



IBC AND FUTURE OF NBFCS IN INDIA

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With the government notifying the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019¹(FSP Rules) on 15th November, 2019, now the applicability of the IBC has been extended to cover the Financial Services Providers (FSPs). Till now FSPswere ordinarily not covered under the Insolvency and Bankruptcy Code but now with this modified framework, doors for resolution of stressednon-banking finance companies has been opened.

[Financial services provider has been defined in Section 3 (15) of the Code as “a person or entity engaged in the business of providing financial services in terms of authorisation issued or registration granted by a financial sector regulator”]

When we talk about financial services providers,we think of banks, financial institutions and NBFCs.Banks take deposits from people and cover a wide range of financial responsibilities while NBFCs as the name suggests are not banks but are involved in lending and other activities, akin to that of banks like providing loans and advances, credit facility, savings and investment products and so on. While banks are registered under the Banking Regulation Act, NBFCs are incorporated under the Companies Act and are regulated by RBI.Banks take part in country’s payment mechanism whereas NBFCs are not involved in such transactions, and since banks are the primary channel for regulation of liquidity in the country, RBI and governments usually impose multiple levels of monitoring and governance to ensure the financial health of the banks. Such stringent compliance structure doesn’t exist for other FSPsespecially for NBFCs in India.

During the last decade NBFC sector in India grewupto the size of ₹ 30.9 lakh crore (F.Y. 2018-19)²because of this rapid credit growth, the total share of NBFCs rose to 20 per cent of all credit in India till March 2018 versus 15 per cent three years ago.Conventionally retail as well as institutional borrowers in India preferred to borrow from commercial banks; however there has been a shift towards private financial lending companies (NBFCs) because of the difficult situation banks finds them in. Lack of proper management of the banks and theirlimited reach among different sections of the society paved the way of

¹The Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019.

²<https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=19367>



growth of the NBFCs, so much that they performed better than banks for the first time in 2017.

However by 2018, the market conditions weren't like before, with the RERA³ coming in force the real estate companies faced strict regulations and could not divert the money given by house owners, so they depended on NBFCs even for their working capital requirements. With the extended slump hitting the real estate market, the realtors were not able to complete the projects resulting into default in payment to the NBFCs making their financial healthworse. The banks tightened their funding towards NBFCs by raising the lending costs and cutting on exposure. NBFCs have also been facing the heat from securitises market as most of the securities issued by them in F.Y. 2018-19 have not been able to secure full subscription.

Finally due to the demand from the Industry, and after failure of one of the biggest and most venerated NBFCs in India, IL&FS, and struggling Reliance Capital, DHFL and recently Altico Capital, Government on November 18, 2019 amended the Insolvency and Bankruptcy Code (IBC) 2016 and introduced (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019.

This rule enabled the regulators of FSP, (in case of NBFCs it's the central bank of the country i.e. RBI) to initiate the resolution process against the FSPs with asset sizes greater than Rs 500 crore. This is different from the usual practice of corporate insolvency resolution process (CIRP) under the Code where any creditor of a company can file an application for initiating insolvency if they can prove that there has been a default by the company in excess of Rs. 1 lakh.

Appointment of an Administrator

Under this new framework, when the regulator will file for initiating CIRP, NCLT shall appoint an individual proposed by the appropriate regulator as the 'Administrator'. The Administrator will have all the powers of an RP. Regulator can constitute an advisory committee to advise the Administrator in the operations of the FSP during the CIRP, the advisory committee has to consist 3 or more members.

Interim Moratorium

Under IBC, a moratorium is declared from the date of admission of an application for initiating CIRP by NCLT. Once a moratorium is declared, no proceedings can be initiated or continued against a corporate debtor.

In case of FSPs, an interim moratorium will also be in effect from the date when an application for initiation of CIRP is filed. Such interim moratorium will continue till the admission or rejection of the application.

³https://www.icsi.edu/media/webmodules/REAL_ESTATE_REGULATION_AND_DEVELOPMENT_ACT.pdf



The FSP Rules also bars the suspension or cancellation of license or registration which authorises the FSP to engage in the business of providing financial services during the interim-moratorium and the CIRP. Even during liquidation proceedings, the license or registration cannot be suspended or cancelled unless an opportunity of being heard has been provided to the liquidator.

Assets of third parties

As per the FSP Rules, moratorium will not apply to any third-party assets or properties in custody or possession of the FSP, including any funds, securities and other assets required to be held in trust for the benefit of third parties.

However, the FSP Rules also provides that an Administrator shall take control and custody of third-party assets or properties in custody or possession of the FSP, including any funds, securities and other assets required to be held in trust for the benefit of third parties only for the purpose of dealing with them in the manner, as may be notified by the Central Government under Section 227.

Resolution Plan

The resolution plan for the insolvency resolution of an FSP has to include a statement explaining how the resolution applicant satisfies or intends to satisfy the requirements of engaging in the business of the FSP, as per laws for the time being in force.

No-objection of the appropriate regulator

The FSP Rules require the approval of the appropriate regulator for the persons, who would be in control or management of the FSP after approval of the resolution plan. The FSP Rules goes on to stipulate that the appropriate regulator should issue a 'no objection' on the basis of the 'fit and proper' criteria applicable to the business of the FSP; thereby also laying down the parameters for the notified appropriate regulator when it takes a decision.

If the appropriate regulator does not refuse 'no objection' within 45 working days of receipt of an application, it shall be deemed that 'no objection' has been granted.

It is expected that these amended rules will bring a much awaited relief for the stakeholders of NBFCs since they will now have a clear pathfor implementation of resolution plans.

Future Ahead

Though with the changes and amendments, the future for resolution of stressed NBFCs looks promising but taking into account their indispensable role in the economy and the crucial investment mechanism it would be critical to see how it safeguards the interest of its creditors, investors and public at large. Further inclusion of NBFCs in the IBC regime could prove to be inimical to the efficacy of the code considering the magnanimous amount of litigation it has resulted since its inception



Dewan Housing Finance Company Ltd. (DHFL) has become the first NBFC to undergo resolution under the new framework for FSPs. RBI superseded DHFL's board and later referred the mortgage lender to the NCLT, citing governance concerns and payment defaults by the firm as reasons for superseding the board. It would be interesting how this case turns out as the retail portfolio of the company is more than Rs. 32000 crores and the company's assets under management (AUM) are at Rs 1.19 lakh crore.