‘Bail-in’ backdown in India

By Elisa Barwick

In July the Indian government informed a Joint Parliamentary Committee investigating its Financial Resolution and Deposit Insurance (FRDI) Bill, which contained a controversial “bail-in” clause, that it was withdrawing the legislation. Significant opposition from the population, unions—including bank employee unions—and politicians played a key role in the decision.

A leader of the opposition party Trinamool Congress (TMC), Saugata Roy, said that the government realised it would lose next year’s election if it went ahead with the legislation, due to widespread concerns about depositors losing their savings, according to *The Economic Times*.

Bail-in is a scheme cooked up by derivatives dealers in the wake of the 2007-08 global financial crisis to prop up failing banks by writing off their “unsecured liabilities”, which category includes certain types of bank bonds and deposits. Such laws exist in Europe and the USA, and there has been a push to extend them across Asia, in order to protect cross-border counterparties in the international derivatives trade worth over US$1 quadrillion.

The Indian bill, to establish a Financial Resolution Corporation (FRC) to monitor financial institutions and resolve them if they fail, was introduced into the Indian Parliament, the Lok Sabha, in August 2017, the same month as the Citizens Electoral Council discovered legislation had been announced for an Australian bail-in power, contained in the Treasury’s Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017. Like its Australian counterpart, the Indian bill was soon referred to a parliamentary committee, as concern over the bail-in clause grew.

In his communication with the committee, caretaker Indian Finance Minister Piyush Goyal said: “The stakeholders including the public have raised apprehensions relating to the provisions of the FRDI Bill, like the use of bail-in instrument to resolve a failing bank, the adequacy of deposit insurance cover and the perceived need to revive the insurance limits substantially, and application of resolution framework for public sector banks.

“Resolution of these issues would require a comprehensive examination and reconsideration”, Goyal continued. “It is, therefore, appropriate that the bill may be withdrawn.” The committee, which had previously asked for two extensions in order to examine the bill more thoroughly, immediately agreed.

This outcome is a stunning contrast to Australia’s experience, where the government, assisted by a media blackout, was able to sneak the bill through Parliament on 14 February 2018, despite the public outcry that the CEC had mobilised. Unlike in Australia, where only a handful of MPs opposed the bill, there were significant and loud objections from opposition parties in India. A Change.org petition against the bail-in power, put up by Indian activist Shilpa Shree, attracted nearly 152,000 signatures. In March there were runs on the banks by customers worried about the safety of their savings, as the bail-in proposal intersected other banking scandals.

Politics doomed the bill

Wall Street is furious. A 23 July *Bloomberg* article by Ila Patnaik headlined “Two steps back: Why govt’s withdrawal of FRDI bill is a missed opportunity” took issue with more than just the defeat of bail-in, taking aim at India’s state-owned banks, “a legacy of India’s socialist past”, which account for nearly 70 per cent of the country’s deposits. “India needs a strategy to get the government out of banking”, said Patnaik. According to the article the state banks hold a high percentage of non-performing loans, and without the new law cannot be easily sold off, so the government has no choice but to recapitalise them.

The announcement of the bail-in defeat on the Change.org campaign page. Photo: Screenshot

“Politics doomed the bill”, said Patnaik, given that the Resolution Corporation would be provided the “the option of ‘bailing in’ troubled banks—using uninsured depositor money to infuse equity into the bank if a buyer couldn’t be found. The optics, at a time when many state banks look like they’re on the verge of failure, were terrible.” Even worse, she pointed out, the matter tipped off many Indians to the fact that only 100,000 rupees of their savings were insured, an amount less than US$1,500. “Pensioners worried they might be stripped of their life savings.”

Patnaik concluded with a warning. “Under current conditions”, she said, “it’s not clear what the government and RBI [Reserve Bank of India] would do if a big private bank failed. There are no public-sector banks healthy enough to buy out a big bank. There’s no fiscal space to infuse equity, as public banks are already bleeding the government’s coffers.

“A high-profile liquidation could possibly trigger a contagion. Many countries set up resolution regimes after the global financial crisis, understanding the grave impact of a banking failure on the real economy.” The Wall Street scribe threatened: “India may soon come to regret not doing so as well.”

The reality is that the only way a bail-in resolution could save a banking system is if only one bank is in trouble, but in a new global financial crisis virtually all banks will be affected. The only way to prevent this is with a clean-sweep of banks which removes all speculative investment activity from their books, with a Glass-Steagall banking separation, modelled on the 1933 Depression-era legislation in the USA. Instead of demanding the government get out of banking, as Australian Treasurer Joe Hockey also did in 2009, which would grant free rein to criminal banking enterprises focused solely on maximising profits, India should utilise its state banks in the manner China has, to issue credit to build desperately needed infrastructure to create an economic boom and return banks to their traditional function of supporting economic activity.