

Towards Consolidating Resolution Infrastructure

Recommendation of the
Financial Sector Legislative
Reforms Commission

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Deposit Insurance and Credit
Guarantee Corporation

Current Laws, Resolution Procedures and Practices

Private Sector : Some Triggers for Reserve Bank intervention

- Banking Regulation Act, 1949 empowers RBI to take action, if:
- Banking company has failed to comply with the directions
- In the interest of the banking company, in public interest, in the interest of public policy, in the interest of banking policy
- for preventing the affairs of a banking company being conducted in a manner detrimental to the interests of the depositors
- for securing the proper management

Current Laws, Resolution Procedures and Practices

Private Sector- Control over Management

- Reserve Bank has powers
 - to remove Managerial Personnel
 - With a proviso to show cause and representation
 - to appoint additional directors
notwithstanding any other law in force
 - Courts cannot stay proceedings

Current Laws, Resolution Procedures and Practices

When a Private Sector Bank is in Problem

- Central Government, in consultation with Reserve Bank, has powers to take over a bank and
 - retain it (**government ownership**) or
 - transfer to a company specially formed for the purpose (**Bridge Bank?**)
- **Suspension of business for a fixed period:** High court may entertain an application if a bank is not able to meet its obligations temporarily provided RBI certifies it is able pay its depositors
 - May lead to winding up finally
- **Courts cannot stay proceedings**

Current Laws, Resolution Procedures and Practices

When a Private Sector Bank is in Problem

- High court order winding up– voluntary or on application from RBI - Voluntary winding-up requires RBI clearance; Reserve Bank/its nominee to be appointed as liquidator
- RBI may seek moratorium from a High Court
 - During moratorium RBI can make a scheme of reconstruction or amalgamation
- Court cannot stay proceedings

Current Resolution Procedures and Practices

State Bank of India / Nationalized Banks

- State Bank of India / Nationalised Bank Act applies
- Dissolution / Liquidation: by order of the Central Government and in such manner as it may direct
- Supersession of Board in certain cases

Cooperative Banks

- State / Multi state Cooperative Societies Act applies
- Supersession of Board and Liquidation powers with State / Central Governments
- MOUs between the RBI and State / Central Governments

DICGC In Evolution

Conceptualizing Deposit Insurance

1948

- Banking Crisis in Bengal

1950

- Support for Deposit Insurance comes from Rural Banking Enquiry Committee

1960

- Failure of two banks stirs up action

DICGC In Evolution

Deposit Insurance is Born

- 1961 - Deposit Insurance Act 1961 is passed
- January 01, 1962 - Deposit Insurance Corporation commences operations as a wholly owned subsidiary of Reserve Bank of India
- Mandate – Pay Box
- To begin with Indian branches of commercial banks deposits– including those of Indian branches of foreign bank, are covered
- 1968 – Law amended to cover deposits of cooperative banks

DICGC In Evolution

Credit Guarantee function is added

- 1960 - Government of India introduces a Credit Guarantee Scheme for credit to Small Scale Industry and Reserve Bank of India operates it till 1981
- 1971 – Reserve Bank promotes a Credit Guarantee Corporation of India for credit guarantee to small loans for non-industrial activity
- 1978 – DICGC is born with consolidating deposit insurance and credit guarantee schemes for small loans through a new act called the Deposit Insurance and Credit Guarantee Corporation, 1961

