

THE WOLF OF DALAL STREET: RE-THINKING LIABILITY FRAMEWORKS FOR SHADOW BANKS

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Shadow Banking via NBFCs has steadily increased in popularity in India over the past decade. Multiple entities offer an array of financial services which provide credit lines for vital projects in infrastructure, housing and other fields. For many start-ups and small businesses across the country, shadow banks are a source of funding. While the growth of the sector is to be appreciated, the potential dangers of this form of capitalism were apparent in 2018 with the collapse of IL&FS. To this end, taking from the lessons learned the hard way from 2018 and the Great Recession of 2007-2009 caused by the meltdown of Wall Street's shadow banks, certain fundamental concepts of company law must be re-examined. It will be argued that further RBI and SEBI Regulations fail to address the issue of banking failures. Rather, the concept of limited liability, long believed as fundamental to the company form, is unsuitable for the NBFC/shadow banking sector and must be diluted to reintroduce a form of multiple liability. This is essential for dissuading the irresponsible and risky strategies employed by management and directors in shadow banks. Such a dilution may also apply to other company forms in the future. Additionally, civil liability, long believed to be the most appropriate way of holding errant bankers liable for their greed and outrageous risk-taking, has turned out to be a disappointment in the United States. The approach of impugning individual directors and managers in civil law will have to be reformed in order to ensure that it is more effective in penalizing their collective negligence.

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I. INTRODUCTION

In the modern economy, funding for large scale ventures and projects do not come exclusively from standard banks. A significant portion of the credit comes from entities which act as ‘Shadow Banks’. This phenomenon is particularly pronounced in the United States with multiple shadow banks operating on Wall Street. These banks are essentially companies which mimic the behaviour and provide the same kind of services that standard banks do. This includes accepting deposits, providing loans, and granting insurance, among other functions. However, they exist outside the standard banking regulations and laws.⁷¹² In India, Non-Banking Financial Companies (“NBFC” or “Shadow Banks”) act as the equivalent of the Wall Street shadow banks. Companies such as Bajaj Finserv and Muthoot Finances are entities which provide a large number of financial services that are the same as those provided by standard banks.⁷¹³ They are created under and governed by the Companies Act, 2013⁷¹⁴, and there is no mention of such institutions under the Banking Act, 1949.⁷¹⁵

⁷¹² Roy Girasa, *Shadow Banking: The Rise, Risks, and Rewards of Non-Bank Financial Services* (Palgrave MacMillan, 2016) 24-25.

⁷¹³ ‘NBFC Stocks by Net Profit’ *MoneyControl* <https://www.moneycontrol.com/stocks/marketinfo/netprofit/bse/finance-nbfc.html> accessed on 12 January 2021.

⁷¹⁴ Companies Act, 2013.

⁷¹⁵ The Banking Regulation Act, 1949, contains no mention of NBFCs. Their activities are hence governed almost entirely by the Companies Act, and RBI regulations/guidelines.

Under the Companies Act, shadow banks have the option of choosing limited liability. All major NBFCs are limited liability companies.⁷¹⁶ The obvious reason for this is that shareholders can limit their exposure in case of a default. This liability regime presents an issue that was seen prominently in the 2008 Wall Street crash. The problem, in simple terms, is that limited liability encourages managers and directors to take extremely risky business decisions. If these strategies are fruitful, the profits made are significant. However, if they fail and lead to a default, the directors/managers are secure in the knowledge that their personal liability is limited only to the amount of their shareholding.

The importance of NBFCs in a post-COVID world is likely to increase. In India, multiple sectors of the economy have significant amounts of Shadow Bank money in them, which funds further growth and development.⁷¹⁷ The amount of lending done by Shadow Banks in India is already much greater than in other major economies.⁷¹⁸ Considering the significant contraction in the Indian economy, it is foreseeable that re-starting it will require large amounts of funds. NBFCs will, therefore, play an important role⁷¹⁹ in providing the necessary loans to stimulate economic activity which had largely stalled during the pandemic.

Recent data has shown a reduction in borrowing costs for a number of Shadow Banks. Considering the ailing condition of several major banks, especially in the public sector, it is likely that businesses will turn to NBFCs for funding.⁷²⁰ Considering this economic reality, it is necessary to examine the legal situation regarding these entities. The cause for concern arises largely due to recent high-profile defaults in major Shadow Banks.

A. The collapse of IL&FS

In 2018, when Infrastructure Leasing & Finance Corporation (“IL&FS”) defaulted and sent markets into a spin, many called it a “mini-Lehman moment”,⁷²¹ with all the accompanying financial turmoil that is associated with banking failures on such large scales.⁷²² Fortunately, the Indian government took steps to correct the crisis which have proved successful.⁷²³ The

⁷¹⁶ Group structure of Bajaj Finserv and its subsidiaries, accessible at: <https://www.bajajfinserv.in/group-structure>; Group Structure of Mahindra Finance, accessible at: <https://mahindrafinance.com/discover-mahindra-finance/subsidiaries>; A survey of the Top 10 NBFCs showed that they were limited liability companies.

⁷¹⁷ Suvashree Ghosh & Dhvani Pandya, ‘\$63 billion of zombie buildings sound warning for Indian banks’ *The Economic Times* (Oct 4, 2019) <https://economictimes.indiatimes.com/industry/banking/finance/63-billion-of-zombie-buildings-sound-warning-for-indian-banks/articleshow/71434585.cms?from=mdr> accessed on 12 January 2021.

⁷¹⁸ Financial Stability Board, ‘Global Shadow Banking Report 2017’ (Credit Suisse, 2018).

⁷¹⁹ Divya Patil & Anil Poonia, ‘Borrowing Costs for India’s Shadow Banks Retreat on RBI move’ *Bloomberg Quint* (19 Nov 2020) <https://www.bloombergquint.com/economy-finance/borrowing-costs-for-india-s-shadow-banks-retreat-after-rbi-move> accessed on 12 January 2021.

⁷²⁰ Ibid.

⁷²¹ Andy Mukherjee, ‘India is having its own mini-Lehman moment on the 10th anniversary of global financial crisis’, *The Print* (13 Sept 2018) <https://theprint.in/opinion/india-is-having-its-own-mini-lehman-moment-on-10th-anniversary-of-global-financial-crisis/117042/> accessed 12 December 2020.

⁷²² Andy Mukherjee, ‘India’s Shadow-Bank Bust has a Lehman Echo’ *Bloomberg* (13 Sept 2018) <https://www.bloomberg.com/opinion/articles/2018-09-13/india-s-il-fs-is-facing-a-lehman-moment> accessed 26 August 2020.

⁷²³ Divya Patil and Anil Poonia, ‘Shadow Banks Ride out the Crisis while Virus Ravages India’, *Bloomberg Quint* (16 Sept 2020) <https://www.bloombergquint.com/business/shadow-banks-are-riding-out-the-crisis-while-virus-ravages-india> accessed on 5 October 2020.

RBI had to take over IL&FS's daily functioning and multiple public sector banks lent it money so that it may begin to re-establish its business.⁷²⁴

The pressure on the RBI while dealing with IL&FS's default could have been more pronounced. Barely a year later, Dewan Housing Finance Corporation ("DHFC"), another Non-Banking Financial Company ("NBFC") similarly defaulted on its debt repayments. This required the RBI to repeat the entire process of removing the Board of Directors and taking over the process of reviving the company.⁷²⁵ If both these defaults had happened together, it would have doubled the workload for the RBI.⁷²⁶

The failure of IL&FS included multiple regulatory failures. There was collusion by multiple IAS officers who were supposed to examine the account books and functioning of the company.⁷²⁷ Additionally, credit ratings agencies gave the long-term and short-term borrowings by IL&FS an 'AAA' rating. This rating was only amended the day before IL&FS defaulted. The agencies evidently failed to appraise themselves of the crisis that IL&FS was in, and its ratings would've misguided several investors regarding the financial health of the NBFC.⁷²⁸ Finally, the RBI added IL&FS to its list of "Systemically Important NBFCs", ostensibly to have greater oversight over it. Despite this, they could not prevent the default and collapse of the Shadow Bank, which brings into question the efficacy of this regulatory oversight.⁷²⁹

B. Law and Regulation of Shadow Banks

Financial law and regulation must better address the lacunae that allowed IL&FS and DHFC's failures. As mentioned above, a large amount of funding for projects comes from such NBFCs and this is likely to increase in the aftermath of the COVID-19 pandemic. Financial Regulation lays out the guidelines and participatory rules for financial markets, targeting banks, consumers and other entities.⁷³⁰ It outlines the rules that must be followed by all participants while carrying out their activities in the financial and banking sphere.

⁷²⁴ Kavaljit Singh, 'What Explains India's Shadow Banking Crisis, and What Can Be Done Now?' *The Wire* (28 Aug 2019) <https://thewire.in/banking/shadow-banking-crisis-ilfs-dhfl> accessed 28 August 2020.

⁷²⁵ Shayan Ghosh, 'RBI takes over DHFL board, appoints an administrator' *Livemint* (21 Nov 2019) <https://www.livemint.com/companies/news/rbi-suspends-dhfl-board-places-the-company-under-administrator-11574254914817.html> accessed on 12 December 2020; Shayan Ghosh, 'Use of insolvency code in Dewan Housing will expedite resolution process' *Livemint* (23 Sep 2019) <https://www.livemint.com/industry/banking/use-of-insolvency-code-in-dewan-housing-will-expedite-resolution-process-1569212343590.html> accessed on 12 December 2020.

⁷²⁶ *Ibid.*

⁷²⁷ Sucheta Dalal, 'IL&FS: SFIO Investigation Throws up new leads on Insolvent Bank's Dealings' *The Wire* (5 April 2019) <https://thewire.in/banking/ilfs-mess-sfio-investigation-new-dirt> accessed on 28 August 2020.

⁷²⁸ Anjan Basu, 'IL&FS and the La-La Land that is Indian Credit Rating' *The Wire* (7 Oct 2018) <https://thewire.in/business/ilfs-moodys-fitch-care-icra-rating-companies> accessed on 28 August 2020.

⁷²⁹ Reserve Bank of India, 'List of Non-Deposit taking Systemically Important (NBFC-ND-SI) companies registered with RBI (As on July 16, 2020) https://www.rbi.org.in/Scripts/BS_NBFCList.aspx; Kavaljit Singh, 'How Should India Resolve the fault lines in its Shadow Banking System' *The Wire* (16 June 2019) <https://thewire.in/banking/india-shadow-banking-system-fault-lines> accessed on 4 October 2020.

⁷³⁰ Joanna Benjamin, *Financial Law* (OUP, 2007) 6-10.

The steps taken following the IL&FS crash to prevent a repeat, have been in the area of Regulation.⁷³¹ This strategy involves creating further rules and guidelines which allow greater monitoring and oversight by the RBI. However, the wisdom of this approach is questionable. Markets are dynamic and constantly evolving, and usually always outgrow and circumvent regulations, no matter how stringent.⁷³² Thus, it may be futile to hope that the RBI and other regulators will be better at enforcing new guidelines.

This has been recognized among scholars in the United States.⁷³³ Following the 2008 Wall Street crash, faith in Financial Regulation being able to prevent financial crises was severely curtailed. American legal scholarship has turned to the larger fields of Company and Financial Law itself.⁷³⁴ This is based on the opinion that changing the legal structure of investment banks will be more effective in controlling banking activities. For example, Lucian and Holger have identified the “Moral hazard” inherent in the wage and bonuses structure of managers. This incentivizes them to take great risks in order to increase their profits.⁷³⁵ Thus, changes in the law must account for such facets of banking.

To this effect, this paper will propose two changes to Company law that would be more effective than the new Financial Regulations. Parts II - IV of the paper will question a fundamental pillar of company law across the world: limited liability. The manner in which limited liability, especially in Shadow Banks, encourages the kind of high-risk strategies as seen in the IL&FS case will be detailed. It will be argued that a return to multiple liability for shadow banks will cause a recalibration of incentive structures within NBFCs and force Directors and managers to make decisions which guarantee sustainability of the Shadow Bank.

Parts V and VI of the paper will then investigate a second limb of managerial control: civil liability for the collapse of NBFCs. It will argue that the Companies Act, 2013 and existing criminal law doctrine is insufficient to deter overt risk-taking in shadow banks. Rather, a mechanism for personal liability of directors must be instituted. Such a mechanism must focus on how a particular crisis is caused by the way a company operates, as determined by senior management. As an aside, while there are numerous ways in which these two proposals may interact with the Insolvency and Bankruptcy Code, the potential contradictions and how to resolve them will not be comprehensively explored within the scope of this particular paper.

