

**Government of India
Ministry of Finance**

**Note on summary of the recommendations of the Committee to draft a Code on Resolution of
Financial Firms (“Committee”)**

Following is the summary of the recommendations of the Committee.

The Report of the Committee is in two parts:

- i. Rationale and Design/Recommendations;
- ii. A comprehensive draft Financial Resolution and Deposit Insurance Bill covering all entities.

The Insolvency and Bankruptcy Code, 2016 enacted by the Parliament earlier this year provides for resolution and liquidation of non-financial firms. Recent experience and research have shown that resolution of financial institutions requires a special regime that is faster than any traditional insolvency procedure, where rights of the creditors and other stakeholders can be overridden in the interest of the financial system (including the consumers) and the economy. The draft Bill proposes to establish a special resolution regime for financial firms in line with international best practices.

The draft Bill consolidates the existing laws relating to resolution of certain categories of financial institutions (“covered service providers”), including banks, insurance companies, financial market infrastructures, payment systems, and other financial service providers (excluding individuals and partnership firms) which are presently scattered in a number of legislations, into a single legislation, and provides for additional tools of resolution, to enable the new authority (“Resolution Corporation”) to maintain the systemic stability in the country. The committee has observed that the enactment of the proposed Bill will empower the Resolution Corporation to contribute to the stability and resilience of the financial system by carrying out speedy and efficient resolution of financial firms in distress, providing deposit insurance to consumers of certain categories of financial services, monitoring the Systemically Important Financial Institutions, where so designated by the Central Government; and protecting the consumers of financial institutions and public funds to the extent possible. The Bill also provides for certain special provisions in relation to resolution of central counterparties because of their unique status in the financial system.

The **major recommendations** of the Report are as follows:

- i. **Establishment and structure of the Resolution Corporation:** The draft Bill envisages the setting up of a Resolution Corporation with its head office at Mumbai. As proposed in the Bill, the general direction and management of the Corporation will be conferred on the Board of the Resolution Corporation. This Board will comprise of representatives from financial sector regulators, like, RBI, SEBI, IRDAI and PFRDA; representatives of the Central Government as well as two independent members.
- ii. **Funds and Accounts:** The Resolution Corporation shall have three types of funds: - the Corporation Insurance Fund for payment of deposit insurance, the Corporation Resolution Fund for covering resolution fees and a Corporation General Fund for meeting the administrative expenses of the Resolution Corporation. The covered service providers shall also be required to pay fees, as specified by the Corporation.
- iii. **Systemically Important Financial Institutions (“SIFIs”):** The Central Government, in consultation with the appropriate sectoral regulator may designate certain categories of financial institutions as SIFIs. These are financial institutions whose failure might pose a risk to not just their consumers or the sector they operate in, but rather the overall financial stability of the country itself. Given their importance for the economy, the Bill envisages some additional powers in respect of these SIFIs.

