Political and Economic Notes:

FRDI Bill
Organised Loot of Middle Class Depositor

The Central government introduced in August 2017, the Financial Resolution and Deposit Insurance Bill, 2017 (FRDI Bill) in the Lok Sabha which was later sent to a Joint Parliamentary Committee for study and report back before the end of next budget session.

The aim of the Bill is to regulate the exit of financial firms and insulate the larger financial system from being effected by their failure. These financial firms, called service providers in the Bill, include commercial, regional and cooperative banks, insurance companies, payment system operators, Non-Banking financial companies (NBFC), pension fund operators, mutual funds and securities firms.

The bill proposes to establish an all-powerful financial resolution authority – a “Resolution Corporation” (RC).The RC will have powers to acquire and transfer the assets of, even liquidate, any financial service provider in case of its probable failure.

At present, the Indian financial sector is being regulated by various institutions like Reserve Bank of India (RBI) for the banks and NBFCs, Insurance Regulatory and Development Authority (IRDA) for insurance sector, Securities and Exchange Board of India (SEBI) for securities and mutual funds and Pension Funds Regulatory and Development Authority (PFRDA) for pension fund managing companies. All these bodies were formed under the Acts passed by the Parliament. Banks and insurance firms belonged to public sector are governed by separate laws. The FRDI Bill intends to amend about 20 of these laws to bring the resolution process of any probable failure under the RC.

The Background

After the financial crisis in 2008 and trillions of dollar bail-outs for the banking sector, the imperialist powers wanted a regulatory mechanism. So G-20 formed Financial Stability Board (FSB) which adopted “Key Attributes of Effective Resolution Regimes for Financial Institutions” in October 2011. This was endorsed by the Heads of G-20’s Cannes summit in November 2011 as the “New International Standards for Resolution Regimes”.

The FSB’s recommendations are based on the premise that the global financial crisis of 2008 was the result of failure of “too-big-to-fail” banks and not because of speculative activities indulged by these banks. Thus it tries to conceal the truth that 2008 crisis was inherent in the capitalist system which drives by its thirst for ever increasing profits. Hence, these G-20’s ‘international standards’ are market based solutions and will not go to resolve the problem created by the very same market forces as the later experience proved. It is clear that this solution is suited to the imperialist economies and not equally suitable to other countries of Asia, Africa and Latin America which have varied economic structures.

This became pronouncedly clear in its implementation. Countries like US, UK, France, Germany, Italy, Netherlands, Spain, Switzerland and Hong Kong had fully implemented the resolution tools recommended by FSB, while Japan implemented all but bail-in clause. Regarding the insurance companies, none of the seven recommendation of FSB was implemented except by Japan, Hong Kong and USA. On the other hand, Argentina, Austria, Brazil, China, Indonesia, South Korea, Mexico, Saudi Arabia,, Singapore, South Africa and Turkey have implemented FSB’s reforms partially – none of them implemented bail-in provision and even some have not provided for the bridge institutions. Only nine out of the 24 member-states of FSB have opted for establishing a single resolution authority while the other states have opted for some form of co-ordination arrangements among the existing regulatory bodies. This clearly shows that there is no need to fully implement the financial resolution methods and tools meant for imperialist economies in India.

Yet the Indian government, by proposing FRDI Bill, is ready to implement the “key attributes” of financial reforms in toto, knowing well that the Indian situation is entirely different.

Totally Unwarranted

Several questions arise regarding the rationale about sweeping ‘reforms’ proposed by the FRDI Bill in financial resolution process. It is a well-known fact that the banking sector is for a long time plagued with the problem of Non-Performing Assets (NPA). By March 2017, the gross NPAs of scheduled commercial banks stood at around Rs.8 trillion. Up from Rs.2.6 trillion in 2014. This is despite generous bad-loan write-offs worth Rs.4.58 trillion over the last three financial years. The financial stability Report of 2017 by RBI said that India’s gross NPAs stand at 9.6 per cent. This is the sum total of all stressed assets by the lending institutions including co-operative banks. It is the second highest ratio of NPAs in the world after Italy (16.48%).

The same report states that the basic metals and cement industries as most indebted followed by construction, infrastructure and automobiles. It is a well-known phenomenon that economic growth decreases with rise in the bad loan ratios.