⁷³¹ ET Editorial, ‘RBI’s welcome steps to reform HFCs’ *The Economic Times* (16 July 2020) <https://economictimes.indiatimes.com/blogs/et-editorials/rbis-welcome-steps-to-reform-hfcs/> accessed 28 August 2020.

⁷³² *ibid.*; Hans-Werner Sinn, ‘Risk Taking, Limited Liability and the Competition of Bank Regulators’ (2001) National Bureau of Economic Research Working Paper No. 8669 available at: https://www.nber.org/system/files/working_papers/w8669/w8669.pdf; Lee C. Buchheit, ‘Did We Make Things Too Complicated?’, (2008) 27 *International Financial Law Review* 24, 26 (noting complexity of financial transactions often obscures their riskiness); Steven L. Schwarcz, ‘Disclosure’s Failure in the Subprime Mortgage Crisis’, (2008) *Utah Law Review* 1109, 1110 (pointing out that securities prospectus’ are too long for average investors to read).

⁷³³ Iman Anabtawi and Steven L. Schwarcz, ‘Regulating Systemic Risk: Towards an Analytical Framework’, (2011) 86 *Notre Dame Law Review* 1349, 1382-1383.

⁷³⁴ *Ibid.*

⁷³⁵ Lucian and Holger deal with moral hazard inherent in bankers’ pay in ‘Regulating Bankers’ Pay’, (2009) *Harvard Law School John M Olin Center for Law, Economics and Business Discussion Paper Series Paper* 634, 98 *Georgetown Law Journal* 247.

II. DEVELOPMENT AND STATUS OF LIMITED LIABILITY

Limited liability was not always the norm in the common law world. The United Kingdom (“UK”) had unlimited liability for banks roughly till 1879 when the law was changed in aftermath of the City of Glasgow Bank collapse.⁷³⁶ The United States had double liability⁷³⁷, and triple liability⁷³⁸, till the Great Depression. In both cases, the reason for transitioning away from multiple liabilities was the burden it placed on ordinary shareholders to pay creditors for defaults.⁷³⁹ This was especially because ordinary shareholders were not involved in the governance of the banks. The trajectory of limited liability in India will now be examined in more detail.

A. Unlimited Liability in Colonial India

The trajectory of company law in India roughly mirrors its corresponding development in Britain. However, the shift away from unlimited liability took place much sooner in the former, motivated in part by the specifics of the colonial economy. The first major banking failure occurred in 1848 with the Union Bank of Calcutta.⁷⁴⁰ The Bank’s unlimited liability status caused the failure to jolt the entire share market⁷⁴¹ and led to debate amongst bankers regarding the utility of continuing with this standard of liability.⁷⁴²

For the next decade, the Indian legislature showed great deference to the academic and legal opinions back in Britain. When limited liability became an option for banks in 1858 in the latter; it was promptly adopted just two years later⁷⁴³ by the colonial administration as well.⁷⁴⁴ Importantly, the first great economic bubble in India coincided with the first five years of limited liability for banks. This was spurred by the rise of the cotton industry in Bombay, which experienced a significant boom due to the supply of cotton from Southern United States drying up as a result of the American Civil War.⁷⁴⁵ During those four years while the Confederate States of America, initially the primary source of cotton for Britain, was at war, the mills of Bombay experienced an unprecedented level of profitability which fuelled a

⁷³⁶ In the 1850’s, the survey - Matthew Willison, ‘Were Banks Special? Contrasting Viewpoints in Mid-Nineteenth Century Britain’ (2018) Bank of England Staff Working Paper No. 755.<https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3249510> accessed 20 September 2020; John Turner, ‘The development of English company law before 1900’, Queen’s University Centre for Economic History (QCEH), Queen’s University Belfast, Working Paper Series No. 2017-01, 124 <<https://www.econstor.eu/bitstream/10419/149911/1/877815712.pdf>> accessed 1 October 2020.

⁷³⁷ National Banking Act of 1863, ch 58, 12 Stat 665.

⁷³⁸ Colorado, COLO STAT ANN vol 2, ch 18, § 50 (Mitchie, 1935) (repealed 1935).

⁷³⁹ Jonathan Macey and Geoffrey Miller, ‘Double Liability of Bank Shareholders: History and Implications’ (1992) 27 Wake Forest Law Review 31, 37; Graeme G. Acheson, Charles R. Hickson and John D. Turner, ‘Does limited liability matter? Evidence from nineteenth-century British banking’, (2010) 6 Review of Law and Economics 247.

⁷⁴⁰ Charles N. Cooke, *The Rise, Progress, and Present Conditions of Banking in India* (Bengal Print Company, 1863), 141-55, 290-95.

⁷⁴¹ *ibid* 293-297

⁷⁴² Shyam Rungta, *The Rise of Business Corporations in India, 1851-1900* (Cambridge University Press, 1970) 42-48, 63-65.

⁷⁴³ Section I, Act XIX (Joint Stock Companies Act) of 1857 (as amended in 1860).

⁷⁴⁴ *ibid* 66-68.

⁷⁴⁵ Dinshaw Edulji Wacha, *A Financial Chapter in the History of Bombay City* (Bombay: Commercial Press, 1910) 212-15.

speculation boom in the financial sector. Predictably, by the time the Confederacy was defeated and the Southern States resumed production, the sudden and drastic drop in demand caused a severe depression in Bombay. The Bank of Bombay, by 1866, was only able to return Rs. 100 on a Rs. 5,000 paid up share.⁷⁴⁶

There are several possible explanations for why liability standards were not re-examined following this period. As mentioned before, the Indian administrators had exhibited a lack of independent thinking in simply following the legal direction taken in Britain. Considering the British financial situation had remained stable throughout these years, supplemented at different times by cotton from either Bombay or Southern United States, there was no reason to re-open the discussion. Alternatively, the boom and bust of Bombay was dismissed as a one-off and revitalization of the economy was already put in motion, this time via the tea industry.⁷⁴⁷ After all, the Indian economy was merely a proxy for fulfilling the needs of the British, as and when they arose.

What is striking is that this period of debate over the usage of limited liability has largely been forgotten in modern discourse on law and business. Tripathi described unlimited liability as “irritating” and opined that the exclusion of limited liability for banks in the 1857 Act was “strange”⁷⁴⁸, without noting the extensive discussions that took place during those times. This approach has led to a dearth of writing which scrutinizes limited liability as it applies to shadow banks and the possibility of altering this facet of law to better regulate the sector. The following sub-section will explore this question, much as colonial lawmakers were doing almost two centuries ago.

B. Shadow banks and limited liability: Enabling overtly risky behaviour?

While it may now be clear that limited liability is far from predetermined, the reason why there is a need for India to adopt a stricter liability regime for NBFC’s requires a brief overview of the functioning and importance of shadow banks. Taking from Lucien & Holger’s earlier observation regarding incentive structures being skewed toward risk taking, Hill & Painter identified how limited liability created a unique situation for bankers, especially for the shadow banks.⁷⁴⁹ Not only was management in these firms using others’ money to make their investments, but limited liability ensured that they could spend much more than the value of their shares, and still have their own money protected.⁷⁵⁰

Thus, it can be said that shadow banks with limited liability give rise to “moral hazard”, whereby irresponsible and dangerous behaviour is encouraged via a corporate structure which unwittingly protects such behaviour.⁷⁵¹ Schwarcz has recognized that the limited liability regime has given rise to three market failures: a) information failure; b) agency failure; c)

⁷⁴⁶ Rungta (n 31) 75-85.

⁷⁴⁷ Rungta (n 31) 90-100.

⁷⁴⁸ Dwijendra Tripathi, *The Oxford History of Indian Business* (Oxford University Press, 2004) 145.

⁷⁴⁹ Claire Hill & Richard Painter, ‘Berle’s Vision Beyond Shareholder Interests: Why Investment Bankers Should Have (Some) Personal Liability’, (2010) 33 *Seattle University Law Review* 1173, 1177-79.

⁷⁵⁰ *ibid*, 1183-84.

⁷⁵¹ Henry Hansmann and Reinier Kraakman, ‘Toward Unlimited Shareholder Liability for Corporate Torts’, (1991) 100 *Yale Law Journal* (1991) 1879, 1882.

responsibility failure.⁷⁵² For our analysis on whether a different form of liability should be introduced, we will only focus on (c), the Responsibility Failure. with the final market failure, the responsibility failure.

In the context of the Responsibility Failure, there are two salient points: First, shadow banks tend to be decentralized as they grow larger which leads to greater asymmetry in information between different parts of the company. Even in smaller banks, issues arise as power is often centred in primary investors/shareholders. The act of taking risks in their long-term investment strategies can lead to outsized profits.⁷⁵³ Thus, management often opts to take these risks so as to increase their margins and, should the trades lead to insolvency, limited liability will cap the amount of money they lose. In the IL&FS example, this could explain why multiple high-profile investors such as LIC and HDFC Bank did not intervene prior to the 2018 collapse. These shareholders failed to launch investigations despite deterioration in the financial performance of the NBFC.⁷⁵⁴

Second, the strategy of intermediation⁷⁵⁵ plays a significant role in the problems experienced by Shadow Banks.⁷⁵⁶ The act of short-term funding of long-term projects is a common business strategy among Shadow Banks, both in India and the United States. The risk with this approach is that the short-term debt might not be possible to pay back especially when the long-term projects on which refinancing is dependent are delayed by several years.⁷⁵⁷ This perfectly highlights the flawed approach taken by IL&FS.⁷⁵⁸ The inability to pay back short-term debt due to massive delays in the projects it was funding, led to IL&FS defaulting and led to insolvency. Of note is that this occurred despite IL&FS being subject to prudential regulations under the RBI's 2016 Directions which should have, in theory, allowed for sufficient monitoring.⁷⁵⁹

Why this is particularly dangerous for the larger economy is that the intermediation portfolio of a shadow bank may be in vital sectors.⁷⁶⁰ Indeed, this was the logic behind the RBI's designation of IL&FS and other NBFCs as systemically important. The interconnectivity

⁷⁵² Steven Schwarcz, 'The Governance Structure of Shadow Banking: Rethinking Assumptions About Limited Liability' (2014) 90 *Notre Dame Law Review* 1 (hereinafter "Schwarcz").

⁷⁵³ *ibid*; Stacy Preston Collins, 'Valuation of Hedge Fund Businesses', (2008) 21 *Journal of the American Academy of Matrimonial Lawyers* 389, 397.

⁷⁵⁴ Hemindra Hazari, 'Behind IL&FS Default, A Board that Didn't Bark when it was supposed to' *The Wire* (17 Sep 2018) <https://thewire.in/business/behind-ilfs-default-a-board-that-didnt-bark-when-it-was-supposed-to> accessed on 28 August 2020.

⁷⁵⁵ Financial intermediation refers to the activities of an institution wherein it voluntarily assumes liabilities in order to acquire financial assets in return and does so through engaging in multiple financial transactions. The ultimate goal is to provide a source of funds, from lenders to borrowers, by acting as the intermediary between the two.

⁷⁵⁶ Schwarcz (n 41) 20.

⁷⁵⁷ Steven L. Schwarcz, 'Regulating Shadows: Financial Regulation and Responsibility Failure', (2013) 70 *Washington & Lee Law Review* 1781.

⁷⁵⁸ Gurbachan Singh, 'How can we discourage IL&FS and Other Shadow Banks from Relying on Short-Term Funding?' *The Wire* (17 Oct 2018) <https://thewire.in/banking/ilfs-short-term-funding> accessed on 14 October 2020; Andrew Crockett & Benjamin H. Cohen, 'Financial Markets and Systemic Risk in an Era of Innovation', (2001) 4(1) *International Finance* 127.

⁷⁵⁹ Master Direction – Non-Banking Financial Company – Systemically Important Non-Deposit taking Company and Deposit Taking Company (Reserve Bank) Directions, 2016 (RBI/DNBR/2016-17/45) as on 16 July 2020.

⁷⁶⁰ Anabtawi and Schwarcz (n 22), 1376.

in the banking sector in general makes it likely that a single failure will rapidly lead to contagion and affect the economy and financial market as a whole.⁷⁶¹ While the dissolution of IL&FS dealt a significant blow to the economy,⁷⁶² a situation where some of the larger publicly traded NBFCs were to experience similar troubles would raise even greater alarm.⁷⁶³ Both are listed and traded on the NSE and BSE, meaning a much larger number of ordinary people who trade in their shares would be hard hit by a downturn in their investments. Considering the size of these NBFCs and the greater diversity in their areas of investment in comparison to IL&FS or DHFC, defaults would spread to multiple sectors of the economy.⁷⁶⁴ While the RBI has wisely decided to enforce Prudential Regulations on a host of NBFCs⁷⁶⁵, IL&FS's fate has been evidence that this may be insufficient.

