Editorial

Is FRDI Bill: A Cogent Tool or Muddled Dream for Banking Regulation

The year 2008 marked the outburst of global financial crises creating fear amongst depositors about the absence of a regulated framework to avoid failure of financial institutions. Worldwide, the countries started formulated legal frameworks to reduce the systemic impact of failures for the protection of the depositors. In India, the need to develop a ruling system for financial institutions in distress while protecting the interests of taxpayers was greatly felt. This urgent need has paved the way for the Financial Resolution and Deposit Insurance Bill (FRDI), 2017. The proposed legislation together with the Insolvency and Bankruptcy Code, 2016 is expected to provide a comprehensive resolution mechanism for the economy.

The Resolution Corporation

So far, the Reserve Bank of India, enjoy the exclusive powers to monitor the banking system and provide remedial measures in case of financial problems. Now the proposed bill advocates for the setting up of a Resolution Corporation in place of the present Deposit Insurance and Credit Guarantee Corporation. The proposed Resolution Corporation will take over the vital power of RBI thereby diluting its regulatory role as it will be responsible for determining an 'potential risk' of the bank showing financial and will weakness suggest the remedial measure. Further, FRDI seeks to alter all exclusive laws governing financial institutions, including the State Bank of India Act. Further the composition of the corporation is such that, it will give supreme powers to the Union government rather than the RBI to determine the fate of a bank.

The Bail–in Clause

The bail-in clause included in the proposed bill is the provision that right away affects depositors and has created a stir amongst depositors and bank unions because it poses a threat to their deposits with various public sector banks. This bail-in clause gives statutory rights to the government to convert depositors' money into equity and convert existing depositors into shareholders in order to recapitalise the financial institution in distress. The only amount that cannot be used for a bail-in is the amount under deposit insurance. Under that law, deposits of up to Rs 1 lakh,

including interest, are protected by the insurance cover that the bank takes. Any amount over and above Rs 1 lakh does not have this protection and a customer with a large deposit might lose his money if the bank gets into financial trouble.

However, the government has emphasized its implicit guarantee about the solvency public of the bank's and has assured for the bail-out if needed, there by eliminating the need for a bail-in. Moreover, the bail-in clause as a reinstatement plan can only be used in private banks as a last resort by the Resolution Corporation. This clause indicates around the biased intensions of the government. The need for protection of the private bank depositors also exists, which the regulatory authorizes cannot forego as the private banks hold 25% of the deposits in the country.

International Experiences

After the Greek crisis in 2012, Cyprus' economy declined and fell resulting in the acute financial turmoil and collapse of its banking system. Thus, Cyprus became the testing ground for the bail-in programme, which was advocated in 2012 by the International Monetary Fund (IMF). With the failure of its second largest bank, the customers with over €100,000 as deposits, lost 40 to 60 percent of their deposits. Cyprus bail-in programme was a disaster.

In the 24 months following the Cyprus story New Zealand, Canada UK , US, and Germany also introduced legislations that gives the governments in those countries the option of freezing, and perhaps seizing bank deposits above a certain level.

In India, the deposit protection limit is Rs 100,000, roughly one-sixtieth of the value protected in other jurisdictions. For example, in the UK, the deposits are guaranteed to an upper limit of £85,000. In the rest of Europe, that translates into €100,000. The UK's Financial Services Compensation Scheme (FSCS) has gone further, it also provides a protection limit of up to £1 million on 'temporary high balances' that depositors may have held when the bank failed.

Therefore, while the advanced economies like France, Germany, Italy, Netherlands, Spain, Switzerland, Hong Kong, United Kingdom (UK), and the United States (US) are clearly pushing this resolution reform agenda, the emerging or developing economies like Argentina, Australia, Brazil, China, Indonesia, South Korea, Mexico, Saudi Arabia, Singapore, South Africa, and Turkey have implemented the reforms only partially, are more cautious about them, particularly the provisions of bail-in and temporary bridge institution.

The proposed FRDI bill in its current form looks as if this framework will further weaken the banking system by diluting the powers of RBI in India and will create suspicion in the minds of the account holders. The banking unions highly oppose the bill stating on the grounds of the violation of labour rights. There are clauses in the bill that enable the Resolution Corporation to terminate employment or change the compensation structure of bank employees when the bank goes through various stages of resolution restricting the employees to claim compensation for loss of employment.

In fact, the IMF, which advocates “from Bail-out to Bail-in”, also emphasis on having clear and consistent legal framework for bail-ins. An appropriate balance between the rights of private stakeholders and the public policy interest in preserving financial stability is highly desired. The objective of the government is to fully protect the interest of both, the financial institutions and depositors at the same time, but how it is going to do it is not clear yet. Indeed, the bill is at an early stage and requires changes regarding the danger it poses to depositors’ money at a time when country’s bad loans have increased to a record high.