Insolvency and Bankruptcy Hotline

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APPLICABILITY OF INSOLVENCY AND BANKRUPTCY CODE TO NBFCS

KEY TAKEAWAY

- NCLAT says CIRP cannot be initiated against a 'financial service provider', irrespective of whether such financial service provider is *actively* engaged in the business of providing financial services.

INTRODUCTION

The introduction of the Insolvency and Bankruptcy Code ("**IBC**") was aimed to provide a mechanism for restructuring and rehabilitation of stressed entities. However, in its success the IBC has left corporate debtors more vulnerable to having insolvency proceedings initiated against them as means of debt recovery. This is particularly concerning in situations where the corporate debtor has numerous public stakeholders, or is systemically important to the economy. Accordingly, the legislature has excluded from the purview of the IBC, financial service providers, and consequently the resolution of insolvency situations for these entities was left to the mechanisms provided by the Reserve Bank of India ("**RBI**"). This exclusion has been recently contested in a judgement before the National Company Law Appellant Tribunal ("**NCLAT**").

WHAT CONSTITUTES A 'FINANCIAL SERVICE PROVIDER'

The NCLAT addressed this issue in the matter of HDFC *v. RHC*[1]. In this case, an appeal was filed by HDFC ("**Appellant**") against the judgment of the New Delhi Bench of the National Company Law Tribunal ("**NCLT**") which had held that RHC ("**Respondent**"), the corporate debtor in this case, was outside the purview of the IBC as it was a non-banking financial company ("**NBFC**").

The Appellant argued that the intent of the legislature in exempting financial service providers was overlooked by the NCLT judgement. It maintained that the IBC is applicable to all entities other than those which are specifically engaged in business of providing 'financial services' as listed in Section 3(16)[2]. Reliance was further placed on the definition of 'financial service provider' covered under Section 3(17)[3] to suggest that it must be '*actively*' engaged in the business of providing financial services, which the Respondent was not, it being merely a holding company by its own admission.

The Respondent maintained that it qualified as a 'financial service provider' and placed reliance on *Randhiraj Thakur v. M/s Jindal Saxena Financial Services*,[4] wherein it was held that an application for initiation of insolvency resolution process was not maintainable against a company which had been granted the status of NBFC by the Reserve Bank of India ("**RBI**"). The Respondent in this case had been issued a Certificate of Registration by the RBI granting it permission to commence/carry on the business of "non-banking financial services". However, it had not been allowed to accept public deposits.

The NCLAT's judgment hinged on the registration of the Respondent as an NBFC. It noted that Section 3(7)[5], which defines a 'corporate person', excludes from its definition any 'financial service provider' (and consequently excludes the same from the definition of a 'corporate debtor'). To qualify as a 'financial service provider', a person must be "engaged in the business of providing financial services in terms of authorisation issued or registration granted by a financial sector regulator". Section 3(16)[6] provides a non-exhaustive list of 'financial services'. It held that it is not necessary that 'financial service providers' must accept deposits. If any of the services under Section 3(16)[7] are being provided, then the definition of 'financial service provider' would be sufficiently met, as the list provided in the definition is an inclusive list.

The NCLAT also considered the definition of 'financial institutions' in Section 45-I(c) of the Reserve Bank of India Act, 1934 ("**RBI Act**"), which includes in its ambit any non-banking institution which carries on as its business or part of its business the "acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature"[8]. Relying further on this definition, the NCLAT held that the Respondent qualifies as a 'financial institution' under the RBI Act and would therefore also qualify as a 'financial service provider' under the IBC.

ANALYSIS

The NCLAT in pronouncing this judgment, limited itself to the letter of the law. The arguments advanced by the Appellant aimed to highlight the purposive intent of the legislature in excluding the applicability of the IBC and consequent insolvency proceedings to financial service providers. The rationale behind this exclusion, would reasonably be to safeguard such financial service providers, which otherwise play a key role in the economy. The failure of a systemically important financial institution could cause a domino effect resulting in a financial crisis that could crumble the economy. Moreover, the stakeholders in these financial institutions, would be members of the

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public whose interests must be safeguarded first and foremost.

Therefore, NBFCs, specially which are deposit taking, or systemically important, would be important to be protected from an economic standpoint in public interest. However, there seems to be little cause to extend this protection to NBFCs which becoming insolvent would otherwise have no impact on the general public. Moreover, the NCLAT placed reliance on the definitions under the RBI Act, the language of which is generally broader to bring an increased number of entities under the purview of the RBI and the regulations made by it. While the general intent of section 45-I(c) the RBI Act is to cast a wider net, the provisions of the IBC are only meant to exclude applicability to entities, where there is a significant impact to public interest.

The NCLAT judgment however, has only considered the letter of the law, without delving into the statutory intent. It is highly unlikely that the intent of the legislature to exclude the applicability of the restructuring mechanism under IBC to NBFCs, was simply because they have been registered with the RBI, without due consideration on the extent of the impact, if any, that such transaction might have with respect to the general public. In this instance, there seems to be no rationale behind excluding an NBFC which does not accept deposits and is not systemically important, to be proceeded against under IBC.

– Desiree D'Sa, Arjun Gupta & Karan Kalra
You can direct your queries or comments to the authors

[1] *Housing Development Finance Corporation Ltd v. RHC Holding Private Ltd,* Company Appeal (AT)(Insolvency) No.26 Of 2019.
[2] Section 3(16) of the Insolvency and Bankruptcy Code, 2016.
[3] Section 3(17) of the Insolvency and Bankruptcy Code, 2016.
[4] *Randhiraj Thakur v. M/s Jindal Saxena Financial Services*, Company Appeal (AT)(Insolvency) No.32 and 50 of 2018.
[5] Section 3(7) of the Insolvency and Bankruptcy Code, 2016
[6] Supra note 2.
[7] Id.
[8] Section 45-I(c) of the Reserve Bank of India Act, 1934.

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