C. Changes to Company Law instead of further Regulation

As already alluded to above, financial regulations have been opined as ineffective for preventing shadow bank failures. The RBI had, by virtue of classifying IL&FS as "Systemically Important", imposed prudential regulations upon it.⁷⁶⁶ In principle, this should have been enough to safeguard against banking failure. As the sequence of events shows, this belief was misplaced. Arvind Subramanian, former Chief Economic Advisor to the Government of India, opines that the issue is not one of regulatory insufficiency, but rather supervisory incompetence.⁷⁶⁷ In essence, the problem lies less with the exact parameters of the applicable Regulations and more with the RBI and SEBI's respective abilities to actually supervise compliance.⁷⁶⁸

He notes that IL&FS effectively covered up its bad loans through moving money around across its group of companies, which exceeded 300 entities.⁷⁶⁹ He also noted that RBI's

⁷⁶¹ Steven L. Schwarcz, 'Systemic Risk', (2008) 97 *Georgetown Law Journal* 193, 207, 235 (Schwarcz II).

⁷⁶² PTI, 'IL&FS default impact: NBFCs, HFCs lending to real estate almost halved in FY' 19 to Rs. 27,000 cr, says report' *Firstpost* (25 July 2019) <https://www.firstpost.com/business/ilandfs-default-impact-nbfc-hfc-lending-to-real-estate-almost-halved-in-fy19-to-rs-27000-cr-says-report-7055161.html> accessed on 15 October 2020.

⁷⁶³ 'Largest NBFCs by Net Profit' *Moneycontrol* (Latest stocks).<https://www.moneycontrol.com/stocks/marketinfo/netprofit/bse/finance-nbfc.html> accessed on 25 October 2020

⁷⁶⁴ Schwarcz (n 41) 20.

⁷⁶⁵ Master Direction – Non-Banking Financial Company – Systemically Important Non-Deposit taking Company and Deposit Taking Company (Reserve Bank) Directions, 2016 (RBI/DNBR/2016-17/45) as on 16 July 2020; Master Direction – Non-Banking Financial Company – Systemically Important Non-Deposit taking Company and Deposit Taking Company (Reserve Bank) Directions, 2015 (RBI/2015-16/23); Master Direction – Non-Banking Financial Company – (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.

⁷⁶⁶ Reserve Bank of India, 'List of Non-Deposit taking Systemically Important (NBFC-ND-SI) companies registered with RBI (As on July 16, 2020) https://www.rbi.org.in/Scripts/BS_NBFCList.aspx; Kavaljit Singh, 'How Should India Resolve the fault lines in its Shadow Banking System' *The Wire* (16 June 2019) <https://thewire.in/banking/india-shadow-banking-system-fault-lines> accessed on 4 October 2020.

⁷⁶⁷ Arvind Subramanian, *Of Counsel: The Challenges of the Modi-Jaitley Economy* (Penguin Books, 2018) 95-97.

⁷⁶⁸ *ibid.*

⁷⁶⁹ *Ibid*; Press Trust of India, 'RBI's Regulatory failure created IL&FS mess, says Arvind Subramanian' *Economic Times* (Nov 29, 2018) <https://economictimes.indiatimes.com/news/economy/policy/rbis-regulatory-failure-created-ilfs-mess-says-arvind-subramanian/articleshow/66866097.cms?from=mdr> accessed on 24 February, 2021.

Financial Stability Report made no mention of IL&FS, even in its 2018 edition, just before the NBFC collapsed.⁷⁷⁰ The RBI in its own report on the failure, published in 2019, admitted that IL&FS had successfully hidden 4 years' worth of bad loans from it.⁷⁷¹ What this alludes to is the reality that a majority of scholars⁷⁷² have recognized i.e. that a bank which seeks to obfuscate and cover up its activities will always find creative ways to do so. The respective regulatory body, whether in the United States or in India, has always struggled to keep up. The prevailing wisdom now is that focusing on trying to find ever more stringent RBI or SEBI Regulations is no longer prudent. Sanyal has detailed how increasing regulations across sectors merely shifts the systemic risks from one entity to another.⁷⁷³ Greater regulations on regular banks were what caused businesses to turn to NBFCs to meet their credit needs. Now, trying to crack down on specific NBFCs will merely shift the systemic risk to other Shadow Banks. Like Subramanian, he advises much greater focus to be placed on actual supervision and detection of potential issues in these entities.⁷⁷⁴

Thus, any further preoccupation with specific Regulatory controls by the RBI and SEBI will risk missing the forest for the trees. Regardless, it seems that the RBI will continue to try and address this issue through regulatory means. Their recent Discussion Paper on NBFCs has proposed the creation of a 4-tier ranking of NBFCs with different regulatory obligations on each tier.⁷⁷⁵ What is important to note is that 9,209 out of 9,429 NBFCs will make up the bottom layer and have minimal additional regulatory controls placed upon them. The only major positive is the inclusion of the top 30 NBFCs to the 3rd tier which will mandate exposure, capital and provisioning rules similar to established banks. However, at the same time, cash reserve and liquidity ratios have not been introduced.⁷⁷⁶

The Discussion Paper seems to be attempting to walk a tightrope between regulation and allowing for economic growth. However, in line with Sanyal and Subramanian's views, further nit-picking on the exact ambit of regulations while not doing enough to improve actual

⁷⁷⁰ Press Trust of India, 'RBI's reports never mentioned possible IL&FS crisis: Arvind Subramanian' *Financial Express* (July 12, 2019) <https://www.financialexpress.com/economy/rbis-reports-never-mentioned-possible-ilfs-crisis-arvind-subramanian/1642510/> accessed on 25 February, 2021.

⁷⁷¹ Reuters, 'IL&FS may not have disclosed bad loans for 4 years' *Business Today* (Aug 15, 2019) <https://www.businesstoday.in/current/economy-politics/ilfs-may-not-have-disclosed-bad-loans-for-4-years-rbi-report/story/372754.html> accessed on 24 February, 2021.

⁷⁷² Lee C. Buchheit, 'Did We Make Things Too Complicated?', (2008) 27 *International Financial Law Review* 24, 26 (noting complexity of financial transactions often obscures their riskiness); Steven L. Schwarcz, 'Disclosure's Failure in the Subprime Mortgage Crisis', (2008) *Utah Law Review* 1109, 1110 (pointing out that securities prospectus' are too long for average investors to read); Hans-Werner Sinn, 'Risk Taking, Limited Liability and the Competition of Bank Regulators' (2001) National Bureau of Economic Research Working Paper No. 8669 available at: https://www.nber.org/system/files/working_papers/w8669/w8669.pdf; Anabtawi and Schwarcz (n 22).

⁷⁷³ ENS Economic Bureau, 'Struct bank-type rules on NBFCs may shut off capital or shift systemic risk to another part of the system' *Indian Express* (Feb 21, 2020) <https://indianexpress.com/article/business/banking-and-finance/strict-bank-type-rules-on-nbfc-may-either-shut-off-capital-or-shift-systemic-risk-to-another-part-of-system-6278741/> accessed on 26 February, 2021.

⁷⁷⁴ *ibid.*

⁷⁷⁵ Publications - Discussion Paper on Revised Regulatory Framework for NBFCs - A Scale-Based Approach, 22 January, 2021.

⁷⁷⁶ Editorial, 'Regulating NBFCs' *Business Line* (Jan 27, 2021) <https://www.thehindubusinessline.com/opinion/editorial/regulating-nbfc/article33677923.ece> accessed on 23 February, 2021.

supervision will inevitably lead to further banking crises down the road. The preferred and sustainable solution is alteration of the incentive structure for management personnel in NBFCs. Keeping this in mind, this paper will now elaborate on the potential solutions to this issue under Company Law.

III. ALTERNATIVES TO THE LIMITED LIABILITY APPROACH

With the scepticism about limited liability laid out, a possible alternative must be offered. Several have been posited over the past decade in the academic world, especially in the United States, the worst hit by the failure of shadow banks.⁷⁷⁷ These alternatives have come from both economists/finance experts and lawyers/regulators. While the former are concerned mostly with methods of capping managerial pay and bonuses and tying them to the performance of the firm, the latter have looked at the possible influence of tort law and altering the corporate structure itself. While both sets of proposals have merit, the legal suggestions have, for the most part, avoided making any significant changes to limited liability beyond suggesting how one could go about it.⁷⁷⁸ For this reason, the alternatives, as will be discussed, do not go far enough. The focus will instead be on a more radical and prescient approach, put forward by economists rather than lawyers, which correctly identifies the manner in which to alter the corporate structure while taking into account the past criticisms offered for unlimited liability.

A. Legal solutions to the problems caused by limited liability

The most popular solution forwarded by legal scholars has been a redefinition of the objectives of the board of directors/senior management of a banking company. Two primary means of effecting this redefinition have been suggested by Schwarcz and others.⁷⁷⁹ These proposals include: a) Having a social component added to the duties of directors and management; and b) Focusing on torts as a means of checking externalities created by risk taking.⁷⁸⁰

With regard to the first, Mayer has opined that Directors should be statutorily mandated to keep in mind the larger social and economic consequences of their actions. This will ensure that they will make decisions which guarantees the sustainability of the shadow banks they govern.⁷⁸¹ India has attempted to address this issue from a different perspective through Corporate Social Responsibility. The reception to it has been lukewarm at best. Its effectiveness and overall utility have been questioned often.⁷⁸² Additionally, as Professors Goodhart and Lastra note, mandating that Directors consider the economic fallout of their strategies can be redundant. It would be difficult to prove that Directors disregarded those larger responsibilities

⁷⁷⁷ Colin Mayer, *Prosperity. Better Business Makes the Greater Good* (OUP 2018) (hereinafter "Mayer"); Peter Conti Brown, 'Elective Shareholder Liability' (2012) 64 *Stanford Law Review* 409.

⁷⁷⁸ Schwarcz (n 41) 22-25 [suggesting that a redesign of limited liability will have to take into account two factors: a) reduce systemic risk, and b) avoid discouraging investment. He suggests double liability may be the optimum approach].

⁷⁷⁹ Mayer (n 66); S Schwarcz, 'Misalignment: Corporate Risk-Taking and Public Duty' (2016) 92 *Notre Dame Law Review* 1.

⁷⁸⁰ Schwarcz (n 41) 10-12.

⁷⁸¹ Mayer (n 66).

⁷⁸² Pushpa Sundar, 'Five years after CSR became mandatory, what has it really achieved?' *The Wire* (21 Aug 2018) <https://thewire.in/business/five-years-after-csr-became-mandatory-what-has-it-really-achieved> accessed on 4 October 2020.

to society, as they can always defend themselves by claiming they acted to the best of their knowledge.⁷⁸³ Ultimately, refocusing attention on CSR or a social component to Directors' duties may be futile due to the continuing limited liability regime and the incentive structure for directors and managers. Firms will treat the requirement in a formalistic manner, just like they do in India.

The second suggestion involves internalizing the costs of bad business decisions. When a bank fails, multiple outsiders who are involved in business with it or have relied on its representations are affected. These are externalities which tort law attempts to curb. It does so by penalizing the bank and the management personnel who are responsible for making the decisions that led to failure.⁷⁸⁴ However, this solution has little utility in a situation where the bank and its shareholders are simply unable to pay up.⁷⁸⁵ Additionally, the interconnected nature of the banking system as alluded to above, means the overall effects of a collapse can be wide ranging to the extent that proving the prerequisites for a tort claim becomes too difficult.⁷⁸⁶ From an Indian perspective, the backlog of cases and difficulty in gaining speedy redressal in Indian courts makes this a toothless relief, not to mention the non-existent nature of tort litigation in general.

B. Non-Legal alternatives and the Two-tier model of Liability

Most economists and scholars from the financial world have focused on methods of tying the performance of the bank to the remuneration of top management.⁷⁸⁷ While this correctly identifies the need to align the interests of management with those of the firm, the more intriguing proposition from a legal perspective is that of Professors Goodhart & Lastra (collectively "the Professors"). They have suggested creating a two-tier system of liability for shadow banks.⁷⁸⁸ While the overall proposal is extensive and includes multiple caveats, they propose, in principle, that the liability regime should separate "insiders" and "outsiders" respectively. This is done by identifying those who are closely involved in the management of the company and have significant knowledge about the state of the market and investment strategy being followed by the firm. These would be the "insiders" who would be subject to a multiple liability⁷⁸⁹ while "outsiders" who are not involved in the day-to-day management of the bank and are thus not responsible in case of defaults or failures, would retain limited liability protection.

⁷⁸³ Charles AE Goodhart & Rosa Maria Lastra, 'Equity Finance: Matching Liability to Power' (2020) 6(1) Oxford Journal of Financial Regulation 1.

