

# *Analytical Speaking*



## Little-noted provision of Companies Act 2013 gives NBFCs parity with banks

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## *Note*

A little-known provision of the Companies Act 2013 gives NBFCs parity with banks. This will have far reaching consequences as NBFCs will be able to charge borrowers with “fraud provisions” of the Companies Act if the borrower has induced the lender to lend money by supplying misleading information. There are serious implications of fraud under the Act, with imprisonment for at least 6 months but going upto 10 years. Not only this, since auditors of NBFCs is mandatorily required to report fraud, NBFCs may effectively force the auditors to report the fraud to the MCA.

This article opens up this little known mystery.

### **Genesis of the provision:**

The genesis of the new-found parity granted by Companies Act to NBFCs is a newly inserted definition of “financial institution” in section 2 (39) of the Act, whereby financial institution is defined to include a bank, or any “financial institution defined or notified under the RBI Act”. At first blush, one would have thought, the financial institutions defined under the RBI Act would include public financial institutions such as the IFCI or IDBI of yester-years. However, if one sees the definition of “financial institutions” in section 45I (c) of the RBI Act, read with section 45I (e), the definition clearly covers non-banking financial companies.

Therefore, there is no doubt that the expression “financial institutions” under the Companies Act 2013 includes not only banks but also financial institutions.

### **Fraudulent inducement to lend money:**

Let us now see an innocuous looking provision in section 36 of the Companies Act. The section deals with fraudulent inducement to invest money. The section provides for prosecution for fraud, if any fraudulently induces an investor to lend. The language of the law uses words “knowingly or recklessly makes any statement, forecast or promise, which is false, deceptive or misleading, or deliberately conceals any material facts”. The section is to be applied where promoters may have made false or misleading statements and induced investors to invest money by making tall claims.

Large part of the section has been there in the Companies Act 1956 as well – however, there is an interesting addition here – it now includes not only investments by shareholders, but also includes credit facilities by banks or financial institutions. So, read in context of credit or borrowing facilities, if any person



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(obviously persons in charge of management of the company) knowingly or recklessly makes any statement, forecast or promise, which is false, deceptive or misleading, or deliberately conceals any material facts, and thereby induces a bank or NBFC to lend money to the company, such person is liable for fraud provisions of section 447.

### **Use of Fraud provisions by NBFCs:**

The Companies Act 2013 is heavily loaded with provisions dealing with fraud. It has over 300 references to fraud, and introduces section 447 which fixes a minimum imprisonment of 6 months, going upto 10 years, and a monetary fine of at least the amount involved in fraud, going upto 3 times the money.

The Act is laden with anti-fraud measures. The Serious Frauds Investigation Office, almost equivalent of a corporate CBI, is equipped with powers to arrest without warrant, and the offence is non-bailable. The auditor of the company has mandatorily to report frauds to the MCA if he has “reasons to believe that a fraud exists in relation to the company”.

Having been defined as a “financial institution”, enjoying parity with banks, NBFCs may, therefore, make a case, under appropriate circumstances, that the borrowers made deliberately false or misleading statement to induce the NBFC to lend or grant a credit facility. Therefore, the borrower, or officers of the borrower, should be liable to charged with fraud. The prospect of fraud reporting, or fraud prosecution, will be strong enough deterrent for a borrower to listen to an NBFC very seriously.

### **Other implications of bank-NBFC parity:**

The newly granted parity with banks as “financial institutions” has several other implication for NBFCs too.

First of all, if there is a default in payment of a credit facility to a bank or NBFC, a company is prohibited from doing any buyback of shares. This is section 70.

Second, the provisions for appointment of nominee directors, as a part of lending contracts, now extends to NBFCs too, if the requisite power is there in the loan agreement. That is to say, where the loan agreement empowers, an NBFC may appoint its nominee on the board of the borrower company.



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### **Conclusion:**

While the newly-inserted parity is a great status-booster for NBFCs, equating borrower-lender disputes with frauds undermines the gravity with which the word “fraud” is associated. Needless to say, the Companies Act 2013 has several provisions which are reactive – reactions to recent corporate scandals in India and elsewhere – hence, the statute is laden with lethal powers of prosecution, which may be abused to a large extent.

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