VOLUME 3 | JAN | 2018 **ISSN: 2456-9704**

THE FIANNCIAL RESOLUTION AND DEPOSIT INSUARANCE BILL: MODERNISATION OF THE INDIAN ECONOMY AT THE COST OF THE DEPOSITORS' MONIES?

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I. ABSTRACT

*Globally many of the developed economies are in the process of or have already introduced the bank bail-in regime that would involve participation of bank depositors in bearing the costs of restoring a failing bank to revive in a downfall. Keeping in mind the global acceptability of the bail-in clause for banks, the Government of India, vide its new proposed legislation of the Financial Resolution and Deposit Insurance Bill, 2017 ("***FRDI Bill***") would be inducted the new bail-in clause to save faltering banks, even though there is a very long list of hypothetical or real advantages attached to the bail-in process. Therefore, the need arises for a closer examination of the bail-in process, if it is to become a successful substitute to the currently practiced method of bailout package approach. The bail-in clause involves replacing the implied public guarantee on which fractional reserve banking has operated, with a system of private penalties. The bail-in approach may indeed, be much superior to bailouts in the case of idiosyncratic failure. In other cases, the bail-in process may entail important risks. The article provides a legal and economic analysis of some of the key potential risk bail-ins may entail in the domestic market vis-à-vis in the international context of the bail-in clause. The article also explains how bail-in regimes will not eradicate the need for injection of public funds where there is a threat of systemic collapse, because a number of banks have simultaneously entered into difficulties or in the event of the failure of a large complex commercial bank, unless the failure was clearly idiosyncratic.*

> ***"It is well enough that people of the nation do not understand our banking and monetary system, for if they did, I believe there would be a revolution before tomorrow morning."***
>
> ***-HENRY FORD***

KEYWORDS: FRDI Bill, Bank failures, Bank bail-ins, bailouts, Finance Resolution Corporation.

II. LIST OF ACRONYMS

- FRDI: Financial Resolution and Deposit Insurance Bill, 2017
- IBC: Insolvency and Bankruptcy Code, 2016
- PSB: Public Sector Banks

- SIFI: Systemically Important Institutions
- OLA: Orderly Liquidation Authority
- DFA: Dodd-Frank Act
- NCLT: National Company Law Tribunal
- NPA: non-performing assets
- ESM: European Stability Mechanism

"Rather than justice for all, we are evolving into a system of justice for those who can afford it. We have banks that are not only too big to fail, but too big to be held accountable."

— Joseph E. Stiglitz

III. INTRODUCTION

In the outcome of the 2007-2008 worldwide global financial crisis, and lacking adequate composed rules or enactments, measures to address falling financial institutions all around were taken over a few economies to investigate the size of misfortunes spilling out of bank failures is initially independent of the identity of those upon whom the burden of meeting that loss falls. In any case, such losses additionally would then be able to involve basic externalities. These have generally supported the general population bailouts to keep away from the foundational danger that the disappointment of any bank, past a specific size, conveys with it. In any case, open bailouts of banks are a wellspring of good risk and they undermine showcase train. One of the key standards of a free market economy is that proprietors and banks should bear the misfortunes of a fizzled wander. Bailouts can likewise have a destabilizing sway on open funds and sovereign obligation.[1]

The most recent real economies to embrace such an action is India. The Government of India through different activities like the enactment of the Insolvency and Bankruptcy Code, 2016 ("IBC") recapitalization of Public Sector Banks ("PSBs") and Foreign Direct Investment in different area has given a lift to the economy which had been seeing as a time of pseudo economic outshoot. But, with the Union Cabinet led by the Hon'ble Prime Minister of India supporting the proposition to present the Financial Resolution and Deposit Insurance Bill, 2017 (henceforth, the "FRDI Bill"), the bill was presented on the second a day ago of the monsoon session of the parliament of the current fiscal year and has since been under the thought of a joint parliamentary board of trustees comprising of members from the two places of the parliament for advance examination.[2]

The concerns mainly outlined by the media and academia have given rise to reforms to internalize the costs of bank failure of which the foremost is the drawing up of bank creditor bail-ins.

