Legal Updates

Money Lending Laws not applicable to NBFCs, holds Gujarat High Court

- Ruling leaves several unanswered questions on usurious money lending in India

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In *Radhey Estate Developers vs Mehta Integrated Finance Co Ltd*., a Division Bench of Gujarat High Court (ruling dated 26th April 2011) ruled that the Bombay Money Lenders Act, as applicable to the State of Gujarat, does not apply to non-banking financial companies which are regulated by the RBI. While the ruling may come as a great respite to NBFCs, it opens up several questions which go to the very heart of regulation of the financial sector in India.

Money lending laws:

Many may not even know that something called money lending laws, other than the RBI controls, exists. Lost somewhere in the dark alleys of state legislations, money lending laws are enactments made by the States that are supposed to regulate moneylenders. One of the earliest, Bengal Moneylenders Act, was enacted pre-Independence in 1940. Several other states, over period of time, enacted money lending legislation. Note that the Constitution, in Item 30 of Part II of the Seventh Schedule, grants power to the State governments to enact legislation for monelending, moneylenders and agricultural indebtedness.

Moneylending laws typically require licensing of moneylenders, impose a ceiling on rate of interest that moneylenders can charge, and generally provide that a court shall not take cognizance of a matter filed by an unlicensed moneylender.

While the intent of the moneylending laws, as apparent from the social setting in which they were enacted as well as the wording of Item 30 of Part II of the Seventh Schedule, clearly shows that these laws were designed to protect borrowers from usurious indigenous moneylenders, in actual sweep of their language, they have not been limited to lending by such moneylenders only. In fact, some of the laws clearly say that they apply even to a commercial loan, and even to a loan given on a one-off basis. There is no exemption for loans given by companies to companies either. For instance, in the Bengal Moneylenders Act, there are express provisions dealing with commercial loans.

With the advent of organized banking and institutional lenders such as NBFCs, both the state and the subjects over period of time almost forgot about these laws. In some cases, people approached the State government for a new license – it was not even possible to find which department or official actually dealt with such licenses. Once in a while, a borrower who fails to repay a loan takes a defence that the lender in question is a not a licensed moneylender – that is where the legal alleys discuss the interesting subject of moneylending laws. This is exactly what has happened in the Gujarat High court ruling discussed in this article.

RBI's review of Moneylending laws:

It is not, however, that moneylending laws have been completely forgotten. However, the issue in India is that unless some farmers somewhere commit a suicide, we do not think the issue is politically sensitive enough to demand attention. In May 2006, the RBI constituted a Technical Group that submitted a report on reforms of moneylending legislation. The Group highlighted the need to have protection against usurious moneylending, and in fact, proposed a model legislation for States to adopt. The Report has been on the website of the RBI since July 2007, and nothing has been done on it, until farmer suicides catapulted the issue of microfinance regulation. Of course, now we are discussing a topical problem – microfinance regulation, and usurious moneylending by anyone other than a microfinance lender is not causing us a worry at all, possibly until the next round of suicides.

Are NBFCs covered by Moneylending laws?

The question whether NBFCs are covered by moneylending laws or not has been discussed in several court rulings. The Kerala High court has in *Link Hire-Purchase And Leasing Co. (Pvt.) Ltd. And Premier Kuries And Loans (Private) Ltd. vs State Of Kerala And Ors.* 103 Comp. Cas 941 (Ker) held that the moneylending laws of the State are applicable to a company even if the company is a financial company. However, in *Vellanki Leasing & Finance Pvt Ltd v. Pfimex Pharmaceuticals Ltd and two others* http://www.indiankanoon.org/doc/1662308/ the AP High court dealing with a case under sec 138 of the NI Act refused to give consideration to the fact that the plaintiff was not a registered money-lender, holding that the Act applied only to "professional moneylenders".

In the litigation before the Division Bench of the Gujarat High court, several NBFCs had joined. The argument pressed was one of repugnancy of laws – that if there is a Central law and a State law, operating in the same field, in situations such that there is an inconsistency between the two, the Central law will override. Also, a legal dictum called "occupied field" was used, implying that where a field of regulation was already occupied by a regulator, another legislation cannot make an ingress into the same. In the present case, the RBI that regulates NBFCs has already "occupied" that field.

Usury unregulated:

The court obviously answered the technical question that came before it. However, it is not for the courts to fill the policy gap that the ruling leaves. There are several points one must note, pertaining to the Gujarat High court ruling:

- First, since every state has its moneylending law, with difference of language, the ruling is limited to Gujarat only.
- Second, as the essence of the ruling is that an NBFC which is regulated by the RBI cannot face overlapping regulation from the State law, the ruling will operate only in respect of such NBFCs which are registered with the RBI. There are tens of thousands of companies that carry NBFC business, though without any registration. There are at least equal amount of entities that are unincorporated – hence, outside the RBI jurisdiction. LLPs are incorporated, and yet outside the RBI jurisdiction. None of them can claim the benefit of the Gujarat High court ruling.
- Third, the key point of repugnancy of a law may, with respect, be discussed further. One is not sure whether the case will be taken further up in the process of appeal, but there are several rulings of the Supreme Court on when is a law inconsistent or repugnant. If two laws can be complied with simultaneously, without one destroying the other, the same cannot be said to be repugnant. The purport of State control on moneylending is completely different – it is regulating/eliminating usury. That is surely not the purpose of the RBI regulations on NBFCs. The RBI nowhere controls lending practices or rates of interest that lenders can charge. In fact, the RBI in one of its circulars says NBFCs may charge rate of interest decided by them – they just have to disclose the rate of interest being charged. Hence, the contention that there is a conflict between the State laws and RBI regulations does not seem well founded. Even the RBI Technical Group did not conclude that there was a conflict – of course, the Group did recommend that NBFCs may be exempted from the regulation. But exemption is a different issue – the question of exemption would not even arise if NBFCs were not covered by the State laws in the first place.

The above legal nitty-gritty apart, if the State laws do not apply to NBFCs or companies in general, there is no control on usury in India. Usury is a form of civilized exploitation – it has existed in all ages, and perhaps in all nations. It is this that inspired Shakespeare to write all-time masterpiece; it is this that might have inspired Prophet Mohammed to give *riba* against moneylending itself. And usury continues to live in different forms even today – the rates of interest being charged by microfinance lenders came under glare for political reasons, but variety of forms of such lending continue to thrive, right under the nose of the regulators. The so-called distressed debt funds do this very thing, in a disguised form. It is pitiable that even banks get into this business, calling it by such queer names as “debt consolidation loan”.