

Finance Companies Regulation Bill**Financial Companies Regulation Bill, 2000 : An overview**

The functioning of non-banking financial companies (NBFCs) is governed principally by provisions contained in Chapters III-B and III-C of the Reserve Bank of India Act, 1934 ('RBI Act'). The RBI, in its capacity as the body empowered to administer the aforesaid provisions, had issued several notifications, press releases, circulars, etc., to regulate and monitor the activities of NBFCs. The Government has introduced the Financial Companies Regulation Bill, 2000 in the Lok Sabha with a view to consolidate the law pertaining to the regulation and monitoring of the activities of the NBFCs with the aim of ensuring proper functioning of the NBFCs and safeguarding the interests of depositors. In this article, the author summarises some of the salient features of the Bill, highlighting the differences between them and the older (existing) provisions. The new provisions are, of course, yet to be enacted into law by the Parliament -

EDITOR

Introduction

1. The activities of non-banking finance companies (NBFCs) accepting public deposits are regulated by Chapters III-B and III-C of the Reserve Bank of India Act, 1934 ('the Act') which have been amended from time to time, particularly in 1997, in order to provide for safeguards for the functioning of NBFCs so as to ensure their viability and also for protection of depositors' interests. Despite these safeguards, several defaults have been made by NBFCs in the last few years in repayment of deposits and interest accrued thereon. In order to provide an effective remedy for the situation, the Government has introduced a bill, namely, 'The Financial Companies Regulation Bill, 2000' ('the bill') in the Lok Sabha which not only provides adequate safeguards but also an efficient and quick system for redressal of grievances of individual depositors.

At present activities of NBFCs are regulated by instructions/directions contained in numerous circulars, press releases, notifications, etc., issued by the RBI from time to time; therefore, the bill is an attempt to consolidate all of them at one place. As the bill seeks to consolidate and amend the law relating to regulation of financial companies, it contains almost all the provisions of Chapters III-B and III-C with certain modifications besides certain new safeguards for protection of interests of depositors. The bill, once enacted by the Parliament will provide a comprehensive and independent statute regulating the activities of NBFCs and the provisions

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contained in the Act relating to regulation of activities of NBFCs will be repealed.

Definition of Financial Company

2. It is worthwhile to note here that after the Act comes into force, NBFCs will be known as financial companies. As per the bill, 'financial company' means a financial institution which is a company and 'financial institution' means a non-banking institution which is carrying on as its principal business the 'business of financial institution'.

"Business of financial institution" has been defined as :

- (i) the financing whether by way of making loans or advances or otherwise, of any activity other than of its own;
- (ii) the acquisition of shares, stocks, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature;
- (iii) the letting or delivering of any goods to a hirer under a hire-purchase finance agreement or to a lessee under a financial lease agreement;
- (iv) managing, conducting or supervising, as foreman, agent or in any other capacity, of chits or any business similar thereto;
- (v) receiving deposits from or providing loans or advances against securities to its shareholders;
- (vi) receiving public deposit under any scheme or arrangement or in any other manner;
- (vii) such other business or class of business as the bank may, with the previous approval of the Central Government by notification, specify.

Registration with RBI

3. Just like the existing provision in the Act, the bill also requires compulsory registration of all the financial companies with the RBI before they commence business as a financial company. The company should also have owned funds of at least Rs. 25 lakhs before commencing the business. This limit can be raised to Rs. 2 crores by the RBI by issuing a notification. 'Owned funds' means the aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance-sheet of the company after deducting therefrom :

- (i) accumulated loss;
- (ii) deferred revenue expenditure; and
- (iii) other intangible assets.

A distinction has been made between the companies which intend to accept public deposits and which do not, inasmuch as companies which intend to accept public deposits should obtain prior authorisation of the RBI which shall be recorded in the company's registration certificate. The company will be so authorised only if it has 'net owned funds' of at least

Rs. 2 crores. However, this limit can be raised to any amount not exceeding Rs. 10 crores by the RBI by issuing a notification. The difference between 'Owned Funds' and 'Net Owned Funds' is that 'Net Owned Funds' do not take into account the following :

- (a) Investments of such company in shares of :
 - (i) its subsidiaries or holding company;
 - (ii) companies in the same group;
 - (iii) all other financial companies; and
- (b) the book value of debentures, bonds, outstanding loans and advances (including hire purchase and lease finance) made to, and deposits with,
 - (i) subsidiaries or holding company of such company; and
 - (ii) companies in the same group, to the extent such amount exceeds 10 per cent of 'Owned Funds'.

Definition of Public Deposit

4. Although no major change has been made in the definition of 'deposit', it has been specifically provided in the definition of 'public deposit' that any amount received by way of subscription to any shares, stock, bonds or debentures pending allotment for a period of not more than 180 days shall not be deemed to be public deposits. In other words allotment of shares, debentures, bonds, etc., must be made within 180 days of receipt of subscription amount, otherwise amount received by way of subscription or calls in advance will be regarded as a public deposit.

Prior approval of RBI in certain cases

5. The company shall obtain prior approval of the RBI for any substantial change in management, change in the location of its registered office or change in its name. The expression 'substantial change in management' has been defined as 'change in the management by way of transfer of shares or amalgamation or transfer of the business of the company'. The definition is not very clear as no limit of acquisition of shares has been prescribed, the acquisition within which would not be deemed to be change in management. It would have been better if just like the SEBI (Substantial Acquisition of Shares & Takeovers) Regulations, 1997 a limit, say, 15 per cent, had been fixed. It seems that the bill considers amalgamation of any other company with financial company only, as substantial change in management and not *vice versa*. In order to settle all such problems, it has been provided that decision of the RBI as to whether the change in management is a substantial change or not shall be final. The provision of the RBI approval prior to change in name of company is a very welcome move as we have observed that during the time of boom in infotech stocks a large number of finance companies had changed their names so as to give an impression to investors that they were infotech companies. As a result of this a large number of investors

have burnt their fingers by purchasing such stocks, whereas promoters of such companies have minted money by off-loading their holding. Similarly a provision has been made for prior approval for change in location of registered office in order to tackle the problem of vanishing companies.

