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12. FRDI BILL, 2017: An Overlook

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Introduction

The financial resolution and deposit insurance bill, 2017 was introduced in parliament during monsoon session 2017. The bill proposed to create a framework for monitoring financial firms such as banks, insurance companies and stock exchanges. Pre-empt risk to their financial position. Resolve them if they fail to honour their obligations (such as repaying depositors). To insure continuity of a failing firm, it may be resolves by merging it with another firm, transferring its assets and liabilities or reducing its debts. According to the Ministry of Finance, there is presently no comprehensive and integrated legal framework for resolution, including liquidation, of financial firms in India. 'The Insolvency and Bankruptcy Code, 2016' has introduced in the country a comprehensive resolution regime for mainly non-financial firms, but such a regime is not available in the country for financial firms. So, in the financial crisis, the firm may be liquidated and its assets sold to repay its creditors.

However, the government on Tuesday, 7th August,2018 withdrew the controversial Financial Resolution and Deposit Insurance (FRDI) bill following widespread criticism of its controversial provisions, including a "bail-in" clause that suggests depositor money could be used by failing financial institutions to stay afloat and lack of clarity over protecting existing levels of deposit insurance (i.e. upto rs.1 lack) for smaller deposits, whether it will be continued in the bill.

Financial Resolution and Deposit Insurance (FRDI) Bill, 2017 was similar to the Insolvency and Bankruptcy Code, 2016. FRDI deals only with the companies that are in the financial sector entities such as banks and insurance companies. The Insolvency Code Act deals with companies in all other sectors. Purpose of the Bill was to create a resolution regime for financial institutions when they face crisis without creating financial burden for the tax payers, proposed under the bill.

"It's a law which deals with financial stress in case any institution feel stress. This was one area where there was no law. So obviously this gap had to be filled up"

- Finance Minister Arun Jaitley.

Objectives

- To study the FRDI BILL, 2017.
- To study the Bail-in and Bail-out clause.
- To know about the role of resolution corporation under FRDI Bill.
- Conclude as an overlook on FRDI Bill.

Methodology

This paper is mainly based on "**Secondary Data**". The sources are as follows: -

1. Internet
2. Newspapers
3. Magazines

Content

Frdi Bill

The Financial Resolution and Deposit Insurance Bill (FRDI) aimed to set up a resolution corporation which will monitor financial companies, categorise them as per their risk profiles and step in to prevent them from going bankrupts by writing down their liabilities.

The bill recognizes that financial firms are different in nature and hence should be handled differently. It talks about setting up of a Resolution Corporation (RC) that will identify early warning signs of distress at financial institutions including banks, non-banking financial companies, insurance companies, stock exchanges, etc.

Special points about FRDI Bill

The bill was first brought to attention by Union Finance Minister Arun Jaitley in his 2016-17 budget speech. The senior BJP leader had said that a systemic vacuum exists with regard to bankruptcy situations in financial firms and that a comprehensive Code on Resolution of Financial Firms will be introduced as a Bill in the Parliament during 2016-17.

- In March 2016, a committee was set up under the chairmanship of Ajay Tyagi, additional secretary, Department of Economic Affairs, Ministry of Finance, to draft and submit the Bill.
- The draft of Financial Resolution and Deposit Insurance Bill 2017 was drawn up based on the recommendations of this committee.
- The finance ministry, then, gave time until 31st October 2016 to given comments. After considering the suggestions, the Union Cabinet approved to introduction of FRDI Bill 2017 in the Parliament.

- The Finance Ministry believes that the bill seeks to protect customers of financial service providers in times of financial distress.
- The bill will also help to encourage discipline among the financial service providers by putting a limit on the use of public money to bail out distressed entities.
- It seeks to decrease the time and costs involved in resolving distressed financial entities.
- In order to strengthen the stability and resilience of the entities in the financial sector, a resolution corporation will be set up after the bill is enacted.
- However, the FRDI Bill has received its share of criticism from various stakeholders for some of its controversial provisions including a 'bail-in' clause which suggests that depositor money could be used by failing financial institutions to stay afloat.
- Another controversial inclusion is that the Resolution Corporation (rescue body) which is proposed under the Bill, can use your money in case the bank sinks. The bill empowers the rescue body to decide the amount insured for each depositor.

Bail Out Clause

According to the bill, the RC has the authority to resolve the stressed assets of firms by various means, including a bail-in or a combination with other methods. Traditionally, the resolution of stressed assets can be through support from outside of the bank, like resorting to recapitalisation from the budget. These are known as bail-outs, and have been standard practice in India.

