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THE FINANCIAL RESOLUTION AND DEPOSIT INSURANCE BILL, 2017

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THE FINANCIAL RESOLUTION & DEPOSIT INSURANCE BILL, 2017

Introduction

The Financial Resolution and Deposit Insurance (FRDI) Bill, 2017¹ was introduced in the Lok Sabha on August 10, 2017. The FRDI Bill has been referred to a Joint Parliamentary Committee of both the Houses, under the Chairpersonship of Shri Bhupender Yadav, Member of Parliament, Rajya Sabha, for examination and presenting a Report to the Parliament by the last day of the first week of the Winter session, 2017.

In 2008, the failure of a bank (Lehman Brothers) impacted the financial system across the world, and triggered a global financial crisis. After the crisis, various countries have sought to review their laws to develop new regulations and specialised capabilities for resolving failure of financial firms like banks, insurance companies *etc.* and to prevent occurrence of another crisis. In India, there is no specific law so far for the resolution of financial firms or deal with distressed financial institutions and protecting consumers and public funds. Provisions to resolve failure of financial firms are found scattered across different laws. The FRDI Bill, 2017² seeks to create a consolidated framework for monitoring financial firms, pre-empt risk to their financial position; and resolve them if they are bankrupt to honour their obligations (such as repaying depositors).

The Government has recently enacted the Insolvency and Bankruptcy Code, 2016 for the insolvency resolution of non-financial entities. The proposed legislation (FRDI Bill) together with the Insolvency and Bankruptcy Code, 2016 is expected to provide a comprehensive resolution mechanism for our economy (solutions for

¹ Pursuant to the Budget Announcement of 2016-17 on framing a draft code on resolution of financial firms, the Government constituted a committee on 15.03.2016 under the chairmanship of Shri Ajay Tyagi to draft and submit a Bill on resolution of financial firms. The Committee submitted its report on 21.09.2016 and draft bill was titled as “The Financial Resolution and Deposit Insurance Bill, 2016”. The Cabinet approved the proposal on 14.06.2017 to introduce the FRDI Bill, 2017.

² For statement of objects and reasons, see **Annexure- I**

bankruptcy cases for both financial and non-financial entities) thereby contributing to the stability and resilience of the financial system.

Features of the FRDI Bill

The FRDI Bill is divided into several chapters, and provides for comprehensive resolution framework to deal with bankruptcy situations in financial sector like banks and insurance companies, the establishment of a Resolution Corporation, categorisation of Systematically Important Financial Institutions (SIFIs), repeal of the Deposit Insurance and Credit Guarantee Corporation Act, 1961, restoration and resolution plan, method of resolution, liquidation etc.

Details of the key features of the FRDI Bill, 2017 are as follows:

i. Establishment of the Resolution Corporation

The Central Government will establish a Resolution Corporation. The Corporation will have a Chairperson and its members will include representatives from all financial sector regulators (the Reserve Bank of India, Securities and Exchange Board of India, Insurance Regulatory and Development Authority, and the Pension Fund Regulatory and Development Authority), the Ministry of Finance as well as independent members. The functions of the Corporation will include:

- Providing deposit insurance to banks (to repay deposits to consumers in case of failure),
- Classifying service providers (banks and financial institutions) based on their risk,
- Undertaking resolution of service providers in case of failure,
- It may also investigate the activities of service providers, or undertake search and seizure operations if provisions of the Bill are being contravened.
- Setting up of certain funds including *Corporation Insurance Fund* for deposit insurance provided by the Corporation to the insured service providers and *Corporation Resolution Fund* for meeting the expenses of carrying out resolution of specified service providers and *Corporation General Fund* for all other functions of the Corporation.
- Any other functions as may be prescribed.

ii. **Deposit Insurance**

Chapter IV of the FRDI Bill discusses about deposit insurance and largely deals with:

- Determination of amount payable by the Corporation, to a depositor on account of deposit insured;
- The Corporation Insurance Fund shall be utilised for payment to a depositor of an insured service provider (ISP) in respect of his deposit in case of its liquidation;
- If the Resolution Corporation is dealing with the resolution of an ISP, then the Corporation may decide to invite offers from other ISP to take over the liabilities, deposits or realisable assets of the ISP.

iii. **Categorisation as SIFIs**

The Central Government in consultation with the appropriate regulator, can designate a financial provider as SIFI, if it meets the prescribed criteria. Once classified as SIFIs, the Government may designate, its holding, subsidiary, associate company or any other body corporate related to it as financial service provider.