[1] Raghavan Sharad, "*What does the FRDI Bill do for you?*:, accessible at http://www.thehindu.com/business/Economy/what-does-the-frdi-bill-do-for-you/article21386264.ece

[2] http://www.prsindia.org/theprsblog/?p=3932

Essentially, bail-in constitutes a radical rethinking of who bears the ultimate costs of the operation of fractional reserve banking. Hypothetically this might be right, open to scholastic debate. As a general rule, a great many average citizens in the Indian banking framework know no hypothesis.[3]

Indian financial sector and particularly banking sector has an inherent strength. Indeed, even subsequent to tolerating defilement and great terms for the huge and powerful, normal Indian feels his cash is protected in Indian banks. This trust and coming about brand esteem is exceptionally hard to evaluate in money related terms. The esteem will be comprehended when we take a gander at it from the opposite side - how much will it cost to pick up trust of 1.3 billion individuals and to manage it.

IV. RESEARCH OBJECTIVES

Research Objective 1: To understand the need for a legislation of FRDI as being enacted in India

Research Objective 2: To analyze the International legal framework on the 'Bail-in' provisions being implemented in various economies across the globe

Research Objective 3: Too understand the challenges that FRDI would face when tested in the Indian economic scenario

Research Objective 1: To understand the need for a legislation of FRDI as being enacted in India and a closer understanding of the reasons for enactment of the FRDI legislation in India.

To comprehend the ramifications of bail-in arrangements in the proposed FRDI Bill, we need to comprehend what this intend to a standard normal Indian resident having a bank account. A bail-in is regularly protecting a monetary foundation when it is going to fail, by constraining its leasers and contributors pay for the loss of the money related establishment. At the end of the day, a piece of your cash kept in the bank will be used to cover for the misfortunes brought about by the bank or the money related establishment.
A bail-in is the exact inverse of a bail-out. In bail-out a bank in emergency is safeguarded by outer gatherings without influencing contributors. Here the government comes to the rescue utilizing citizen's cash. The administration now recommends that the financial specialists and investors in the bank to pay for the misfortunes previously citizens.
A great momentum has developed for basing resolution on bail-in, which infrequently looks like a 'chorus'.[4] The regulatory authorities in most of the

[3] "*Bail in at what cost*", accessible at https://www.outlookindia.com/website/story/bail-in-at-what-cost/305307

[4] Exact wording used in J McAndrews and others, 'What Makes Large Bank Failures so Messy and What to Do about It?' 20 Federal Reserve Bank of New York, Econ Pol Rev (Special Issue: Large and Complex Banks, March 2014) 14

world's developed economies have developed, or are in the process of developing, resolution regimes that allow, in principle, banks to fail without resorting to public funding.[5]

1.1 THE ENACTMENT OF THE FRDI BILL

The bail-in approach is intended to counter the dual threat of systemic disruption and sovereign over indebtedness. It is based on the penalty principle, namely, that the expense of bank failures are shifted to where they best belong: bank shareholders and creditors. Namely, bail-in replaces the public subsidy with private penalty[6] or with private insurance forcing banks to internalize the cost of risks, which they assume.

In these new schemes, apart from the shareholders, the losses of bank failure are to be borne by *ex ante* funded resolution funds, financed by industry levies, and certain classes of bank creditors whose fixed debt claims on the bank will be commonly converted to equity, along these lines reestablishing the value cradle required for continuous bank operation.

This is a critical advancement, since in the past banks' subordinated debt did not give any cover when bank liquidation was impossible, which implied that subordinated loan bosses were bailed out close by senior leasers by taxpayers.[7]

Turning unsecured debt into bail-in debt ought to boost creditors to resume a monitoring function, thereby helping to restore market discipline. For instance, as the potential expenses of bank failure would fall on loan bosses, notwithstanding investors, such lenders ought to wind up plainly more ready about the levels of use the bank carries,[8] constraining a standout amongst the undoubtedly reasons for bank failures and the administration costs related with exorbitant leverage.[9] Normally, investors have each motivating force to manufacture use to augment their arrival on equity.[10]

[5] KPMG 'Bail-in Liabilities: Replacing Public Subsidy with Private Insurance' (July 2012); JN Gordon and W-G Ringe, 'Bank Resolution in the European Banking Union: A Transatlantic Perspective on What It Would Take' Oxford Legal Research Paper Series 18/2014, available at

[6] TF Huertas, 'The Case for Bail-ins' in A Dombret and PS Kenadjian (ed), The Bank Recovery and Resolution Directive (De Gruyter 2013).

[7] S Gleeson, 'Legal Aspects of Bank Bail-Ins' LSE Financial Markets Group Series Special Paper 205 (2012).

[8] JC Coffee, 'Systemic Risk after Dodd–Frank: Contingent Capital and the Need for Strategies Beyond Oversight' (2011) 111 Columb L Rev 795.

