

Bill Summary

The Bilateral Netting of Qualified Financial Contracts Bill, 2020

- The Bilateral Netting of Qualified Financial Contracts Bill, 2020 was introduced in Lok Sabha on September 14, 2020. The Bill seeks to provide a legal framework for bilateral netting of qualified financial contracts which are over the counter derivatives contracts.
- **Bilateral netting:** Netting refers to offsetting of all claims arising from dealings between two parties, to determine a net amount payable or receivable from one party to other. The Bill allows for enforcement of netting for qualified financial contracts.
- **Qualified financial contracts (QFC):** QFC means any bilateral contract notified as a QFC by the relevant authority. The authority can be Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority of India (IRDAI), Pension Fund Regulatory and Development Authority (PFRDA) or International Financial Services Centres Authority (IFSCA). The Central government may, by notification, exclude contracts between certain parties or containing certain terms from being designated as QFCs.
- **Qualified financial market participant:** The relevant authority may, by notification, designate an entity regulated by it as a qualified financial market participant to deal in QFCs. This would include entities such as non-banking finance companies (NBFCs), insurance companies and pension funds.
- **Applicability:** The provisions of the Bill will apply to QFCs between two qualified financial market participants, where at least one party is an entity regulated by the specified authorities (RBI, SEBI, IRDAI, PFRDA or the IFSCA).
- **Enforceability of netting:** The Bill provides that netting of QFCs is enforceable if the contract has a netting agreement. Netting agreement is an agreement that provides for the netting of amounts involving two or more QFCs. A netting agreement may also include a collateral arrangement. Collateral arrangement is a form of security provided for one or more QFCs in a netting agreement. It may include a pledge of assets, or an arrangement to transfer the title to a collateral or a third-party guarantor.
- The inclusion of non-qualified financial contracts in a netting agreement will not invalidate the enforceability of netting of QFCs under the agreement.
- **Close-out netting arrangement:** Close-out netting refers to the termination of all obligations arising out of relevant QFCs. The process may be initiated by a party to the QFC in the case of: (i) a default (failure to honour the obligations of a QFC) by the other party, or (ii) a termination event, as specified in the netting agreement that gives one or both parties the right to terminate transactions under the agreement. In case where one party to the agreement is placed under administration, the consent of such party or the administration practitioner is not required. Administration refers to imposition of moratorium, proceedings of winding up, insolvency or bankruptcy, among others. Administration practitioner is the entity that administers the affairs of the party.
- The parties to a QFC must ensure that all obligations owed by one party to the other, under the contract, are replaced by a single net amount. The netting will have the effect of liquidating present and future obligations arising out of QFCs to which the netting agreement applies. The net amount payable/receivable under the close-out netting would be determined: (i) in accordance with the netting agreement entered into by the parties, if one exists, or (ii) through agreement between the parties, or (iii) through arbitration. Unless the agreement specifies otherwise, collateral provided under a collateral arrangement may be liquidated without consent from any entity.
- **Enforceability of close-out netting:** Close-out netting is enforceable against an insolvent party and against the person providing collateral (if applicable). Close-out netting is also enforceable against a party placed under administration, notwithstanding any injunction, moratorium, insolvency, resolution, winding up or order of a court issued under any law.
- **Limitations on powers of administration practitioner:** The administration practitioner cannot render ineffective, any transfer of cash, collateral or other interests made in connection with a netting agreement between the insolvent party and the non-insolvent party to a QFC.
- **Power to amend Schedules:** The Central government can, by notification, amend the list of authorities and Acts which regulate entities that are party to a QFC.

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