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Market Watch

How to make the FRDI bill more effective

BY ET CONTRIBUTORS | DEC 04, 2019, 06.14 AM IST

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By Manas R Das

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The 1999 [Reserve Bank of India](#) (RBI) report on reforms in deposit insurance in India had recommended to give the Deposit Insurance and [Credit Guarantee Corporation](#) (DICGC) powers to act as receiver and liquidator of failed banks.

This RBI recommendation was taken to its logical conclusion by the tabling of the Financial Resolution and Deposit Insurance (FRDI) Bill in Parliament in August 2017. It was, however, withdrawn a year later after concerns about the [bail-in clause](#), according to which depositors of a failing financial institution would have to bear part of the resolution cost.

There is now talk of the possibility of the Bill — especially the aspects related to the banking sector — with the recent Financial Stability and Development Council (FSDC) meeting last month headed by finance minister [Nirmala Sitharaman](#) reportedly discussing the [FRDI Bill](#). So, it is an appropriate time to evaluate different aspects of the once-considered, once-removed Bill, beyond the already much-discussed bail-in provision, and suggest a few modifications.

The Bill does have several merits. For the first time in the history of Indian financial laws, a Bill details the resolution of troubled financial institutions.

Combining the two related functions of deposit insurance and resolution into one law, and bringing both under one institutional framework, constitutes another of its virtues. The incorporation of the 'No Creditor Worse Off than in Liquidation' (NCWOL) provision satisfies the [Financial Stability Board's](#) (FSB) 'bail-in' principle.

Inclusion of cross-border resolution, and emphasis on recovery and resolution planning are noteworthy.

Depositors, obviously, had earlier rejected the 'bail-in' provision. But they did realise that banks, like other businesses, are failure-prone, and that bank crises can jeopardise their savings. Such sensitisation will enhance depositor discipline on banks, besides improving one's own financial planning. There are demerits of the FRDI Bill.

Bringing in non-banking financial companies (NBFCs) last month under the Insolvency and Bankruptcy Code (IBC) is a welcome move, which also rectifies an earlier aberration in the law. But the question of extending deposit insurance to NBFCs remains unresolved.

The non-banking sector is amorphous, less transparent and more vulnerable than banks, as recent turmoil showcased.

Earlier, different committees had disfavoured deposit insurance for non-banks. The 2014 [International Monetary Fund](#) 'Deposit Insurance Database' was against it. According to the 2018 Survey of Deposit Insurance Systems (DISs) by the International Association of Deposit Insurers, of the 131 DISs in the world, only five provided coverage to securities companies, seven to insurance companies and 17 to investment banks.

Among the lower-middle income economies — to which India belongs — no DIS covered such entities. Therefore, each category of financial institutions necessitates a separate DIS — if, at all, necessary.

At present, the [Banking Regulation Act, 1949](#), coupled with the DICGC Act, 1961, protects interest of bank depositors well. Additionally, if DICGC can be bolstered with requisite statutory powers, capital, personnel and technology, it can become an independent deposit insurance-cum resolution corporation (RC) exclusively for banks. There would then be no need for a new institution.

From the perspective of banks, however, RC should be brought in after some time, as the sector is undergoing a churn, what with the mega-merger of public sector banks (PSBs) yet to shape up, with some PSBs still under 'Prompt Corrective Action' (PCA), and some out of PCA yet to stabilise. Further, adoption of Indian Accounting Standards by the scheduled commercial banks — except regional rural banks (RRBs) — which will impact their financial statements and capital, is pending. Hence, it will be pragmatic to wait till there is some crystallisation.

In addition to RBI's oversight and [PCA framework](#) for banks, another 'risk to viability' framework could lead to duplication, and be a wastage of scarce regulatory and supervisory resources. For banks, only one framework is needed. It seems RC will be highly dependent on sectoral regulators/supervisors.

This will not only add to the latter's workload, but also may, occasionally, cause friction. So, sound coordination and information-sharing between the two parties, which the Bill emphasises, would be crucial. Ideally, RC should have a deposit insurance expert on its board or as an adviser, since one of the key determinants of efficient resolution and depositor's confidence is how fast the latter's money is made good.

Finally, the Bill would necessitate a time-consuming 'repeals and amendments' of over a dozen legislations. So, the new Act should consider keeping its ripple effects on other laws to the minimum. Besides, the related provisions in these Acts should be seamlessly woven into one to preclude any doubt or confusion, both in letter and spirit.

Before the FRDI Bill is indeed resurrected, more granular, multidisciplinary research is required before deciding on its enactment. The extent to which it syncs with FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions also needs assessing.

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