[9] AR Admati and others, 'The Leverage Ratchet Effect' Max Planck Institute (MPI) for Research on Collective Goods Working Paper Series 2013/13; E Avgouleas and J Cullen, 'Excessive Leverage and Bankers' Pay: Governance and Financial Stability Costs of a Symbiotic Relationship' (2015) 21(1) Columb J Euro L (forthcoming).

[10] A Admati and others, 'Debt Overhang and Capital Regulation' Rock Center for Corporate Governance at Stanford University Working Paper 114/2012, 23 March 2012; E Avgouleas and J Cullen, 'Market Discipline and EU Corporate Governance Reform in the Banking

Such monitoring might, in turn, reduce the scale of loss in the event of a bank failure: creditors could force the bank to behave more cautiously, especially where the bail-in regime allows for earlier intervention and closure than a bailout mechanism. It should also, in principle, eliminate the 'too-big-to-fail' subsidy enjoyed by bigger banks. Essentially, bail-in provisions mean that, to a certain extent, a pre-planned contract replaces the bankruptcy process, giving greater certainty[11] as regards the sufficiency of funds to cover bank losses and facilitating early recapitalization. Moreover, the bail-in tool can be used to keep the bank as a going concern and avoid disruptive liquidation of the financial institution in distress.

But the idea that the penalty for failure can be shifted onto an institution, such as a bank, is incorrect. Ultimately all penalties, and similarly benefits, have to be absorbed by individuals, not inanimate institutions. When it is said that the bank will pay the penalty of failure, this essentially means that the penalty is paid, in the guise of worsened terms, by bank managers, bank staff, bank creditors, or borrowers. The real question is which individual will be asked to absorb the cost.

1.2 UNDERSTANDING THE FOREIGN IMPLEMENTATION OF THE IDENTICAL LEGISLATION OF FRDI AS ENACTED IN THE DEVELOPED ECONOMIES ACROSS THE GLOBE

The goals of the bail-in process are not the same in every jurisdiction. In the USA the process through which bail-in and subsequent conversion of creditor claims takes place for Systemically Important Institutions ("**SIFIs**") is imbedded in the mechanics and architecture of the resolution process that is applied to systemically important institutions, the so-called Orderly Liquidation Authority ("**OLA**").[12] This means that triggering the bail-in process under Title II of the Dodd-Frank Act ("**DFA**") aims at providing with sufficient capital, following liquidation of the resolved holding company, the entities for which the resolved company acted as parent.

In the European Union (EU), on the other hand, the doom loop between bank instability and sovereign indebtedness has left Eurozone governments with a major conundrum. The traditional route of a public bailout is increasingly ruled out, not only due to a principled adherence to the avoidance of moral hazard, but also due to its potential impact on already heavily indebted countries. The European Stability Mechanism (ESM)[13] acts, among other purposes, as a component of the European Banking Union (EBU). Both

Sector: Merits, Fallacies, and Cognitive Boundaries' (2014) 41 J Law and Society 28.

[11] Coffee (n 6) 806.

[12] Title II of the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (Act (Pub L 111–203, HR 4173, in the following: "Dodd-Frank Act" or "DFA")).

[13] Intergovernmental Treaty Establishing the European Stability Mechanism of 2 Feburary 2012, T/ESM 2012/en 2. Available at

the new EU Resolution regime, based on the EU Bank Recovery and Resolution Directive (BRRD),[14] and the ESM statute[15] require the prior participation of bank creditors in meeting the costs of bank resolution. This means that either the bank remains a going concern and the bail-in process is triggered to effect bank recapitalization to restore it to health ('open bank' bail-in process) or in conjunction with the exercise of resolution powers treating the bank as gone concern ('closed bank' bail-in process).

Similarly, the intention is that intervention will be sooner (less forbearance), so that losses will be fewer, but whether that hope will be justified is yet to be seen.

The desire to find an effective way to replace the public subsidy and the unpopular bailout process is entirely understandable and can lead to welfare-enhancing outcomes. At the same time, there is a danger of overreliance on bail-ins, in part owing to the growing momentum for its introduction. One useful role for an academic is to query contemporary enthusiasm for fear of group-think, which the last crisis has shown may prove a dangerous aspect of policy-making in the financial sector. In placing bail-in at the heart of bank resolution regimes, legislators and regulatory authorities ought not to overlook some important shortcomings attached to this approach. This article sets out to discuss these shortcomings and to explain why, arguably, bail-in regimes will not remove, in the case of resolution of a large complex cross-border bank, unless the risk is idiosyncratic (e.g. fraud), or in the event of a systemic crisis, the need for public injection of funds.

