



INSOLVENCY FRAMEWORK FOR FINANCIAL SERVICE PROVIDERS (FSPs)

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In the Indian Insolvency scenario the insolvency and bankruptcy is governed by a uniform law of Insolvency and Bankruptcy Code, 2016 (“Code”) which came into force in 2016. In the almost 4 years of its inception, the Code has seen a lot of important judgments and orders being given by the National Company Law Tribunal (“NCLT”) / National Company Law Appellate Tribunal (“NCLAT”) as well as the Apex Court of India. The Code provides a framework for the insolvency resolution; *inter alia*, corporate and individuals which does not include Financial Service Providers. Section 3(16) of the Code defines ‘Financial Services’ and reads as,

(16) “Financial service” includes any of the following services, namely: –

- (a) Accepting of deposits;
- (b) Safeguarding and administering assets consisting of financial products, belonging to another person, or agreeing to do so;
- (c) Effecting contracts of insurance;
- (d) Offering, managing or agreeing to manage assets consisting of financial products belonging to another person;
- (e) rendering or agreeing, for consideration, to render advice on or soliciting for the purposes of— (i) buying, selling, or subscribing to, a financial product; (ii) availing a financial service; or (iii) exercising any right associated with financial product or financial service;
- (f) Establishing or operating an investment scheme;
- (g) Maintaining or transferring records of ownership of a financial product; (h) underwriting the issuance or subscription of a financial product; or
- (i) Selling, providing, or issuing stored value or payment instruments or providing payment services;

Section 3(17) defines financial service providers as a person engaged in providing financial services and would also include non-banking financial companies, micro finance institutions etc.

Insolvency of Financial Service Providers was not covered under the Code, however, the Central Government has power under Section 227 of the Code to notify Rules for FSPs as and when necessary.



The definition of FSP and what constitutes Financial Services was deliberated in the matter of *Housing Development Finance Corporation Ltd v. RHC Holding Private Ltd*¹, wherein NCLAT held that, “13. The definition of ‘financial services’ as defined in Section 3(16) of I&B Code is not limited to the 9 activities as shown at Clause (a) to (i) of Section 3(16). The aforesaid Clauses (a) to (i) are inclusive which means there are other services means there are other services which come within the meaning of “financial services”.

14. The Registration of Certificate issue by RBI shows that it has granted certificate to commence/carry on business of “non-banking financial services”. However, the Respondent has not been allowed to accept the public deposit and such certificate is condition to other conditions as provided in the back of the Certificate.”In this order, NCLAT held that a non-banking financial institution which is carrying on business of financial institution and thereby it being financial service provider will not come within the meaning of Corporate Person/Corporate Debtor. The NCLAT also suggested for the Appellant to bring any complaints against the Financial Institution to the Regulator, i.e., Reserve Bank of India.

The need for a framework to deal with FSPs was felt in the market and was also expressed in various cases such as that of *Randhiraj Thakur v. Jindal Saxena Financial Services*², wherein it was held that, “10. If the entire scheme of the I&B Code is seen, it will be evident that the Code is to consolidate and amend the laws relating to reorganisation and insolvency resolution of ‘corporate persons’, ‘partnership firms’ and ‘individual’ in a time bound manner. It is a self-contained Code which is exhaustive in nature when it comes to reorganisation and insolvency resolution. However, an exception had been carved out while enacting the Code that the ‘financial service providers’ have been kept outside the purview of the Code. Being a consolidating legislation only those acts are permitted which are mentioned in the Code and it cannot be made applicable to ‘financial service providers’ including ‘non-banking financial institutions’ and MFI’s banks, which have been kept outside the purview of the Code.”In the present case, the Corporate Debtor was a NBFC and had undertaken financial deposits from the respondent thus, falling under the ambit defined under Section 3(16) of the Code. The application was thus found non-maintainable under Section 7 of the Code. It is by virtue of these cases that a need for rules for FSP and their categories were recognized.

