A Study of Resolution of NBFC under the IBC

♦ Introduction

The Insolvency and Bankruptcy Code, 2016 ("***IBC***") is an amalgamated enactment of numerous laws. The primary objective behind the code is to provide a central single contact point clearance scheme for all the earlier laws. The Code offers consolidated and amended laws for restructuring along with insolvency resolution of corporate persons, partnership firms, LLP's and individuals in a stipulated time frame.[1]

Although, IBC provides a framework for the insolvency resolution of, *inter alia*, corporates, however it does not include 'financial service providers' ("***FSP***") in the classification of 'corporate person'. Thereby meaning, an organization or entity engaged in providing 'financial services' is not to be made to undergo the Corporate Insolvency Resolution Process ("***CIRP***") under the IBC.

Interestingly, the term 'non-banking financial companies' ("***NBFC***").is not used anywhere in the Code particularly.[2] However, FSP's[3] having a dedicated section in the code the extent of its applicability has always been uncertain. Courts have nevertheless attempted to interpret the same

♦ Case Studies

The primary argument behind excluding FSPs from the IBC Code was that FSPs involve pubic money and insolvency in this sector could lead to economic instability. The NCLT and NCLAT have confirmed time and again that the definition of 'corporate persons' under IBCs excludes FSPs and ergo, no CIRP can be initiated against the FSPs.

The National Company Law Appellate Tribunal ("***NCLAT***") discussed this issue in the matter of *HDFC* v. *RHC*[4] wherein, HDFC filed an appeal against the judgment given by the National Company Law Tribunal ("***NCLT***") which held that the corporate debtor ("***RHC***") did not lie within the reach of the code as it was a Non-Banking Financial Company

The appellant contended that while determining the intent of the legislature, with regards to the exclusion of financial providers from the code was overlooked by the bench, it was also argued that the code extended to all the entities except the ones listed under section 3(16)[5] which predominantly engaged '*actively*' in the business of providing 'financial services', emphasis was further placed on the definition of 'financial service provider' under the code[6], a claim which RCH denied.[7]

Similarly in *Randhiraj Thakur* v. *Jindal Saxena Financial Services (P.) Ltd.* [2018] 98 taxmann.com 192/150 SCL 154[8], the NCLAT found the NBFC as a FSP and hence was excluded from the code. The NBFC status was granted viaa certificate of registration for carrying out business (by The Reserve Bank of India[9] "***RBI***"), however, the company's MoA highlighted the objective which included all types of business activities that were carried by an investment company, financial operations, financial services including industrial, housing and consumer finance, etc.

The NCLAT noted that the NBFC had entered into "an inter-corporate deposit agreement" with the financial creditor (respondent) in turn undertaking financial service by accepting such deposits. Thus, excluded from the definition of corporate person, hence CIRP cannot be initiated.

It can be safe to conclude from these instances that, the NCLAT has restricted itself to the letter of law and limited the scope of inclusion of NBFCs under the umbrella of the Code.

♦ Recent Developments

The central government has the power to notify CIRP for FSPs under section 227 of the IBC. In the year 2017, the government came up with Financial Resolution and Deposit Insurance Bill for regulation of Insolvency and Bankruptcy proceedings but it was withdrawn due to certain loopholes, however, by virtue of section 227 of the IBC, the government formulated the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 for NBFCs which include housing finance companies with asset size of Rs. 500 crore or more as per the previously audited balance sheet.[10] Furthermore, the insolvency process can be initiated against the NBFC under this framework only upon an application by the RBI. The Rules hint towards a 'regulator driven approach' rather than the conventional 'creditor driven approach' followed by the Code. Other rule hinting towards this approach is the mandate of obtaining a "no-objection" from the RBI within forty-five days of finalising the resolution plan by the Committee of Creditors (CoC). In contrast, as highlighted in the Essar Steel Insolvency process, the Supreme Court had upheld that commercial decision of the CoC cannot be interfered with.