By 2014 when BJP came to power at the Centre, the manufacturing sector was in a dismal state. Many infrastructure projects, mainly highways, have locked up huge amounts of bank loans and were suspended. Modi’s much placated ‘Make in India’ scheme had not made any conceivable progress and the manufacturing sector continues to suffer. The demonetisation and Goods and Service tax have further deteriorated the situation. Thus Gross NPA ratio had risen from 5.8 per cent in 2014 to 9.6 per cent in 2017.

Out of every Rs.100 deposited in the bank, Rs.4 is parked with the RBI as Cash Reserve Ratio (CRR) and Rs.19.5 is invested in the easily saleable assets such as government bonds, securities or gold as Statutory Liquidity Ratio (SLR). In case of any contingency nearly one fourth of the money can be retrieved in a short time. The bank is free to lend the remaining Rs.76.5 to corporate and retail borrowers. The interest earned on such loans is used to compensate the customers as interest payment, expenses and remainder is the bank’s profits. NPAs arise when banks lend to clients who default on their repayment.

Political and bureaucratic corruption and manipulation is the foremost cause for the NPAs. Major chunk of NPAs was the result of failure to repay on part of 30 odd families according to Arun Jaitely, the finance minister of NDA. In many cases, defaulters can afford to pay, but don’t and this was pointed out by former RBI Governor Raguram Rajan who said these defaulters throw lavish parties and buy luxurious yachts but don’t repay their loans. It is an open secret that the reason for the stoppage of 14 national highway projects was the corruption and political pressure. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI Act) empowers the banks to auction assets or properties that were submitted as collateral while sanctioning loans. Under this act, 64,519 properties were seized in 2015 while the value recovered from them was very small. There are hardly any cases wherein the properties of these big wanton defaulters have been taken over and money recovered through a quick sale of the same. In the case of poor, who had genuine reason for default, particularly in rural areas, their cattle and utensils are taken over ruthlessly.

There are other Acts and structures that enable banks to deal with NPAs. The Insolvency and Bankruptcy Board of India (IBBI) which implements Insolvency and Bankruptcy Code, Recovery of Debts due to Banks and Financial Institutions (RDDBFI) and Debt Recovery Tribunals were instituted. The Deposit Insurance and Credit Guarantee Corporation (DICGC) was established through an Act passed by the Parliament in 1961.If the political corruption and interference were avoided in the banking operations, the problems of NPAs could be tackled easily by the banks themselves.

Indian financial sector is dominated by the public sector banks, insurance and other financial institutions. When compared with those in the imperialist countries, the Indian financial entities have not reached to the level of so-called ‘too-big-to-fail’ as proposed by the G-20. Only SBI appeared at 55th place in the largest global banks list. None of the Indian financial entities appear in the list of “Global Systemically Important Financial Institutions” identified by the G-20.

Secondly, the Indian public sector financial institutions insulated Indian financial sector from 2008 crisis. This fact was noted by the RBI and was placated many times by the central government.

Thirdly, after the nationalization of banks, no Public sector Bank (PSB) failed in India. Bank failures in the post-liberalisation period have all been of private sector, which were amalgamated with PSBs.

Five such cases have occurred : the Benarus State Bank (BSBL) amalgamated with Bank of Baroda on 19 June 2002; Nedungadi Bank amalgamated with Punjab National Bank on 1 February 2003; Global Trust Bank merged with Oriental Bank of Commerce on 14 August 2004; Ganesh Bank of Kurundwad amalgamated with the Federal Bank Limited on 2 September 2006; and United Western Bank amalgamated with Industrial Development Bank of India (IDBI) on 3 October 2006. Only one commercial bank has faced liquidation—the Bank of Karad in 1992[3].

Several small urban and rural cooperative banks have also faced insolvencies, with the RBI cancelling their licenses and the DICGC settling the claims of their depositors over time. But the bigger banks as well as the broader financial system in India have been stable over the decades, remaining largely unscathed even during and after the global financial crisis of 2007–08. The DICGC balance sheets over the years clearly show that its outstanding liability arising out of the claims of depositors of failed banks, mostly small urban and rural cooperative banks, had peaked at 6.6% of the Deposit Insurance Fund in 2008–09 has fallen since then to below 1%, 2013–14 onwards. The DICGC has accumulated a deposit insurance fund of Rs.70,155 crores till March 2017.

This reflects that bank failures in India have become rarer over time in the recent past. The changes in the resolution regime proposed through the FRDI Bill are clearly not being driven by domestic financial conditions.