Banking Structure evolves in the Background in the meanwhile

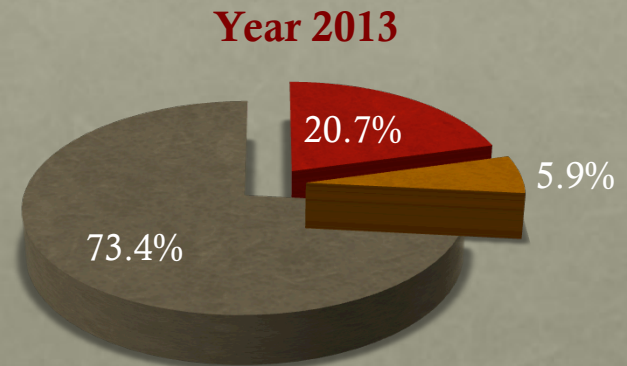
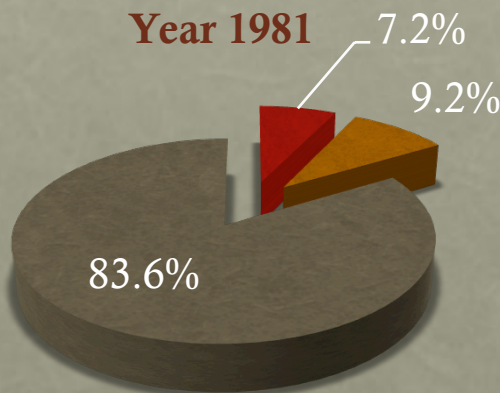
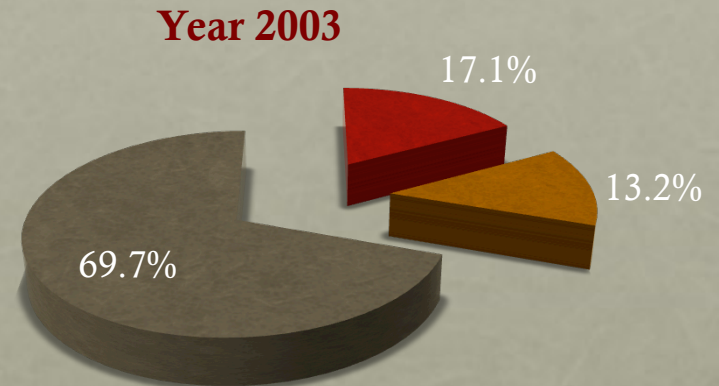
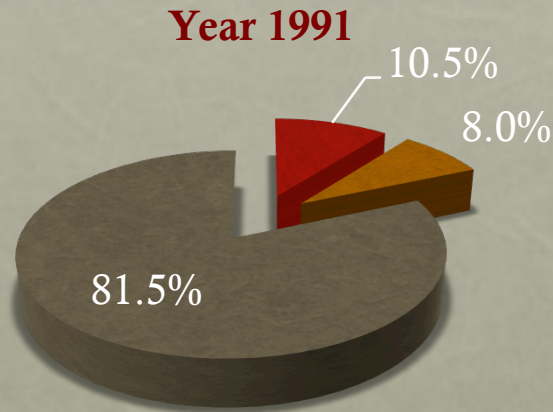
Shifting Relevance of Deposit Insurance as banking environment evolves

- Early years - Banking System was largely private
- 1955 – Imperial Bank becomes State Bank of India
- 1969 – 14 banks nationalized
- 1980 – 6 more banks nationalized
- Banking Sector re-opened for private sector
 - 1993 – 10 new bank licenses issued
 - 2001 – 02 new bank licenses issued
 - Churning happened – now 08 remain.

Share Dynamics of Private Sector

Shifting Relevance of Deposit Insurance as banking environment evolves

- Private Sector
- Coop Sector
- Public Sector



Financial Sector Legislative Reforms Commission - FSLRC

The Approach

- For aligning the laws with the evolving global financial system environment
- Shift away from Sectoral perspective
- Adopting Principles Based Approach
- Three pillars of commission's work –
Consumer Protection, Micro-prudential Regulation and Resolution

Objectives of Resolution Mechanism

Protecting the stability and resilience of the financial system

Protecting consumers of covered obligations up to a reasonable limit and

Objectives

Enhancing financial market efficiency through efficient pricing and allocation of risks

Protecting public funds

To develop an optimum and effective to cross border resolution over a period of next 5 years

FSLRC Thought Process



FSLRC Recommends a Resolution Corporation

Key Capabilities and Features

- A corporation which is capable of dealing with an array of financial forms that make intense promises– banks, insurance companies, defined pension benefits, and payment systems
- With a sophisticated legal apparatus – FSLRC has drafted an elaborate financial code (draft law)
- Emphasizes speed of action with disaster management capabilities
- A body that assumes primacy as a firm approaches failure

Resolution Corporation

Key elements of Organizational Structure –

The corporation Board to

- have a board with executive, non-executive and nominees as members (max 9)
- have representation from across the financial regulatory architecture, including
 - the central bank, financial regulators, and the Central Government, and must be headed by a Chief Executive
- Executive members (max 3) to include Chairman and an administrative law member

Resolution Corporation

A 'Covered Service Provider' defined

- Regulator in consultation with Corporation to determine based on:
 - Nature and extent of detriment that may be caused to consumers on non-fulfillment of obligations
 - Lack of ability of consumers to access and process information relating to the safety and soundness of the covered service provider; and
 - the inherent difficulties that may arise for financial service providers in fulfilling those obligations.

Resolution Corporation

Powers of the Corporation versus Member Institutions

- Eligibility, application and assessment for Corporation Insurance
- Terminate insurance in specific circumstances
- To conduct regular evaluations at periodic intervals and “special” evaluations
- To impose monetary penalty if a covered service provider fails to disclose relevant information or cooperate with the corporation.

