’s inclination would be to attempt as far as possible to bring back the FSP to health through supervisory processes and delay resolution. In contrast, the resolution authority would prefer earliest intervention to preserve value through resolution. If the prudential supervisor acts as a resolution authority, there could be perverse incentives for it to not recognise the failure of a financial firm since that may reflect poorly on its own supervisory abilities.

Even when the resolution and prudential functions are kept separate, there is a symbiotic relation between the resolution authority and the prudential supervisor. The financial resolution framework should clearly stipulate the information and expertise sharing arrangements with the resolution authority in good times, and the specific point at which the resolution authority can step in to take corrective or resolution measures.

3. Resolution authority and deposit insurance

Resolution and deposit insurance are meant to subserve the ultimate objective of financial stability.\(^\text{109}\) Yet, they are two different and distinct functions.


\(^{109}\) Armour et al., supra note 19.
Resolution uses *ex ante* and *ex post* tools primarily to resolve the distress in a failing financial institution and to prevent any contagion effect across the financial system. Deposit insurance guarantees depositors, especially retail depositors that their claims on a bank will be met up to the predetermined limit by a third party in case the bank defaults.\(^{110}\) Consequently, retail depositors have little incentive to run on the bank, thus, preventing the bank from being pushed into further distress.\(^{111}\)

Whether these two functions should be housed within the same entity is an important policy question. There are some advantages of putting both functions in the same institution. First, compared to a third-party insurer, a resolution authority can quickly pay out deposit insurance and subrogate itself into the position of the depositors *vis-à-vis* the bank in the resolution process. Quick payout is essential for an effective deposit insurance scheme. Second, if the resolution authority is responsible for paying out deposit insurance, it would have an incentive to monitor the prudential supervisor’s oversight on the bank. This tension between the resolution authority and the prudential supervisor would improve the accountability around prudential supervision of banks, enabling early detection of distress.

Third, given the information sharing between the prudential supervisor and the resolution authority, the latter would have better information about the risk profile of the banks. This would enable the resolution authority to charge appropriate risk-based premiums from every bank covered by its deposit insurance scheme. Fourth, if the resolution authority fails to provide deposit insurance and delays in initiating the resolution process, the consequences would soon be evident. The prudential supervisor, the government and other stakeholders are likely to then point fingers at the resolution authority. The resolution authority would therefore have enough *ex ante* incentive not to delay pay-out of deposit insurance. Evidently, there is a strong case for allowing the resolution authority to provide deposit insurance.

4. Powers of the resolution authority

The resolution authority should have powers to take *ex ante* measures as well as use *ex post* resolution tools.

*Ex ante* measures could be taken by the resolution authority to address the complications that may arise during resolution. First, systemically important FSPs could be required to maintain Recovery and Resolution Plans (‘RRP’)—often referred to as a ‘Living Will’. The purpose of the RRP is to describe the FSP’s strategy for rapid and orderly resolution in the event of material financial distress or failure of the FSP. Further, it also helps plan for continuance

\(^{110}\) Id.
\(^{111}\) Id.
of crucial services if the business is transferred to another entity during resolution. RRPBs may also have \textit{ex ante} impact on how a bank is operated by rationalising the group structure.\footnote{Id.}

Second, ensuring that intervention by the resolution authority occurs in a calibrated manner, with a gradual shifting of roles and responsibilities from the prudential supervisor, is an important consideration in conceptualising the range of \textit{ex ante} powers of the resolution authority. Gradual intervention into a distressed financial institution by a resolution authority allows the prudential supervisor time to try and revive the distressed institution, and apply appropriate regulatory tools (such as the Prompt Corrective Action framework in the case of Indian banks, overseen by the RBI).

The resolution authority steps in at a stage when organic revival is no longer feasible, and takes over the task of ensuring timely resolution. This helps ensuring that resolution, whenever triggered, is swift and effective, and that the value of the distressed financial institution is not completely eroded.\footnote{Reserve Bank of India, \textit{supra} note 67, \textit{¶¶}4.55, 4.56.} In this context, developing a framework where stages of risk of FSPs are specified, along with the level of involvement of the prudential supervisor/resolution authority, is essential. The manner in which the same was sought to be done by the FRDI Bill, 2017 is described in Box 2 below.

**Box 2: The stages of risk classification proposed under the FRDI Bill, 2017**

- Chapter VI of the FRDI Bill, 2017 contains a five-stage risk classification for financial institutions based on certain attributes (such as asset quality, adequacy of capital, assets & liabilities, capability of management, etc.).

