

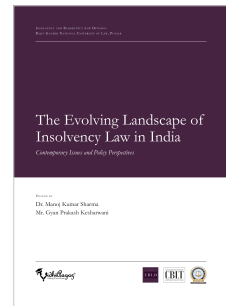
CHAPTER 17

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Bhanu Suhalka and Aakriti

in *The Evolving Landscape of Insolvency Law in India: Contemporary Issues and Policy Perspectives*, edited by Manoj Kumar Sharma and Gyan Prakash Kesharwani (VidhiAagaz 2026), pp. 295–312

DOI <https://doi.org/10.63108/VAB.IBL.1.17>



CITE THIS CHAPTER

BLUEBOOK (21ST ED.)

Bhanu Suhalka & Aakriti, *Netting Arrangements vs. Insolvency Regime in India: A Tug of War between Finality and Resolution*, in *THE EVOLVING LANDSCAPE OF INSOLVENCY LAW IN INDIA: CONTEMPORARY ISSUES AND POLICY PERSPECTIVES* 295 (Manoj Kumar Sharma & Gyan Prakash Kesharwani eds., VidhiAagaz 2026).

OSCOLA, Chicago and APA citations, RIS and BibTeX: vidhiaagaz.com/books/the-evolving-landscape-of-insolvency-law-in-india/chapter-17/

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CHAPTER 17

Netting Arrangements vs. Insolvency Regime in India: A Tug of War between Finality and Resolution

BHANU SUHALKA* AND AAKRITI**

The Insolvency and Bankruptcy Code, 2016 (IBC) reshaped India's insolvency framework, yet it says little about close-out netting, where contracts are terminated on default and mutual obligations are set off into one net sum. This gap matters as the derivatives market grows, and becomes apparent when a counterparty to a qualified financial contract seeks to net its obligations against a corporate debtor undergoing insolvency.

This paper critically examines the interface between the Bilateral Netting of Qualified Financial Contracts Act, 2020 (Netting Act) and the IBC, i.e., Sections 14, 43 to 51 and 238 of the IBC. Sections 6 and 10 of the Netting Act make close-out netting effective despite insolvency, but Section 238 of the IBC claims the same overriding force, with no stated hierarchy. The IBC lacks an express carve-out for qualified financial contracts. This creates uncertainty, since a broad reading of the moratorium could stay netting or expose it to challenge as a preference. This risks higher capital costs and de facto preference over unsecured creditors.

The United States, the United Kingdom and the European Union protect netting through safe harbour rules, but India has no equivalent in its insolvency law. Without statutory coordination, financial institutions and resolution professionals cannot tell how the two regimes interact.

This paper argues that India must adopt a calibrated statutory framework reconciling contractual finality with collective resolution. The proposed framework combines statutes, judicial decisions, regulatory notifications, international standards and comparative legislation with scholarly commentary, ensuring both financial stability and creditor equality.

1 INTRODUCTION

The evolution of India's financial and insolvency jurisprudence has brought to the fore a nuanced legal conundrum i.e. the apparent tension between the principle of contractual

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finality in sophisticated financial markets and the overarching objective of collective insolvency resolution. This conflict is most prominently reflected in the interface between the Bilateral Netting of Qualified Financial Contracts Act, 2020 (“Netting Act”), and the Insolvency and Bankruptcy Code, 2016 (“IBC”). These two laws, though intended to enhance the credit structure of the Indian economy, are based on different conceptual foundations: the Netting Act is motivated by the needs of financial stability, certainty, and containment of systemic risk, while the IBC is based on the postulates of creditor parity, value maximisation, and equitable distribution in collective insolvency procedures.

The Netting Act was passed to align India’s financial regulatory environment with international best practice, specifically the recommendations of the Bank for International Settlements (“BIS”) and the Financial Stability Board (“FSB”).¹² It gives statutory recognition to close-out netting clauses in qualified financial contracts (“QFCs”) so that counterparties can enforce netting rights despite the pendency of insolvency or resolution proceedings. In facilitating the termination of obligations and determination of a single net amount due on default, the Netting Act is vital to the operational integrity of derivatives, repo, and over-the-counter (“OTC”) markets, where the high volume and velocity of transactions necessitate legal certainty and enforceability.³

But it is awkwardly situated in relation to the scheme of the IBC. The IBC puts in place a statutory moratorium under Section 14 on the initiation of the corporate insolvency resolution process (“CIRP”), thus prohibiting all enforcement steps and contractual rights against the corporate debtor. Additionally, its avoidance provisions under Sections 43 to 51 give powers to resolution professionals and adjudicating authorities to reverse preferential, undervalued, or fraudulent transactions executed before insolvency. They are not only key to maintaining value of the corporate debtor but are essential to providing parity among creditors by avoiding a “first-mover advantage” or asset-stripping before resolution.⁴

The result is a jurisdictional and normative tension between two regulatory imperatives. While one is focused on systemic finality in order to avoid cascading defaults in inter-institutional markets, the other demands procedural fairness and group recovery for all creditor classes.⁵ This underlying tension generates hard legal issues: To what degree should the IBC’s moratorium and avoidance powers take a backseat to the netting rights enjoyed under the Netting Act? Should the inviolability of financial contracts be preserved from insolvency proceedings in the interests of maintaining market resilience, or absorbed by the larger aims

¹ Ministry of Corporate Affairs, Notification S.O. 2618(E), Gazette of India, Extra. (Aug. 5, 2016).