Research Objective 2: To analyse the International legal framework on the 'Bail-in' provisions being implemented in various economies across the globe

2.1 THE ARCHITECTURE AND MECHANICS OF THE BAIL-IN PROCESS

2.1.1 BANK RESOLUTION AND BANK BAIL-IN UNDER THE FRDI BILL

The primary concern expressed by banking unions is the provision in the law that creates a new Resolution Corporation. Until now, the Reserve Bank of India had exclusive powers to determine the financial health of a bank and recommend remedial measures in case banks got into financial trouble. But

http://www.efsf.europa.eu/attachments/esm_treaty_en.pdf.

[14] Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/ EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and regs (EU) No 1093/2010 and (EU) No 648/2012, [2014] OJ L 2014 173/190. [BRRD].

[15] 'European Stability Mechanism By-Laws' 8 October 2012.

the proposed Resolution Corporation will usurp this crucial power, thereby weakening the regulatory role of the Reserve Bank of India. The new law seeks to amend all exclusive laws governing financial institutions, including the State Bank of India Act.[16]

The proposed Resolution Corporation will determine if there is an "imminent risk" of the bank failing financially and will trigger what it feels would be the right remedy. It will also replace the Deposit Insurance and Credit Guarantee Corporation and take over the role of providing deposit insurance.[17]

According to Chapter II of the bill, the corporation will have a chairperson and one representative each as ex-officio member from the finance ministry, the RBI, the Securities and Exchange Board of India and the Insurance Development and Regulatory Authority. It will also have a maximum of three full-time members appointed by the Union government, and two independent members. Banking unions said that the very composition of the corporation will give supreme powers to the Union government rather than the RBI to determine the fate of a bank.

The government, however, has consistently maintained, as seen from the objectives of the bill itself that the new law will only bring in more financial discipline. It will complement the new Insolvency and Bankruptcy Code, 2016 (hereafter, the "IBC") legislated in December, 2016 that aims at recovering defaulted loans at a very fast pace from the current traditional time frame for recovery of defaults.[18]

Under the proposed law, no court other than the National Company Law Tribunal("NCLT") will be able to take cognizance of disputes on liquidation. The law gives all powers to the NCLTs in case of liquidation. However, the public sector banks are currently not covered under the Companies Act and any such process of liquidation is to be looked into by the Banking Regulation Act in place in the domestic arena of regulatory banking sector.

There is also a major concern of the violation of labour rights. There are clauses in the bill that enable the Resolution Corporation to terminate

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[16] Strivastava Pragya, "*FRDI Bill: Bail-in concept not that bad, but its current Indian version puts your bank deposit in danger*" accessible at http://www.financialexpress.com/economy/frdi-bill-bail-in-concept-not-that-bad-but-its-current-indian-version-puts-your-bank-deposits-in-danger/964619/

[17] "*FRDI Bill: Pushing Bail-in provision isn't easy*", accessible at http://www.financialexpress.com/industry/banking-finance/frdi-bill-pushing-bail-in-provision-isnt-easy-brave-strategy-needed/970410/

[18] Abraham Rohit, "*All you need to know about India's NPA crisis and the FRDI Bill*" accessible at http://www.thehindu.com/business/Economy/all-you-need-to-know-about-indias-npa-crisis-and-the-frdi-bill/article21379531.ece

 ISSN: 2456-9704

employment or change the compensation structure of bank employees when the bank goes through various stages of resolution. The employees may not be able to claim compensation for loss of employment, which, unions said, is a direct violation of the right to constitutional remedies guaranteed under Article 32 of the Constitution.[19]

While looking into the US Bank resolution practice for example, in 2008, the FDIC exercised its existing powers and resolved the part of the Washington Mutual group that was not sold to JP Morgan Chase, mainly claims by equity holders and creditors, under the least-cost resolution method. It imposed serious losses on the unsecured creditors and uninsured depositors (deposit amount above USD 100,000).[20] OLA further expands the resolution authority of FDIC, including its power to cherry-pick which assets and liabilities to transfer to a third party, (though these will be subject to strict conditions to be further detailed by the FDIC) and to treat similarly situated creditors differently, for example, favoring short-term creditors over long-term creditors or favoring operating creditors over lenders or bondholders. This discretion is curbed by the introduction of a safeguard, under section 210(a)(7)(B) of the DFA,[21] that creditors are entitled to receive at least what they would have received if liquidation had taken place under Chapter 7 of the Bankruptcy Code (comparable to the 'best interests of creditors' test under the Bankruptcy Code).[22]