- Every risk classification is to be done by the prudential supervisor or the Resolution Corporation, and the responsibility for such classification shifts from the prudential supervisor to the Resolution Corporation gradually. The Resolution Corporation does not have the power to classify any financial institution into the lowest two stages of risk. Additionally, resolving differences of opinion over classification, between the prudential supervisor and the Resolution Corporation, is contemplated.

- The proposed risk classification (or risk to viability) is as follows:
  
  (i) Stage 1 (low): At this stage, the probability of failure is substantially below the acceptable probability;
(ii) Stage 2 (moderate): At this stage, the probability of failure is marginally below or equal to the acceptable probability;

(iii) Stage 3 (material): At this stage, the probability of failure is marginally above the acceptable probability;

(iv) Stage 4 (imminent): At this stage, the probability of failure is substantially above the acceptable probability, and the financial institution is on the verge of failing to meet its obligations; and

(v) Stage 5 (critical): At this stage, the probability of failure is substantially above the acceptable probability, and the financial institution is on the verge of failing to meet its obligations to consumers

- In terms of the scheme proposed under the FRDI Bill, 2017, the risk classification is important. Actions to be taken by the prudential supervisor/Resolution Corporation entirely depend on the stage of risk. For example,

(i) a financial institution classified at material or imminent risk is required to submit a restoration plan to the prudential supervisor, and a resolution plan to the Resolution Corporation (Clause 38); and

(ii) at the stage of imminent risk to viability, the Resolution Corporation can take actions in the nature of inspection of the financial institution, etc. (Clause 43(3)).

Conceptually, there could be four main types of ex post resolution tools. First, the resolution authority could act as a receiver which steps in and arranges for a liquidation of the assets of the financial institution. The resolution authority could sell the assets at a considered pace to avoid fire sale contagion. Insured depositors could be paid from the deposit insurance fund. However, such liquidation could destroy considerable value in some cases.

Second, the distressed FSP could be merged or amalgamated into another healthy FSP. This could either be voluntary or involuntary. In this regard, the Purchase and Assumption (‘P&A’) transaction is a useful resolution tool. The resolution authority could arrange for purchase of the assets by another transferee financial institution. Deposits, if any, could be assumed by the transferee. The proceeds from the purchase are then distributed among the non-depositor creditors of the failed financial institution. In case there are doubts about quality of some of the assets, such toxic assets could be left behind. The rump entity could be subjected to an orderly winding-up over time.

114 Armour, supra note 18.

For the Indian banking resolution experience, see, Saran & Gopinath, supra note 31 (2010); P. Saran & T. Gopinath, supra note 31 (2011).
Third, a Bridge Bank could be used if an immediate sale cannot be agreed but it is likely at some point of time in the future. In such cases, the Resolution Corporation could transfer the business to a new bridge bank, which is owned and operated by the Resolution Corporation. Depositors who want immediate repayment are paid; the claims of those remaining are guaranteed by the Resolution Corporation. In due course, the business could be sold to a private sector purchaser or else it could be liquidated.

Fourth, occasionally it may be difficult to find a suitable purchaser to effect a rapid transfer of the failed financial institutions assets and liabilities. To tackle such circumstances, the bail-in tool has been developed. The core idea is that instead of the state stepping in to make payments to save the creditors from losses, the creditors should be expected to bear the losses themselves.\textsuperscript{115} Essentially, it is akin to a restructuring as opposed to a going concern sale or piece-meal liquidation.\textsuperscript{116} To facilitate such bail-in, specific debt capital requirements such as Total Loss Absorption Capacity (‘TLAC’) have been developed for Globally Systemically Important Banks (‘G-SIBs’).\textsuperscript{117} Such bail in-able bonds could act as useful buffers in restructuring of such banks in the event of distress. The main advantage of such bail in-able bonds is that they avoid the moral hazard implicit in a state-funded bail-out of banks, while offering a certain degree of protection to uninsured retail deposits.\textsuperscript{118} Box 3 below briefly discusses how loss-absorbing internal capacity may come to play an important role in bank resolutions.

Box 3: Adequate loss-absorbing internal capacity

Post the financial crisis of 2008, the concept of loss-absorbing capacity developed to deal with the potential failure of too big to fail SIFIs.

Globally, regulators have been taking measures to ensure that SIFIs have adequate levels of dedicated internal capital for the writing down of liabilities in case of financial stress. This reduces the need for tax-payer funded bailouts, reducing the moral hazard risks associated with a large SIFI failing.