Restriction on carrying any other business

6. The existing law allows finance companies to carry any business along with the finance business but the bill specifically provides that all financial companies, whether or not accepting public deposits, shall be engaged only in the business of finance and no other business. If any existing company is carrying on any business other than that of finance, it must close down the same within a period of three years from the date of commencement of this Act. However, a subsidiary of such financial company may carry on any business, whether financial or non-financial; therefore, an easy way out for such financial companies may be to hive off their non-financial business to their subsidiary companies.

Creation of Reserve Fund and Investment thereof

7. As per the bill, every financial company that accepts public deposits shall create a reserve fund and transfer therein a sum not less than 20 per cent of its net profit every year. An appropriation can be made from the fund only for purposes specified by the RBI and every such appropriation shall be reported to the RBI within 21 days. The RBI may, in public interest or in the interest of the depositors, direct that part of the reserve fund not exceeding 25 per cent shall be invested in unencumbered specified securities. In addition to investment of part of reserve fund in aforesaid manner, the company shall also invest in unencumbered term deposits with a scheduled bank or in unencumbered approved securities such percentage of sum-total of public deposits outstanding at the close of business on any day as the RBI may from time to time specify by notification. 'Approved Securities' means securities of any State Government or of the Central Government and such bonds, both the principal whereof and the interest whereon shall have been fully and unconditionally guaranteed by any such Government. The RBI may specify different percentages of investment in respect of different classes of financial companies. In the event of default in repayment of public deposits all the depositors shall have a first charge over these investments.

Measures to deal with defaulters

8. The RBI can issue directions to a finance company which has violated any provision of the Act or failed to comply with any direction or order issued by the RBI, restraining it from selling, transferring, creating charge on or mortgaging property without prior written permission of the RBI. The bill empowers the RBI to appoint special officers, if in its opinion, the affairs of the company are being conducted in a manner prejudicial to the public interest or in a manner detrimental to the interest of the company or its depositors. The duty of special officers shall be to obtain information regarding the affairs of the company so as to ensure compliance with the

orders or directions issued by the RBI. The bill also confers powers upon the RBI to direct a financial company or a class of financial companies to seek prior approval for appointment of statutory auditors in certain cases.

Recovery of unpaid public deposits

9. Elaborate provisions have been introduced for redressal of depositors' grievances which, *inter alia*, empower depositor(s) to make an application to the Company Law Board (CLB) in the prescribed form, in the event of default by a financial company in repayment of deposits. The CLB is empowered to pass such interim or final orders as it deems fit including an order prohibiting alienation of assets or for attachment of properties and realisation of money by sale of such properties. The CLB has also been empowered to appoint Recovery Officers in order to ensure effective recovery of unpaid public deposits of such defaulting financial companies. Recovery Officers may proceed to recover the unpaid amount of public deposits from financial companies through one or more of the following modes :

- (i) attachment and sale of movable or immovable property of the financial company or any other person against whom the order is passed;
- (ii) arrest of any person, who, at the time of receiving public deposit or default in repayment thereof, was incharge of and was responsible for the conduct of business of the financial company.

It has been specifically provided that a civil court, except the Supreme Court or the High Court exercising jurisdiction under article 226 or 227 of the Constitution, shall not have any jurisdiction to entertain any suit or proceeding in respect of any matter which the CLB is empowered to determine. It is expected that these provisions will further strengthen the existing provision in the Companies Act, 1956 under section 58A(9) which empowers the CLB to pass an order directing the defaulting companies (including NBFCs) to repay the deposits forthwith or within a stipulated time period.

Un-incorporated bodies not to accept public deposits

10. Just like the provisions of Chapter III-C, the bill also prohibits un-incorporated bodies from accepting public deposits, and if any person accepts deposits in contravention of this provision, he shall be deemed to have committed a cognizable offence. In other words, no person being an individual or an unincorporated association of individuals shall accept any public deposit if his/its business wholly or partly includes any of the businesses of a financial institution. However, just like the existing provision in the Act the bill also does not debar an individual or an unincorporated body from receiving money by way of loan from his relatives or from the relatives of the individuals constituting that unincorporated body, as the case may be. In order to ensure that individuals or unincorporated bodies do not accept public deposits, District Magistrates have been given power to call for information or inspect

records or books of account of such individuals or unincorporated bodies. If a person receives public deposit(s) in contravention of any directions issued by the RBI or contravenes provisions relating to registration or net owned funds or fails to comply with the order of the CLB, he shall be deemed to have committed a cognizable offence. Section 2(c) of the Code of Criminal Procedure, 1973 defines a 'cognizable offence' as an offence for which a police officer may, in accordance with the first schedule under the code or any other law for the time being in force, arrest a person without a warrant.

Constitution of Advisory Council

11. The RBI may, by notification, constitute a council to be known as the Advisory Council for Financial Institutions consisting of the Deputy Governor, the RBI as the chairperson and other members of the Council, to advise and make recommendations on matters referred to it by the RBI. However, the decisions and recommendations of the Council shall not be binding on the RBI.

Conclusion

12. It is expected that the new provisions sought to be introduced through the bill will help a lot in development of a healthy market for public deposits in the country as now only serious finance companies wanting to utilise funds raised from public deposits for their business purposes will come out with public deposit schemes and fraudulent promoters who just want to gobble public money will stay away from the market.