2.2 Evaluation of the FRDI Bill Approach to Resolve the Banking Crisis and Bail-In Clause

Post the huge steps to revitalize the economy by the implementation of the demonetization vide the Specified Bank notes (cessation of liabilities) Act, 2017, the new FRDI Bill brings in new era of modern economic strategies to revive economies in the future in case of a dreading condition of any unit of the economy by introduction of the FRDI Bill. Through the FRDI Bill, includes the 'bail-in' clause that theatrically allows faltering banks and financial institutions to legally take control over the depositors' monies in a bid to prevent any mishap with the economy on a failure of a bank. Few weeks ago the Government of India infused nearly $32 billion bail-out to the banks which are facing a tremendous rise in the non-performing assets ("NPA") resulting in huge losses to the banking institution of the country.

[19] Datta Prosenjit, "*IBC may end NPAs problem, but won't help banks get their money back*" accessible at http://www.businesstoday.in/opinion/prosaic-view/npa-nclt-reserve-bank-of-india-liquidation-banks-ibc-process/story/265782.html

[20] FDIC Press Release, 'Information for Claimants in Washington Mutual Bank' 29 September 2008

[21] https://www.fdic.gov/regulations/reform/dfa_selections.html

[22] International Monetary Fund and Capital markets Department, "*United States: Financial Sector Assessment Program-Review of the of the Key Attributes of Effective Resolution Regimes for the Banking and Insurance Sectors*"

With the introduction of the FRDI Bill, the depositors utilizing the banking services of the banking sector face the crucial question that if the FRDI Bill is passed in its current form, what would be the consequences to the depositors in case financial crisis does hit the domestic Indian economy in the future.[23]

Revisiting the Indian financial history, as some of the opponents of the bill have been trying to co-relate the new FRDI Bill with is to the period between 1913 and 1960 when 1,600 private banks closed down operations and depositors lost all their money, when was then that the All India Bank Employees Association (AIBEA) took up the issue in Parliament, following which the Banking Regulations Act was suitably amended in 1960.Any failed bank would henceforth be put on moratorium and merged with a peer bank. In the last 55-plus years, a number of banks that faced liquidation have been led into merger in this manner. Neither has any bank been liquidated nor has any depositor lost his/her money. Among the affected banks were Bank of Bihar, Belgaum Bank, Lakshmi Commercial Bank, Miraj State Bank, Hindustan Commercial Bank, Traders Bank, Bank of Tamil Nadu, Bank of Thanjavur, Parur Central Bank, Purbanchal Bank, Bank of Karad, Kashinath Seth Bank, Bariely Bank, Sikkim Bank, Benaras State Bank, Nedungadi Bank, Global Trust Bank, United Western Bank.[24]

In contrast, the 'bail-in' clause in the FRDI could discredit this glorious history of law-making that gave primacy to the interest of depositors.Banksneed resources and deposits of the people constitute the main resource. The clause could drive away these very depositors, which would in turn make banks unviable.[25]

2.3 THE GLOBAL ANALYSIS OF THE BAIL-IN APPLICABILITY AND REAL LIFE EXPERIENCE.

A global analysis of the Bail-in provisions being applied in the real world and gaining utmost importance is that of Cyprus where in the bail-in approach was implemented in March, 2013.

2.3.1 CYPRUS

Triggering a regime shift The Cyprian country case is of particular importance for the analysis because it combines two important features that we assume to be essential. First, the bail-in basis is wide due to the involvement of senior debt and even large customer deposits. Second, the decision to expand the bail-in basis to senior debt and retail depositors was backed by the Eurogroup after protracted

[23] Shenoy Deepak, "*The Great Indian Bank Recapitalization Push*" accessible at https://thewire.in/190554/explained-great-indian-bank-recapitalisation-push/

[24] Kurian Vinson, "*Will FRDI Bill mean a throwback to the tumultuous pre-1960s*" accessible at http://www.thehindubusinessline.com/money-and-banking/will-frdi-bill-mean-a-throwback-to-the-tumultuous-pre1960s/article9994097.ece

[25] http://www.nipfp.org.in/media/medialibrary/2017/12/11122017.pdf

negotiations.[26] This was a watershed in the way of dealing with distressed banks. We identify three events for the Cyprian case:

1. The outcome of the eurozone finance minister meeting on 11 February 2013. At this early stage, the bail-in of senior debt was considered as one of three possible alternatives of the meeting.
2. The second event on 18 March 2013 is characterized by the Cyprian proposal to introduce a levy on all depositors, even if their claims were below the insured amount of one hundred thousand euros.[27] While this is not an explicit bail-in procedure its economic effect on private investors would be very similar, as it transfers the rescue costs from taxpayers to investors.
3. The last event on 25 March 2013 marks the actual bail-in in Cyprus.[28]

Cyprus is the key bail-in event because it clearly transported the signal that the euro area was going for a bail-in of creditors in bank restructurings and moreover that the bail-in basis could be very wide, including senior unsecured debt and even large deposits. Apart from the early Danish case, retail investors had not yet faced haircuts. The different bail-in options became public in February 2013. On 18 March 2013, the government of Cyprus and the eurozone Finance Ministers announced that all deposits, including those below 100 000 euros (the legal deposit guarantee limit of the EU), would be facing losses. Following an uproar and a week of further frantic negotiations, the deal finally announced on 25 March 2013 bailed in senior unsecured debt and large deposits but not retail deposits below 100 000 euros.[29]

To understand the FRDI Bill which is being considered to be the at least enactment of the Government to modernize the economy to the global standard, we need to look into a few case studies to better understand the provisions of bail-in and its impending results thereto.[30]

2.3.2 DENMARK

Firstly, is the case of the creditor bail-in of the Danish bank *Amagerbanken*. The small retail bank – with total assets of only 4.5 billion euros was wound up in early 2011 under the Danish national resolution procedure “Bank Package III”. The Danish resolution procedure aimed at protecting taxpayers from bank losses and included a bail-in of senior debt. Hence, depositors and other unsecured

[26]Acharya, Viral and Sascha Steffen, 2015, “The ‘Greatest’ Carry Trade Ever? Understanding Eurozone Bank Risks,” Journal of Financial Economics, 115 (2), 215–236

[27] ‘Resolving Globally Active, Systemically Important, Financial Institutions’ a joint paper by the FDIC and the BoE, 10 December 2012.

[28]Cyprus Resolution Law, 2013, http://www.centralbank.gov.cy/nqcontent.cfm?a_id=12727 &lang=en

[29]Guiso, Luigi, Paola Sapienza and Luigi Zingales, 2013, “The Determinants of Attitudes toward Strategic Default on Mortgages,” Journal of Finance, LXVIII, 4, pp.1473–1515

[30]Reinhart, Carmen and Kenneth Rogoff, 2009, “This Time is Different: Eight Centuries of Financial Folly”, Princeton University Press

creditors of this distressed bank could not be sure to receive full coverage of their claims. On Sunday, 6 February 2011, the bank announced the transfer of its assets to a state-owned bank. CreditSights estimated that holders of senior debt and unsecured deposits would face a haircut of 41 percent. This case is of particular interest since it was the first European bank in our sample whose bail-in basis included senior unsecured debt as well as larger deposits. It is noteworthy that the authorities in Denmark, which is not part of the eurozone, decided to bail in bank creditors long before the decision for a European banking union and the creation of a SRM.[31]

2.3.3 SPAIN

Secondly, when the time Spain applied for the European Stability Mechanism ("ESM") assistance in bank restructuring and recapitalization in June 2012,[32] recapitalization needs of Spanish banks were estimated at 100 billion euros. The largest bank in distress was *Bankia* with a balance sheet of about 300 billion euros. At the insistence of euro area finance ministers, the Memorandum of Understanding (MoU) included the participation of junior creditors in the losses of the Spanish institutes as a necessary condition for granting bank aid. Subordinated Liability Exercises (SLEs) included hybrid capital and subordinated debt and were either voluntary or – where necessary – mandatory.[33] In the second half of the year 2012 the Spanish government implemented a national law on the restructuring and resolution of their credit entities.[34]

2.3.4 THE NETHERLANDS

Case number three is the creditor bail-in of the Dutch bank SNS Reaal, which had total assets of about 80 billion euros. After the bank had suffered from substantial write-downs on its real estate portfolio during the year 2012, the Dutch government nationalized SNS Reaal on 1 February 2013.[35] In the context of nationalization, the state injected 2.2 billion euros, shareholders and junior creditors were both wiped out. One billion of subordinated debt was expropriated with zero compensation under a new Dutch law.[36]This case happened during the negotiation of the SRM.[37]Its political spillover effect was probably further magnified for an additional reason: the responsible Dutch finance minister had just been appointed as the president of the Eurogroup. Hence, his involvement in the decision to bail in creditors in the Netherlands was a strong

[31]Vurderingsrapport, for Andelskassen J.A.K. Slagelse under kontrol, PwC, April 27, 2016

[32]Royal Decree-Law 24/2012 on restructuring and resolution of credit institutions, passed by Parliament as Law 9/2012 on November 14.