The Financial Stability Board (‘FSB’) has been dealing with the issue of the resolution of globally systemically important banks (‘G-SIBs’) since 2010, when it first highlighted the need for G-SIBs to have higher loss absorbency


\textsuperscript{118} Id.
capacity to reduce the moral hazard posed by their potential failure. This led to the FSB’s Total Loss Absorbency Capacity (‘TLAC’) Term Sheet for G-SIBs in November 2015.\textsuperscript{119} The TLAC standard requires G-SIBs to have available financial instruments during the period of resolution to enable recapitalisation and loss-absorption by making debt/equity holders absorb losses (through ‘bail-in’), so that there is continuity in the performance of critical functions. In practice, the TLAC requirement applies at the level of the resolution entity in bank resolutions.

Additionally, the Basel Committee on Banking Supervision (‘BCBS’) also published its standards on the treatment of banks holdings’ in TLAC, applicable to all banks subject to BCBS standards, including non-G-SIBs.\textsuperscript{120}

In the European Union (‘EU’), the Banking Resolution and Recovery Directive, 2014 (‘BRRD’) requires that financial institutions maintain a ‘minimum requirement for own funds and eligible liabilities’ (‘MREL’) within a group.\textsuperscript{121} The MREL requirement may be met through contractual bail-in instruments. In furtherance of the BRRD and the FSB guidelines on TLAC for G-SIBs, the EU has recently adopted Directive 2019/879, which \textit{inter alia} seeks to align eligibility criteria for MREL, with that required for TLAC for G-SIBs.

In the United States, the Federal Reserve Board adopted rules requiring financial institutions to meet TLAC requirements in December 2016.\textsuperscript{122} The rules apply to domestic firms identified by the Board as G-SIBs, as well as to domestic operations of foreign G-SIBs.

\section*{IV. OTHER ISSUES}

Policymakers designing a resolution law face many challenges. Unique challenges emerge in cross-border resolutions as well as in resolution of special categories of FSPs such as SIFIs and FMIs.

\subsection*{A. RESOLUTION OF FINANCIAL FIRMS IN THE CROSS-BORDER CONTEXT}

Cross-border resolution of financial firms is important from the perspective of maintaining systemic stability. The presence of large cross-border financial groups carrying out a range of activities across jurisdictions raises

\begin{footnotesize}
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\item \textsuperscript{119} \textit{Id.}
\item \textsuperscript{120} \textsc{Basel Committee on Banking Supervision, TLAC holdings: Amendments to the Basel III Standard on the Definition of Capital} (October 2016).
\item \textsuperscript{121} \textsc{Banking Resolution and Recovery Directive, 2014, Art. 45.}
\item \textsuperscript{122} \textsc{Press Release, Federal Reserve Board, Federal Reserve Board adopts final rule to strengthen the ability of government authorities to resolve in orderly way largest domestic and foreign banks operating in the United States, December 15, 2016, available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20161215a.htm (Last visited on February 29, 2020).}
\end{itemize}
\end{footnotesize}
concerns of transmitting shocks across jurisdictions in case of their financial distress. Since consensus for handling cross-border resolution at the level of a treaty may not be forthcoming,\textsuperscript{123} it is desirable that domestic resolution frameworks contain provisions dealing with the resolution of cross-border financial groups. Consequently, the Key Attributes provided by the Financial Stability Board highlight the importance of legal frameworks enabling cross-border cooperation including the recognition of foreign resolution actions.\textsuperscript{124}

Some of the complexities that may arise in cross-border resolution of financial groups are:

- supervision of the parent group resting with the home country supervisor, while supervision of the subsidiary rests with the host country supervisor, under the Basel Accords;\textsuperscript{125}

- supervisory and resolution authorities promoting financial stability and protecting depositor interest within their own jurisdictions and therefore, ‘ring-fencing’ domestic assets to protect domestic interests; and

- differing national insolvency regimes, depositor protection legislation, etc., which create uncertainty in the application of resolution measures in a cross-border context.

In India, the RBI has favoured domestic incorporation of foreign banks in India, as separate legal entities, which delineates the assets and liabilities of the domestic bank from its foreign parent.\textsuperscript{126} This is further strengthened by provisions of the BR Act, which facilitate ring-fencing of domestic assets of foreign banks operating in India.\textsuperscript{127} This legal mechanism has worked well in the past. For example, the Indian branch office of the Bank of Credit and Commerce International (during 1991-93) was resolved by liquidation of the branch office as a going concern (and takeover by a subsidiary of the State Bank of India, supervised by the RBI).\textsuperscript{128} Similarly, the Indian subsidiaries of Lehman Brothers (during the financial crisis of 2007-08), were resolved by the liquidation of the subsidiaries (as a result of the bankruptcy of the US parent which held its entire shareholding).