⁷⁸⁴ Schwarcz (n 41).

⁷⁸⁵ Nina A. Mendelson, 'A Control-Based Approach to Shareholder Liability for Corporate Torts' (2002) 102 Columbia Law Review 1203, 1209–10; Steven L. Schwarcz, 'Marginalizing Risk', (2012) 89 Washington University Law Review 487.

⁷⁸⁶ Schwarcz (n 41) 10-12; Schwarcz II (n 50) 207, 235.

⁷⁸⁷ Thomas Huertas, 'Rebalance bankers' bonuses: use write-down bonds to satisfy both supervisors and shareholders' (2019), SSRN: <<https://ssrn.com/abstract=3336186>> accessed 17 September 2020; Patrick Bolton, Hamid Mehran and Joel D. Shapiro, 'Executive Compensation and Risktaking' (2015) 19(6) Review of Finance 2139.

⁷⁸⁸ Goodhart and Lastra (n 72).

⁷⁸⁹ Multiple liability is seen as being greater than double liability but less than unlimited liability. For an example of where this has been used see Colorado (n 27).

The core concept of creating layers of liability may still be the correct approach. One of the most important concerns that it successfully addresses is the historical concern which led to unlimited liability and double liability being abandoned in the UK and US respectively: the disproportionate burden on the ordinary shareholder in case of default.⁷⁹⁰ These shareholders would generically qualify as outsiders in this two-tiered model of liability and would, thus, be protected. Simultaneously, it targets the incentive structure of senior management and has more teeth than imposing a formalistic “social component” to their responsibilities. The potential impact upon their own pockets, should their risky strategies lead to bankruptcy, acts as a natural deterrent through an alteration of the corporate structure.⁷⁹¹

While this is an intriguing idea, it runs into practical issues. To begin with, as the Professors identify themselves⁷⁹², the distinction between an insider and outside is not always clear. A sleeping member on the board would surely be considered an insider in their model, considering their position of seniority and, likely, high wages. However, in terms of actual knowledge of the company’s affairs, one of the metrics that is used in the Professors’ two-tiered approach, such a board member could very well know so little that he should be an outsider. Regardless, the Professors include such Directors, including external Directors, in the category of “Insiders” as, principally, silent partners or Board members retain the ability to significantly influence the functioning of the bank. This incentivizes these Directors to take a more active role in the running of the bank. Numerous other examples of instances where the two categories blend into each other and become indistinguishable can be listed.⁷⁹³

C. Classification and Problems with the two-tier model

At the heart of it, the issue with this approach seems to be the identification of “insiders”. The issue is not that one must have a precise and formalistic distinction. The Professors acknowledge that it will necessarily be arbitrary to an extent. Rather, the guidelines must be flexible so as to account for different situations across companies.⁷⁹⁴ Therefore, what is important is identifying certain principles that can apply across banks, and are indicators of which individuals hold power inside banks. They provide the following principles to determine this demarcation: a) Shareholding Percentage; b) Decision making power within the bank according to internal documents and Minutes of Meetings; c) Amount of remuneration.

Such usage of principles is preferable to simplistic usage of provisions which are, in no way, meant for this purpose. For example, Section 447 which deals with fraud under the Companies Act, implicitly categorizes Directors as “insiders”.⁷⁹⁵ However, that is incongruous with the purpose of this classification exercise which seeks to identify individuals who would be subject to multiple liability. A fraud provision would be unhelpful in that context. Further,

⁷⁹⁰ Text to n 25; Text to n 28.

⁷⁹¹ Steven L. Schwarcz, ‘Understanding the Subprime Financial Crisis’, (2009) 60 South Carolina Law Review. 549, 562–63.

⁷⁹² Goodhart and Lastra (n 70).

⁷⁹³ Goodhart and Lastra (n 70).

⁷⁹⁴ Goodhart and Lastra (n 70).

⁷⁹⁵ Companies Act, 2013, Section 447.

no actual details regarding classification are contained in Section 447. Therefore, it is a manifestly inferior solution to the flexible principles enunciated by the Professors.

While the principles are helpful, the two-tier model arguably defines “Insiders” too broadly and includes too much of the lower-level managers or department heads in the mix.⁷⁹⁶ These individuals may have significant shareholding in the bank, or be paid extremely high wages which put them on a similar level as the Board. It is quite possible that heads of risk management teams or chief analysts, for example, would be privy to the meetings and discussions surrounding the soundness of a particular strategy.⁷⁹⁷ By several metrics they would be “insiders”.⁷⁹⁸ Armour notes that the most important decisions in implementing policies, actually lies with secondary managers.⁷⁹⁹ However, in actuality, their ability to determine the overall direction of the bank is significantly reduced in comparison to the Executive Board and the Directors.⁸⁰⁰ Schwarcz notes that these details are extremely specific and differ from each bank to the other.⁸⁰¹ As an aside, this is another reason why using proxies such as Section 447 are redundant. A model which would then equate the two groups in assigning greater liability by virtue of them being insiders may seem unfair.

Conversely, these “secondary managers” who are below the top executives and above the rank and file of the bank, often wield significant influence in the actual operation of the firm, if not on the overall policy. Anabtawi & Schwarcz have noted how secondary management handle highly technical tasks which are outside the expertise of more senior members who may not have studied or been exposed to such tasks.⁸⁰² The two-tier model does not sufficiently recognize these nuances as such individuals may exert great influence on the execution of policies and by implication manipulate it if they choose to do so, actually being able to decide what that policy is. Whether they qualify as “insiders” or “outsiders” is left unclear and there is little guidance on how to address this confusion.

If we apply the functioning of certain managers, as laid out by Schwarcz & Anabtawi, to the principles laid out by The Professors, the results can be troubling. In terms of Principle (a), such managers could hold significant shares in the bank. In accordance with Principle (c), they may receive high salaries, due to their specific functions, as outlined above. However, as elaborated upon earlier, the reason Shadow Banks fail is often because of the policy. In that sense, Principle (b) plays a significant role and managers may not always be able to determine said policy, even if they are involved in the process in a minor way. They are, often, just executing it.

⁷⁹⁶ Lucian Arye Bebchuk et al., ‘Managerial Power and Rent Extraction in the Design of Executive Compensation’, (2002) 69 *University of Chicago Law Review* 751, 777 (2002).

⁷⁹⁷ Steven L. Schwarcz, ‘Conflicts and Financial Collapse: The Problem of Secondary- Management Agency Costs’, (2009) 26 *Yale Journal on Regulation* 457, 458 (hereinafter “Schwarcz III”).

⁷⁹⁸ Stephen M. Bainbridge, *Corporate Law* (2nd Ed. 2008) Sections 5, 9.

⁷⁹⁹ In the context of shadow banks, these can include managers in charge of selling, structuring and investing in securities, or overseeing loans and financial transactions. See Schwarcz III (n 86) 459-460.

⁸⁰⁰ For the differences between primary and secondary management, see: Anabtawi and Schwarcz (n 22) 1376; Schwarcz III (n 86).

⁸⁰¹ Schwarcz (n 41).

⁸⁰² Anabtawi and Schwarcz (n 22) 1376.

The Professors actually recognize this as a general problem, though not specifically in the context of secondary managers. They suggest that individuals, who may be concerned with the bank's policy, can confide in the regulatory authorities in order to signal themselves as conscientious objectors.⁸⁰³ This would shield them from blame, and from the higher standard of liability, in case their fears turn out to be justified. However, the act of informing the regulator regarding potentially risky activities in one's own company carries several risks, discovery being the foremost.⁸⁰⁴ This would almost certainly prejudice the individual's position at the firm, if not in the entire market, as the individual would be known as a whistleblower.⁸⁰⁵ However, as recent history shows however, the disaster is often not apparent right up until it is already too late.⁸⁰⁶ In fact, having this standard makes it easier for careless individuals to pretend that they had serious doubts about the bank's activities all along. This would be easy to do in the 11th hour when the damage is already done and the disaster is imminent, by which point even the most irresponsible of managers can foresee a default.⁸⁰⁷

What this means is that secondary managers may be classified as "insiders" as they may fulfil either or both of principles (a) and (c). However, as mentioned before, the third principle regarding decision making power, is what actually leads to bank failure. An individual may be very well paid, and/or hold many shares. However, they may not have much decision making power, despite these two factors. In this situation, would it be fair to classify an individual with limited power over the bank's policy, as an "Insider"? This is an issue that must be addressed.

Finally, one further question remains of how to adjudge shareholders who jump ship by selling their shares before a crisis sets in. An individual may instead of raising the alarm, such a shareholder/manager could simply remain long enough to profit off the increase in value in the firm's shares and then liquidate at the appropriate time, before a downward trend sets in. The Professors try to deal with this argue that if the shareholder/manager exits the company more than three years before a default, then that would be a sufficient buffer time to absolve them of liability.⁸⁰⁸

Once again though, this runs into practical pitfalls. The individual may not exit all at once but do so in a phased manner, especially to avoid suspicion. However, enough shares may be sold whereby he would fall outside the parameters of an insider. He may resign from managerial roles but still retain an informal means of staying updated on the ongoing at the

⁸⁰³ Goodhart and Lastra (n 72).

⁸⁰⁴ Alexander Dyck, Adhair Morse & Luigi Zingales, 'Who Blows the Whistle on Corporate Fraud?' (2010) 65(6) *The Journal of Finance* 2213.

⁸⁰⁵ K Giriprakash, 'Why India's Whistleblower Protection Programme is not as effective as that in the US' *The Hindu Business Line* (25 Oct 2019) <https://www.thehindubusinessline.com/companies/why-indias-whistleblower-protection-programme-is-not-as-effective-as-that-in-the-us/article29794564.ece> accessed on 5 October 2020; Jayshree P. Upadhyay, 'Just how safe are whistleblowers under Indian law' *Livemint* (22 Oct 2019) <<https://www.livemint.com/news/india/just-how-safe-are-whistleblowers-under-indian-law-11571763505941.html>> accessed on 4 October 2020.

⁸⁰⁶ See Steven L. Schwarcz, 'Protecting Financial Markets: Lessons from the Subprime Mortgage Meltdown', (2008) 93 *Minnesota Law Review* 373, 379-80.

⁸⁰⁷ Matthew Rabin, 'Inference by Believers in the Law of Small Numbers', (2002) 117 *Quarterly Journal of Economics* 775, 776, 785-87; Anabtawi and Schwarcz (n 22) 1366-1367.

⁸⁰⁸ Goodhart and Lastra (n 72).

bank. Thereafter, his reduced shareholding would still allow him to profit while simultaneously enjoying the reduced liability associated with an outsider.

These shortfalls do not have an easy fix. However, what the Professors correctly identify, is that the fundamental solution lies in diluting limited liability. In the next section I will outline my proposal for how the two-tier system of liability can be adjusted in a way that achieves the objective of disincentivizing risk taking, as well as encouraging whistleblowing on dangerous investment strategies being followed by an NBFC. While the third issue is a standalone problem, it is no less pressing and will also be dealt with.

IV. A THREE-TIER APPROACH TO LIABILITY

From the discussion above, we have identified three lacunae that have to be addressed in case of any attempt to change the liability regime: a) The classification of individuals within the two-tier model which may lead to overreach; b) The problem of conscientious objectors within management who may be left vulnerable if they choose to blow the whistle or be saddled with multiple liability if they decide not to; and c) Identifying and holding liable the shareholders/managers who exit the bank prior to its collapse in order to escape liability. Subsection A will attempt to address the (a) and (b) cumulatively, while B will tackle (c) separately. Drawing from the Professors' implicit assumption, we assume that the upper management and directors are also partial shareholders in the company.

A. The role of Secondary Management and the Intermediate Tier

To begin with, the two-tier model creates a black and white picture of a bank's corporate hierarchy and functioning and often misses out on the nuances that have been highlighted above. To prevent this, the dilution of limited liability should be more structured by distinguishing between levels of management on the basis of factors that have already been alluded to.⁸⁰⁹ Particularly, what I suggest is that we abandon the binary distinction of "insider" and "outsider" and add an extra layer of intermediary liability in between the senior-most executives/shareholders who are involved in the running of the firm, and the ordinary shareholders who are not involved at all, and who are subject to limited liability. In this intermediary layer, we will include the secondary managers alluded to above. In this manner, proportionate liability will be allotted to each level: triple liability to senior-most managers and directors, double liability to secondary managers and limited liability for ordinary shareholders.

