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Position of Depositors under The Insolvency and Bankruptcy Code 2016

Introduction to Financial Service Providers and Depositors

A. At the time of inception of the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as the **'Code'**), the processes with respect to insolvency and liquidation of financial service providers (**'FSPs'**) and the treatment of persons depositing their monies with the said FSPs (**'Depositors'**) were not brought into force under the Code. The rationale of the legislature behind such exclusion was rooted in the fundamental difference between other companies and FSPs, wherein the former dealt with independent business operations, while the latter engaged with customers funds/public deposits in its daily business activities. During that time, multiple legislative frameworks viz the Companies Act, 2013, National Housing Bank Act, 1987, Banking Regulation Act, 1949, and the Insurance Regulatory and Development Authority of India Act, 1999, providing for processes and provisions for the resolution and winding up of FSPs were in place, however, the same remained ineffective and untested.

B. In order to provide a unified framework for the resolution of the FSPs and also to ensure that insolvency and liquidation of FSPs is conducted in an efficient and time bound manner while ensuring that the rights of the stakeholders of the FSPs including Depositors are not compromised, Section 227 of the Code empowering the Central Government to notify FSPs for the purpose of their insolvency and liquidation proceedings was promulgated. In this regard, the Central Government has also brought into force the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 (**'FSP Rules**'), which are applicable to financial service providers, as may be notified by the Central Government under Section 227 of the

Code, from time to time, for the purpose of their insolvency and liquidation proceedings.

Provisions of The Code and FSP Rules

C. Section 227 of the Code provides that the Central Government may, if it considers necessary, in consultation with the appropriate financial sector regulators, notify FSPs 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. The FSP Rules are applicable to such FSPs or categories of FSPs as may be notified by the Central Government under Section 227 of the Code.

D. As per the FSP Rules, the provisions of the Code pertaining to corporate insolvency resolution process of a corporate debtor shall *mutatis mutandis* apply to the insolvency resolution of FSPs with certain modifications including the following:

- insolvency proceedings in the context of a FSP may be initiated only by an appropriate financial sector regulator in terms of the FSP Rules;
- the application of such financial sector regulator shall be treated in a manner akin to an application made by a financial creditor under Section 7 of the Code;
- on such application being made, the adjudicating authority shall appoint an individual of the financial sector regulator's choice as the 'administrator' of the FSP, having powers and functions of an interim resolution profession/ resolution professional/ liquidator;
- an interim moratorium (having effect of Section 14(1), (2) and (3) of the Code) shall commence from the date of filing of application for insolvency of the FSP by the financial sector regulator till the admission or rejection of the said application.
- interim moratorium shall not be applicable to third party assets or properties (including of Depositors) which are in custody or possession of the FSPs (including any funds, securities and other assets required to be held in trust for the benefit of said third parties) and the said custody or possession shall be with the 'administrator'.
- the license or registration of the FSP to engage in the business of providing financial services shall not be suspended or cancelled during the period of interim moratorium or CIRP.

E. Similarly, the FSP Rules provide that provisions of the Code relating to the liquidation process and voluntary liquidation process of the corporate debtor shall, mutatis mutandis apply to the liquidation process and voluntary liquidation process of a financial service provider, respectively, subject to certain modifications.

Status of Depositors and Procedurefor Participation in the Insolvency Resolution Process

F. The term 'deposits' draws its meaning from the Companies Act, 2013 wherein Section 2(31) defines it to include "any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India". Under the Code, deposits are included within the ambit of 'financial product' under Section 2(15) of the Code while the process of inter alia accepting deposits by a FSP along with safeguarding and administering assets consisting of financial products belonging to another person, comes under the scope of 'financial service' under Section 2(16) of the Code.

G. During the initial years of the Code, the status of Depositors was uncertain pending decision of adjudicating authorities on classification of Depositors as either financial or operational creditors. This was evident from the NCLAT's decision in ***Hind Motors vs. Adjudicating Authority (Company Appeal (AT) (Insolvency) No. 11 of 2017)*** and ***NCLT's decision in Prabodh Kumar Gupta vs. Jaypee Infratech Limited (CP No. (IB) 68/Ald/2017).*** While in the former, the NCLAT left the question of whether the public depositors qualify as financial creditors undecided; the NCLT in the latter case termed the public depositors as "other stakeholders" and vested the resolution professional ('RP') with the power to take appropriate action towards the Depositors as he/she may deem fit.