\textsuperscript{123} Reserve Bank of India, 	extit{supra} note 67, ¶5.1-5.17.
\textsuperscript{124} Financial Stability Board, 	extit{supra} note 108, Key Attribute 7.
\textsuperscript{125} The Basel Accords refer to banking regulation recommendations of the Basel Committee on Banking Supervision (BCBS) which is a committee of banking supervisory authorities. There have been three Basel Accords so far: Basel I (1988), Basel II (2004) and Basel III (2018).
\textsuperscript{126} Reserve Bank of India, 	extit{Scheme for Setting up of Wholly Owned Subsidiaries (WOS) by foreign banks in India, November 2013}, available at https://rbidocs.rbi.org.in/rdocs/Content/PDFs/SBSC061113F.pdf (Last visited on February 29, 2020).
\textsuperscript{127} Banking Regulation Act, 1949, §§11(4), 25.
\textsuperscript{128} Reserve Bank of India, 	extit{supra} note 67, ¶5.6.
The RBI enjoys a range of supervisory/resolution powers in relation to banking companies which operate in India. These include the following powers:

(i) inspection;\(^{129}\)

(ii) giving directions to banking companies to secure proper management or preventing their affairs from being conducted in a manner detrimental to public interest;\(^{130}\)

(iii) removing managerial personnel and appointing additional directors;\(^{131}\)

(iv) superseding the Board of Directors of a banking company and appointing an Administrator;\(^{132}\) and

(v) applying to the Central Government for suspension of business of banking companies and making of a scheme of reconstruction/amalgamation.\(^{133}\)

Despite the RBI enjoying certain resolution powers in relation to the business of banking companies operating in India, under the BR Act there is no dedicated framework for cross-border bank resolution. The BR Act does not contain clear guidance on how cross-border bank resolution operates. For instance, there do not seem to be provisions dealing with cross-border co-operation between regulators or recognition of foreign resolution proceedings. Further, the Report of the Committee on Cross-Border Insolvency excluded FSPs from the scope of the cross-border insolvency framework under the IBC being recommended by it.\(^{134}\) In light of the current regulatory framework governing cross-border resolution of FSPs, there is a clear need to move ahead on this front. This was sought to be done by the FRDI Bill, as explained in Box 4 below.

Box 4: The FRDI Bill, 2017 and resolution in the cross-border context

The FRDI Bill, 2017 contains a number of provisions aimed at setting up a cross-border resolution framework for financial firms. This has been done by introducing a dedicated chapter (Chapter XIV) dealing with Foreign Resolution Actions.

Amongst other things, Chapter XIV enables:

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\(^{129}\) Banking Regulation Act, 1949, §§35(1), 35(1A).

\(^{130}\) Id., 1949, §35A.

\(^{131}\) Id., Part IIA.

\(^{132}\) Id., Part IIAB.

\(^{133}\) Id., §45.

\(^{134}\) INSOLVENCY LAW COMMITTEE, Report of Insolvency Law Committee on Cross Border Insolvency, ¶1.4 (October 2018).
(i) Sharing of information between the proposed Resolution Corporation and international authorities on a reciprocal basis;

(ii) Assistance by the proposed Resolution Corporation in case of the resolution of a branch office situated in India of a foreign financial firm;

(iii) Recognition and enforcement of foreign resolution actions by the Resolution Corporation, provided certain conditions are satisfied; and

(iv) Resolution of a local branch office of a foreign financial firm, and providing for a first charge of domestic creditors over the assets of such branch office, in certain cases.

Thus, although there is no dedicated framework for cross-border bank resolution, the RBI has used various provisions to meet the unique challenges as they arose. Going forward, a proposed resolution framework for FSPs should build upon this, and provide for a comprehensive cross-border resolution mechanism for different categories of FSPs.

B. SPECIAL TREATMENT FOR SIFIS AND FMIS

1. Systemically Important Financial Institutions (SIFIs)

SIFIs are essentially large financial institutions which by virtue of their size, complexity and inter-connectedness (amongst other factors), pose the risk of systemic disruption, should they fail. The disorderly failure of any SIFI, domestic or global, is capable of causing significant disruption to the wider financial system and economic activity. However, the risk of disruption is likely to be greater in the case of G-SIFIs.

Designating a financial firm as a SIFI often imposes higher regulatory burden on the financial firm, and can often lead to legal challenges. For instance, in the US, the designation of MetLife as a SIFI by the Financial Stability Oversight Council was overturned by courts. This was because there was a failure to assess MetLife’s vulnerabilities to extreme financial distress and the potential economic impact of the designation.

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136 Id.