² BANK FOR INTERNATIONAL SETTLEMENTS, REPORT ON NETTING SCHEMES, BIS Committee on Payment & Settlement Systems, Doc. No. CPMLd02 (Jan. 1990).

³ ISDA Model Netting Act and Guide (2018).

⁴ FIN. STABILITY BD., THEMATIC REVIEW ON RESOLUTION REGIMES, PEER REVIEW REPORT (2016).

⁵ ISDA, NETTING SUCCESS IN INDIA (2020).

of fair insolvency resolution?⁶ These are not abstract questions; they cut to the heart of insolvency law's dialogue with capital markets, particularly in an economy where sophistication of regulation has to be met by definiteness of doctrine. The growing complexity of the financial system in India, characterized by increases in multi-leg derivative contracts, structured finance instruments, and cross-border obligations, necessitates that the legal framework for defaults should not compromise financial stability or confidence of creditors.⁶

In an attempt to critically examine the functional and normative conflict between the Netting Act and the IBC, we further hope to consider whether a harmonised legal regime can be constructed, one that maintains the enforceability of close-out netting in qualified financial markets, yet does so without jeopardizing the fundamental insolvency goals of value maximisation, creditor parity, and preventing dissipation of assets.⁷

2 CONCEPTUAL FOUNDATIONS AND THEORETICAL FRAMEWORK

The enforceability of netting agreements, especially close-out netting, holds a place of prominence in the structure of contemporary financial markets. Based on both economic sense and legal certainty, netting arrangements help to reduce credit exposure, minimize counterparty risk, and provide for systemic stability, particularly for high-value and high-frequency markets like derivatives, repos, and foreign exchange. From a risk management standpoint, netting facilitates the concentration and offsetting of bilateral obligations between counterparties, thus significantly lowering the gross exposure that would otherwise be present in the case of a counterparty default. In turbulent financial conditions, lack of enforceable netting agreements can lead to contagion risk, where default by one institution can create a domino effect across interlinked institutions, compounding systemic stress. The 2008 financial crisis provided a grim example of how the absence of strong netting protections can incite rampant market disruption. Legal recognition of netting also interacts directly with prudential regulatory regimes, most importantly the Basel III capital adequacy standards, which enable regulated institutions to calculate their risk-weighted assets (RWAs) on a net exposure basis instead of a gross basis assuming netting arrangements are legally binding even in all scenarios, including insolvency. Lack of such enforceability in a jurisdiction increases capital costs for financial institutions, resulting in inefficient allocation of capital and a disincentive to engage in markets in which exposures of this kind are common. At its essence, the legal basis for netting is founded on the *doctrine of finality of financial contracts*, the requirement that rights and obligations under market-standard deals not be perpetually suspended or displaced by ex post insolvency law. Netting supports contractual freedom, gives

⁶ WORLD BANK, PRINCIPLES FOR EFFECTIVE INSOLVENCY AND CREDITOR/DEBTOR REGIMES (2015).

⁷ U.N. COMM'N ON INT'L TRADE LAW, LEGISLATIVE GUIDE ON INSOLVENCY LAW recs. 101–107 (2005).

rise to legal certainty, and adds to operational efficiency, which are essential aspects of deep and liquid markets in finance. In markets with highly developed financial markets, i.e., in the US and UK, netting is accorded safe-harbour status, and these contracts are protected from stay, claw-back, and avoidance provisions under insolvency legislation.

Contrary to the finality and bilateral risk reduction facilitated by netting, the insolvency framework is rooted in the underlying principle that default sets off a transition from separate creditor enforcement to a collective and cooperative process.⁸ The IBC, 2016 is a paradigm change for India's creditor enforcement regime in that it substitutes an array of fragmented recovery mechanisms with a single-window, time-bound insolvency resolution process designed to maximise the value of the assets of the debtor while also ensuring procedural and distributive equity.⁹

The IBC enshrines maximisation of value of the assets of the corporate debtor as a fundamental objective, as reiterated in milestone judgements like *Swiss Ribbons Pvt. Ltd. v. Union of India*.¹⁰ The rationale is that the collective resolution process results in a higher realisation of value in comparison to piecemeal enforcement under various individual creditors. In that regard, the moratorium contained in Section 14¹¹ is a standstill mechanism that maintains the status quo and avoids a dismemberment of the estate of the debtor by disparate enforcement steps. The protections enshrined in IBC find their doctrinal foundation in the equity rule that all creditors in similar circumstances must be treated uniformly, and no one creditor can gain an unfair benefit through acceleration of recovery by side agreements or self-help.¹² Arguably the most important normative divergence between the netting regime and insolvency law is in their paradigms of enforcement. Netting arrangements embody a paradigm of individualistic enforcement, whereby contracting parties anticipate in advance the default effects and shield themselves from the effects of systemic breakdown. Insolvency law, on the other hand, is based on collectivisation of claims, whereby creditor entitlement is pushed into the background by the pursuit of orderly and fair distribution.¹³

This theoretical difference is described in insolvency literature as the “*collective action theory*”, which perceives insolvency as a realignment of bargaining from market-based to court-supervised redetermination of rights for the benefit of all parties involved.¹⁴ As it has been argued by scholars like Thomas Jackson, the “*creditors' bargain model*” necessitates that the

⁸ Rajendra K. Bhutta v. Maharashtra Hous. & Area Dev. Auth., 2020 SCC OnLine SC 292.

⁹ Bhargavi Zaveri & Shivangi Tyagi, *The Indian Insolvency Code: Implementation and Comparative Analysis*, 13 NUJS L. REV. 101 (2021).