H. Considering prevalence of conflicting decisions, the 'Report of The Sub-Committee of The Insolvency Law Committee for Notification of Financial Service Providers Under Section 227 of the Insolvency and Bankruptcy Code, 2016' dated 4 October 2019 ('Report') specifically addressed that the amounts deposited by Depositors with an FSPs will be treated as financial debt and as such depositors will be classified as financial creditors and will be treated accordingly under the Code. The position of law in this regard has also been clarified by various judicial precedents to include Depositors as financial creditors under the Code.

I. As such, the procedure for submission of claims by a Depositor is identical to that of a financial creditor and covered under Regulation 8 of the CIRP Regulations. The procedure of the same may be encapsulated as follows:

(i) the Depositor shall submit claim with proof to the interim resolution professional ('IRP') in electronic form in Form C of the Schedule-I of the CIRP Regulations (claim may also be submitted as a class of financial creditors vide Form CA). The Depositor may also submit supplementary documents or clarifications in support of the claim before the constitution of the CoC;

(ii) the existence of a financial debt due to the Depositors may be proved by:

- the records available with an information utility, if any; or

- other relevant documents, including:
  - — financial contract supported by financial statements as evidence of the debt;
  - — a record evidencing that the amounts committed by the financial creditor to the corporate debtor under a facility has been drawn by the corporate debtor;
  - — financial statements showing that the debt has not been paid; or
  - — an order of a court or tribunal that has adjudicated upon the non-payment of a debt, if any.

(iii) Further, as per Regulation 10 of the CIRP Regulations, the IRP or RP may call for other evidences or clarification as he deems fit from a creditor for substantiating the whole or part of its claim.

J. In the event there are a large number of Depositors, an authorised representative may be appointed in terms of Section 21(6A) of the Code. Such authorised representative shall represent the Depositors in the CoC of the FSP and vote on behalf of them to the extent of their voting share in terms of the provisions of the Code.

Solidification of The Status of Depositors under The Code

K. The status of deposit holders and their position in their waterfall mechanism of Section 53 of the Code was recently settled by the National Company Law Appellate Tribunal ('NCLAT') in the matters of:

(i) ***Air Force Group Insurance Society vs. Mr. R. Subramaniakumar, Administrator of Dewan Housing Finance Corporation Limited & Ors. and Mr Anup Kumar Shrivastava & Ors. vs. Mr. R. Subramaniakumar, Administrator of Dewan Housing Finance Corporation Limited & Ors. (Company Appeal (AT) (Insolvency) No. 546 & 552 of 2021) vide order passed on 27 January 2022 ("DHFL Case 1");***

(ii) ***Vinay Kumar Mittal & Ors. vs. Dewan Housing Finance Corporation Limited & Ors. (Company Appeal (AT) (Insolvency) No. 506 & 507 and 516 of 2021) vide order passed on 27 January 2022 ("DHFL Case 2")***; and

(iii) ***Mr. Raghu K S & Ors. vs. Mr. R. Subramaniakumar, Administrator of Dewan Housing Finance Corporation Limited (Company Appeal (AT) (Insolvency) No. 538 of 2021) dated 7 February 2022 ("DHFL Case 3").***

L. DHFL Case 1

Factual Background

(i) The appellants were Depositors and had deposited their money in the fixed deposit scheme offered by a FSP which had promised higher returns and money security. The said FSP was then admitted into insolvency on 29 November 2019 and its insolvency resolution process was initiated by the RBI under rule 5 of the FSP Rules vide CP No. 4258 of 2019.

Subsequently, the resolution plan submitted by a resolution applicant was approved by the Committee of Creditors ('CoC') of the FSP. In terms of the approved resolution plan, small investors including the appellants were proposed to be paid less than 40% of the admitted claims agreed to be paid to secured financial creditors.

Vide the impugned order, the NCLT had disposed the appellant's application with the direction to the CoC to reconsider payment to small investors under the resolution plan to match the secured financial creditors. The NCLT further requested the CoC to repay the entire admitted claim of Army Group Insurance Fund ('Army Fund') without any haircut and consider them as a separate class/ sub-class of creditors in consideration of nature of duties being performed by them. However, the suggested revision was rejected by the CoC by a majority of 89.49% vote share.