Resolution Corporation

Interaction with the Agencies

- A regular interaction between the Resolution Corporation, micro-prudential regulators, competition commission and FSDC
- Exemption from consultation with the competition commission in certain circumstances, if the resolution corporation determines that those actions need to be taken immediately to prevent the probable failure of a covered service provider
- Where actions are likely to involve a SIFI, the resolution corporation to obtain the permission of the FSDC;

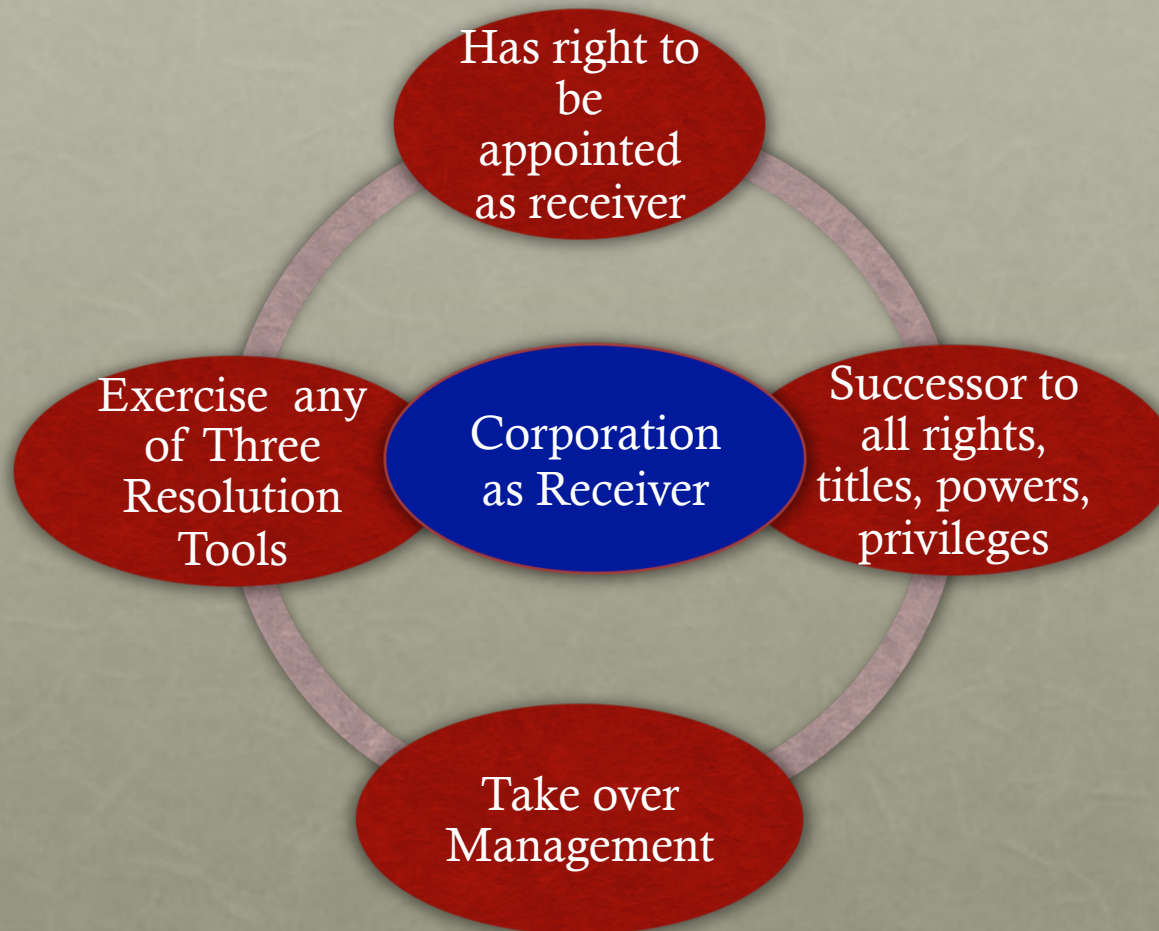
Financial Resources

Funding – Resolution Fund

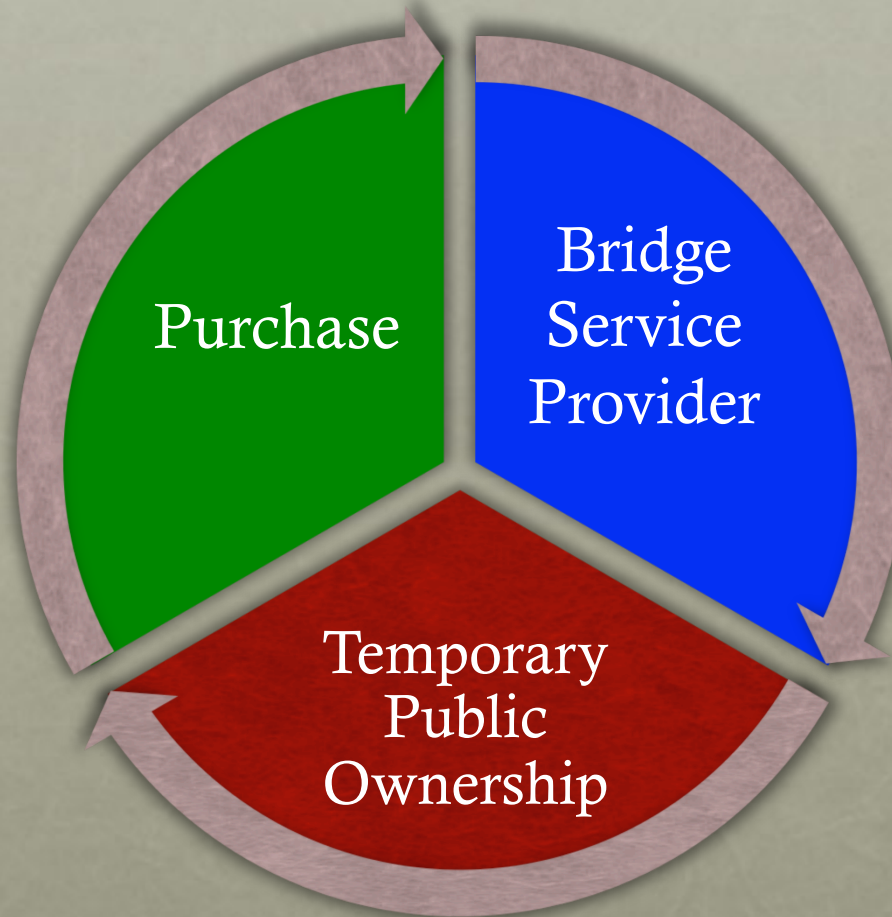
- Obligation to cover each consumer upto specified limits
- Obligation to cover each covered service provider upto specified limits
- Set Up a Resolution Fund - All covered service providers to pay fees commensurate with the prospective costs they may impose upon resolution
- Back up Funding : Line of Credit from Central Government

Resolution Corporation

Powers of the Corporation as Receiver



Tools of Resolution



Should be independent of ownership structure

Tools of Resolution

Some Issues - Public Sector and Cooperative Sector institutions

- No provision of law relating to winding up of corporations shall apply to a public sector banks
- These can be placed in liquidation save by order of the Central Government and in such manner as it may direct.
- Central Government may, for reasons to be recorded in writing, by order, supersede the Board of Directors
- Cooperative Banks : MoUs
- *FSLRC – Application of Tools should be independent of ownership structure*

“Prompt Corrective Action” – A Key Action Plan Framework

Based on a Risk Assessment Measure

Low risk to Viability	Resilient to normal adverse movements