¹⁰ *Swiss Ribbons Pvt. Ltd. v. Union of India*, (2019) 4 SCC 17.

¹¹ Insolvency and Bankruptcy Code, 2016, § 14.

¹² *Innoventive Indus. Ltd. v. ICICI Bank*, (2018) 1 SCC 407.

¹³ S. RAJYALAKSHMI & PRASHANT BHUSHAN, *INDIAN BANKING LAW AND PRACTICE* (2022).

¹⁴ *Overview of the Evolving Jurisprudence Under the Indian IBC*, SMU INDIA LAW BLOG (2024).

debtor's estate is treated as a common pool open for distribution in terms of statutory priority and not contractual exceptions that can have disruptive effects on the integrity of the estate.¹⁵

3 THE DOCTRINAL CLASH: FINALITY VS. FAIRNESS

The essential theoretical conflict, then, is between contractual finality (as embodied in the Netting Act) and procedural fairness (as embodied in the IBC). While the former attempts to ensure party autonomy and forecastability, the latter demands fair treatment and process integrity. The Netting Act presumes that financial markets need to be shielded from insolvency-driven disturbance, whereas the IBC considers insolvency to be a public process in which private contracts should give way to public interest values.¹⁶

This doctrinal tension is amplified in QFC cases where counterparties aim to enforce close-out netting rights under a corporate insolvency resolution process (CIRP), and do so potentially outside the scope of the statutory moratorium, and at the expense of the resolution goals. The issue, then, is whether India's insolvency regime is capable of allowing for contractual netting mechanisms within its collective resolution framework without subverting either's governing logic.

4 THE NETTING ACT, 2020

The passing of the Bilateral Netting of Qualified Financial Contracts Act, 2020 (hereafter, the "Netting Act" or "BNQFCA") is a turning point in India's quest to establish a firm legal foundation for its growing financial markets. The law provides statutory recognition and enforceability of bilateral close-out netting arrangements, bringing India in line with international standards that consider such arrangements critical for financial system stability, especially during periods of stress or counterparty insolvency.¹⁷

The Netting Act is applicable to QFCs into which qualified financial market participants, as defined under Sections 2(g) and 2(f) of the Act, respectively, enter. The Central Government, after consultation with the concerned regulatory bodies like the RBI, SEBI, IRDAI, and PFRDA is authorized to notify classes of contracts and participants within the statute.^{18,19} This restricted and limited scope guarantees that netting protections extend only to those market players who deal in regulated and systemically important financial

¹⁵ WORLD BANK, PRINCIPLES FOR EFFECTIVE INSOLVENCY AND CREDITOR/DEBTOR REGIMES (2015).

¹⁶ Anuj Jain, Interim RP for Jaypee Infratech Ltd. v. Axis Bank Ltd., 2020 SCC OnLine SC 237.

¹⁷ RBI Master Direction – Derivatives (2022).

¹⁸ IRDAI Circular: Netting Obligations of Insurers (2021).

¹⁹ SEBI Circular on OTC Derivatives (2022).

segments—banks, NBFCs, clearing corporations, insurance companies, pension funds, and mutual funds—thus balancing regulatory supervision with contractual freedom.

Section 6 of the Netting Act is the pivot of its legal design. It prescribes that close-out netting shall be effective despite the insolvency, winding-up, administration, or resolution proceedings against one of the counterparties. The Act pre-empts the automatic stay or moratorium doctrine that otherwise disables counterparties from ending or enforcing contracts on insolvency in accordance with general corporate legislations or sectoral laws. In particular, the Act preserves netting provisions in “netting agreements” and provides that termination, liquidation, and computation of the net payable or receivable amount shall be valid and enforceable in law notwithstanding other inconsistent enactments including insolvency legislation.

Section 10 of the Act includes a non obstante clause that confers overriding force upon the Netting Act over inconsistent provisions in any other law, regulation, or rule. This is notable in the context of the Insolvency and Bankruptcy Code, 2016 (IBC) too, where Sections 14 (moratorium) and 238 (overriding clause of the IBC)²⁰ have been read widely to prohibit all enforcement steps against a corporate debtor. By passing a sector-specific override, the Netting Act puts QFCs in a ring-fenced position away from the disruptive effects of the insolvency moratorium and similar avoidance provisions. However, this legislative interface finds itself in a space of doctrinal vagueness, especially when other non obstante clauses (such as Section 238 of the IBC) enter into an interpretational tension with one another within judicial trial.²¹

Under the Netting Act, the RBI in January 2021 issued a notification informing different classes of derivatives, repo, and reverse repo contracts as QFCs and selecting scheduled commercial banks, cooperative banks, and primary dealers as eligible financial entities and qualified participants.²² Likewise, SEBI, in its circulars and consultation papers, has resonated with the significance of enforceability of netting for the growth of India’s capital markets and has favoured its introduction through risk management systems for clearing corporations and financial intermediaries.²³ This multi-regulator implementation framework mirrors the concept of cooperative federalism in financial supervision, such that the benefits of netting are provided only within a prudentially supervised environment, thus protecting against the abuse in the system but promoting financial innovation.

²⁰ Insolvency and Bankruptcy Code, 2016, § 238.

²¹ ISDA, INDIA NETTING OPINION (revised by Juris Corp, May 2021).

²² Reserve Bank of India, Notification on Eligible Qualified Financial Contracts, Notification No. RBI/2020-21/64 (Oct. 2020).