¹https://ibbi.gov.in/webadmin/pdf/order/2019/Jul/11493138195d25d9f0d704d_2019-07-11%2010:08:57.pdf

²https://ibbi.gov.in/webadmin/pdf/order/2018/Oct/Randhiraj%20Thakur%20Director%20Mayfair%20Capital%20Private%20Limited%20Vs%20Jindal%20Saxena%20Finacial%20Services%20Private%20Ltd._2018-10-11%2021:29:41.pdf



FSP Rules³

In exercise of the powers conferred under section 227 read with clause (zk) of sub-section (2) of section 239 of the Insolvency and Bankruptcy Code, 2016 (31 of 2016), the Central Government made the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 and notified them on 15th November 2019. The rules were framed to provide a generic framework for insolvency and liquidation proceedings of systemically important Financial Service Providers (FSPs) other than banks. The Rules shall apply to such FSPs or categories of FSPs, as will be notified by the Central Government under section 227 from time to time in consultation with appropriate regulators, for the purpose of their insolvency and liquidation proceedings. As per the FSP Rules, all provisions of the Code relating to a corporate insolvency resolution process ("CIRP") and liquidation process of a corporate debtor shall apply to FSPs with certain modifications as specified in the FSP Rules. However, it does not mean that all FSPs would now be covered under these Rules. The FSP Rules will apply to only those FSPs who are notified by the Central Government under Section 227 from time to time. A notification was issued for all systemically important NBFCs and for RBI to be the appropriate regulator in this regard. For all other FSPs, the IBC is required to apply in the same manner as that to all other corporate debtors.

Just like in insolvency proceedings of a Corporate Person, a Resolution Professional (RP) is appointed to take over the control of assets and management of the Corporate Debtor. The FSP Rules provide that on the admission of an application for initiation of CIRP against an FSP, NCLT shall appoint an individual proposed by the appropriate regulator as the 'Administrator'. The Administrator will have the powers of an RP.

The appropriate regulator can constitute an Advisory Committee to advise the Administrator in the operations of the FSP during the CIRP. The Advisory Committee has to consist of 3 or more members, who shall be persons of ability, integrity and standing, and who have expertise or experience in finance, economics, accountancy, law, public policy or any other profession in the area of financial services or risk management, administration, supervision or resolution of an FSP.

Ministry of Corporate Affairs notified the manner of dealing with the third party assets in custody or possession of a FSP; by the Administrator appointed under FSP Rules *vide Notification No. S.O. 464(E) dated 30.01.2020*.⁴ The FSP Rules note that moratorium will not apply to any third-party assets or properties in custody or possession of the FSP, including funds, securities and other assets required to be held in trust for the benefit of third parties.

³<https://ibbi.gov.in/uploads/legalframework/cb1d53c7fe47f8f22ab36a40f441db2c.pdf>

⁴<https://ibbi.gov.in/uploads/legalframework/3878e1c4a2332a3e4398d924fac58166.pdf>



However, the FSP Rules provide that an Administrator shall take control and custody of third-party assets or properties in custody or possession of the FSP, including any funds, securities and other assets required to be held in trust for the benefit of third parties only for the purpose of dealing with them in the manner, as may be notified by the Central Government under Section 227.

The Rules were put to test in the cases initiated under these FSP Rules. The first case initiated under these Rules was that of *Reserve Bank of India v. Dewan Housing Finance Limited*⁵. The whole process to be followed under the rules was laid down in the order. RBI as the regulator had also appointed an administrator and formed an advisory committee to act as a COC for the same. NCLT, Mumbai Bench held that "The Applicant RBI in the capacity of "Appropriate Regulator" has submitted this Application against the 'Financial Service Provider' Dewan Housing Finance Corporation Limited on account of the fact that the default in repayment of the ECB Loan to SBI was committed, therefore, after following the due procedure as discussed supra prayed for "Admission" of the Petition u/s 7 to be read with Section 227 of the Insolvency Code.

....7.4. Upon Admission it is hereby pronounced that "Moratorium" as defined u/s.14 of the Insolvency Code shall commence with effect from the date of Application i.e. 29.11.2019 as prescribed under Rule 5(b)(i) of FSP Rules 2019. On commencement of "Moratorium" the institution of any Suit or continuation of proceedings or execution of any decree against the Financial Service Provider (DHFL) shall be prohibited."

The process followed has proved that IBC can prove to be a beneficial law for reconstruction and recovery even for financial service providers.

Conclusion

The wait for the Rules to deal with FSPs was long but the mechanism has provided a definite band-aid solution to the current problem of having no framework. These Rules however cannot be construed as a permanent solution to deal with all the restructuring and liquidation of Financial Service Providers as a whole. The FSP rules provide for a complementary system wherein the Adjudicating Authority, the Regulator and the Administrator, all have to work in tandem with each other for best results.

Although, these Rules provide a much needed relief to all the stakeholders of FSPs for smooth and clear implementation of Resolution and Restructuring, a comprehensive framework which can be considered a one stop solution, just like the Code, is what should be the aim of the government in the long run.

⁵<https://ibbi.gov.in/uploads/order/d9c77ba13d4eea5107ae79715a8c0402.pdf>