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Bank depositors should be recognised as financial creditors in IBC cases

BY ET CONTRIBUTORS | SEP 05, 2018, 08.44 AM IST

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By M R Umarji

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The Financial Resolution and Deposit Insurance Bill, 2017 (FRDI Bill), which was introduced in Parliament, was recently withdrawn by the government on account of widespread criticism of its controversial provisions particularly a BAIL-IN clause that provided for use of depositors' money by failing financial institutions to stay afloat. Since

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the proposal to enact a new law for resolution of insolvency of financial service providers is deferred, the existing law applicable to such financial service providers should have continued to be applicable, but the legal position is otherwise.

The Insolvency and Bankruptcy Code, 2016 (IBC 2016) is applicable to insolvency resolution and liquidation of corporate persons, that is, a company as defined in the Companies Act, 2013, or the limited liability partnership as defined in the LLP Act, 2008. The definition of corporate person, however, explicitly excludes any financial service provider (FSPs) and the effect of such provisions is that the IBC 2016 is not applicable to FSPs. The list of such FSPs is long and includes private and public sector banks, public financial institutions, non-banking financial companies, [housing finance](#) companies, asset reconstruction companies, [life insurance](#) companies, general insurance companies, [asset management](#) companies, collective investment schemes, pension funds, chit funds, Nidhi companies, etc.

The FSPs are regulated by various regulatory authorities established by law, such as the Reserve Bank of India, the Insurance Regulatory and Development Authority of India, [National Housing Bank](#), the Securities and Exchange Board of India and other authorities. The respective regulatory laws empower the regulators to file winding-up application against the FSPs and also provide various other related powers that can be exercised by the regulator with regard to the windingup of FSP. The regulatory powers to file

winding-up petition are contained in section 37 (4) of the Banking Regulation Act, 1949, section 86(6) of the Insurance act, 1938, and section 45MC of the Reserve Bank of India Act, 1934. The old company laws referred to in the regulatory laws, have been replaced by the Companies Act, 2013. Section 271 of the Companies Act, 2013 contained provision for filing winding-up petition against any company for non-payment of debt. The regulators of financial service providers could have filed a winding-up petition against insolvent FSPs, but the provisions of section 271 of the Companies Act has been amended by the IBC 2016 deleting “inability to pay debts by a company” as a ground for insolvency petition. The effect of this amendment is that no person, including the regulators of FSPs, can file winding-up petition under the provisions of the Companies Act on the ground of inability to pay debts. In effect, there is no law applicable to FSPs for insolvency and bankruptcy.

Section 227 of IBC 2016 empowers the central government to notify FSPs for the purpose of their insolvency and liquidation proceedings, which may be conducted under the IBC 2016 in such a manner as may be prescribed. It is necessary that this power is exercised and the applicability of IBC 2016 is extended to private sector banks, non-banking finance companies and housing finance companies and other FSPs. While extending the IBC provisions to FSPs, it will be necessary to save the powers of the regulators to initiate insolvency proceedings against FSPs and give other directions under the respective regulatory laws applicable to the FSPs. On account of a very efficient, strict and meticulous exercise of regulatory powers by the Reserve Bank of India, the need for filing insolvency petitions against FSPs is very rarely felt. But in respect of such important matter of insolvency law for FSPs, a vacuum cannot be allowed to exist as far as the applicability of the law is concerned.

One other important issue which needs to be considered with regard to FSPs is the rights of depositors of banks and non-banking finance companies in the event of insolvency. The new law could not be passed on account of objections to BAIL-IN provisions contained in the FRDI Bill. It is advisable that depositors of any bank or financial institution are recognised as financial creditors in insolvency proceedings, with exclusive security rights over the cash reserve maintained by such banks and financial institutions, as well as investments made as per the statutory liquidity ratio (SLR) requirements. Amendments to IBC need to be considered to protect the interest of depositors in addition to the deposit insurance cover that may be extended to the depositors.

(Former Executive Director, RBI)

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