The problem with SIFIs arises because due to factors such as their size and inter-connectedness with the larger financial system, SIFIs may not be allowed to fail or be liquidated even when they become insolvent, unlike other financial firms. This means that SIFIs may continue to operate and their creditors and stakeholders continue to be protected, unlike the case of non-SIFIs. This not only creates problems of moral hazard ex ante (especially in view of the possibility of publicly-funded bail-outs), but may also confer significant competitive advantages to the largest financial institutions. Thus, credible resolution within a specially designed resolution framework is key to addressing the problems created by SIFIs.

Since SIFIs encompass multiple kinds of FSPs, there are multiple categories of SIFIs. Internationally, SIFIs are mainly recognised as globally systemically important banks (‘G-SIBs’) and globally systemically important insurers (‘G-SIIs’). There has also been discussion surrounding creating a regulatory framework for non-bank non-insurer global systemically important financial institutions (‘NBNI G-SIFIs’).

The FSB and the Basel Committee on Banking Supervision (‘BCBS’) identify G-SIBs, while the FSB and the International Association of Insurance Supervisors identify G-SIIs. A list of G-SIBs and G-SIIs as on date is set out in Table 1 and Table 2, respectively, below.

**Table 1: G-SIBs (as on November 2019)**

<table>
<thead>
<tr>
<th>Bucket</th>
<th>G-SIBs</th>
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</thead>
<tbody>
<tr>
<td>5</td>
<td>-</td>
</tr>
<tr>
<td>4</td>
<td>JP Morgan Chase</td>
</tr>
<tr>
<td>3</td>
<td>Citigroup, HSBC</td>
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</tbody>
</table>

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### Table 2: G-SIIs

<table>
<thead>
<tr>
<th>G-SII</th>
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<tbody>
<tr>
<td>Aegon N.V.</td>
</tr>
<tr>
<td>Allianz SE</td>
</tr>
<tr>
<td>American International Group, Inc.</td>
</tr>
<tr>
<td>Aviva plc</td>
</tr>
<tr>
<td>Axa S.A.</td>
</tr>
<tr>
<td>MetLife, Inc.</td>
</tr>
<tr>
<td>Ping An Insurance (Group) Company of China, Ltd.</td>
</tr>
<tr>
<td>Prudential Financial</td>
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<tr>
<td>Inc. Prudential plc</td>
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</table>

In the Indian context, the RBI has been designating certain domestic banks as Domestic Systemically Important Banks (‘D-SIBs’). Additionally, the RBI also recognises certain non-deposit taking NBFCs (having total assets of INR 500 crore and above as shown in their last audited balance sheet) as systemically important non-deposit taking NBFCs (‘NBFC-NDSI’).

### 2. Financial Market Infrastructure

A Financial Market Infrastructure (‘FMI’) is defined as a multilateral system among participating institutions, including the operator of the system, used for the purposes of clearing, settling, or recording payments, securities, derivatives, or other financial transactions. The five key types of FMIs include...

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141 Financial Stability Board, 2016 list of global systemically important insurers (G-SIIs) (21 November 2016). Note: The list of G-SIs has not been updated since 2016.


payment systems, central securities depositories (‘CSDs’), securities settlement systems (‘SSSs’), central counterparties (‘CCPs’) and trade repositories (‘TRs’).  

FMI{s facilitate critical functions in financial markets and when properly managed have the ability to promote financial stability. At the same time, FMI{s can be sources of significant financial shocks and transmit them to financial markets, if themselves in distress.  

Payment systems are considered systemically important if they illustratively, are the sole payment system in a country, are the principal system in terms of the aggregate value of payments or mainly handle time-critical, high-value payments. Other FMI{s i.e. CSDs, SSSs, CCPs, and TRs are presumed to be systemically important, in the jurisdiction of their location, because of their critical roles in the markets they serve.  

Therefore, there is a valid justification to think through the application of the resolution regime for FMI{s. As an example, it would be useful to consider a particular category of FMI in more detail.  

a. Central Counterparties  

Central Counterparties (‘CCPs’) interpose themselves between counterparties to contracts traded in financial markets, and play the role of buyer to every seller and vice-versa. Through multilateral netting of trades and requiring system participants to provide collateral, CCPs can potentially reduce systemic risks for participants, as well as the markets in which they operate. The Key Attributes recognise that FMI{s such as CCPs play a critical role in financial markets, and that resolution should be guided by the need to maintain continuity of critical functions.  