(ii) The appellant in its appeal to the NCLAT contended that it would fall within the same class of creditors as Army Fund. It also contended that the approved resolution plan ought to have rejected since the same did not make full payment of the admitted claims of the appellants and was therefore violative of various provisions of the National Housing Bank Act, 1987 ('NHB Act'). The appellant resorted to the RBI Act, 1934 stating that it mandated full payment to the depositors and that any resolution plan having the effect of extinguishing the claims of the Depositors upon payment as per the plan is illegal, violative and cannot be sustained in law. The appellants additionally stated that the deposits were held in trust by the FSP until maturity and did not come under the ambit of loans.

Observations

(iii) The NCLAT after due consideration of the submissions of all parties stated the following observations:

a) In light of the Supreme Court's decision in ***N. Raghvender vs. State of Andhra Pradesh (2021 SCC OnLine SC 1232),*** it was held that the bank is not a trustee of the money deposited by the customers and that their relationship is that of a creditor and debtor. Since, the FSP took fixed deposits from the appellants on agreed interest on the amount invested, their relationship

was that of a creditor and debtor.

b) In view of the Apex's court stance in ***Essar Steel vs. Satish Kumar Gupta and Ors (2020) 8 SCC 531,*** the NCLAT reiterated that the CoC in its commercial wisdom may negotiate and accept the resolution plan involving differential payment to different class of creditors along with differences in the distribution amounts between different classes of creditors.

c) In light of the above, the NCLAT stated that having participated in the insolvency resolution process, the appellants cannot challenge the actions of the CoC which is otherwise in compliance with the provisions of the Code. The NCLAT unequivocally stated that the task of the CoC members is to work towards the maximisation of value for all stakeholders of the corporate debtor and not the depositors alone. The appellants' who were financial creditors and hence a part of the CoC, by seeking payment outside the resolution plan are acting in silo. Such action is not only detrimental to the interest of other stakeholders but also against a holistic resolution for maximisation of value and distribution of funds among other creditors.

d) The Depositors of the FSC stand on an equal footing with other financial creditors. There exists no rationale for treating them as a separate class with preferential treatment being accorded in the matter of distribution of fund and that the commercial wisdom of the CoC reigns supreme.

e) That the powers of the adjudicating authorities under Section 60(5)(c) of the Code or Rule 11 of the NCLT Rules are limited in view of ***Jaypee Kensington Boulevard Apartments Welfare Association vs. NBCC (India) Ltd 2021 SCC OnLine 253 and Ebix Singapore (P) Ltd. vs. Committee of Creditors of Educomp, 2021 SCC OnLine Sc 707***. The powers of the adjudicating authorities are relating to the broader compliance with the insolvency framework and its underlying objective, one of which is timely resolution of the corporate debtor.

f) Neither the NHB Act nor the RBI Act provides for full payment of the holders of fixed deposits. The stated acts merely envisage the cancellation of license in the event of non-payment. Additionally, the above acts operate in the ordinary circumstances wherein the company is not undergoing insolvency. It is of utmost

importance that once a company is admitted into insolvency, it is the Code which governs the entire process with respect to its resolution.

g) Lastly, considering the decision of the Supreme Court in ***Pratap Technocrats Private Limited vs. Monitoring Committee of Reliance Infratel Limited & Anr. 2021 SCC OnLine SC 569***, the NCLAT stated that the adjudicating authorities are endowed with limited jurisdiction under the Code and cannot act as courts of equity or exercise plenary powers to prevail over the commercial wisdom of the CoC.

In light of the above observations, the appeals were dismissed with no interference with the approved resolution plan.

M. DHFL Case 2

Factual Background

(i) The appellant had filed the stated appeals on behalf of himself and 444 other individual Depositors and other charitable trust holding fixed deposits in the FSP. They were filed against a common order dated 7 June 2021 of the NCLT, Mumbai Bench which had declared the appellant's objections raised post the approval of the resolution plan as infructuous and had disposed their interim applications. It was the contention of the Depositors that they could not be legally subjected to the resolution process by considering the same assets of the FSP and that the NCLT erred in approving the resolution plan without considering the objections of the appellants.