Moderate risk to Viability	Vulnerable to normal adverse movements but may recover on PCA
Material risk to Viability	Fails to meet minimum requirement but may recover on PCA
Imminent risk to Viability	Significantly below minimum requirement but may recover on PCA
Critical risk to Viability	Fails to meet minimum requirement <i>and</i> may not recover on PCA

Resolution Corporation

Protection to the Corporation

- Stay on Other Proceedings involving covered service provider; fresh proceedings cannot be commenced
- The decision to resolve a covered service provider, as determined by the resolution corporation, is final, conclusive and may not be appealed;
- A court will not have jurisdiction over any claim or any action seeking a determination of rights with respect to the assets of the covered service provider, including any assets which the resolution corporation may acquire as receiver; and
- ***Rider:*** Throughout the exercise of its functions, the resolution corporation must be bound by a clearly defined legal process. If it strays, it may be open to challenge before the tribunal.

Liquidation and Compensation

Corporation's Obligations and Privileges

- In allocation of losses, hierarchy of claims to be respected
- The resolution corporation to be the creditor of the first priority if the resolution corporation has utilised proceeds from the fund towards meeting the expenses of liquidation.

Appeals

Protection to the Corporation

- No review of Resolution Order
- Provision of a tribunal
 - For appeal against compensation order
 - For review of decisions taken
 - If error apparent on the face of record
 - Not considered relevant material or considered irrelevant material
 - Principle of natural justice have been violated



Thank You