²³ Securities and Exchange Board of India, Notification under Netting Act, SEBI/HO/IMD/IMD-I/DOF5/P/CIR/2021/045 (Mar. 2021).

Before 2020, India did not have an explicit statutory regime acknowledging the enforceability of close-out netting. Courts and regulators had been inconsistent in their views, generally considering netting clauses to be dependent upon judicial discretion or subject to overall moratoriums under insolvency or banking legislation. This had the effect of producing a chilling factor for dealing with the Indian derivatives and structured finance markets, particularly by cross-border financial institutions subject to jurisdictions mandating legal certainty of enforceability of netting.²⁴ The lag in enacting netting legislation also deprived Indian financial institutions of realizing netting benefits in regulatory capital calculations and thus weakened the nation's compliance with Basel III norms, as well as artificially increasing capital charges on exposures that were otherwise nettable.

The Netting Act, thus, aimed to address this regulatory gap and announce India's compliance with the Financial Stability Board (FSB) and Bank for International Settlements (BIS) standards, both of which recognize enforceable netting as a central element of a successful financial market infrastructure. By eliminating legal uncertainty regarding netting, the Netting Act facilitates more liquid and deeper derivatives markets, lowers systemic counterparty risk, and improves capital efficiency. Financial institutions are able to determine their exposure on a net basis, thereby maximizing their capital adequacy ratios and risk-weighted asset (RWA) profiles. This directly affects the cost of credit, pricing of sophisticated financial instruments, and the integration of Indian financial markets with international systems. For instance, the lack of netting protection was earlier referred to by international banks and clearinghouses as a hindrance for cross-border access to Indian CCPs and exchanges.

The introduction of the Netting Act also addresses the report of the Financial Sector Assessment Programme (FSAP) done by the IMF and World Bank, which had raised the issue of the non-enforceability of close-out netting as a significant weakness in India's legal framework. By fixing this, India has advanced the cause of compliance with the G-20 reform agenda on derivatives, thereby enhancing its rating in international regulatory benchmarking and risk management assessments.

5 THE IBC FRAMEWORK AND ITS DOCTRINAL AIMS

5.1 Overview of the Insolvency and Bankruptcy Code (IBC)

The IBC, 2016 is a tectonic change in India's insolvency jurisprudence going away from the pre-existing regime of debtor-in-possession to a creditor-in-control regime. Fundamentally, the IBC aims to recover the assets of the corporate debtor to their highest value, achieve

²⁴ ISDA & Trilegal India, *Netting FAQ* (Industry Guidance Note, 2021).

creditor equality, and facilitate time-bound resolution of stressed entities for retention of economic value and prevention of stakeholder erosion. The IBC contemplates a tripartite resolution framework of:

- Initiation of the Corporate Insolvency Resolution Process (CIRP) under Sections 7, 9, or 10.
- Imposition of moratorium and formation of a Committee of Creditors (CoC) with decision-making powers regarding resolution.
- Liquidation and distribution in case of failure of resolution, as per the waterfall mechanism under Section 53, which enshrines a structured priority regime in the release of proceeds.

This collectivized model is premised on inter-creditor coordination, asset value preservation, and non-fragmentation of enforcement actions, which distinguishes insolvency law from general civil or commercial remedies.²⁵ The tension between financial market finality and insolvency collectivism is most acutely felt in the interplay between netting rights under the Netting Act, 2020, and certain foundational provisions of the IBC:

5.1.1 Section 14: Moratorium

This measure grants an across-the-board stay on institution or continuation of proceedings, such as execution of a judgment, decree, or order and transfer, encumbrance, alienation, or disposal of any asset of the corporate debtor. Significantly, the moratorium also precludes repudiation of critical contracts or recovery in security enforcement, hence suspending all individualized enforcement to permit a structured restructuring process.²⁶ In QFCs, this provision would apparently hinder the functioning of close-out netting, by nature, which is activated in default or insolvency events.

5.1.2 Sections 43 to 51: Avoiding Vulnerable Transactions

These provisions allow the Resolution Professional (RP) or Liquidator to invoke preferential, undervalued, extortionate, or fraudulent transactions within a stated lookback period. The essential goal is to retrieve value improvidently parted with and redistribute it fairly among creditors. Automatic close-out netting, in particular, if invoked near the insolvency start date, might conceivably be brought within these provisions as a preference or undervalued transfer, especially where it seems to unfairly favour a counterparty.

²⁵ Amol Baxi, *India's Experience in Insolvency Laws: Learnings for the Global South* (RIS Discussion Paper No. 294, 2024).

²⁶ *Section 14 of IBC, 2016: Moratorium—Meaning, Scope & Case Law*, LEGAL SCHOOL BLOG (2025).

5.1.3 Section 238: Non-Obstante Clause

The overriding clause of the IBC places it above any such inconsistent provision in any other law, presenting a doctrinal dilemma: whether close-out netting rights made enforceable under the Netting Act should be overridden by IBC's collective insolvency regimes. This presents a normative clash between systemic risk management and procedural collectivism.²⁷

5.2 Protection of the Corporate Debtor's Estate vs. Enforceability of Netting Rights

This tension between financial market efficiency and insolvency process sanctity is foundational and jurisprudential. The IBC is intended to ringfence the estate of the corporate debtor, arrest piecemeal enforcement, and enable the CoC to consider resolution strategies in a neutral, value-maximizing forum. It is the "collective process" theory of insolvency law that prioritizes coordinated creditor treatment over individualistic enforcement rights. Conversely, close-out netting is a building block of contemporary financial markets, especially for derivatives, repos, and OTC transactions, where near-instantaneous closure and valuation of reciprocal obligations in case of default are essential to limit counterparty contagion. Netting diminishes systemic risk by fixing exposures, facilitates capital efficiency under Basel III, and prevents the domino effect of deferred settlements.²⁸