- iv. **Deposit Insurance:** After the enactment of the Bill, the Deposit Insurance and Credit Guarantee Corporation shall be dissolved and all its functions will be carried out by the Resolution Corporation. Thereafter, the Resolution Corporation will be the authority responsible for providing deposit insurance in the country.
- v. **Risk to Viability:**
 - a. The Resolution Corporation in consultation with the Appropriate Regulator, will specify objective criteria for the classification of covered service providers into five categories, namely, low, moderate, material, imminent and critical, taking into account several features of the covered service providers, including adequacy of capital, asset quality, leverage ratio, liquidity and capability of management.
 - b. The classification of a covered service provider as ‘low’, ‘moderate’ and ‘material’ can only be done by the Appropriate Regulator. The classification into ‘imminent’ can be either by the Appropriate Regulator or the Resolution Corporation. In case of a difference in opinion between the Appropriate Regulator and the Resolution Corporation, the Bill provides for a consultation process for the final determination by the Resolution Corporation.
 - c. The powers of the Appropriate Regulator at the ‘material’ stage include preventing the covered service provider from carrying out a number of activities, including accepting funds, payment or declaration of dividends and acquiring any interest in any other business. The powers of the Resolution Corporation are limited until the covered service provider reaches the ‘imminent’ stage.
 - d. The classification to be at ‘critical’ risk to viability by the Appropriate Regulator or the Resolution Corporation shall only be through an order in writing, to be published in a manner specified.
 - i. At this stage, the Resolution Corporation shall be appointed a receiver of the covered service provider.
 - ii. There will be a stay on legal actions and proceedings till the conclusion of the resolution.
 - iii. There will also be a stay on the payment or acceptance of deposits to the depositors of the covered service provider in a manner provided through an order in writing. There shall also be a stay on the contractual rights to exercise surrender rights or a stay on terminating an insurance cover or any other stay as decided by the Resolution Corporation.
- vi. **Resolution and Restoration Plans:** Every covered service provider shall be required to prepare and submit a restoration plan and a resolution plan, to the sectoral regulator and the Resolution Corporation, respectively. While the purpose of the restoration plan is to identify the steps the covered service provider shall take in order to stay at no higher than “moderate” risk to liability, the resolution plan shall act as the action-plan of the covered service provider in the event the covered service provider goes into resolution. These plans are required to be periodically updated and all changes are required to be notified to the Resolution Corporation and the Appropriate Regulator.
- vii. **Stay on Termination Rights:** The Corporation has been empowered, to temporarily stay the operation of any early termination rights in respect of contracts, when such rights are triggered solely by the entry of a covered service provider into resolution. This power has been circumscribed and is accompanied by adequate safeguards including a limit of two days on the stay. Further, this power can only be exercised in consultation with the sectoral regulator and for ensuring overall systemic stability of the country
- viii. **Tools of Resolution:**

- a. The Bill proposes that the Corporation use one or more (in combination or otherwise) of the tools for resolving a covered service provider, subject to certain safeguards.
 - i. transferring the whole or part of the assets and liabilities of the covered service provider to another person, on terms agreed between the Corporation and such person;
 - ii. creating a bridge service provider;
 - iii. bail-in;
 - iv. merger or amalgamation of the covered service provider;
 - v. acquisition of the covered service provider;
 - vi. liquidation;
 - vii. run-off in case of an insurance company, if deemed appropriate by the Resolution Corporation.
 - b. Resolution has to be completed within two years, with the provision for an extension of one additional year, except in the case of liquidation.
- ix. **Receivership:**
- a. The Corporation as the receiver shall take over the management of the affairs of the covered service provider, with the suspension of the powers of the board of directors of the covered service provider.
 - b. The Corporation shall have a number of powers as the receiver, including the power to act and execute in the name and on behalf of the covered service provider all deeds, receipts, and other documents, take such actions as may be specified. The Corporation will also have the power to remove managerial and other persons from office, appoint additional directors and supersede the board of directors.
- x. **Liquidation:**
- a. Where the Corporation determines that liquidation is the most appropriate tool for the resolution of a covered service provider, the Corporation shall make an application to the National Company Law Tribunal (“NCLT”) for an order of liquidation, subsequent to which the NCLT shall pass an order of liquidation, appointing the Corporation as a liquidator for a covered service provider.
 - b. The powers of the Corporation as a liquidator include, amongst others, the power to verify claims of all the creditors, take into custody all the assets, property and actionable claims of the covered service provider, sell property, access information, consolidate and verify claims, admit or reject claims and payments of deposit insurance.
 - c. A covered service provider wanting to close its business voluntarily shall only do so by applying, in writing, to the Corporation in a specified manner. The Corporation, in consultation with the Regulator shall determine the risk to viability of the firm and shall allow liquidation or resolution depending on such determination.
- xi. **Cross Border Insolvency:** The Central Government and the Resolution Corporation, with the prior approval of the Central Government, can enter into memorandums of understanding with the governments and their regulators of other countries and exchange information with them to give full effect to the provisions of this Act.

XXXXXXXXXX