iv. **Risk based classification**

The Resolution corporation, in consultation with the respective regulators³ specify criteria for classifying service providers based on their risk of failure. The Bill specifies five categories of risk to viability under Section 36 (5) and are as follows :

Category	Probability of failure
Low	Substantially below acceptable levels
Moderate	Marginally below acceptable levels
Material	Above acceptable levels
Imminent	Substantially above acceptable levels
Critical	Service provider on the verge of failure

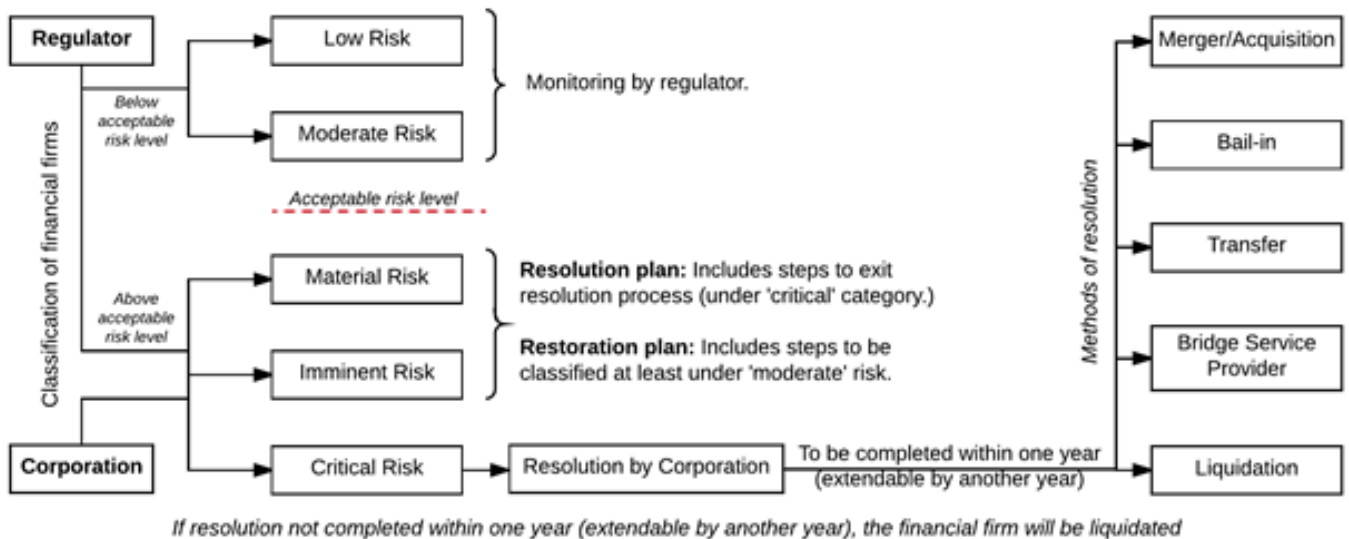
The classification of a specified service provider into any of the categories of risk to viability except the category of critical risk to viability under section 45, shall be

³ The Reserve Banks of India for banks, Insurance Regulatory and Development Authority of India (IRDA) for insurance companies.

kept confidential by the appropriate regulator, the Corporation and by all relevant parties.

5. Restoration and Resolution Plan

Any service provider categorised under the ‘imminent’ or ‘critical’ category will submit a restoration plan to the regulator, and a resolution plan to the Corporation. These plans will contain information, including: (i) details of assets and liabilities, (ii) steps to improve risk based categorisation, and (ii) information necessary for resolution of the service provider.



- **Resolution:** The Corporation will undertake resolution of a service provider classified under the ‘critical’ category using options which include: (i) transfer of its assets and liabilities to another person, (ii) merger or acquisition, and (iii) liquidation, among others.
- **Administration:** The Corporation will take over the management of the service provider from the date when it is classified as ‘critical’.