[33] Ashurst (2012).

[34] Dübel (2013b), p. 40.

[35]M Haentjens, What Happens when a Systemically Important Financial Institution Fails: Some Company Law Observations re. SNS Reaal, European Company Law Journal, nr. 2, 2013

[36] Financial Times – European edition „Dutch moralist sends stern message", on 26 March 2013, p. 2.

[37]LGA Janssen & JT Tegelaar, How to Compensate Expropriated Investors? The Case of SNS Reaal, JIBLR 2016

indication for the future stance of the Eurogroup, including in their negotiations with the incipient case, Cyprus.[38]

2.3.5 PORTUGAL

The last country case focuses on the creditor bail-in of the Portuguese bank Banco Espírito Santo, which had total assets of about 85 billion euros. For a few days, this event dominated the news and raised the spectre of renewed turbulence in the euro area. On 10 July 2014, fears over this bank briefly triggered a stock sell-off across European financial markets. Portugal's PSI 20 share index dropped by 4.3% which was the biggest drop in more than a year.[39] In September 2014 the bank posted record losses for the first half of the year. On 4 August 2014, the bank was split up into a "good bank" and a "bad bank" after a frenzied weekend of negotiations between Portuguese and European Union officials. The good bank, Novo Banco, received all sound assets, deposits and senior debt plus a capital injection of 4.9 billion euros. The bad assets were transferred to the bad bank and its losses had to be borne by junior creditors.[40]

2.4 LESSONS LEARNT FROM THE USAGE OF BAIL-IN PROCESS FOR BANKS IN THE GLOBAL SCENARIO

Within 24 months of the Cyprus bank crisis countries like Canada, New Zealand, the US, the UK and Germany also introduced legislation that in effect gives the governments in those countries the option of freezing, and perhaps seizing bank deposits above a certain level.[41]

In the UK, for example, protected deposits have an upper limit of £85,000. In the rest of Europe, that translates into €100,000. The UK's Financial Services Compensation Scheme (FSCS) goes some steps further. It also provides a protection limit of up to £1 million, yes, a million pounds sterling – on 'temporary high balances' that depositors may have held when the bank failed.[42]

In India, the deposit protection limit is Rs 100,000, roughly one-sixtieth of the value protected in other jurisdictions. The Rs 1 lakh limit was set in 1993, and hasn't been upgraded since. Even adjusted for inflation, the level of cover won't increase too much. And if you have more than one account at the same bank, the

[38] Rapport van de evaluatiecommissie nationalisatie SNS Reaal (2014) (Report of the evaluation committee nationalisation SNS Reaal (2014)

[39] Financial Times, online: "Fear over Banco Espirito Santo trigger stock sell-off", 10 July 2014, 6:48pm. http://www.ft.com/intl/cms/s/0/4b0ce5ce-0815-11e4-9afc-00144feab7de.html#axzz3HcLjBF7Y

[40] P Tucker, 'Regulatory Reform, Stability and Central Banking' Hutchins Center on Fiscal and Monetary Policy, Brookings, 18 January 2014 www.brookings.edu.

[41] https://www.bloomberg.com/news/articles/2017-06-16/canada-proposes-new-bail-in-regulations-for-the-country-s-banks

[42] https://www.gov.uk/government/consultations/bail-in-powers-implementation-including-draft-secondary-legislation/bail-in-powers-implementation

limit of Rs 1 lakh applies to the total of all your accounts.[43]

Think of having to find low cost way of distributing your deposits across several banks; if that turns out to be too expensive or cumbersome, you'll have to look for other means of protecting your savings.

What troubles most people is that the primary objective does not appear to be deposit protection, but financial institution resolution. And what worries them even more is that the FDRI bill puts depositors at the bottom of the totem pole when it comes to actual protection. Consider again, the example of Cyprus.

Research Objective 3: To understand the challenges that FRDI would face when tested in the Indian economic scenario wherein due to the fast tracking of the revitalization of the Indian economy many new laws have been enacted to ease the economy and compete that of the modern global economic standard. However, the pros and cons of the FRDI need to be understood in light of the challenges the Bail-in centered resolutions under the FRDI Bill would take shape in the real world scenario.