The Bail-in

All the tools for resolution recommended by the FSB are incorporated in the FRDI Bill. They are: power to transfer or sell assets and liabilities; power to establish temporary bridge institution; powers to write-down and convert liabilities (bail-in); powers to impose temporary stay on early termination rights; resolution powers in relation to holding companies; recovery planning for SIFIs; resolution planning for SIFIs and powers to require changes to firm’s structure and operation to improve resolvability.

During the financial crisis of 2008 in imperialist countries, the banks that were on the verge of collapse were saved by providing money from the exchequer. It was called bail-out. The FSB recommended bail-in in the place of bail-out, that means the banks take away the depositor’s money to stay afloat. The same provision is incorporated in the FRDI Bill.

Who are these depositors? The proportion of bank deposits in the gross financial savings of household sector was around 40 per cent on average in the 1980s. During 1990s, it came down to 35 per cent. After UTI scam in 2001, it rose to 45 percent only to reach 60 per cent after demonitisation. For the current decade it is around 50 per cent.

67 per cent of term deposits are below Rs. 1 lakh, while only 1.3 per cent of term deposits are over Rs.15 lakh. One can safely assume that 80 per cent of deposits can be below Rs. 2 lakh. It is the middle class that is depositing its savings from hard earned income in the banks. These deposits vanish into thin air once the RC decides to “convert liabilities” (take away the deposits) to save the ‘ailing’ bank. This is nothing but an organized loot of middle class depositors.

Most of the depositors are putting their monies in PSBs because of sovereign gurantee provided by the government for insulating the PSBs and other public sector financial institutes from failure. The RBI has noted that the private sector banks do not enjoy such consumer confidence and during global financial crisis, deposits migrated from private sector banks to PSBs and concluded that “the predominance of government owned banks in India has contributed to financial stability in the country” (RBI Report-2013). Once this confidence and trust is diluted, it weakens the PSBs and consequently brings instability. The entire burden of this instability will be transferred on to the backs of common man.

This is not a guess. The RBI working group on the resolution regime, while not rejecting the bail-in mechanism per se, had recommended that deposit liabilities, inter-bank liabilities and short term debt be entirely excluded from its purview, because these liabilities "if subjected to bail-in can induce financial instability".

The government claims that it ensured the interests of small depositors by providing for deposit insurance. The DICGC Act stipulated that the deposit premium should be Rs.1500 and the maximum insurance amount payable is Rs. 1 lakh. This limit was set a quarter of a century back. If it were to be adjusted with inflation it should have risen to Rs.5 lakh. The DICGC Act is going to be repelled once FRDI Bill gets the accent of the Parliament. The Section-29 of FRDI Bill merely states that the RC will specify the total amount payable with respect to any one depositor "in consultation with appropriate regulator". This omission of specific maximum amount means that the depositor's money would be at the whims of bureaucratic decision.

The Bridge

The FRDI bill provides for powers to RC to constitute a bridge company 'wholly' owned by RC to oversee the transfer of assets and liabilities of financial companies that are slated for recovery or liquidation. It may issue shares of Bridge Company to other financial institutions not exceeding 40 per cent.

The FRDI Bill weakens the public sector financial institutions which are the mainstay of Indian financial system. These weakened institutions would be transferred to powerful financial companies from the imperialist countries in the name of recovery and resolution. The bridge company will act as yet another tool to be utilized to tighten the grip if imperialist finance on the Indian financial system.

Trampling the Rights

The FRDI Bill proposes to empower the RC to deny emoluments and bonuses of employees of a financial service provider under various stages of resolution, to change their service conditions and even terminate them without recourse to justice system. This is part of the wider attack on the hard own rights of employees and workers through prolonged struggles.

It is clear that the FRDI Bill grabs the money of depositors above a limit when a financial institution is caught in a crisis for no fault of depositor. The fault lies with the financial institute as was the case of NPAs of banks. The FRDI bill absolves this irresponsibility. The recovery and resolution process makes way for the foreign financial sharks to gobble up the Indian public sector financial entities, leading to strengthening the hold the imperialist powers on the Indian economy. More than this the government, through FRDI Bill eased itself from the responsibility of providing security to the savings of Indian citizens. This Bill has to be rejected lock, stock and barrel.

(This article was prepared based on the information gathered from RBI, articles in EPW and news reports in Business Standard)

***