- **Time limit:** The resolution process will be completed within a year from the date when a service provider is classified as ‘critical’. This time limit may be extended by another year (i.e. maximum limit of two years). The service provider will be liquidated if its resolution is not completed during this time period.
- **Liquidation and distribution of assets:** The Corporation will require the approval of the National Company Law Tribunal to liquidate the assets of a service provider.
- **Proceeds from the sale of assets** will be distributed in the following priority order: (i) amount paid by Corporation as deposit insurance to insured depositors, (ii) resolution costs, (iii) workmen dues for 24 months and secured creditors, (iv) wages to employees for 12 months, (v) amount to uninsured depositors and other insurance related amounts, (vi) unsecured creditors, (vii) government dues and remaining secured creditors (remaining debt if they choose to enforce their collateral), (viii) remaining debt and dues, and (ix) shareholders.
- **Offences:** The Bill specifies penalties for offences such as concealment of property, and destruction or falsification of evidence. Penalties vary based on the nature of the offence, with the maximum penalty being imprisonment for five years, along with a fine.

References:

1. Lok Sabha, *The Financial Resolution & Deposit Insurance Bill, 2017*; Bill No. 165 of 2017.
2. India, Ministry of Finance, *Report of Committee to Draft Code on Resolution of Financial Firms*, 21 September, 2016.
3. *The Financial Resolution and Deposit Insurance Bill, 2017: Key Highlights*, by Nidhi Bothra, 20 September, 2017.
4. Press Information Bureau, *Cabinet approves to introduce FRDI Bill*, 14 June 2017.
5. *FRDI Bill Summary*, PRS Legislative Research, 29 August 2017.
6. Rajya Sabha Unstarred Question No. 252 dated 18 July 2017.

STATEMENT OF OBJECTS AND REASONS

At present, there is no specific law in India for resolution of failures of financial service providers. However, some provisions relating to the failures of financial service providers can be found scattered in certain enactments, such as, the Banking Regulation Act, 1949, the Reserve Bank of India Act, 1934, the Insurance Act, 1938, the Life Insurance Corporation Act, 1956, the General Insurance Business (Nationalisation) India Act, 1972, the Regional Rural Banks Act, 1976, the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, the State Bank of India Act, 1955, the State Bank of India (Subsidiary Banks) Act, 1959 and the Multi-State Co-operative Societies Act, 2002.

2. The impact of failures of financial service providers is much wider and can have a systemic effect on the economy and financial stability of a country, unlike traditional insolvency, where the affected parties are limited to the creditors of the insolvent entity. Since financial service providers handle consumer funds, some of them are critical for stability of the financial system, it is important to resolve failing financial service providers expeditiously through a specialised resolution process, as lengthy resolution proceedings can lead to losses for consumers, or instability in the financial system. The existing laws are inadequate, ineffective and fail to address the larger issue of preserving financial stability as they do not provide effective resolution tools and powers to the resolution authorities. Therefore, with a view to comply with the emerging international norms for establishing effective resolution regime for financial sector, it is proposed to regulate certain categories of financial service providers listed in the Second Schedule to the proposed legislation.

3. The Insolvency and Bankruptcy Code, 2016 has been enacted with a view to comprehensively reform the legislative framework for insolvency and bankruptcy. However, at present the said Code does not automatically cover financial service providers. The proposed legislation together with the Insolvency and Bankruptcy Code, 2016 is expected to provide a comprehensive resolution mechanism for our economy with the objective of protecting consumers of specified service providers and public funds, thereby contributing to the stability and resilience of the financial system.

4. The proposed Financial Resolution and Deposit Insurance Bill, 2017, *inter alia*, provides for,—

- (a) establishment of a Resolution Corporation and to confer upon the Corporation certain powers of resolution relating to transfer of assets to a healthy financial firm, merger or amalgamation, liquidation to be initiated by an order of the National Company Law Tribunal and some new methods of resolution, such as bail-in and creation of a bridge service provider;
- (b) designation of certain financial service providers as Systemically Important Financial Institutions, based on the criteria to be determined by the Central Government, the failure of which may disrupt the entire financial system and in view of their importance for the economy, the proposed legislation confers some additional powers in respect of such institutions;
- (c) constitution of certain funds for the purposes of the proposed legislation, namely, (i) the Corporation Insurance Fund for deposit insurance provided by the Corporation to the insured service providers; (ii) the Corporation Resolution Fund for meeting the expenses of carrying out resolution of specified service providers; and (iii) the Corporation General Fund for all other functions of the Corporation;
- (d) repeal of the Deposit insurance and Credit Guarantee Corporation Act, 1961;
- (e) amendment of certain enactments, in the manner provided in the Fourth Schedule to the proposed legislation, with a view to give resolution powers to the Resolution Corporation under those Acts.

5. The Bill seeks to achieve the above objectives.

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