Everyone has long been used to the word "bailout", where governments step in to protect the interests of savers or depositors — like in the UK when there was a run on the deposits of banks such as Northern Rock, Llyods Bank, or RBS. There were cases in the US and other parts of Europe, too. The fact that huge public funds were used for such support, and criticism that bailouts incentivised bank managements to take risky bets — called "moral hazard" by economists — led governments to seek other solutions. Regulators put in place laws and rules to discourage or prevent such bailouts with new resolution regimes. Losses of these financial firms had to be borne by shareholders and creditors rather than taxpayers. One of the tools for such resolution is "bail-in".

Bail -In Clause

The other option is the utilisation of in-house resources, or a bail-in, as is being proposed in the FRDI bill.

Thus, **bail-in clause** is a last option when financial firms are on critical stage; can scare the depositors and redirect their savings back into gold, land, chit funds, equity and even cash. Similarly, in the case of Switzerland, a contractual **bail**-in regime is fully established, including the assessment of **loss-absorbing capacity of banks and financial institutions.**

On the "Bail-in" provision of FRDI Bill, the ministry of finance said that it has only been proposed as one of the tools to be used in the event a financial firm is sought to be sustained by resolution. "Bail-in amounts to liabilities' holders bearing a part of the cost of resolution by reduction in their claims. Bail-in is only one of many resolution tools in the FRDI Bill; others are acquisition, merger and bridge service provider, and is to be used either singly or in combination with other tools," the statement explained. "Bail in provision may not be required to be used in case of any specific resolution. Most certainly, it will not be used in case of a public sector bank as such a contingency is not likely to arise."

The ministry added that the FRDI Bill does not prohibit the central government from extending support to banks, including PSU banks.

However, the bail-in clause, though internationally accepted, may not be appropriate for India's banking system.

Role of Resolution Corporation

- Monitoring financial firms.
- Anticipating their risk.
- Taking corrective actions.
- Reserving them in case of failure.
- Classifying financial firms on their risk of failure –
  - Law, Moderate, Material, Imminent or Critical.
- Resolution Corporation is powered to Bail-in-
  - To cancel liabilities of a failing financial institution.
  - Provides measures to minimize the impact of these failing institutions on the entire financial sector.
  - Provides for statutory Bail-in, where consent of creditors/depositors is not required for Bail-in.

Conclusion

- The FRDI Bill was introduced in 2017, in monsoon season and now has withdrawn on 7th August, 2018.

- "Bail-out" is a monetary support which has given by the government to the high profile banks which is in critical risk situation; by utilizing taxpayer's money.
- 'Bail-in' concept was introduced by G20 at 'Cannes summit' in 2011. As per this concept, depositors of banks having in critical situation become stakeholders or owners without taking preconcert of them to support the banks critical financial position. (It's one form of 'Recapitalization of bank'.)
- In our country no special law has been there to give resolution for financial firms at bankruptcy stage. So consolidated framework is necessary to give solution.
- Now, question is that "Is common public or law or middle class people are liable for large NPA of high profile banks?"
- Everyone knows the answer : Answer is 'No'
- 'Why' should not take "Narco Test in Public" of the responsible authority and collect maximum amount from their private estate?" ----------According to Rahul Mehta (one expert researcher).
- It is very important to take action on the authority who is liable for NPA. (eg. who sanction big amount of loan even though it is fix that it will not be recoverable)
- It is necessary to find a solution or provide measures to minimizes the impact of failing institutions which is badly effect on the entire financial sector of the country. Economic health of a country must have to be strong.
- Common man's (depositors) interest as well as financial institutions should be fully protected.
- In India, deposits in banks are insured for a maximum of Rs 1 lakh by the Deposit Insurance and Credit Guarantee Corporation. The Bill may not clearly lay down the quantum of protection for deposits, or classify deposits separately.
- The "bail in" clause could have been scrapped and insurance limits raised. If the insurance were raised to Rs.15,00,000, virtually all depositors would be covered. Otherwise, public banks should give 100% guarantee or insurance to the depositors.
- However, the government vociferously defended the provisions of the bill, pointing out that the bail-in clause will not adversely impact depositors.
- The government had maintained that the implicit sovereign guarantee for state-run banks remains unaffected. Prime Minister Narendra Modi had also sought to assure people that the bill was consumer friendly and will protect the public's deposits.

- High-profile liquidation could possibly trigger a contagion. Many countries set up resolution regimes after the global financial crisis, understanding the grave impact of a banking failure on the real economy. India may soon come to regret not doing so as well.

Even though, a Bail-in clause included in the bill was the provisions that immediately affect depositors. Depositors in good faith put their money in public sector banks because they know that government bails out the bank if it collapses. This bill will create panic in public. If the moment news gets out that banks are financially seeks, there will be rush to take out the deposits. So, this bill has to modify considering common man's security.

Union finance minister Piyush Goyal said that the resolution of these issues would require a comprehensive examination and reconsideration.

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