The question of core policy here is whether such systemic imperatives are compatible with the IBC's collectivized goals. The Netting Act claims to grant netting rights irrespective of any other legislation, but the IBC's Section 238 does the same thus bringing statutory simultaneity about without explicit hierarchy.²⁹ Without judicial harmonization, this creates interpretive uncertainty over which statute gives way in the case of insolvency. Essentially, the enforceability of netting rights under the 2020 Act needs to be considered in the context of:

- Value preservation vs. value extraction
- Systemic risk externalities vs. fair treatment of creditors
- Efficient market results vs. distributive justice in insolvency

Whether the asset pool of the corporate debtor should be inviolate under resolution or whether qualified financial contracts must be exempted from the clutches of the IBC are issues that continue to be unresolved and living ones in Indian insolvency law.

²⁷ Arjun Sathees, *The Bilateral Netting Law and Its Impact on the IBC*, IBC LAW BLOG (2024).

²⁸ Habib Motani, *Enforceability of Close-Out Netting Is the Single Most Important Legal Reform for Financial Stability*, ISDA Q. (2021).

²⁹ Amol Baxi, *India's Experience in Insolvency Laws: Learnings for the Global South* (RIS Discussion Paper No. 294, 2024).

6 THE CENTRAL CONFLICT: FINALITY VS. RESOLUTION

6.1 Doctrinal Conflict: Autonomy of Netting vs. Collective Insolvency Proceedings

Central to the legal conflict is a basic conflict between contractual finality, particularly in systemically important financial markets, and the collectivist culture of insolvency law under the IBC. The enforceability of close-out netting under QFCs, as authorized by the Bilateral Netting of QFCs Act, 2020 (Netting Act), is based upon the fundamental concept of legal certainty and instantaneous crystallization of obligations often activated by an “event of default,” like insolvency. All these provisions are aimed at enabling non-defaulting financial institutions to complete termination, valuation, and netting of obligations without undue delay or intervention of courts, so as to immunize themselves from further exposure of credit.

In contrast, the IBC contemplates a regime of moratorium under Section 14, where private creditor action enforcement, recovery, as well as even termination is not allowed during the CIRP. The moratorium is the juridical firewall safeguarding the status quo and avoiding dissipation of assets, thereby ensuring an orderly and maximally effective resolution in the interest of all stakeholders as a group.³⁰ This creates a normative conflict: whereas netting arrangements are self-executing and individualistic by nature, insolvency law aims at freezing the estate of the debtor and subjecting all claims to a disciplined, court-monitored waterfall of distribution. The conflict is more pronounced where netting agreements admit close-out termination and netting without judicial intervention, which may compromise *pari passu* treatment of creditors and the resolution process in general. This doctrinal inconsistency is not an abstract one, it carries deep significance for the operation of contemporary financial markets and the stability of the economy at large.

6.1.1 Systemic Uncertainty for SIFIs and Market Participants

The lack of a clearly defined hierarchy between the IBC and the Netting Act gives rise to regulatory uncertainty for Systemically Important Financial Institutions (SIFIs) and institutions that are active in over-the-counter (OTC) derivatives, repo markets, and foreign exchange contracts.³¹ If close-out netting under the IBC moratorium is stayed, counterparties will be discouraged from dealing with institutions under financial duress due to potential exposure and inability to easily unwind positions. In turn, this chilling effect undermines

³⁰ Ghanashyam Mishra & Sons Pvt. Ltd. v. Edelweiss Asset Reconstruction Co., 2021 SCC OnLine SC 313.

³¹ Shardul Amarchand Mangaldas & Co., *Analysis of the Netting Bill* (Firm Report, 2020).

liquidity provisioning, price discovery, and risk hedging mechanisms, especially in the context of interbank markets that rely heavily on netting efficiencies.

6.1.2 *Disruption in Derivative Clearing and Counterparty Exposure*

Without enforceable netting, financial institutions cannot promptly consolidate exposures, leading to gross exposure accounting on balance sheets. This could result in increased capital adequacy requirements under Basel III norms, deteriorating the creditworthiness and market credibility of the affected entity.³² More importantly, it could trigger procyclical effects where mark-to-market losses amplify systemic stress during a financial downturn. In addition, if a clearing member or central counterparty (CCP) cannot close out and net its positions in consequence of the CIRP moratorium, it may have the potential to lead to chain reactions of defaults, cascading through the financial system.³³

6.1.3 *Unequal Treatment and Preference Concerns*

Enforceability of close-out netting in insolvency has the potential to cause de facto preferential treatment of financial market participants who are QFC holders as opposed to similarly situated unsecured creditors. Such counterparties can capture value outside of collective process contravening the principle of equitable distribution enshrined in Sections 43–51 of the IBC dealing with avoidance transactions. That brings fundamental issues of horizontal equity and possible abuse of derivative arrangements to avoid insolvency priorities, especially in related party transactions, structured finance, or embedded options. Overall, the unsolved tension between netting finality and insolvency resolution is no legal footnote; its blow reaches the very heart of India's financial regulatory structure. Unless resolved through legislative clarification or judicial interpretation, this tension threatens to undermine both financial stability and the effectiveness of insolvency resolution processes.

