

Fears of overlap misplaced

THE SECURITIES MARKETS Code (SMC), 2025, has generated considerable debate about its interface with the Insolvency and Bankruptcy Code (IBC), 2016. Concerns have been raised that SMC provisions on settlement finality, close-out netting, and collateral enforcement may conflict with the moratorium, waterfall, and estate provisions of the IBC. The presence of overriding clauses in both Codes has reinforced the perception of overlap and possible conflict.

The concern is understandable, but misplaced. What appears to be an overlap in fact conceals a fundamental gap in India's legal architecture: the absence of a specialised resolution framework for financial service providers (FSPs) that perform critical market functions and whose failure may have systemic consequences.

The two Codes largely operate in different domains. One seeks to prevent disruption of the securities market despite a participant's stress; the other seeks to resolve financial distress in an orderly manner. Using harmonious construction, courts confine overriding provisions to the specific field for which they were enacted.

Much of the perceived conflict disappears once the nature of assets handled by clearing corporations (CCs) and clearing members (CMs) is properly understood. These institutions routinely hold margins, collateral, securities, and funds that beneficially belong to investors, counterparties, and other market participants. Such assets are often held in custodial, fiduciary, or contractual capacities. They are not the proprietary assets of the CC or CM.

The IBC recognises this. Assets belonging to third parties but held by the debtor under trust, custody, bailment, or similar arrangements do not form part of the insolvency estate. Likewise, the Code recognises the special treatment of collateral, set-off, and multilateral netting arrangements. Consequently, a substantial portion of what the SMC seeks to protect is already outside the pool of assets available for distribution among

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creditors under the IBC.

The SMC's emphasis on settlement finality and collateral protection therefore does not undermine insolvency law; it largely operates in respect of assets and obligations that insolvency law itself treats differently. Viewed through this lens, the two Codes are better understood as complementary than competing regimes. The real challenge lies elsewhere: how should a CC or CM be resolved if it fails?

The SMC clearly contemplates such failures. Its provisions address the consequences of insolvency, liquidation, and resolution proceedings. They protect settlement finality, netting arrangements, and collateral enforcement even after insolvency proceedings commence. Yet the SMC does not itself provide a resolution framework for CCs and CMs. Nor does the ordinary framework of the IBC.

FSPs are generally excluded from the IBC's scope. Parliament recognised, however, that some categories of FSPs may require the IBC's procedural architecture with modifications suited to their specialised functions. Section 227 of the IBC, therefore, empowers the central government, in consultation with the relevant regulator, to apply the insolvency framework to specified categories of FSPs with appropriate modifications.

Read together, the SMC and Section 227 demonstrate that a workable resolution framework can be constructed. The IBC supplies the procedural machinery, while the SMC identifies the modifica-

tions required to preserve settlement finality, close-out netting, collateral protection, and the continuity of critical market functions. This, however, is an interim solution at best. The policy question is whether India should continue to rely on the modified framework under Section 227 or establish a dedicated resolution regime for financial institutions.

CCs and CMs are unlike ordinary commercial enterprises. They handle client assets, intermediate transactions among market participants, and perform func-

tions that are essential to the stability of financial markets. Their failure can have consequences that extend far beyond their shareholders and creditors. In many respects, they resemble banks, payment systems, and other systemically important financial institutions more than manufacturing companies or trading firms.

This points to a broader policy question. Not all FSPs are alike. Some hold substantial customer assets, perform critical infrastructure functions, or pose systemic risks. Others operate in a manner that is economically similar to ordinary commercial enterprises. Treating all FSPs identically may, therefore, be neither necessary nor desirable. India should adopt a differentiated resolution architecture.

Systemically important institutions should ideally be resolved under a financial resolution framework designed specifically for financial-sector failures. At the other end of the spectrum are FSPs whose

business models and risk profiles closely resemble those of real-sector firms. There is little reason why such entities cannot continue to be resolved under the IBC's ordinary framework. Between these two categories lie institutions that require modifications to conventional insolvency rules but do not justify a separate resolution statute. Section 227 of the IBC provides an appropriate bridge for such entities.

Such an approach would preserve the coherence of India's insolvency architecture. Insolvency law functions best when it remains unified. Creating sector-specific insolvency exceptions through isolated provisions scattered across multiple statutes, as in the SMC, risks fragmenting the insolvency framework and misallocating resources. Any departure from the general insolvency regime should ordinarily be accommodated within the insolvency framework itself.

The SMC should therefore neither be viewed as an alternative insolvency regime nor as a challenge to the IBC. It identifies the market-stability safeguards that any insolvency framework applicable to securities market infrastructure institutions must respect. The IBC provides the institutional and procedural framework through which those safeguards can be implemented.

The debate therefore should move beyond the question of whether the SMC and the IBC overlap. The overlap is far smaller than commonly assumed, largely because much of the subject matter of the SMC concerns third-party assets and settlement arrangements that lie outside the insolvency estate itself. The more important issue is the gap that the debate has exposed: the absence of a comprehensive resolution framework for FSPs.

The SMC has not created that gap; it has merely exposed it. The challenge before policymakers is not to choose between the SMC and the IBC, but to design a resolution architecture that preserves market stability, protects client assets, and maintains the integrity of the insolvency process.

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