

NBFCs vs. FINANCIAL SERVICE PROVIDERS UNDER THE PURVIEW OF IBC

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Introduction:

Insolvency and Bankruptcy Code, 2016 (IBC) is a consolidated enactment of various codes. This code provides single window clearance system of all earliest enactment. IBC provides for consolidation and amendment of the laws relating to reorganization and insolvency resolution of **corporate persons**, partnership firms, LLP and individuals in a time bound manner.

IBC however is not applicable to the financial service providers. Realizing the vital role of financial sector Financial Resolution and Deposit Insurance (FRDI) Bill was introduced. It is expected to pave way for a comprehensive resolution framework for specified financial sector entities to deal with bankruptcy situation in banks, insurance companies and financial sector entities, as per the statement given by the government. It also aims to strengthen and streamline the current framework of deposit insurance for the benefit of a large number of retail depositors.

The purview of IBC identifies Non-banking Financial Companies as a financial creditor as defined under (7) of Part II of IBC. However, it has been a long-standing debate if the same would be considered under the ambit of IBC as a Corporate person or excluded from financial service providers. The financial service providers, which are regulated by separate financial regulators, have been specifically excluded from the purview of IBC.

Relevant provisions:

Definitions:

(7) “**corporate person**” means a company as defined in clause (20) of section 2 of the Companies Act, 2013 (18 of 2013), a limited liability partnership, as defined in clause (n) of sub-section (1) of section 2 of the Limited Liability Partnership Act, 2008 (6 of 2009), or any other person incorporated with limited liability under any law for the time being in force **but shall not include any financial service provider**;

(17) “**financial service provider**” means a person engaged in the business of providing financial services in terms of authorisation issued or registration granted by a financial sector regulator;

(16) “**financial service**” includes any of the following services, namely: –

- (a) accepting of deposits;
- (b) safeguarding and administering assets consisting of financial products, belonging to another person, or agreeing to do so;
- (c) effecting contracts of insurance;
- (d) offering, managing or agreeing to manage assets consisting of financial products belonging to another person;
- (e) rendering or agreeing, for consideration, to render advice on or soliciting for the purposes of–
 - (i) buying, selling, or subscribing to, a financial product; (ii) availing a financial service; or (iii) exercising any right associated with financial product or financial service;
- (f) establishing or operating an investment scheme;
- (g) maintaining or transferring records of ownership of a financial product;
- (h) underwriting the issuance or subscription of a financial product; or
- (i) selling, providing, or issuing stored value or payment instruments or providing payment services;

(18) “**financial sector regulator**” means an authority or body constituted under any law for the time being in force to regulate services or transactions of financial sector and includes the Reserve Bank of India, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority of India, the Pension Fund Regulatory Authority and such other regulatory authorities as may be notified by the Central Government;

Do NBFCs come under the definition of Corporate person?

When we examine the applicability of the Insolvency and Bankruptcy Code, 2016 (IBC), the definition of a Corporate person explicitly excludes Financial service providers (FSPs) from the purview of IBC. A deposit taking NBFCs shall qualify to be service provided as provided under the definition of financial service under sub-section 16(a). Therefore, NBFCs performing various other activities cannot be covered by expression “Financial Service Provider”. The code has thus not excluded a class of persons namely NBFCs but has laid down the test of being a financial service provider.

NBFCs ipso facto have not been excluded from the definition of Corporate Person under Section 3(7) but have to go through the test of being a financial service provider.

Exclusion of FSPs does not leave NBFCs outside the purview:

The definition of financial services under IBC does not per se include NBFCs (except the ones accepting deposits). The nature of the business the NBFCs are involved needs to be considered.

The same is reinstated by the order passed by the NCLT principal bench, New Delhi in the case of **M/s Jindal Saxena Financial Services Pvt. Ltd. V. M/s Mayfair Capital Pvt. Ltd.**

The Court in this case held that the fact that the applicant-respondent is registered as an NBFC would not be sufficient to assume that all transactions irrespective of their nature and character would be regarded as activity of a financial service provider.

However, in the case of NCLAT held in **-Randhiraj Thakur, Director, Mayfair Capital (P) Ltd. Vs. M/s. Jindal Saxena Financial Services (P) Ltd** is not a Corporate Person.

The NCLAT held that if the entire scheme of the IBC is seen, it will be evident that the Code is to consolidate and amend the laws relating to reorganization and insolvency resolution of ‘corporate persons’, ‘partnership firms’ and ‘individual’ in a time bound manner. It is a self-contained Code which is exhaustive in nature when it comes to reorganization and insolvency resolution.

However, an exception had been carved out while enacting the Code that the ‘financial service providers’ have been kept outside the purview of the Code. Being a consolidating legislation only those acts are permitted which are mentioned in the Code and it cannot be made applicable to ‘financial service providers’ including ‘non-banking financial institutions’ and MFI’s banks, which have been kept outside the purview of the Code.

Even though the NCLAT reversed the order passed by NCLT, maintaining the stance an NBFCs among other should be treated as a Financial Service provider, an NBFCs can have several activities of which all don’t fall under the test of a financial service provider like NBFCs can buy goods, take properties on lease, avail professional services, etc. CICs or investment companies apart from providing financial services. Hence, to construe that NBFCs on the grounds of being a

FSPs are excluded from the purview of IBC without testing the activities NBFCs are involved in, would not fall under the definition of Financial services under section 16 of IBC.

Why are FSPs excluded from IBC?

Financial Service providers as under IBC include various participants, which facilitate smooth functioning and play a key role in the economy. The rationale behind excluding FSPs is to curb the impact of failure of “**Systematically critical**” financial institutions causing a financial crisis, which would lead to a **Domino effect** in the economy. These institutions are colloquially referred to as “**Too big to fail**”.

With the Financial Resolution and Deposit Insurance Bill, 2017 (FRDI Bill), (though withdrawn on account of objections to the bail-in provisions) aims for providing resolution of insolvency of financial service providers through which the government is trying to ensure that, in the rare event of failure of a financial service provider which are “**systematically critical**”, there is a system of quick, orderly and efficient resolution in favor of depositors. The idea being that the financial service provider, which become critical in nature are identified and a resolution plan can be put into action to safeguard the interest of depositors on a pro-active basis.

The NBFCs, which are deposit taking have a bearing on the interest of the depositors at large and are hence come under the purview of financial services as defined under IBC.

Power of Central government under IBC to notify FSPs:

Relevant Provision:

Section 227. Power of Central Government to notify financial sector providers etc.-

*Notwithstanding anything to the contrary examined in this Code or any other law for the time being in force, the Central Government may, if it considers necessary, **in consultation** with the appropriate financial sector regulators, **notify** financial service providers or categories of financial service providers for the purpose of their insolvency and liquidation proceedings, which may be conducted under this Code, in such manner as may be prescribed.*

Under the aforesaid provision the purview of IBC is sought to be extended to FSPs in consultation with the respective financial sector regulators; this empowers the central government to protect the interests in case where the financial services providers seem to significantly affect the economy.

Conclusion:

While the debate on the NBFCs being treated as Corporate person or Financial service provider continues, it demands more clarity with time in the provisions. It is however important to understand that it is vital to judge whether the NBFCs are performing in nature of financial services and are then excluded else, it should fall within the definition of a Corporate Person and hence be considered under the purview of IBC.