7 COMPARATIVE LEGAL ANALYSIS

7.1 United States: Bankruptcy Code and Safe Harbor Provisions

The United States provides one of the most advanced and mature systems reconciling systemic risk mitigation with insolvency resolution. The U.S. Bankruptcy Code preserves “safe harbour” provisions enacted under § 362(b)(6), § 546(e), § 556, § 560, and § 561 that *de facto* immunize QFCs like derivatives, repurchase agreements, and swap contracts from the automatic stay, avoidance actions, and other bankruptcy limitations. § 362(b)(6) excuses

³² ASS'N OF CORP. TREASURERS, CLOSE-OUT NETTING IN PRACTICE: A LEGAL PRIMER (2023).

³³ *Rethinking OTC Derivatives: The Imperative for Legal Reform in India's Financial Landscape*, OXFORD BUSINESS LAW BLOG (2024).

certain financial transactions (i.e., margin payments, settlement payments) from automatic stay. § 546(e) protects settlement payments to or from financial institutions from avoidance as preferential or constructively fraudulent. §§ 556, 560, and 561 allow exercise of contractual close-out netting rights, termination, and liquidation of collateral notwithstanding the debtor's bankruptcy.³⁴ The legislative justification rests in avoiding the domino effect that a refusal to permit netting would initiate in highly interconnected financial markets, especially among systemically important financial institutions (SIFIs). Judges have consistently emphasized that timely close-out of unstable financial derivatives is essential for maintaining market stability and reducing counterparty risk. The U.S. system places financial solidity and risk control above by making QFCs statutorily immune from core insolvency mechanisms such as the stay and claw-back, in light of their system-wide effects.

7.2 United Kingdom: FSMA and Financial Collateral Regulations

Statutory sanctity is accorded to netting and collateral arrangements by the UK law under a two-tiered regulatory framework.³⁵ The Financial Services and Markets Act, 2000 (FSMA) provides regulatory powers to the FCA and PRA in respect of designated QFCs and prohibits interference with netting and set-off rights during insolvency. The Financial Collateral Arrangements (No. 2) Regulations, 2003, which give effect to the EU Financial Collateral Directive, protect enforcement of security financial collateral arrangements (SFCAs) and title transfer financial collateral arrangements (TTFCAs). Under the UK system:

- Close-out netting rights are safeguarded even in the event of administration or liquidation.
- Financial collateral takers can realize financial collateral (e.g., securities, cash) instantly or without judicial intervention.
- The protection is extended subject to the arrangement being “formalised in writing” and parties being non-natural persons (e.g., financial institutions, pension funds, corporates).

The UK system raises contractual certainty and enforcement of collateral for financial contracts, considering them essential to market confidence, particularly in the post-2008 era.³⁶

7.3 European Union: Directive-Based Harmonisation

The EU's response relies on a set of directives targeting legal harmonisation, to wit:

³⁴ U.S. Bankruptcy Code § 562.

³⁵ Financial Services and Markets Act 2000, c. 8, pt. VII (UK).

³⁶ Banking Act 2009, c. 1, schs. 2–3 (UK).

- Directive 2002/47/EC on Financial Collateral Arrangements³⁷
- Directive 2001/24/EC on the reorganisation and winding-up of credit institutions³⁸
- EMIR (European Market Infrastructure Regulation) and BRRD (Bank Recovery and Resolution Directive)

These instruments together:

1. Acknowledge close-out netting as enforceable, even during resolution or liquidation, regardless of diverging national insolvency regimes.
2. Stress finality of settlement and safeguarding of central counterparties (CCPs) and clearing arrangements.
3. Ensure legal certainty to cross-border financial contracts, avoiding the fragmentation risks that hit the 2008 crisis response.

The BRRD also introduces resolution moratoria, but leaves QFCs outside their scope in order to maintain market functioning and prevent aggravating liquidity stress. EU law has a strong pro-netting tilt, viewing netting enforceability as fundamental to both financial integration and prudential regulation.³⁹

India's enactment of the BNQFC Act, 2020 marks a crucial step towards enhancing financial stability, yet it remains insufficiently integrated with the IBC, 2016. Drawing lessons from global best practices, particularly the U.S. and EU models, three key improvements are necessary: *first*, structured statutory carve-outs must be created within the IBC especially in Sections 14 (moratorium) and 43–51 (avoidance transactions) to safeguard netting rights for qualified financial contracts (QFCs); *second*, India must establish a clearly defined QFC ecosystem by listing eligible instruments like swaps, repos, and forwards, identifying eligible entities such as banks, NBFCs, and central counterparties, and ensuring definitional consistency across the Netting Act, RBI/FEMA regulations, and the IBC; and *third*, any such carve-outs must be counterbalanced by regulatory oversight mechanisms to prevent abuse, such as mandatory pre-registration of netting agreements, disclosure obligations to resolution professionals, and judicial scrutiny of close-outs during suspect periods.⁴⁰ A well-calibrated statutory and regulatory framework can help India harmonize the finality of financial contracts with the collective principles of insolvency resolution, protecting both the rights of individual creditors and the broader stability of the financial system.

³⁷ EU Directive 2002/47/EC on Financial Collateral Arrangements.

³⁸ EU Directive 2001/24/EC on the Reorganisation and Winding up of Credit Institutions.

³⁹ European Banking Authority, Guidelines on the Treatment of Netting Sets.

⁴⁰ Trilegal, *Bilateral Netting of Qualified Financial Contracts Act, 2020* (Legal Update).