The Professors, in passing, recognize the possibility of including double liability but do not elaborate on the exact category of individuals who would fall under this. The specific situation faced by secondary managers, as elaborated on above, has largely been overlooked. Schwarcz puts this down to the fact that, as secondary managers are subject to control by the top management anyway, there is little utility in looking into the effects of their actions.⁸¹⁰ However, secondary managers such as analysts play a significant role in structuring the securities sold by shadow banks. The CDO or the mortgage bonds with multiple subprime

⁸⁰⁹ See Lucian A. Bebchuk et al., 'The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000-2008', (2010) 27 *Yale Journal of Regulation*. 257, 263-64 (discussing the compensation of bank executives).

⁸¹⁰ H.D. Vinod, 'Conflict of Interest Economics and Investment Analyst Biases', 70 (2004) *Brooklyn Law Review* 53, 69, 72.

mortgages were the securities which facilitated the 2008 collapse. Regardless of the highly technical nature of their job, due to the buffer zone they occupy in between the senior management and the rest of the shareholders, their peculiar position requires greater scrutiny in order to make clear why they should occupy the middle rung in a triple-tiered liability structure.

The nature of their work makes them important for the three-tier liability model being proposed here. Unlike non-participative shareholders, due to their daily activities and conversations with the top brass, secondary managers are updated on the policy of the bank and the potential dangers associated with it. In some cases, even more so than senior managers, considering they are the ones who actually know the viability of the securities they are buying and selling. In India's case, this may not be that great a concern, considering the small bond market (even though it is likely to continue growing).⁸¹¹ Regardless of whether the commodity in question is a highly complex financial instrument, the position held by secondary managers in the process of financial transactions and their participation in meetings gives them an insight into the company's direction.⁸¹²

This anomalous position of secondary managers may be utilized to prevent bank failure. Recall earlier, where the difficulty in recognizing that a bank is heading toward a default was mentioned. Thus, what is necessary is to incentivize this class of managers to be vigilant and raise red flags regarding the potential effects of the company's business model. Thus, they must be subjected to a higher level of liability than ordinary shareholders as it would greatly increase their incentive to be cautious. It would also reduce the burden on outside shareholders to conduct due diligence when most of them may not have the resources nor the expertise to do so.⁸¹³

Such managers would be subject to multiple liability under the Professors' model of two-tiered liability. As identified above, this would be a problem as they often lack policy-making ability, which is the primary determinant of whether a bank fails. Thus, they are "insiders" within the two-tier model, but do not have the ability to prevent banks from taking dangerous policies. Therefore, recognition of this unique situation would require that they not be subject to multiple liability. Instead, double liability would be a better approach. This appropriately recognizes the level of actual power that they hold.

I suggest double liability for secondary management serves another purpose. Double liability can motivate secondary managers, who are sceptical of the financial soundness of the intermediation strategy followed by the company, to try and intervene in the policy formulation. If they are unsuccessful, their only remaining avenue would be to blow the whistle to regulators regarding the bank's policies. As previously noted, the Professors had suggested whistleblowing as a way of avoiding liability, however, the important drawback in their model

⁸¹¹ Karan Bhasin, 'India's corp bond market is finally drawing interest' *Livemint*(19 Aug 2020) <https://www.livemint.com/mutual-fund/mf-news/india-s-corp-bond-market-is-finally-drawing-interest-11597853629092.html> accessed on 4 October 2020.

⁸¹² Dyck, Morse and Zingales (n 83).

⁸¹³ Steven L. Schwarcz & Lucy Chang, 'The Custom-to-Failure Cycle', (2012) 62 *Duke Law Journal* 767, 789; Schwarcz II (n 50) 207.

was the unlimited liability that individuals would be exposed to in case they were unable to do so. In the three-tier model, they could potentially avoid a comparatively lower double liability standard imposed on them by the company defaulting.

However, in an Indian context, the protections for whistle-blowers and the mechanism for addressing their concerns are weak.⁸¹⁴ Two whistle-blowers from IL&FS had attempted to alert management to the goings on at the company but were turned away.⁸¹⁵ Furthermore, whistle-blowers often face punishment⁸¹⁶, and threats in terms of their careers and even their lives, for attempting to raise their voices.

Therefore, to get the most out of this opportunity, a revamping of India's whistleblower laws is necessary.⁸¹⁷

One could argue that this distinction is unnecessary as the highest level of liability (triple liability in our model) would go the greatest extent toward encouraging secondary managers to raise red flags. However, this would run into the same issue as with CGB and Depression era banks i.e. people being disproportionately punished in case of bankruptcy. The history of banking and the consequences of companies failing has shown that the perception of unfairness is a powerful determinant for which policies are acceptable and which are not.⁸¹⁸ Moreover, we would be underestimating the dangers that accompany raising concerns internally regarding bank investment policies, as discussed briefly already.

To summarize, the basic idea put forward by the Professors is the correct approach. The targeted dilution of limited liability is necessary, but it is only effective if it is flexible and recognizes the difference between groups of shareholders and managers. The three principles do so to a certain extent. However, it is submitted that the intermediate layer of liability that has been proposed here goes further toward recognizing that complexity. This three-layered liability regime should ideally be divided into escalating levels with only the ordinary shareholders who are outside the functioning of the company having limited liability. While it is true that limited liability was meant to incentivize economic growth, it is only natural that alterations to this must be made over time in order to prevent the externalities that have, regrettably, arisen over time.

⁸¹⁴ The Whistleblowers Protection Act, 2014 applies only to public servants and is inadequate for dealing with corporate fraud; Section 177(9), Companies Act, 2013 r/w The Companies (Meetings of Board and its Powers) Rules, 2014 requires an audit committee to investigate complaints from whistleblowers. However, there is no external protection for whistleblowers outside of the internal audit committee.

⁸¹⁵ PTI, 'IL&FS fraud: Whistleblower sought to uncover it in 2017, but top-brass covered it up' *The Hindu* (9 June 2019) <https://www.thehindu.com/business/ilfs-fraud-whistleblower-sought-to-uncover-it-in-2017-but-top-brass-covered-it-up/article27703369.ece> accessed on 6 October 2020.

⁸¹⁶ The Companies (Meetings of Board and its Powers) Rules, 2014 allow companies to move against employees who make "frivolous complaints".

⁸¹⁷ For a comparative perspective see Sulette Lombard, 'Regulatory Policies and Practices to Optimize Corporate Whistleblowing: A Comparative Perspective' in Sulette Lombard, Vivienne Brand and Jane Austin (eds), *Corporate Whistleblowing Regulation: Theory, Practice and Design* (Springer Link 2020).

⁸¹⁸ Paddy Ireland, 'Limited liability, shareholder rights and the problem of corporate irresponsibility' (2008) 34(5) *Cambridge Journal of Economics* 837.

B. Opportunistic share transfers as a means of escaping liability: Lessons from the United States

Having laid out the three-tiered liability regime and discussed the issues pertaining to whistleblowers, we can now address the remaining issue of opportunistic transfer of shares to consolidate the three-tier model. This problem was not adequately tackled by the Professors. However, as Macey & Miller have comprehensively demonstrated, this is not a novel concern. Throughout the history of double liability in the United States, the issue of transfer of shares prior to insolvency, whether opportunistic or otherwise, and complications arising out of such deals, was often faced by courts. Thus, the question of identifying the person who would be liable to pay has an extensive jurisprudence which domestic courts in India may readily draw from.

The jurisprudence on this point is extensive and will not be reproduced entirely here. However, of importance was the way the US Courts tackled the issue of bank holding companies, which would be relevant in an Indian context given that several of the largest NBFCs are subsidiaries of larger holding companies and form part of a group.⁸¹⁹ The Courts took a significant step in finding the shareholders of the holding company itself liable, rather than the company, even though it was the latter which was recorded as the shareholder on the subsidiary banks' books.⁸²⁰ Even dissolution of the holding company would not offer any reprieve for the shareholders who would be traced and held personally liable for the debts of their former subsidiary.⁸²¹

The issue that will likely be the most common, is the opportunistic transfers of shares, as already identified by Professors Goodhart & Lastra, and alluded to above. Macey & Muller demonstrate the Courts' deft handling of multiple scenarios. The broad rule, which was highly effective in ensuring that creditors received as much of their money back as possible, was that any transfer made to a person who could not fulfil the liability obligation, would be "void as to the creditors." This meant that creditors would receive their money back from solvent shareholders who had transferred their shares prior to insolvency to individuals who did not have the financial capacity to pay.⁸²² However, in order to bring some balance to this rule, it was also held that if the transfer was "final and without recourse", the transferor would be liable for only the debts accumulated prior to the transfer.⁸²³

In case the transfer was made before any significant troubles were experienced by the bank, the determining factor was whether the transfer was effected for the purpose of avoiding future liability. This would be gleaned from surrounding circumstances and also looking at the nature

⁸¹⁹ Group structure of Bajaj Finserv and its subsidiaries, accessible at: <https://www.bajajfinserv.in/group-structure>; Group Structure of Mahindra Finance, accessible at: <https://mahindrafinance.com/discover-mahindra-finance/subsidiaries>; A survey of the Top 10 NBFCs showed that all of them were subsidiaries of a holding company and themselves had multiple subsidiaries dealing with different areas of finance.

⁸²⁰ *Anderson v. Abbott*, 321 US 349 (1944); *Fors v. Farrell*, 260 NW 886 (Mich. 1935).

⁸²¹ *Benton v. American Nat'l Bank*, 276 F 386 (5th Cir 1921).

⁸²² *McDonald v. Dewey*, 202 US 510, 520 (1906); *Stuart v. Hayden*, 169 US 1, 8 (1898); *Pauly v. State Loan & Trust Co.*, 165 US 606, 619 (1897); *Richmond v. Irons*, 121 US 27, 58 (1887); *Bowden v. Johnson*, 107 US 251, 261 (1882).

⁸²³ *McDonald v. Dewey*, 202 US 510.

of the transferee and whether the underlying intention of the agreement was to treat the transferee as a nominee of the transferor.⁸²⁴ In dealing with this issue, an alternative solution would be for legislative rules to specify a cut-off date beyond which transfers are deemed to be for the purpose of avoiding liability.⁸²⁵ This would be for the purpose of avoiding judicial discretion over the issue and laying down a definitive rule, if that is deemed a better method.

What this series of cases shows is that practical issues are bound to arise following a dilution of limited liability. However, this should not act as a deterrent, especially when there are past cases to fall back upon and from which to take guidance. The ancillary problems in applying the three-tier standard of liability will require a combination of legislative and judicial intervention. I do not contend that the two areas highlighted above are the only potential complications and, undoubtedly, further scholarship on this will be required. This is merely an attempt to pave the way forward by addressing some foreseeable hurdles in giving the layered model of liability its full effect. Taken together, these legal adjustments can assist in preventing banking failures, as well as in fairly allocating responsibility for those that are unavoidable.

C. Can the Three-tier Model apply to other Companies?

A question that may arise is whether the proposal outlined above can be extrapolated to companies of all kinds. Corporate insolvency is certainly not restricted merely to shadow banks and occurs across sectors, with several notable examples in the recent past. The Professors and Ireland certainly believe that their own critiques of, and alternatives for, limited liability may be extended to all companies eventually.⁸²⁶ Simultaneously, the Professors note that it is inadvisable to make this extension in the short-term as further study is required on specific practical concerns in different sectors. To that effect, they identify shadow banks as urgently in need of regulation. On the contrary, Schwarcz believes that shadow banks are special in ways that make dilution of limited liability an exclusive requirement for them. Thus, there is no need to extend this to other corporations.⁸²⁷

Regardless of the disagreement, all agree that shadow banks have exceptional regulatory requirements. Their approach of prioritizing a dilution of limited liability for shadow banks has historical support. In line with the experience in colonial India, 19th century lawmakers in the UK and US specifically desired that banks mandatorily have unlimited liability, even while limited liability was made an option for all other forms of companies.⁸²⁸ Many of these reasons reflect modern concerns regarding limited liability for banks. Primary among these issues was the difficulty for creditors and small shareholders to accurately track the financial health of the bank they invested in. As the bank's own investment portfolio can be very diverse and constant monitoring of the status of these loans is difficult, legislators believed there was an exceptional

⁸²⁴ *Davis v. Stevens*, 7 F Cas. 177, 178 (SDNY 1879).

⁸²⁵ For example, the US introduced 38 Stat 273 (1913) for the purpose of preventing "dishonest or cowardly" shareholders from transferring their shares within 60 days of a bank's default to "some dummy" to avoid double liability. Changes in the Banking and Currency System of the United States, HR Rep No 69, 63d Cong, 1st Sess 72 (1913). This could potentially be adapted to include a certain number of days prior to default as well.

⁸²⁶ Goodhart and Lastra (n 72) 23; Ireland (n 107) 837, 845-847.

⁸²⁷ Schwarcz (n 41) 19-22.