CCPs raise some unique concerns. First, given the unique status of a CCP as the buyer to every seller, and seller to every buyer, a significant source of risk arises from the default of one of the parties (counterparty risk). This leaves the CCP with the obligation to continue performance to the non-defaulting participant, by replacing the defaulting member’s position. Even though CCPs have a risk waterfall of resources to fund this exercise, starting with the defaulting member’s margins, there may be a situation where a CCP may have to move down this waterfall to reach its own resources at the very end, leading to unpredicted financial

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144 Id., ¶1.9.  
145 Id., ¶1.20.  
146 Id., ¶1.9.  
147 Id., ¶1.20.  
148 Id., ¶1.20.  
149 Id., ¶1.13.  
150 Id., Background.  
151 Financial Stability Board, supra note 108, Key Attribute 1.2.
losses, as well as adversely impacting systemic risk. Further, operational risks (such as fraud) may be a critical risk in the context of CCPs.

Second, the clearing function performed by CCPs is viewed as a public good, and there are obligations placed on users of OTC trades (especially post the financial crisis) to clear trades at CCPs. This creates a strong incentive favouring the continuation of CCPs, which reflects in the objective of CCP resolution (as set out by the FSB) being “the pursuit of financial stability and ensuring the continuity of critical CCP functions in all jurisdictions where those functions are critical and without exposing taxpayers to the risk of loss.”

Third, unlike banks, CCPs do not have loan-books or creditors. They only perform the function of clearing. Thus, unlike the case of a failed bank, no separation of assets and liabilities may be possible, and therefore the tool of separating the viable and unviable parts of a bank’s business may not be available in case of a CCP.

Thus, the unique features of FMIs need to be recognised in developing an effective resolution regime.

V. CONCERNS WITH THE FRDI BILL, 2017

The FRDI Bill 2017 raised much controversy due to the bail-in provision and its application to different types of banks. This Part argues that the bail-in provision may not be of much practical significance in the present Indian context. Moreover, the concerns around bail-in could potentially be ameliorated through deposit insurance and exclusion of retail deposits from the ambit of bail-in. However, the extent to which public sector banks and co-operative banks may be covered under an omnibus central law may require deeper thought.

A. BAIL-IN

As discussed earlier, bail-in is a resolution tool used to capitalise a failing financial institution (usually a bank) from within through conversion/cancellation of its debt/liabilities. This stands in contrast to the concept of external capital infusion into a failing bank. After the financial crisis, the bail-in tool had caught on with regulators globally as a means to avoid the moral hazard problems associated with tax-funded bailouts.

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152 Manmohan Singh & Dermot Turing, Central Counterparties Resolution - An Unresolved Problem, IMF WORKING PAPERS 18/65 (March 2018).


154 Singh & Turing, supra note 152, 50.

155 Dell’Ariccia et al., Trade-offs in Bank Resolution, Executive Summary, IMF Staff Discussion Notes (February 2018).
The most controversial issue with bail-in is the potential cancellation of retail deposits or converting them into equity. This has raised concerns that bail-in could impose significant haircuts on such retail depositors. In fact, this perception was one of the prime reasons for withdrawal of the FRDI Bill, 2017.\textsuperscript{156}

It is important to recognise that use of bail-in on a bank is akin to restructuring the bank. It is relevant usually when there are no external buyers for the bank’s assets. This is likely to be the case only for very large internationally active banks, essentially the G-SIBs. Bail-in could save such banks from sudden and disorderly liquidation by restoring their solvency and enabling them to continue as going concern till a resolution plan is worked out.

As on November 2018, 27 G-SIBs have been identified by the FSB and the BCBS, as set out in Table 3. To facilitate bail-in of G-SIBs, the FSB has highlighted the need for G-SIBs to have higher loss absorbency capital. Accordingly, the Total Loss Absorbency Capacity (‘TLAC’) Term Sheet for G-SIBs was released in November 2015.

**Table 3: List of G-SIBs as of November 2019**\textsuperscript{157}

<table>
<thead>
<tr>
<th>Bucket</th>
<th>G-SIBs</th>
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<tr>
<td>4</td>
<td>JP Morgan Chase</td>
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<tr>
<td>3</td>
<td>Citigroup, HSBC</td>
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It is important to note here that no Indian bank features in the list of G-SIBs. Neither is any Indian bank internationally active at a very large scale. Table 4 below shows that the big Indian banks are classified as Domestically Systemically Important Banks (‘D-SIBs’). In practice, merger and amalgamation (compulsory or voluntary) remains the most commonly used tool for bank resolution in India. For instance, Global Trust Bank merged with Oriental Bank of Commerce in 2004 and Bank of Rajasthan merged with ICICI Bank in 2010.

\textsuperscript{156} Nupur Anand, *Indians no longer have to worry about their money being used to rescue banks*, QUARTZ, August 1, 2018, available at https://qz.com/india/1345237/india-drops-frdi-bill-proposing-use-of-deposits-to-rescue-banks/ (Last visited on April 25, 2020).