The enacted rules aim to bring a systematic framework for insolvency and liquidation proceedings of FSPs other than banks. According to the definition, FSPs have no direct relation to 'financial institutions'. Ergo, a financial institution is not necessarily an 'FSP'. It follows that, only if an institution provides financial services, it is eligible to place itself under the category of 'FSP'[11], thus, NBFC is eligible to fall under the classification of 'final service provider' if business carried by the same falls under the clauses between (*a*) to (*i*) of section 3(16) of the IBC.[12]

Correspondingly, a corporate debtor who is engaged in the business of providing financial services in terms of authorization issued or registration granted by a financial sector regulator as stipulated in section 3(17) of the Code shall be categorised as an FSP. By extending the provisions of the Code to financial service providers, the RBI has brought NBFCs within the purview of the code.[13]

Also, recently, the Finance Minister while presenting the 2021-22 budget, brought down the value of loans, introduced for debt recovery under SARFAESI Act, to 20 lakhs from 50 lakh for NBFCs having a minimum asset size of Rs. 100 crore, explaining that it will bring credit discipline and will protect the interests of small borrowers.[14]

Another instance highlighting the compelling need for regulating finance entities was *IL&FS case*[15], a case wherein, an investment company,tookshort-term debt without considering the fact that its revenues were aimed towards longerterms, shook the conscience of the Indian financial market as the NCLAT allowed the banks (creditors of IL & FS) to declare the accounts of IL&FS and its group companies that had defaulted on payments as non-performing assets. Further, the auditors of the debt-ridden company faced prosecution.

Making headway the DFHL[16] case is one such instance that made the RBI expand the scope of the code by taking requisite steps and bringing NBFCs under the Code's preview. DHFL defaulted in interest payments worth INR 900 crores leading to downgrading of commercial papers of DHFL by the credit rating agencies. The phenomenon led RBI to take over the board of directors of the company under section 45-ID(1) of the RBI Act as presented via an amendment made by the Finance Bill for the financial year 2019.

On November 20, 2019, RBI appointed the ex-MD and CEO of Indian Overseas Bank R Subramania Kumar as administrator for the insolvency resolution process of DHFL. With the initiation of these proceedings, DHFL became the first NBFC to undergo insolvency proceedings.

Both of these cases, IL&FS and DHFL, highlight the difficulties faced by the FSPs which were defaulting in their payments resulting in additional stress over the economic framework in India.

♦ Analysis and Suggestions

Firstly, although with the introduction of the new rules a systematic method is offered for better holding of resolution, yet it cannot be discounted that, certain loopholes are needed to be addressed by the government. One such major concern is the definition of FSP and its applicability to the NBFCs. It is known that NBFCs have functions other than accepting deposits, therefore whether NBFCs falling under the definition of FSP remains a debatable question.

Secondly, amidst the possibility that the potential investors of an NBFC would prefer the court-monitored IBC process rather than risking a private settlement, apprehensions of untimely initiation of the rules has been raised.

It is noted that the courts in India are overburdened with multiple cases, needless to mention the time-consuming proceedings being an integral part of proceedings, the same could have been addressed by the government by giving due importance to the efficiency of Dispute Resolution Mechanism for FSP as an alternative mode of settlement as opposed to the traditional court proceedings.

While considering such loopholes, it is pertinent to consider the jurisdictional tussle between the IBC Code and the RBI Act.There is a dire need to decide a uniform regime regarding the case-to-case applicability of the law. The Reserve Bank of India, under section 45 MC, the RBI Act (1934) provides for the winding up provision of an NBFC by the RBI, resulting in a catch-22 situation wherein, which jurisdiction supersedes the other becomes a bone of contention.

As far as the third party assets are concerned, they will fall under the direct control of the administrator who shall be dealing with the same, and the moratorium period shall not apply to them, this creates ambiguity in the applicability of scope and extent of the rules, only a government release notification simplifying the scope and intent of applicability of the rules, can provide clarity on this issue.

♦ Conclusion

Until today there is no systematic mechanism for distressed FSPs which includes NBFCs, which in cases of default aim to avoid converting into NPAs therefore the most anticipated introduction of the rules which bring FSPs under the veil of IBC can be seen as a milestone achieved in the journey of protecting interests of investors engaged in financial business services set up, it is an all-encompassing holistic provision which provides for a systematic approach towards the liquation proceeding, indeed as discussed above there are some lacunas and identification of the same will lead to some relief, once addressed by the authority, it will result in smooth functioning and dealings of proceedings, the rules indeed come to rescue in order to serve and protect the interests of investors and stakeholders of FSPs in times of financial distress.

(Source: Taxmann.com)