⁸²⁸ Matthew Willison, 'Were Banks Special? Contrasting Viewpoints in Mid-Nineteenth Century Britain' Paper No 755 (2018) Bank of England Staff; Ireland (n 107).

risk associated with banks.⁸²⁹ As already outlined above, this is a prominent issue for shareholders in both the two and three-tier models, reflecting the same fears that existed 150 years ago.

A second issue is the position of banks in the economy. As Schwarcz has also outlined in the modern era, shadow banks act as the middle point between multiple sectors and projects. The interwoven network of loans makes any banking failure much more likely to cause contagion across the economy.⁸³⁰ Additionally, as has been elaborated on extensively above, the investment strategy of an NBFC such as IL&FS increases the actual possibility of a failure. Thus, the higher possibility of such entities actually failing and the consequent possibility of causing systemic harm has led to all these scholars agreeing on an immediate need to regulate them.⁸³¹

Beyond this point, I agree with the Professors' principled position that a solution should be conceived for other corporations as well. However, this does not necessarily mean that it must be a targeted dilution of limited liability, as has been proposed for shadow banks. Ireland notes that it is worth exploring alternative options which principally look to detach governance rights from shareholding⁸³², which is an intriguing and far-reaching recommendation in and of itself. Economists have weighed in with proposals outlining different remuneration structures for Directors and senior management.⁸³³ The entire ambit of these different solutions for companies in other sectors of the economy cannot be detailed here and requires a separate and thorough discussion. What is agreed upon by lawyers, academics and economists, is that the specific structure and position of shadow banks means a dilution of limited liability is a practical solution for an urgent problem.

D. Implementing the Three-tier Model

One further point of interest may be the manner in which the IBC would interact with this altered model of liability. Considering the statute was brought about to prevent winding up of companies in public interest, the question may arise as to when enforcement of multiple or double liability against management would actually take place. However, this is predicated on the assumption that the liability only comes into effect at the time of insolvency and closure. The Professors consider their model to be applicable even on the occurrence of an actual loss

⁸²⁹ Ibid.

⁸³⁰ Schwarcz (n 41) 19-22, 25.

⁸³¹ Schwarcz (n 41) 19-22; Goodhart & Lastra (n 72).

⁸³² Ireland (n 107) 837, 856

⁸³³ Thomas Huertas, 'Pay to Play' (17 February 2019), available at SSRN: <<https://ssrn.com/abstract=3336186>> (revised May 2019, now entitled 'Rebalance bankers' bonuses: use write-down bonds to satisfy both supervisors and shareholders'); CW Calomiris and RJ Herring, 'How to Design a Contingent Convertible Debt Requirement that Helps Solve Our Too-Big-to-Fail Problem' (2013) 25(2) *Journal of Applied Corporate Finance* 39; Patrick, Hamid and Joel D., 'Executive Compensation and Risktaking' (2015) 19 *Review of Finance* 2139.

and not merely when the bank has failed entirely.⁸³⁴ Economists have provided multiple ways in which this may be effectuated.⁸³⁵

Another way of looking at the question of applying such unlimited liability would be to make adjustments to the Insolvency and Bankruptcy Code itself. The process of revival of the bank could take into account the assets of the 1st and 2nd tier. Considering that multiple and double liability applies to them respectively, that proportion of value in terms of their personal wealth/assets may be included in the Resolution Plan for repayment of loans to different creditors. Board members of both IL&FS and Yes Bank have been subjected to criminal liability and the addition in this case would be to also make them liable for repayment of the debts of the bank.

Both of these usages of this altered model of liability can exist simultaneously and it may be unnecessary to restrict it to merely one or the other. However, for the present purposes, a thorough examination of how these two scenarios may play out may require greater elaboration than can be included within this paper. However, the ideal scenario should be to include both these usages in order to take full advantage of this alteration in liability.

V. CIVIL OR CRIMINAL LIABILITY FOR SENIOR MANAGEMENT

As mentioned, our discussions above address the senior and secondary managers who are also shareholders, to whatever extent, in the company. While this may be the case for small to medium sized NBFCs this is not always be true for the largest ones, whether private, public or listed. Given this, a further method of controlling the excesses associated with shadow banks is imposition of sanctions, both civil and criminal. However, recent track record on utilizing these legal tools has been underwhelming.⁸³⁶ Even in the US, the aftermath of the subprime mortgage crisis saw only a single arrest of a banker, Kareem Serageldin.⁸³⁷ Even in that case, he was far from being part of the senior management and would have fallen within the “secondary management” bracket.⁸³⁸ The disappointment and outrage of the public in seeing the vast majority of top managers/shareholders get away with nothing more than fines/penalties, and in some cases not even that, was palpable.⁸³⁹

⁸³⁴ Goodhart & Lastra (n 72) 15.

⁸³⁵ P Sinclair, ‘Advantages and Drawbacks of Bonus Payments in the Financial Sector’ in G Caprio, P Bacchetta, J Barth, T Hoshi, P Lane, D Mayes, A Mian and M Taylor (eds), *The Handbook of Safeguarding Global Financial Stability* (Academic Press 2012) 259; John Thanassoulis and Misa Tanaka, ‘Optimal pay regulation for too-big-to-fail banks’ (2018) 33(c) *Journal of Financial Intermediation* 83; Goodhart & Lastra (n 72) 16-17.

⁸³⁶ In India, cases against directors or management personnel in the aftermath of banking collapses have been primarily criminal charges, brought against a very small group of individuals within the company.

⁸³⁷ Peter J. Boyer, ‘Why Can't Obama Bring Wall Street to Justice?; Maybe the Banks Are Too Big to Jail. Or Maybe Washington's Revolving Door Is at Work’ *Newsweek*, (14 May 2012) available at <https://www.newsweek.com/why-cant-obama-bring-wall-street-justice-65009> accessed 4 October 2020; Marian Wang, ‘Why No Financial Crisis Prosecutions? Ex-Justice Official Says It's Just Too Hard’, *Propublica* (6 Dec, 2011) <https://www.propublica.org/article/why-no-financial-crisis-prosecutions-official-says-its-just-too-hard> accessed 4 October 2020.

⁸³⁸ Jesse Eisinger, ‘Why only one Top Banker went to Jail for the Financial Crisis’ *New York Times* (4 May 2014) <https://www.nytimes.com/2014/05/04/magazine/only-one-top-banker-jail-financial-crisis.html> accessed on 10 October, 2020.

⁸³⁹ Ben Hallman, ‘Too Big to Jail: Wall Street Executives Unlikely to Face Criminal Charges, Source Says’ *Huffington Post* (8 Sept 2012) <https://www.huffingtonpost.in/entry/criminal-charges-wall-street_n_1857926?ri18n=true> accessed 5 October 2020.

In comparison, the Serious Fraud Investigation Office (“SFIO”) has investigated IL&FS aggressively, even though the focus has only been on a small group of individuals in the company. Regardless, two arrests of senior management⁸⁴⁰ were made and criminal proceedings against them are ongoing. Despite this, the absence of a clear legal framework for dealing with group liability in India which holds directors personally liable is a cause for concern. Part IV of this paper will look at the state of the law regulating liability for directors/managers in India and in other jurisdictions, with emphasis on the United States. In doing so, it will dip into the debate on whether civil or criminal sanctions are most appropriate for addressing corporate misconduct and how the shadow banking sector’s peculiarities affect the outcome of the discussion. It will suggest that, instead of focusing on each individual’s actions, the law of civil liability should instead look at the group of senior management as a whole where the manner in which a bank functioned or collective negligence regarding the effects of the bank’s policies made it more likely to default.

A. Limitations of civil law sanctions

Civil charges can be brought under Section 447 of the Companies Act.⁸⁴¹ While it has been used intermittently since its inception, it has recently been used to pursue charges of fraud in the aftermath of the Bhushan Steel insolvency.⁸⁴² However, the charges in those cases are criminal in nature. The drawback of these standalone provisions is that there is no mechanism for holding entire groups liable.

There may be a misconception that Indian law allows for the group of Directors to be liable. This is an erroneous assumption. The actual difference between group and individual liability has been elaborated upon in American jurisprudence. Group liability connotes liability that is determined at the group level where individual behaviour is irrelevant.⁸⁴³ This is used in cases where Duty of Care and other fiduciary duties have been breached. This is no-fault liability for the entire board for a particular failure.⁸⁴⁴ The reason for this is that determination of which particular director is liable in cases of negligence/failure of due care, is difficult.⁸⁴⁵ Thus, when the company suffers due to such negligence, such as when a bank fails due to dangerous policies, the entire Board is liable. Importantly, this is regardless of whether they were directly involved in the decision, or whether they were in charge of implementing that policy.⁸⁴⁶

⁸⁴⁰ Rashmi Rajput, ‘How an IL&FS arm systematically kept lenders in the dark’, *The Economic Times* (4 June 2019) <https://economictimes.indiatimes.com/industry/banking/finance/sfio-alleges-ilfss-subsiary-forged-documents-for-loans/articleshow/69642211.cms> accessed on 26 September, 2020; Rashmi Rajput, ‘ED arrests two former IL&FS executives in PMLA probe’ *The Economic Times* (19 June 2019) (<https://economictimes.indiatimes.com/news/politics-and-nation/two-directors-of-ilfs-arrested-by-mumbai-ed-reports/articleshow/69863036.cms?from=mdr> accessed on 26 September, 2020 (Rajput ED)).

⁸⁴¹ Section 447, Companies Act, 2013.

⁸⁴² For notable exceptions, see: *Serious Fraud Investigation Office v. Neeraj Singhal* (2019) 11 SCC 446, *Serious Fraud Investigation Office v. Nittin Johari* (2019) 9 SCC 165.

⁸⁴³ Darian M. Ibrahim, ‘Individual or Collective Liability for Corporate Directors?’ (2008) *William & Mary Law School* 1689, 1700-1705.

⁸⁴⁴ *Smith v Van Gorkom* 488 A2d 858 (Del 1985).

⁸⁴⁵ *Ibrahim* (n 149).

⁸⁴⁶ *Smith v Van Gorkom* (n 150).

Individual liability for different directors, is for cases of disloyalty or fraud where each director's actions are evaluated.

Fiduciary duties under the Companies Act are provided under Section 166. However, there is no parallel case law in India which applies the group liability principle in the same way as American courts have done. Additionally, Section 166 defines fiduciary duties for each director individually and does not explicitly talk about the Board's liability as a group.⁸⁴⁷ Case law does not provide any further assistance on this matter.

Picking individual directors or managers from companies for liability does not address the issue. Directors state that the Managing Director or other specific Directors had greater knowledge than them, and should be the ones held responsible. The claim that decisions were made by the group of Directors can be circumvented by claiming that accurate information was not provided. Moreover, the question of whether a particular policy is the best for the company is not an objective fact. It is a subjective evaluation. Therefore, without having no-fault liability, Directors have several ways to avoid responsibility. .

The IL&FS board was criticized for failing to step in when the actions of senior management began showing signs of hurting the company.⁸⁴⁸ Negligence-based liability for directors is provided under the Companies Act, no attempt has been made to enforce it against them thus far.⁸⁴⁹ Holding them liable would not be a problem if no-fault group liability was possible. As it stands, only specific Directors have been charged with criminal sanctions while the rest of the Board have not been impugned. Further, offences under Section 166 are compoundable, thus making it possible for any individual director to merely plead guilty and pay a fine.

Similar issues exist with the doctrine of piercing the corporate veil. While fraud is one of the grounds which may allow for the doctrine to be utilized for imposing personal liability on a director⁸⁵⁰, the process of enforcing it through courts is tedious enough that, once a default takes place, it becomes essentially redundant to subsequently go through the process. Looking into all the facts behind the functioning of a company is difficult. This is especially so considering the complexity in shadow bank functioning, as already explained.⁸⁵¹ Further, it would only impugn specific directors, which one again fails to address the issue highlighted above. Further, the complexity of NBFCs functioning and difficulty in ascertaining crucial facts in the aftermath of fraud in such large corporations, reduces the doctrine's utility. Narrow exceptions, such as violations under the Prevention of Money Laundering Act, allowed the SFIO and Enforcement Directorate to proceed directly against the IL&FS management.⁸⁵²

⁸⁴⁷ Companies Act, 2013, Section 166.

⁸⁴⁸ Hazari (n 43).

⁸⁴⁹ Section 2(60), Section 166(3), Companies Act, 2013.

⁸⁵⁰ Estate Officer v. Esys Information (2016) 12 SCC 582; S. Sukumar v. Institute of Chartered Accountants of India (2018) 14 SCC 360.