8 INDIAN JURISPRUDENCE: TRENDS AND AMBIGUITIES

India's insolvency framework, while relatively nascent, has undergone rapid jurisprudential evolution under the IBC, 2016. At the core of recent interpretative developments lies the dynamic tension between the absolute moratorium envisaged under Section 14 of the IBC and the economic imperatives of modern financial markets particularly concerning QFCs governed by the *Netting Act*.

Indian courts, and notably the Supreme Court, have gradually shifted toward a purposive and functionalist interpretative model. This trajectory has seen an increasing willingness to engage in sector-specific harmonisation, even in the absence of explicit statutory carve-outs. Two significant decisions illustrate the evolving judicial landscape and its implications for the enforceability of netting arrangements in the insolvency context.

In the case of *EPFO v. Jaykumar Pesumal Arlani* the National Company Law Appellate Tribunal (NCLAT) adopted a broad interpretation of Section 14 of the IBC, holding that the moratorium extends even to quasi-judicial and non-coercive proceedings.⁴¹ Notably, the tribunal ruled that assessment proceedings and recovery notices initiated by statutory authorities such as the Employees' Provident Fund Organisation (EPFO) fall within the moratorium's ambit. The ruling reinforced the principle that the corporate insolvency resolution process (CIRP) must not be disrupted by individual claims—regardless of the claimant's statutory or secured status. This decision underlines the judiciary's strong commitment to preserving the integrity of collective resolution, even at the expense of individual enforcement actions. Now if such a blanket interpretation of the moratorium were to be applied automatically to QFCs, it could have the unintended effect of obstructing close-out netting and the enforcement of collateral arrangements. Such an outcome would undermine the legislative intent behind the Netting Act, which was specifically enacted to promote financial stability by protecting netting rights, even during insolvency.⁴²

In the landmark judgment of *Vidarbha Industries Power Ltd. v. Axis Bank Ltd.*⁴³, the Supreme Court held that the adjudicating authority under Section 7 of the IBC retains discretion and is not bound to admit an insolvency application solely on proof of default. The Court emphasised that tribunals may consider extraneous commercial and economic factors such as the financial viability of the debtor, pending legal disputes, or sectoral dynamics before initiating CIRP. This decision represents a doctrinal shift away from a mechanical, rule-based trigger for insolvency. It acknowledges that financial default does not ipso facto

⁴¹ *EPFO v. Jaykumar Pesumal Arlani*, 2021 SCC OnLine NCLAT 268.

⁴² DALVINDER SINGH, *THE LAW OF CLOSE-OUT NETTING IN FINANCIAL MARKETS* (2019).

⁴³ *Vidarbha Indus. Power Ltd. v. Axis Bank Ltd.*, (2022) 8 SCC 352.

mandate insolvency proceedings, particularly where the debtor entity remains commercially viable or is engaged in ongoing legal disputes affecting its financial position.

The Court's nuanced, context-sensitive approach to insolvency triggers may offer a doctrinal foothold to balance QFC enforcement with the broader insolvency framework. By opening the door to context-specific considerations, the judgment creates space for systemic factors—such as financial stability and contagion risk—to inform judicial treatment of close-out netting during insolvency. This, in turn, strengthens the possibility of judicial harmonisation between the IBC and the Netting Act.

These rulings herald a paradigmatic change in the judicial approach to insolvency law away from strict adherence to statutory impediments towards a sophisticated, purposive weighing of contradictory legislative goals. In particular:

- Courts are more and more attuned to the differentiated character of financial creditors, particularly where the creditor is a counterparty to a QFC with systemic ramifications.
- The supremacy of collective resolution under IBC is being challenged, alongside the sector-specific laws: The Netting Act, the RBI Act, and Securities Contracts (Regulation) Act, all are more inclined to promote financial stability and transactional certainty.
- There is a suggested jurisprudence of growing readiness to harmonize IBC's moratorium and set-off mechanisms with the statutory recognition of netting and finality of collateral under the Netting Act, 2020 despite judicial precedent still being inadequately developed in this particular domain.

Notwithstanding these forward-looking developments, Indian jurisprudence still does not have a specific judicial pronouncement on the enforceability of close-out netting during moratorium or of the inviolability of collateral enforcement rights under QFCs. Some issues remain pending resolution:

1. Whether close-out netting can be enforced after commencement of CIRP without inviting Section 14's prohibition
2. Would collateral enforcement under a financial contract qualify as a preferential transaction or extortionate credit under Sections 43 or 50 of the IBC?
3. Can there be an implied statutory override from the Netting Act, or is there a requirement for judicial acceptance of an express carve-out?

The Indian judicial response demonstrates an emergent awareness of the requirement to balance insolvency resolution with financial market stability. But until they are specifically adjudicated or clarified by regulatory notice, QFC counterparties are still at legal risk in insolvency proceedings. The Supreme Court's purposive turn in *Vidarbha* and the broad moratorium reading in *Jaykumar Arlani* need to be harmonized by either legislative reform

or judicial clarification best through a test case considering the interaction between the IBC and the Netting Act.

9 TOWARDS A HARMONISED FRAMEWORK

9.1 Reconciling Netting and IBC Objectives

The key legal trade-off between the finality of close-out netting and the collective resolution goals of the IBC requires a nuanced strategy that balances systemic stability with creditor equality. A pragmatic balance is achieved through delimiting the reach of netting protections with regulatory specificity. As per the Netting Act, the advantages of enforceability are only limited to “QFCs” executed by “Qualified Financial Market Participants” (QFMPs) notified by the concerned authorities. This establishes a definitional corridor which could be used to great effect to ring-fence systemically material financial transactions from insolvency moratoria without derogating the IBC’s moratorium in its entirety.