\textsuperscript{157} Financial Stability Board, *supra* note 140.
Consequently, statutory bail-in not of much practical significance for Indian banks, public or private.

This is more so since bail-in could be achieved by contract too. A contractual trigger in the debt contracts could provide that on occurrence of certain events, the debt contract would automatically transform into equity or even stand cancelled. For instance, the Additional Tier 1 bonds of Yes Bank Ltd., which were cancelled in its recent restructuring, would be an example of debt contracts with such contractual trigger.\textsuperscript{158} Such contractual triggers are permissible and in fact, a must, for certain capital instruments issued by banks in India.\textsuperscript{159} Therefore, the need for statutory bail-in is even lesser in the Indian context.

**Table 4: List of D-SIBs as on April 1, 2019\textsuperscript{160}**

<table>
<thead>
<tr>
<th>Risk Bucket</th>
<th>Banks</th>
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<td>4</td>
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<tr>
<td>3</td>
<td>State Bank of India</td>
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<tr>
<td>2</td>
<td>-</td>
</tr>
<tr>
<td>1</td>
<td>ICICI Bank, HDFC Bank</td>
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There are good reasons to exclude retail depositors from bail-in. Ideally, bail-in should be applied only to sophisticated creditors who could monitor a bank. Moreover, certain jurisdictions explicitly allow exclusion of uninsured retail deposits from bail-in. For instance, the EU Banking Recovery and Resolution Directive, 2014 (‘BRRD’) allows deposits that are held for natural persons, and micro, small and medium-sized enterprises and which exceed the amount protected by national guarantee schemes, to be excluded from bail-in.\textsuperscript{161} Therefore, Indian policymakers could consider explicitly excluding retail deposits below a certain threshold (to be specified by regulations) from the scope of bail-in.

Another safeguard against bail-in is deposit insurance. For instance, the European Union excludes covered deposits from the ambit of the bail-in tool.\textsuperscript{162} This is also the position under the FRDI Bill, 2017.\textsuperscript{163} However, as on March 2018,

\textsuperscript{158} Reserve Bank of India, *Draft Yes Bank Ltd. Reconstruction Scheme 2020*, March 6, 2020.

\textsuperscript{159} Reserve Bank of India, Master Circular, *Annex 16: Minimum requirements to ensure loss absorption of Additional Tier 1 instruments at pre-specified trigger and of all non-equity regulatory capital instruments at the point of non-viability*, Basel III Capital Regulations (Issued on July 1, 2015).


\textsuperscript{161} Banking Resolution and Recovery Directive 2014, Art. 44(3)(c).


\textsuperscript{163} Financial Resolution and Deposit Insurance Bill, 2017, Cl. 52(7)(a).
29.2% of total assessable deposits and 91.5% of the total number of bank accounts in India were fully insured through deposit insurance.\textsuperscript{164} Indian policymakers could therefore consider enhancing the deposit insurance coverage to safeguard most retail depositors against bail-in. A step forward in this regard has been the recent revision in deposit insurance coverage for depositors in February 2020.\textsuperscript{165}

\textbf{B. APPLYING THE RESOLUTION FRAMEWORK TO SPECIFIC BANKING INSTITUTIONS}

1. Public sector banks

A resolution framework helps avoid the moral hazard involved in state-funded bail-outs of private banks. However, resolution of a public sector bank cannot be equated with a bail-out. A public sector bank is an instrumentality of the State, meant to achieve social objectives and not just pursue profits. The State may therefore, be serving a social goal by resolving it. The moral hazard argument may not hold in this case. Yet, the FRDI Bill, 2017, applies the same resolution framework to both public sector as well as private sector banks. Bringing in both public sector banks and private banks under a framework meant primarily for private banks may not be ideal. Therefore, Indian policymakers may need to reconsider whether the resolution framework meant to mitigate the moral hazard of state-funded bail-out of private banks should be applied to public sector banks.

2. Co-operative banks

Failure of co-operative banks in the Indian context has been a recurring problem. Co-operative banks have historically been main beneficiaries of the prevalent deposit insurance system. They have obtained far greater deposit insurance pay-outs in relation to deposit insurance premiums paid, compared to commercial banks.\textsuperscript{166} Most recently, during 2017-18, all deposit insurance claims settled by the DICGC were on account of co-operative banks,\textsuperscript{167} while deposit insurance premia paid by co-operative banks were roughly 7% of the total, with the rest being collected from scheduled commercial banks.\textsuperscript{168}

There is a significant problem with the regulation of co-operative banks in India, which impedes regulating co-operative banks in the manner

\textsuperscript{164} Deposit Insurance and Credit Guarantee Corporation, Annual Report 2017-18.