Observations

(ii) The NCLAT after due consideration of the submissions of all parties stated the following observations:

a) Similar to DHFL 1, the NCLAT herein observed that there was no provision either under the RBI Act or the NHB Act or any other law in force which mandated full payment to the Depositors and that the stated acts only provided for the revocation of license in the event of non-payment by an FSP to the Depositors;

b) While reiterating the view laid down in several judgement e.g. ***Innoventive Industries Limited, ICICI Bank and anr. (2018) 1 SCC 407*** and ***The Directorate of Enforcement vs. Sh. Manoj Kumar Agarwal and ors., Company Appeal (AT) (Ins) No 2019,*** the tribunal held that it is a settled position of law that a special statute enacted on a later date will prevail over the earlier statute, in the event both contain a non-obstante clause. Hence, the Section 238 of the Code shall prevail over the NHB Act, NHB Directions and the RBI Act.

c) The NCLAT while relying on the Report cemented the position of Depositors as financial creditors in the insolvency of a FSP. Additionally, in light of the law laid down in ***Chitra Sharma vs. Union of India (2018) 18 SCC 575,*** the tribunal held that during the pendency of the CIRP, the Depositors cannot claim a disbursement since the same shall amount to preferential treatment to a particular class of creditors which is impermissible under the Code.

d) That on the combined reading of the FSP Rules, related provisions of the Code along with the various precedents under it, it becomes clear that it is the Code that provides for a detailed mechanism whereunder the claims of the creditors, including the Depositors have been sufficiently dealt with. Accordingly, the interest of the Depositors as a class of creditors has been adequately represented and protected in the CIRP and is valid in law. Considering the above, the tribunal held that claims of the appellant's must be viewed only in terms of the statutory mechanism under IBC and the FSP Rules.

e) The order emphasised that when a statute has conferred the power to do an act and has laid down the method in which the power is to be exercised, the doing of the said act in any other manner is prohibited. Hence, the Depositors (herein the dissenting financial creditors) cannot seek an amount which is beyond the liquidation value of their debt as the same is provided in terms of the Code.

f) The objections of the Depositors on being dissatisfied with the distribution under the approved resolution plan was found to be not maintainable on the ground that the NCLT/ NCLAT has been endowed with limited jurisdiction as and cannot act as a court of equity or exercise plenary powers. It was thereby held that CoC's commercial or business decisions are not open to judicial review by the NCLT or NCLAT under the Code.

In light of the above observations, the appeals were dismissed with no interference with the approved resolution plan.

N. DHFL Case 3

Factual Background

The facts of the present matter were similar to DHFL Case 1 and DHFL Case 2. The appellants had invested in the fixed deposit scheme of a FSP post which the latter was admitted

into insolvency. The appellants were given the biggest haircut in terms of the distribution envisaged with only a sum equivalent to ₹ 1243,00,00,000/- (Rupees One Thousand Two Hundred Forty Three Crores Only) (23.08%) being allotted out of the admitted claim of ₹ 5375,00,00,000/- (Rupees Five Thousand Three Hundred and Seventy Five Crores Only). The allotted value fell short by a huge margin and was against the 40% (minimum) of the admitted claims agreed to be paid to secured financial creditors with huge risk appetite.

Such action was opposed by the appellants via I.A. No 625/2021 preferred in C.P. (I.B)/4258/(M.B.)/C-11/2019 which was disposed by the NCLT with the direction of reconsideration to the CoC so as to enhance the payment to a minimum of 40% of the amount being paid to secured financial creditors in the resolution plan. The above order was appealed against by the appellants under Section 60(5) of the Code who sought declaration from the NCLAT to the effect that the resolution plan passed by the CoC was illegal and violative of the Code. Additionally, directions were also sought to the effect that resolution plan be modified such that the fixed deposits of the appellants are refunded along with their interest in terms of the NHB Act.

Observations

The NCLAT in light of the decision in DHFL Case 2 disposed of the appeals with the previous judgement being made part of the decision in DHFL Case 2.

Conclusion

We are increasingly witnessing multiple FSPs being admitted into insolvency under the Code. It is imperative to note that the insolvency of a FSP is far more complex with myriad issues since they hold the deposits and assets of the general public. Considering its importance, the adjudicating authorities have been vigilant in clarifying the position of law wherein the Depositors of FSPs are considered to be financial creditors and constitute part of the CoC. The legislators and regulators have also been prompt in framing comprehensive rules and regulations to address the procedure to be followed for realization of claim by the Depositor of a FSP. Such steps have ensured that the Depositors have a say in the treatment meted out to them by the resolution applicant and realize their claim value in a timely manner.

It is to be noted that vide the judgements in the three DHFL cases referenced above, the NCLAT has amply clarified that the Code under Section 238 supersedes the provisions of the RBI Act and NHB Act. This shall reduce multiplicity of forums in resolving the stress in FSPs and bring respite to the stakeholders who in light of the nascent jurisprudence face extreme delays in resolution, subsequently leading to erosion of value of the FSP. Hence, a successful resolution may set the precedents for resolution of stress on FSPs going forward.

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