IMPORTANT CHALLENGES OF BAIL-IN-CENTERED RESOLUTION UNDER THE FRDI BILL

The Provisions of the FRDI Bill aim at resolving the bankruptcy scenarios among to-big-to-fail financial entities to the least reliable financial instructions in the country. Just implying that a financial institution is 'too-big-to fail' would not be entitled to cease the rights of other people involved with it. According to the Indian Depositors' Act**,** all insurers are insured till a fixed amount of Rs. 1,00,000/-(Rupees One Lakh only) combined in all the accounts of the depositor with the bank, hence the deposit is not 100% insured. Even though the failing rate of the banks in India is fairly low, still less than a third of bank deposits in value terms are insured by the Deposit Insurance and Credit Guarantee Corporation of India (DICGC). If a bank fails, the DICGC will pay back the insured amount to the depositor but that is restricted to just Rs 1 lakh per depositor per bank. The FRDI Bill is reportedly silent on the extent of deposits to be guaranteed and that remains a key source of concern.[44]

Though many would like to say that the 'bail-in' clause is just meant as a last measure or emergency capital for banks, the surreptitious sneaking in of a measure to execute hair-cuts on depositors' money, the bail-in clause in its current form gives the power to convert any securities from one class to another, including the creation of a new security in the modification of an existing security. This may mean that deposits may be converted to shares. This means your

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43 https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/dicgc_act.pdf

44 Khanna Chandan, "*Contentious Bill doesn't allow depositors' money to be arbitrarily used to save banks*" accessible at https://scroll.in/article/861270/new-financial-resolution-bill-does-not-allow-depositors-money-to-be-arbitrarily-used-to-save-banks

deposits can be converted into equity in order to recapitalize and bail out banks that are facing bankruptcy.[45]

V. CONCLUSION

As the emerging market crises and the history of financial crises were made clearer, haircuts started to become the norm of the day for the bank creditors. In this article, we have provided an extensive analysis of the international application of the bail-in provisions and the past Indian banking sector experiences in the current modern financial system. Although we fully understand the revulsion from too-big-to-fail banks and the cost of bailouts, the area of concern that arises is that the development of a bandwagon may conceal some of the disadvantages of the new bail-in regimes. Although the bail-in approach may, indeed, be much superior to bailouts in the case of idiosyncratic failure, the resort to bail-in may disappoint unless everyone involved is fully aware of the potential downsides of the new approach.[46]

This article is not intended to claim that the proposed reforms will make the process of dealing with failing banks necessarily worse. Its purpose is, instead, to warn that the exercise may have costs and disadvantages, which, unless fully appreciated, could make the outcome less successful than hoped. The authorities will no doubt claim that they have already, and fully, appreciated all such points, as and where relevant. But we would contend that many advocates of moving to the latter do not mention such disadvantages at all, or only partially. Perhaps the choice should depend on context. The bail-in process seems, in principle, a suitable substitute to resolution (whether liquidation of a gone concern, or some other form of resolution in a going concern bank) in the case of smaller domestic financial institutions. It could also be used successfully to recapitalize domestic SIFIs, but only if the institution has failed due to its own actions and omissions and not due to a generalized systemic crisis. Otherwise, a flight of creditors from other institutions, that is, contagion, may be uncontainable.[47] Even so, successful bail-in recapitalization would require rapid restoration of market confidence, accurate evaluation of losses, and successful restructuring of the bailed in bank's operations to give it a sound business model to avoid successive rounds of bail-in rescues. It could, of course, prove very hard for regulators to secure all those prerequisites of a successful bail-in recapitalization in the event of a systemic crisis[48]

[45] Mann Gayatri, "*The FRDI Bill: Bail-in provisions explanied*" accessible at http://www.prsindia.org/theprsblog/?p=3932

[46] D Schoenmaker, 'A Fiscal Backstop to the Banking System' Duisenberg Business School, DSF Policy Paper No 44, July 2014.

[47] E. Avgouleas, C. Goodhart and D. Schoenmaker, 'Recovery and Resolution Plans as a Catalyst of Global Reform' (2013) J Financial Stability 210.

[48] G Karamichailidou and DG Mayes, 'Plausible Recovery and Resolution Plans for Cross-Border

To conclude, it is stated that achieving the goal of making private institutions responsible for their actions would be the best policy in an ideal world where financial 'polluters' would be held responsible for their actions. But, in practice, it might prove an unattainable goal. If this turns out to be the case, then developed societies might have to accept that granting some form of public insurance is an inevitable tax for having a well-functioning banking sector. At the same time, other forms of regulation like structural reform and leverage ratios), if they prove to make banks more stable, should come to the forefront with renewed force.

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