⁸⁵¹ Mohsen Manesh, 'The Case Against Fiduciary Entity Veil Piercing', (2017) 72(1) The Business Lawyer 61, 63-67; Colin P. Marks, 'Piercing the Fiduciary Veil' (2015) 19(1) Lewis & Clark Law Review, 73

⁸⁵²Rajput ED (n 129).

In adjudging whether civil liability is an adequate approach to the issue of fraud or other violations by directors, most proponents believe that criminal penalties are too harsh.⁸⁵³ Considering their crimes are primarily in the realm of financial theft, a corresponding financial punishment or penalty would be the proportionate response.⁸⁵⁴ In India, the practice of reaching settlements with violators, especially for regulatory violations in listed companies, is common and often precludes further investigation into the matter by SEBI.⁸⁵⁵ Further, the business judgment rule⁸⁵⁶, though not popular in India, protects managers from liability as it provides a significant degree of leeway in the functioning of a company.⁸⁵⁷ Unlike in criminal suits where the rule does not apply, civil suits are often dismissed on these grounds in jurisdictions where the rule has seen more substantive litigation.⁸⁵⁸ Even apart from this, the aforementioned issues pertaining to difficulty in going through complex internal functioning at a financial institution and pinpointing liability, often eventually leads to settlement. Again, in criminal proceedings, settlement would not be an option.

Further, the legal process of proving civil claims, despite having a lower evidentiary standard than criminal law, remains difficult. Essentially, such claims present a mere theoretical financial risk for an executive or director rather than a certain one.⁸⁵⁹ Directors have a large number of defences at their disposal, such as the Business Judgment Rule, proximate cause, lack of causation, remoteness of the specific harm, and so on. In this way risk of being held liable can be significantly diminished during adjudication through usage of the vast legal and financial resources that these individuals often have at their disposal. A director has every reason to be bullish about his chances in taking extreme risks in investment strategies as it is likely he/she will be able to profit enough that any penalty, if it is awarded at the end of day, will be a small chunk of their newly accumulated wealth. Importantly, this kind of ambitious behaviour cannot amount to fraud. Fraud requires intent, or *mens rea*, which is obviously missing in these instances. Rather, the breach in such cases is failure to exercise due care or negligence, in terms of the policies of the Shadow Bank. This would not be a problem in India if collective liability was recognized under the Companies Act.

⁸⁵³ Christine Hurt, 'The Undercivilization of Corporate Law', (2008) 33 *Journal of Corporate Law* 361, 364.

⁸⁵⁴ *ibid.*

⁸⁵⁵ For example, see: PTI, 'MFL shares case: SEBI settles insider trading matter, receives 15 lakh toward settlement charges', *Moneycontrol* (26 June 2020) <https://www.moneycontrol.com/news/business/mfl-shares-case-sebi-settles-insider-trading-matter-receives-rs-15-lakh-towards-settlement-charges-5465171.html> accessed on 3 October 2020; PTI, 'Four individual settle insider trading case with SEBI' *The Economic Times* (26 June 2020) <https://economictimes.indiatimes.com/markets/stocks/news/four-individuals-settle-insider-trading-case-with-sebi/articleshow/76645800.cms?from=mdr> accessed on 3 October 2020.

⁸⁵⁶ The Business Judgment Rule creates a presumption that the directors are motivated in their actions and decisions by the best interests of the corporation which they are managing. The Rule has used in several common law jurisdictions, but there is little discussion of it in India. See generally *Gimbel v. Signal Cos.*, 316 A2d 599, 608 (Del Ch 1974); *Dodge v. Ford Motor Co.*, 204 Mich 459, 170 NW 668 (1919).

⁸⁵⁷ Martin Petrin, 'Circumscribing The "Prosecutor's Ticket To Tag the Elite"—A Critique of the Responsible Corporate Officer Doctrine' (2012) 84 *Temple Law Review* 283, 303.

⁸⁵⁸ *ibid.*; *Cede & Co. v. Technicolor, Inc.* 634 A2d 345 (Del. 1994); *Aronson v. Lewis*, 473 A2d 805 (1984).

⁸⁵⁹ Jennifer G. Chawla, 'Criminal Accountability and Wall Street Executives: Why the Criminal Provisions of the Dodd-Frank Act Fall Short' (2014) *Law School Student Scholarship* 451; Lisa M. Fairfax, 'On the Sufficiency of Corporate Regulation As an Alternative to Corporate Criminal Liability', (2011) 41 *Stetson Law Review* 117, 118.

The general belief, echoed in the United States, is that civil charges may punish, but are unlikely to deter.⁸⁶⁰ The fact that the penalties or fines can be successfully mitigated through aggressive litigation and in many cases ends in a negotiated settlement with the regulatory authority rather than an outright guilty verdict, reduces the potential of being found guilty of some form of civil violation to a mere “cost of doing business”.⁸⁶¹ This reality is seen starkly in the periodic struggles that keep plaguing Wall Street every few years. Most prominently, any banker looking at the aftermath of the 2008 crisis would have been reassured that the chances of being imprisoned were essentially non-existent and the defences available to civil actions were robust. In the IL&FS scenario, it has been widely reported that the Board was negligent and several members of management and the board made vast sums of money through bonuses.⁸⁶² A similar story can be told for Yes Bank.⁸⁶³ Yet barely a handful of them have been pulled up for criminal fraud or other violations by SFIO or SEBI. The remainder have not, as of yet, suffered any sanction.

B. Criminal Sanctions: Effective but inapplicable

Criminal liability is thus of great importance in acting as an efficient deterrent to wrongdoing by management. While there is significant literature on the effects of incarceration and its potential deterrence value,⁸⁶⁴ the high standards of criminal law have largely negated its benefits. This is due to the difficulty in proving the necessary elements for a successful prosecution. The laws in India and other jurisdictions are mostly unsuited for the realities of corporate fraud in the context of shadow banks.⁸⁶⁵

The Indian Penal Code has provisions on fraud⁸⁶⁶; however, the high standards of proof required mean their utility is limited. Section 447 of the Companies Act can also be used for the same purpose, but similarly has a high standard of proof.⁸⁶⁷ The structure of Indian laws on this point make it necessary for there to be clear evidence of involvement by each individual director along with criminal intent before he/she can be brought to court as an accused

⁸⁶⁰ Lisa L. Casey, ‘Twenty-Eight Words: Enforcing Corporate Fiduciary Duties Through Criminal Prosecution of Honest Services Fraud’, (2010) 35 Delaware Journal of Corporate Law 1, 17.

⁸⁶¹ *ibid.*

⁸⁶² Subrata Panda, ‘Former IL&FS directors got lucrative paychecks even as firm collapsed’ *Business Standard* (21 Dec 2019) https://www.business-standard.com/article/companies/former-il-fs-directors-got-lucrative-paychecks-even-as-firm-collapsed-119122100018_1.html accessed on 10 October 2020.

⁸⁶³ Shrimi Choudhary, ‘YES Bank loan fraud: CBI charges Rana Kapoor with criminal conspiracy’ *Business Standard* (25 June 2020) https://www.business-standard.com/article/current-affairs/yes-bank-loan-fraud-cbi-charges-rana-kapoor-with-criminal-conspiracy-120062501509_1.html accessed on 16 October 2020.

⁸⁶⁴ Paul Robinson, ‘Strict Liability’s Criminogenic Effect’ (2018) 12 Criminal Law and Philosophy 412; Raymond Paternoster and Sally Simpson, ‘Sanction Threats and Appeals to Morality: Testing a Rational Choice Model for Corporate Crime’ (1996) 30 Law and Society Review 549 570-572.

⁸⁶⁵ For the position in different countries in Europe, see: Katalin Ligeti and Angelo, *Punitive Liability of Heads of Business in the EU: A Comparative Study* (Marletta Katalin Ligeti and Angelo Marletta eds, Wolters Kluwer 2019); Goodhart and Lastra (n 72).

⁸⁶⁶ Indian Penal Code, 1860, Sections 421-424.

⁸⁶⁷ Bharat Vasani, Molla Hasan and Esha Himadri, ‘Corporate Frauds – Emerging Legal Architecture & Judicial Trends’ *India Corporate Law* (Oct 13 2020) <https://corporate.cyrilamarchandblogs.com/2020/10/corporate-frauds-emerging-legal-architecture-judicial-trends/> accessed on 10 January 2021.

individual.⁸⁶⁸ This high standard is almost impossible to meet in NBFCs for a number of reasons. The nature of shadow banking operations is such that the claim that defaults were not reasonably foreseeable is not a difficult argument to make. The chances of demonstrating criminal intent would be negligible as managers could merely claim that they acted to the best of their knowledge at the time and as per prevailing market wisdom. In a large and complex organization, this standard is very difficult to effectively implement.⁸⁶⁹

The only other alternative provided under Indian law to this standard is where the relevant statute allows vicarious liability. While the Companies Act under various provisions permits vicarious liability to be assigned to directors and other senior management individuals, this qualifies only for breach of provisions under the Act itself.⁸⁷⁰ The act of a shadow bank taking risks which could eventually endanger the firm and creditors, cannot prima facie factor under any of the provisions of the Companies Act. The SEBI Act also empowers the regulator to assign liability to those in charge of the company but once again restricts this to violations under its provisions and also permits a reasonable care and due diligence defence.⁸⁷¹

The high standards of criminal law have often meant that individuals are able to escape liability or take shelter behind the corporate form. One of the reasons for the aforementioned failure in the United States to prosecute more bankers for criminal wrongdoing was the unhappy experience of their first attempted prosecution of holding senior management in the aftermath of the 2008 financial crisis. The onerous standards led to the highly publicized acquittal of Bear Stearns executives in 2009, which mellowed the Securities and Exchange Commission's appetite for launching similar prosecutions.⁸⁷² It reached the point where a conscious decision⁸⁷³ was made to not pursue criminal charges against bankers where there was a modicum of doubt that there would be no conviction.⁸⁷⁴ Instead, there was a concerted

⁸⁶⁸ N.K. Wahi v. Shekhar Singh & Ors., (2007) 9 SCC 481; Sunil Bharti Mittal v. Central Bureau of Investigation, (2015) 4 SCC 609.

⁸⁶⁹ See generally for an idea of why bringing charges is difficult, Peter J. Henning, 'Dim Prospects for Financial Crisis Prosecutions', *New York Times – Dealbook Newsletter* (29 May, 2012) <https://dealbook.nytimes.com/2012/05/29/dim-prospects-for-financial-crisis-prosecutions/> accessed 7 October 2020; Peter J. Henning, 'How an Inquiry of Goldman Sachs might play out' *New York Times – Dealbook Newsletter* (23 May, 2011) <https://dealbook.nytimes.com/2011/05/23/how-an-inquiry-of-goldman-might-play-out/> accessed 7 October 2020.

⁸⁷⁰ For example see Companies Act, 2013, Section 128.

⁸⁷¹ Securities Exchange Board of India Act, 1992, Section 27.

⁸⁷² Press Release, Dept. of Justice, 'More Than 400 Defendants Charged for Roles in Mortgage Fraud Schemes as Part of Operation "Malicious Mortgage"' (19 June, 2008), <https://www.justice.gov/archive/opa/pr/2008/June/08-odag-551.html> accessed 4 October 2020; Grant McCool and Michael Erman, 'Ex-Bear Stearns Hedge Fund Managers Acquitted' *Reuters* (10 Nov, 2009). <<https://in.reuters.com/article/us-bearstearns-managers/ex-bear-stearns-hedge-fund-managers-acquitted-idUSTRE5A94RW20091110>> accessed 4 October 2020.

⁸⁷³ Reed Albergotti & Elizabeth Rappaport, 'U.S. Not Seeking Goldman Charges', *Wall Street Journal* (9 Aug 2012) <https://www.wsj.com/articles/SB10000872396390443537404577579840698144490> accessed 4 October 2020; Reuters Staff, 'Justice Department Will Not Prosecute Goldman Sachs, Employees for Abacus Deal', *Reuters* (9 Aug, 2012), <https://in.reuters.com/article/us-usa-goldman-no-charges/justice-department-will-not-prosecute-goldman-sachs-employees-for-abacus-deal-idUSBRE8781LA20120809> accessed 4 October 2020.

⁸⁷⁴ Government Accountability Institute, 'Justice Inaction: The Department of Justice's Unprecedented Failure to Prosecute Big Finance' (2012) at 16 (quoting Attorney General Eric Holder: "[W]e found that much of the conduct that led to the financial crisis was unethical and irresponsible . . . we have also discovered that some of this behavior—while morally reprehensible—may not necessarily be criminal") <https://ritholtz.com/2016/10/justice-inaction-department-justices-unprecedented-failure-prosecute-big-finance/> accessed 5 October 2020.

effort to focus primarily on getting civil remedies. Indeed, the Dodd-Frank Act was conspicuous in that it did not introduce any new provisions for applying criminal charges.⁸⁷⁵ It is clear that while criminal law has potential, most jurisdictions consider it a step too far to water down the usually stringent standards that must be met by prosecutors.⁸⁷⁶ The complexity of the corporate structure and the secrecy with which they often operate, SEBI disclosure requirements notwithstanding, make any prosecution a difficult one. In this scenario, the choice could simply be to consider whether the strategic decision made by the US Department of Justice to pursue Wall Street bankers for primarily civil claims, thus discarding criminal prosecutions, is the optimum approach.