\textsuperscript{166} Sujan Hazra, Deposit Insurance for Co-operative Banks: Is There a Road Ahead?, 37(48) ECONOMIC & POLITICAL WEEKLY (2002).

\textsuperscript{167} Deposit Insurance and Credit Guarantee Corporation, supra note 164, Annexure VI.

\textsuperscript{168} Id., Table 2.
banking companies are regulated. This is the dual regulation problem. This dual regulation is a direct consequence of the Indian constitutional framework. Entry 43 of List I empowers the Union Parliament to legislate on ‘incorporation, regulation and winding up of trading corporations, including banking, insurance and financial corporations, but not including co-operative societies’. Entry 32 of List II empowers the States to legislate on ‘incorporation, regulation and winding-up’ of co-operative societies.

Consequently, the incorporation, management and winding up of primary co-operative banks are regulated either under the Co-operative Societies Acts of each state (if the societies are operating in a single state) or the Multi-state Co-operative Societies Act, 2002 (if the societies are operating in more than one state). On the other hand, the regulation of incorporation, management and winding up of state co-operative banks and district central co-operative banks is with the authorities under the Co-operative Societies Acts of each state. Further, the banking functions of co-operative banks are regulated and supervised by RBI, with the proviso that supervision of rural co-operative banks is delegated to NABARD.169

The FRDI Bill, 2017 has proposed the inclusion of co-operative banks within its ambit for the purpose of both deposit insurance and resolution.170 However, policymakers need to be aware that any attempt to regulate State co-operatives directly under a Central law may run into a constitutional challenge. A possible approach to doing this, as recommended by the RBI Working Group on the Resolution Regime for Financial Institutions, may involve State Governments accepting the authority of the Parliament to legislate on matters relating to resolution of failed co-operative banks under Article 252 of the Constitution of India.171 This may address the issues involved in covering co-operative banks, governed by state legislations, within the scope of a Central resolution law.172 It may be useful to mention here that after the PMC crisis in late 2019, the Banking Regulation (Amendment) Bill, 2020 was introduced in the Lok Sabha to empower the RBI with respect to certain co-operative banks. However, it has not yet been passed.

VI. CONCLUSION

The ongoing financial distress among some banks, NBFCs and HFCs has once again drawn attention to the fragmented legal framework on resolution of FSPs in India. The government was quick to extend the IBC to the relatively bigger NBFCs and HFCs. This has renewed interests about the fate of the FRDI Bill as well as the future of financial firm resolution in India. Barring a few legal scholars who have commented on these developments in the Indian media, the

169 Reserve Bank of India, supra note 67, ¶3.9.
170 Financial Resolution and Deposit Insurance Bill, 2017, Chapter XVII.
171 Reserve Bank of India, supra note 67, 85.
172 Id.
Indian academic legal literature has hardly attempted to contextualise these major developments within a theoretical framework. This paper attempted to address this lacuna. It analysed the recent Indian legal developments on this subject from a conceptual perspective and highlighted relevant issues that may have bearing on the future of FSP resolution in India.

A corporate bankruptcy law is well suited for real sector companies, such as manufacturing companies. However, certain FSPs including SIFIs merit a different treatment. The paper explained the inherent differences between real sector companies and FSPs. It provided a conceptual classification of FSPs to better appreciate the unique risks their businesses are exposed to. Accordingly, the paper highlighted that application of IBC to certain FSPs may be problematic. It is therefore hardly surprising that globally different standards for resolution have been laid down for certain FSPs. Currently, in India, the Rules issued by the Ministry of Corporate Affairs provide an interim legal arrangement for FSP resolution. However, the long term solution should be a dedicated resolution law along the lines of the FRDI Bill.

Indian policymakers designing a resolution law would face many challenges. The paper highlighted some specific challenges that may arise in the context of cross-border resolutions as well as in resolution of special categories of FSPs such as SIFIs and FMIs. These aspects need to be addressed in the new resolution law.

The FRDI Bill 2017 was in-principle a good policy initiative. However, it had certain provisions that raised wide ranging concerns. The paper argued that the statutory bail-in powers may not be of much practical significance in the Indian context. Moreover, deposit insurance and exclusion of retail deposits (above a specified threshold) from the ambit of bail-in could ameliorate most concerns around it. Further, the application of the FRDI Bill to public sector banks and co-operative banks should be carefully thought through. Overall, the government would be well-advised to revise the FRDI Bill and reintroduce it in the parliament. That would be the most optimal arrangement in the long run.