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FINANCIAL SERVICE PROVIDERS

- SPECIAL FRAMEWORK UNDER IBC

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SOLICITORS AND ADVOCATES

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Introduction

The Insolvency and Bankruptcy Code, 2016 (“**IBC**”) was enacted in 2016 providing a framework for the insolvency resolution of, *inter alia*, corporates. However, financial service providers (“**FSPs**”) were kept outside the purview of the IBC. FSPs have been defined in section 3(17) of the IBC¹ and would include non-banking financial companies, micro finance institutions etc.

The Central Government however, retained the power to notify FSPs whose insolvency and liquidation proceedings would be conducted under the aegis of IBC. Such power of the Central Government is under section 227 of the IBC (“**Section 227**”)². It is under this provision that the Central Government has today, notified the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 (“**FSP Rules**”).

As per the FSP Rules, all provisions of IBC 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. This note provides an overview of the FSP Rules and its implications in the insolvency and liquidation proceedings of an FSP.

Applicability

A press release of the Ministry of Corporate Affairs state that the FSP Rules provide a generic framework for insolvency and liquidation proceedings of systemically important FSPs other than banks.

To be clear, enactment of the FSP Rules itself does not mean that insolvency and liquidation proceedings of all FSPs will henceforth be conducted under the IBC. The FSP Rules will apply to only those FSPs who are notified by the Central Government under Section 227 from time to time.

Initiation of the corporate insolvency resolution process (CIRP)

Unlike in case of a corporate debtor where a financial creditor or an operational creditor or the corporate debtor itself can initiate a CIRP, in the case of an FSP, an application for initiation of a CIRP of an FSP can be made only by the ‘appropriate regulator’.

Interestingly, while IBC defines a ‘financial sector regulator’ as including the Reserve Bank of India, Securities and Exchange Board of India, Insurance Regulatory and Development Authority of India etc, the FSP Rules also seeks to define an ‘appropriate regulator’ as the financial sector regulator, as may be notified by the Central Government under Section 227, for a category of financial service providers. This measure has been taken to perhaps prevent any ambiguity as to who the ‘appropriate’ regulator for an FSP is, because it is quite possible for an FSP to have multiple regulators, and a possibility of a turf war between regulators cannot be ruled out.

The National Company Law Tribunal (“**NCLT**”) may permit withdrawal of an application before its admission on a request made by the applicant.

¹ As per section 3(17) of the IBC, ‘financial service provider’ means “a person engaged in the business of providing financial services in terms of authorisation issued or registration granted by a financial sector regulator;”

² Section 227 of the IBC states: “Notwithstanding anything to the contrary examined in this Code or any other law for the time being in force, the Central Government may, if it considers necessary, in consultation with the appropriate financial sector regulators, notify financial service providers or categories of financial service providers for the purpose of their insolvency and liquidation proceedings, which may be conducted under this Code, in such manner as may be prescribed.”

Appointment of an Administrator

Under the IBC, when a CIRP is admitted against a corporate debtor, a resolution professional (“RP”) is appointed who exercises the powers of the Board of the corporate debtor and the management of the corporate debtor also vests in the RP³. The FSP Rules provides 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. The terms and conditions of the members of the Advisory Committee and the manner of conducting meetings and observance of rules of procedure shall be determined by the appropriate regulator. The Advisory Committee therefore appears to have only an advisory role and no powers have been ascribed to it under the IBC.

Interim Moratorium

Under IBC, a moratorium is declared from the date of admission of an application for initiating CIRP by NCLT. Needless to mention, if a CIRP is not admitted by NCLT, then the question of a moratorium does not arise. Once a moratorium is declared, no proceedings can be initiated or continued against a corporate debtor⁴.

In case of FSPs, an interim moratorium will also be in effect from the date when an application for initiation of CIRP is filed. Such interim moratorium will continue till the admission or rejection of the application.

The FSP Rules also bars the suspension or cancellation of license or registration which authorises the FSP to engage in the business of providing financial services during the interim-moratorium and the CIRP. Even during liquidation proceedings, the license or registration cannot be suspended or cancelled unless an opportunity of being heard has been provided to the liquidator.

Assets of third parties

The FSP Rules clarifies that moratorium will not apply to any 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.

³ As per section 16(1) of the IBC, NCLT is required to appoint an interim resolution professional (“IRP”) within a period of 14 (fourteen) days from the date of admission of an application for CIRP. The IRP manages the affairs of the corporate debtor from the date of his appointment as an IRP. As per section 21 of the IBC, IRP constitutes a committee of creditors which subsequently appoints the IRP as a RP or replaces the IRP by another RP.

⁴ Under section 14(1) of the IBC, once a moratorium is in place, the following are prohibited:

- a. the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgement, decree or order in any court of law, tribunal, arbitration panel or other authority;
- b. transferring, encumbering, alienating or disposing off by the corporate debtor any of its assets or any legal right or beneficial interest therein;
- c. any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002)
- d. the recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.

However, the FSP Rules also provides 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.

Resolution Plan

The resolution plan for the insolvency resolution of an FSP has to include a statement explaining how the resolution applicant satisfies or intends to satisfy the requirements of engaging in the business of the FSP, as per laws for the time being in force.

No-objection of the appropriate regulator

The FSP Rules require the approval of the appropriate regulator for the persons, who would be in control or management of the FSP after approval of the resolution plan. The FSP Rules goes on to stipulate that the appropriate regulator should issue a 'no objection' on the basis of the 'fit and proper' criteria applicable to the business of the FSP; thereby also laying down the parameters for the notified appropriate regulator when it takes a decision.

If the appropriate regulator does not refuse 'no objection' within 45 working days of receipt of an application, it shall be deemed that 'no objection' has been granted.

Order for Liquidation

NCLT has to provide the appropriate regulator an opportunity of being heard before passing an order for liquidation of an FSP as well as dissolution of an FSP.

Voluntary liquidation

An FSP is required to obtain the prior permission of the appropriate regulator for initiating voluntary liquidation proceedings under IBC.

And finally...

A framework for FSPs was always on the cards, and the stated aim of the FSP Rules is to serve as an interim mechanism to deal with any exigency pending introduction of a full-fledged enactment to deal with financial resolution of FSPs. While a special framework is the need of the hour, however, implementation of the same will be required to be closely monitored due to the significant number of stakeholders involved with respect to an FSP.

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