



Recent Judgment of Madras High Court on Restoration of NBFC License Cancelled Due to Insufficient Net Owned Fund

Enterslice Fintech Private Limited

H 55 Sector 63 Noida U.P. **INDIA**

201301 Uttar Pradesh

Ph: 9870310368

info@enterslice.com


Recently on 29th January 2019, Madras High Court gave relief to more than two thousand NBFCs whose license had been canceled due to non fulfillment of the Net Owned Fund requirement of Rs. 2 Crore. Now, they can apply for restoration of NBFC license. In India, the Reserve Bank of India is empowered to cancel the NBFC license as per the Reserve Bank of India Act. In this article, we are going to discuss the order of the Madras High Court on reinstating the NBFC license which was canceled by the RBI due to non fulfillment of the Net Owned Fund requirement.

An Opportunity of Restoration of NBFC License

Madras High Court has provided a chance to bring back NBFC license which was canceled due to insufficient Net Owned Fund (NOF). The Reserve Bank of India is empowered to regulate the activities of NBFCs in India. As per Section 45-IA of the RBI Act, it is mandatory for NBFCs to obtain a Certificate of Registration (CoR) from the Reserve Bank of India before starting its operations along with this, it is also mandatory for NBFCs to meet the Net Owned Fund (NOF) requirement.

Previous Scenario

Previously, it was required for NBFCs to maintain a minimum Net Owned Fund of Rs. 25 lakhs. Therefore to meet the net owned fund requirement of Rs.25 lakhs, three years time period had been provided under section 45-IA of the RBI Act. During this period, NBFCs were allowed to carry out the NBFC business activities irrespective of the fact they were not meeting the conditions prescribed for NBFC license. Furthermore, this period of 3 years to maintain Net Owned Fund may be further extended to 3 more years which should not exceed 6 years in aggregate, but this could only be done after considering the reason in writing. Further extension of time to NBFCs is a complete discretion of RBI in order to meet the Net Owned Fund requirement in addition to the three years provided by the law itself.



NBFC License Cancellation Authority

In case NBFC failed to comply with Net Owned Fund requirement the Reserve Bank of India is empowered to cancel the NBFC license. On 27th March 2015, the RBI issued notification regarding the maintenance of minimum net owned fund of Rs. 2 Crore in order to carry out the business activities. For this purpose, time to raise Net owned Fund has been extended till 1st April 2016 for up to Rs. 1 crore and 1st April 2017 for up to Rs. 2 crore.

Relief by Madras High Court

On 29th January, 2019 Madras High Court passed an order to provide relief to those NBFCs whose NBFC license had been cancelled due to insufficient Net Owned Fund. In case of the below mentioned:

(Petitioners)

M/s. Nahar Finance and Leasing Limited
M/s. Lodha Finance India Limited
M/s. Valluvar Development Finance Pvt. Ltd.


Vs.

(Respondents)

The Regional Director, Reserve Bank of India
The General Manager, Reserve Bank of India
The Assistant General Manager, Reserve Bank of India

Case Study

In this case, petitioners are NBFCs and respondents had canceled their Certificate of Registration (CoR) because petitioners had not complied with the Net Owned Fund requirement of Rs. 2 Crore. On this, petitioners claimed that "order was passed without giving an opportunity of being heard" therefore this order has violated the principle of natural justice.



The Madras High Court clarified the procedure defined under Section 45-IA of the RBI Act along with this; it has also interpreted the alternative which may be given to NBFCs by the RBI for fulfilling the Net owned Fund requirement.

The above-mentioned petitioners issued Show Cause Notice on April 23rd 2018 in relation to cancellation of their Certificate of Registration (CoR) which was canceled due to non-compliance with the Net Owned Fund requirement.

In Show Cause Notice, petitioner stated that due to changes in economy and policies of government such as demonetization or GST implementation, NBFCs were struggling to recover. Therefore they asked for extension of time to comply with the Net Owned Fund requirement till 31st March, 2019. Even after that RBI passed an order of cancellation of NBFC license that were unable to comply with Net Owned Fund requirement. In response NBFCs filed writ petition.


The High Court suppresses the RBI's order of cancellation of NBFC license on the basis of the below mentioned grounds:

1. Violation of the Principles of Natural Justice

Firstly, the RBI has to make it possible for NBFCs to fulfill the Net Owned Fund requirement before cancellation of NBFC license according to Section 45-IA. In case NBFCs fail to meet the criteria of Net Owned Fund, the opportunity of being heard should be given to the NBFCs prior to the cancellation of NBFC license. The High Court suppresses the RBI's order of cancellation of NBFC license on the basis of the below mentioned grounds:

2. Violation of Section 45-IA of the RBI Act

For meeting the Net Owned Fund requirement, the law itself prescribes time extensions. To meet the Net Owned Fund requirement of Rs. 25 lakhs the 3 year extension have been given by the court. In addition to this, RBI is empowered to extend further period of 3 years. The RBI may give extension till 31 March, 2021 to meet the NOF requirements. However this will be the maximum scope of extension subject to the discretion of RBI.



COMMON ORDER

The challenge in these writ petitions is to the cancellation of the Certificate of Registration issued by the Reserve Bank of India in favour of the petitioners.

Now aggrieved NBFCs (whose license had been cancelled by the RBI) may expect additional time for restoration of NBFC license. The high court has directed respondents to restore the “certificate of registration” of petitioners and to extend the time till 3st March, 2019. Even after this, if petitioner fails to comply with the prescribed requirement, the RBI may take necessary action.

Stay Updated and Keep Evolving





THANK YOU