This seems to present a Hobson's choice, given the drawbacks of purely civil charges, as already discussed. However, when compared to the difficulty of getting a criminal conviction, the approach of the DOJ to follow a purely civil tack makes grudging sense. Considering this, there are a number of adjustments to the law which can be made to bolster its effectiveness in administering justice, even if it is through purely monetary sanctions. This compromise may not possess the same deterrent effect that scholars have posited that criminal sanctions have but it will pave the way forward for a group-based approach to liability in civil liabilities.

VI. TOWARDS A MORE EFFECTIVE CIVIL REMEDY FOR CORPORATE MISBEHAVIOUR

A. Negligence vis-à-vis business strategy

The starting point for civil liability for corporate wrongs in shadow banking should be a focus on a negligence standard.⁸⁷⁷ This is especially the case considering that most individuals involved in shadow banking often do not foresee the harm their actions may have due to excessive optimism or confidence in their investment strategies.⁸⁷⁸ Simply being carried away by large profits during certain periods is also a common fallacy among bankers. Therefore, the appropriate legal way to capture the potential detriments of such behaviour is through focusing on negligence and an emphasis on how ordinary, prudent individuals would have tempered their activities after a certain point or examined the potential consequences of their transactions more thoroughly. Armour & Gordon validly note that this will require a dilution of the business judgment rule, where the level of deference to business decisions and strategies is high.⁸⁷⁹

In the United States, a duty of care has been recognized as a responsibility for the board of directors.⁸⁸⁰ Despite group liability being recognized, the standard of due care itself has been diluted. Now, Directors are required to only exercise due diligence and ensure that no laws were being broken. In *In Re: Citigroup* in the aftermath of the Wall Street crash of 2008, the Delaware court determined that the responsibilities did not encompass investigating the

⁸⁷⁵ Chawla (n 148) 27.

⁸⁷⁶ All surveyed jurisdictions, including the UK, European countries, the US and Australia, possess a mens rea/intent requirement for criminal liability.

⁸⁷⁷ John Armour and Jeffrey N Gordon, 'Systemic Harms and Shareholder Value' (2014) 6 *Journal of Legal Analysis* 35, 64, 66.

⁸⁷⁸ Anabtawi and Schwarcz (n 22) 1366-1367; Rabin (n 86).

⁸⁷⁹ Armour and Gordon (n 166).

⁸⁸⁰ *In re Caremark Int'l Derivative Litig.*, 698 A2d 959 (Del Cg 1996).

business strategies of their companies and any negligence in pre-empting such potentially deleterious policies would not be impugned.⁸⁸¹ This standard is both acknowledged but also narrowed down by subsequent decisions which acknowledged a “duty of care” but confined violations of it instances where the Board “consciously failed” or “utterly failed”.⁸⁸² While the actions of the Board in IL&FS’s case may actually fulfil that standard, overall it is unsuitable as it only looks for the most egregious and obvious failures, which are rare and, in any event, can be explained away during adjudication.

Thus, there are two requirements for the negligence based standard of liability to be effective: a) It must include the requirement for managers and directors to be mindful of the business strategy of an NBFC and not merely the formal requirement of preventing violations of laws. In this respect, the relative lack of usage of the business judgment rule in India is a blessing in disguise and removes a potential mitigating factor; b) As is the case with insider trading laws in India, the standard for violation must on be a “preponderance of probabilities”.⁸⁸³ While this will increase monitoring on the part of the management and board, the second important alteration that must be encouraged is the shift away from looking at actions of each individual Director. The evaluation of fault should instead prioritize looking at the way the bank functioned in order to find systemic faults. This second component of the civil liability standard will be the focus of the next section.

B. Collective over individual liability

By emphasising collective liability, the focus must be not on individuals but the corporate system. The emphasis on the systemic functioning of a bank is complementary with the negligence-based approach. When a bank suffers a default, it is not due to a single individual but rather, a systemic failure that takes place where multiple people either participate or become passive enablers. Inbuilt checks and balances fail to pick up on the danger which eventually results in the bank’s collapse. Assigning individual blame for such events risks missing the forest for the trees. Thus, there needs to be a legal doctrine developed which can capture mass negligence on the part of senior management and the board of directors, as these are the groups who are best placed, usually, to prevent such collapses.

Some countries in Europe have already taken steps toward capturing exactly such excesses committed by senior management within corporations. The UK’s Corporate Manslaughter Act as well as the notion of “Senior Management Mens Rea”⁸⁸⁴ focus on the specific way in which a company functioned rather than on individual acts of people within the company. It should be noted that these are clearly linked to criminal law and are meant to assign criminal liability to the company.

⁸⁸¹ *In re Citigroup Inc. Shareholder Derivative Litig.*, 964 A2d 106 (Del Ch 2009).

⁸⁸² *Stone v. Ritter*, 911 A2d 362, 370 (Del Sup 2006).

⁸⁸³ *VK Kaul v. Adjudicating Officer* (2013) Comp LJ 583 (SAT); for cases where the different burden of proof for criminal and civil cases has been detailed, see *Mousam Singha Roy v. State of West Bengal* (2003) 12 SCC 377; *The Chairman, SEBi v. Shriram Mutual Fund* AIR 2006 SC 2287.

⁸⁸⁴ George R. Skupski, ‘The Senior Management Mens Rea: Another Stab at a Workable Integration of Organizational Culpability into Corporate Criminal Liability’, (2011) 62 Case Western Reserve Law Review 263.

However, Price's critique of the Corporate Manslaughter Act and suggestion that the focus be on the senior management as a group rather than on individuals lends to some interesting possibilities.⁸⁸⁵ Most importantly, he focuses on the role of the corporation, for our purposes an NBFC, as an employer which sets the normative bounds of behaviour.⁸⁸⁶ A bank which encourages bad behaviour either outrightly or by repeatedly covering it up is one which makes it far more likely that insolvency will eventually take place. The decision to allow for, or even promote such behaviour is a top-down one i.e. it comes from upper management. The final decision on imposing a specific corporate structure and culture makes the group of senior management a collective that is responsible for whatever the ensuing consequences may be.⁸⁸⁷

There are a number of justifications for this: a) The recognition, as discussed earlier, that large scale failures such as those which lead to manslaughter, while in the course of company activities, usually results from systemic rather than individual failure; b) To prevent upper management shirking responsibility by blaming the secondary management or ordinary employees for specific failures. This is relevant for shadow banks as the upper management aren't usually the ones who directly undertake in securities trading. Thus, they could defend themselves by claiming they were not the ones designing the securities or directly negotiating the trade; c) No single manager or board member may be culpable enough to impose significant liability at all (an outcome that was common for Wall Street bankers after 2008).

While statutes such as the Manslaughter Act deal with corporate criminal liability for the company itself, the basic essence of Price's suggestion for how liability should be seen can be used for personal liability of a civil nature for the senior management and directors of banks. The collective of the senior management would be evaluated on the touchstone of negligence in failing to adequately monitor their risky investment strategies which could lead to ruination for the company. Those knowingly participating in it can be cleaved out of the herd for outright fraud.⁸⁸⁸ During trial, those who conscientiously objected to this policy may demonstrate this in order to avoid culpability. Finally, one additional complication may be the exact boundaries or contours of senior management. Section 128(6) could be used as a proxy for this purpose as well, however, it is preferable to avoid such proxies. A regime of designation and certification of all Senior Management personnel like in the UK is the preferable solution.⁸⁸⁹

The proposal above seeks to find a middle ground between the efficacy and applicability of civil and criminal penalties. Considering, the idea of reducing the standard of criminal law

⁸⁸⁵ Luke Price, 'Finding Fault in Organisations – Reconceptualising the Role of Senior Managers in Corporate Manslaughter' (2015) 35(3) *Journal of Legal Studies* 385.

⁸⁸⁶ RH Coase, 'The Nature of the Firm' (1937) 4 *Economica* 386, 404.

⁸⁸⁷ CRP Pouncy, 'Re-evaluating corporate criminal responsibility: its all about power' (2011) 41 *Stetson Law Rev* 97, 110.

⁸⁸⁸ Prosecution for fraud and money laundering are the only cases that have been brought against any director from either IL&FS or Yes Bank. As alluded to above, there appear to be no tory claims or claims regarding negligent management of the two companies that are pending.

⁸⁸⁹ Senior Managers and Certification Regime, Prudential Regulation Authority; for information generally on this Oonagh McDonald, 'Holding Senior Bankers to Account' in *Holding Bankers to Account* (Manchester University Press 2019).

for corporate wrongdoings has not yet taken hold in the vast majority of jurisdictions⁸⁹⁰ and its application throws up several concerns, the most that can be done is to improve and strengthen the regime of civil sanctions. Doing so by looking at the corporate structure and culture in order to implicate the entire class of top managers in NBFCs, and subjecting them to a negligence based standard which includes the business strategy of the company, would help bring the group to justice, as opposed to hunting for specific individuals.

VII. CONCLUSION

In recent years, shadow banks have been responsible for fulfilling much of the Indian commercial sector's credit needs following the reluctance of standard banks to shell out loans due to multiple non-performing assets. This has led to NBFCs becoming the foundation blocks of certain segments of the economy such as real estate, where developers had borrowed around Rs. 2 trillion from such banks by the time IL&FS failed.⁸⁹¹ In fact, this mode of funding is more common in India than it is in several other major economies.⁸⁹² Thus, ensuring the health of these entities will be vital for the post-COVID economic recovery, and beyond. Of note, is that the major failures of NBFCs were those in the construction sector.⁸⁹³ Thus, this particular segment of the economy will require Shadow Banks to be healthy in order to properly recover.⁸⁹⁴

The saving grace, in some ways, of the otherwise devastating IL&FS crisis, was that it was owned entirely by a number of large corporations in the public and private sector, and it did not accept public deposits. Had IL&FS stocks been traded on the floor of the NSE or BSE and if ordinary business owners and individuals had deposits, there may have been a far greater impact on the general public. Ultimately, that is primarily what mitigated the ripple effects of the 2018 crisis and separates it from the society wide impacts seen following the subprime mortgage failures of Wall Street.

The cyclical nature in which the financial system runs has been apparent for a long time. Indeed, toward the end of Margin Call, Jeremy Irons's character, John Tuld (a play-off of Lehman Brothers' ex-CEO "Richard Fuld"), recounts every financial bubble and bust since 1637 and remarks, "We just can't help ourselves." Whether we can or not is, to borrow from another fictional character in Olenka Tyrell, "A question for the philosophers". Our responsibility as lawyers and regulators, however, is to now be the first movers and do our best

⁸⁹⁰ For a notable exception of innovative usage of criminal law doctrines to prosecute bankers, see: Eyvindur G Gunnarsson and Stefan Mar Stefansson, 'Criminal Proceedings in the Wake of the Icelandic Banking Crisis' (2019) 21 European Business Organisation Law Review 415.

⁸⁹¹ Tadit Kundu, 'The big challenge of shadow banking in India' *LiveMint* (22 Oct 2018) <https://www.livemint.com/Industry/XbampFSLlmx1kmE51OihJ/ILFS-default-NBFCs-NPAs-shadow-banking-in-India.html> accessed on 14 December 2020.

⁸⁹² *ibid*; Credit Suisse (n 7).

⁸⁹³ Saloni Shukla and Saikat Das, 'NBFCs with exposure to housing & construction sector send SOS to RBI' *Economic Times* (April 17 2020) <https://economictimes.indiatimes.com/industry/banking/finance/banking/nbfc-with-exposure-to-housing-construction-send-sos-to-rbi/articleshow/75192066.cms?from=mdr> access on 12 January 2021.

⁸⁹⁴ Shailja K, 'Last-mile Funding by NBFC to Stressed Real Estate Industry', *Property Advisor* (July 22 2020) <https://propertyadviser.in/news/real-estate/last-mile-funding-by-nbfc-to-stressed-real-estate-industry-754> accessed on 12 January 2021.

to pre-empt the potential crises of tomorrow. Doing so will require fundamentally rethinking our position on liability for the individuals who runs shadow banks. The history of banking shows us that what we consider fundamental tenets of the law today was far from the norm less than a century ago. In that sense, we may have as much to learn from our past, as we do from our present.