The deployment of pre-packaged insolvency schemes especially for financial market counter-parties would offer a practical middle path. Such schemes can nest contractual close-out rights within a regulated resolution framework, maintaining transactional certainty while having oversight. Alternatively, sectoral exemptions (akin to Section 18 carve-outs of the Netting Act) can be operationalised for covered financial institutions such as banks, NBFCs, and insurance firms subject to ex-ante regulatory clearances. With the cross-cutting nature of insolvency law and financial regulation, judicial and regulatory convergence becomes paramount in aligning the twin goals of resolution and financial finality. Courts and tribunals, particularly the National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) need to pursue a purposive and sectorally informed approach of interpretation to insolvency disputes related to netting arrangements. Specifically, tribunal discretion should be exercised cautiously to preserve close-out netting rights if the following cumulative test is met:

- The requesting counterparty is a properly notified QFMP;
- The financial contract is a QFC under prevailing regulatory notice;
- The invocation of netting is before the onset of the Corporate Insolvency Resolution Process (CIRP) under Section 14 of the IBC;
- No evidence of preferential, undervalued, or fraudulent transaction under Sections 43–45 of the IBC.

Regulators like RBI, SEBI, IRDAI, and PFRDA need to coordinate to frame uniform guidelines for the registration, regulation, and audit of netting arrangements. Sectoral standardisation can discourage opportunistic behaviour and avert systemic contagion, especially

in financially connected ecosystems. In order to institutionalize a harmonized framework, the Indian insolvency regime has to look at statutory changes mirroring international best practices without weakening the creditor-in-rem principle of the IBC.

Some of the legislative interventions could be:

- a. Introduction of a new sub-section of Section 14 under the IBC: This provision can create an exception to the moratorium in respect of enforceable close-out netting contracts, following the safe harbour concepts built into § 362(b)(6) and § 546(e) of the US Bankruptcy Code. It would exempt certain terminations, accelerations, and set-offs related to netting from moratorium prohibitions, subject to QFC conditions.
- b. Codification of Safe Harbor Provisions: Transferring the UK's Financial Collateral Arrangements (No. 2) Regulations, 2003, India can incorporate safe harbour provisions safeguarding netting rights in regulated financial transactions, supported by disclosure and audit trails.
- c. Mandatory Registration of Netting Contracts: A centralised database perhaps under the umbrella of the Insolvency and Bankruptcy Board of India (IBBI) or an appointed financial regulator can be created to mandatorily register all enforceable netting agreements ex ante. This will induce transparency, offer documentary certainty in the event of insolvency, and eliminate post-default opportunism.
- d. Clarificatory Cross-Referencing: The IBC can make non-obstante provisions that recognize the applicability of the Netting Act so that its protections are not inadvertently cut short in the course of CIRP proceedings, hence curtailing judicial fragmentation.

10 CONCLUSION: BALANCING SYSTEMIC FINALITY AND RESOLUTION FAIRNESS

The developing interface between netting arrangements and the insolvency law in India represents a fundamental tension: the demand for transactional finality in finance versus the requirement of fair resolution under insolvency law. This tension is very pronounced where Qualified Financial Contracts (QFCs) and derivative exposures overlap with the moratorium and distribution waterfall under the Insolvency and Bankruptcy Code, 2016 (IBC).

India made impressive strides towards conforming with prudential global norms by passing the Bilateral Netting of Qualified Financial Contracts Act, 2020, and giving legal certainty to close-out netting arrangements critical to reducing counterparty risk and a resilient financial system. But such protections need to be weighed against the IBC's central goal of value maximisation for all stakeholders and upholding the integrity of the collective process of insolvency.

Currently, the law indicates lacunae in harmonisation as well as statutory coordination. The lack of an express carve-out in Section 14 of the IBC in favour of QFCs and associated

netting rights causes potential tension. It leaves scope for interpretative vagueness, especially where automatic close-out netting could be viewed as creditor-specific enforcement and hence at variance with the moratorium under Section 14(1). To progress, India's legal framework needs to develop in three key areas:

- a. Clarity: By codifying express carve-outs of QFCs in the IBC, ideally in a new subsection of Section 14 or similar clause, Parliament can integrate netting enforceability with its overarching goal of systemic stability.
- b. Classification: Distinguishing QFC counterparties from mere unsecured creditors by clear definitions and regulatory regulation can avoid preferential results while maintaining valid risk-reduction instruments in the hands of systemically critical institutions.
- c. Coordination: Strong regulatory dialogue among the Insolvency and Bankruptcy Board of India (IBBI), Reserve Bank of India (RBI), SEBI, and sectoral regulators can result in standardized contractual templates, pre-packaged insolvency regimes, or sector-specific safe harbour rules similar to those in the US (under the Bankruptcy Code) and the UK (Financial Collateral Arrangements Regulations).

Finally, the Indian insolvency landscape cannot be considered in splendid isolation from the risk architecture of the financial system. Netting arrangements, employed within a properly regulated context, add to legal certainty and financial foreseeability. Concurrently, however, the IBC needs to remain a disinterested impartial referee of value maximisation, such that no creditor, no matter how systemically significant, is permitted to compromise the equity and procedural justice of the resolution process. This requires the conscious and doctrinally consistent combining of insolvency and financial regulation, informed by the dual guiding beacons of stability and equity.

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