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STATUS OF NON-BANKING FINANCIAL COMPANIES IN INDIA

By

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Introduction

The Indian Financial System has as its integral part the Non-Banking Financial Institutions, inasmuch as they have been providing finances to various bodies, individuals as well institutions for their varied activities. In order to procure the necessary funds, they have been taking investments in the form of various schemes such as 'NIDHI' or other schemes by distinct names. In the recent period, there has been a mushroom growth of NBFC and several instances had come to notice that a few pensioners invested a major part of their retiral benefits with the hope of getting double or triple the investments and were taken for a ride when they found that the institutions had cheated them with no remedy to recover their money. Some of the NBFCs initially created confidence in the members of the public but later duped them. The 'nidis or mutual funds on private investments were guaranteed by their own certificates or bonds. It may be also true that some of the NBFCs earned uneviable reputation for their

honesty and integrity but they could only be quoted as rare institutions¹.

In fact the Governmental authorities encouraged NBFCs and their growth in view of their prime position in the economic development of the private sector and in a way the development of the society. In view of the policy decisions of the Government, NBFCs had acquired the status of the financial institutions and they were able to secure huge resources and these institutions were poised for a large growth during the period December of 1997².

The business of a Non-Banking Financial companies means carrying on the business of a financial institution³, and includes the business of non-banking financial company⁴. The

1. Concepts, Practices and Procedures of NBFCs- Dr. J.C. Verma p.5
2. Khanna Committee Report on growth of NBFCs-1995.
3. Section 45(1)(c) of Reserve Bank of India Act, 1997.
4. Section 45(1)(f) of Reserve Bank of India Act, 1997.

business of NBFCs includes loans and investments, stock-broking, leasing and hire purchase, housing finance, chit funds, mutual benefit funds *etc.*

Non-Banking Financial business has been carried on as a corporate body like a private or public company or as an unincorporated body like a firm. However, it has been observed that 80 per cent of non-banking financial business is done by private companies. Thus, the necessary steps are taken for a formation of a private company by fulfilling the formalities under the Indian Companies Act. Once the Registrar of Companies (ROC) issues a certificate of incorporation, it would be the conclusive evidence as to the compliance with statutory provisions and the company comes into existence as a legal person from the date of incorporations. The validity of the certificate cannot be disputed on any ground whatsoever⁵.

A Non-banking financial company is a body corporate. Its status as a legal person primarily relates to the exercise of rights and performance of duties. NBFCs have therefore, are vested with rights and are required to perform duties imposed by law as well as contractual obligations which are in conformity with the powers of the company within the terms of Memorandum of Association (MOA)⁶.

NBFC serve the nation in economic reconstruction in the same way as non-Government voluntary organizations rejuvenate the social structure. The importance of the role of NBFCs has been felt vehemently for uplifting the various sectors of the economy and boosting the rate of economic growth having learnt the lessons from the experiences of the developed nations where NBFCs have played a significant role in market based free economies⁷.

Regulations and Guidelines

The Reserve Bank of India (RBI) has amended the norms for investments of residuary non-banking finance companies to ensure that these companies work within a tighter purview of the Central Bank.

The new guidelines which have been issued in the form of a notification come into effect for the quarter ending June 30, 1997. Following the new norms, NBFCs which have a negative net worth will have to restrict their investments to flits, mandated securities, and fixed deposits/certificate of deposits of banks.

To ensure that NBFCs do not liquidate their investments in mandated securities, the RBI has asked NBFCs to deposit with a designated public sector bank the unencumbered approved securities that it has invested in. These can be withdrawn by the NBFCs only when it requires the funds for repayment to a depositor.

The Central Bank has also imposed a fortnightly reporting requirement in terms of which every NBFC will have to submit a certificate from its statutory auditors to the effect that- the amounts deposited and investments made by the company are not less than the aggregate amount of liabilities to the depositors outstanding.

The tightening of regulations for NBFCs is in line with recommendation by the Khanna Committee on NBFC Regulations. The Khanna Committee had said that the NBFCs should be made to function within a tighter purview of the RBI. The directions for investments by NBFCs, prescribed in the RBI circular, state that with effect from the quarter ending June 30, 1997, NBFCs will be required to maintain at least 10 per cent of their deposits in the form of deposits or certificate of deposits or of public Financial Institutions (FIs) or both.

Another large chunk, comprising a minimum of 60 per cent of the NBFCs total

5. *Moosa Gulam Ariff v. Ebrahim Gulam Ariff* ILR (1913)

6. *Central Transportation Co. v. Pullman's Co.*, (1890) 1, 39 p.24

7. Concepts, Practices and Procedures of NBFCs- Dr. J.C. Verma p.11

deposits has to be maintained in bonds or debentures or commercial paper of a Government company or public sector bank or FIs.

To ensure that the investments are made in sound companies, RBI has asked NBFCs to ensure that the bonds or debentures enjoy a rating of not less than 'AA' or its equivalent by any of the credit rating agencies⁸.

International Approach of NBFCs⁹:

The system of regulation of NBFCs in a few countries has been studied with a view to drawing lessons from their experiences. The countries include the United Kingdom (UK), the United States of America (USA), Australia, Malaysia, West Germany, Hong Kong and Singapore. The group selected these countries because of the special features of NBFCs in these countries which were expected to help it to concretize views on regulation of NBFCs in India. The U.K. has well diversified financial system. NBFCs are regulated by a separate legislation and the SRO concept has been well received in the UK. In USA NBFCs provide varied range of services and their deposits are also insured as in the UK. In Australia, the NBFCs are regulated by an Act which operates concurrently with State and Territory laws. Many NBFCs have converted themselves into banks in recent years. In West Germany, a different set of regulation is laid down for each category of NBFCs. In Malaysia, a wide variety of institutions are operating in an environment of macro-economic stability. In Hong Kong, a single set of regulations governs both banks as well as deposit taking institutions. In Singapore, finance companies operate along the same line as commercial banks except that they cannot operate current accounts. Thus, regulatory framework for governing NBFCs in each of the countries

has certain special features and has relevance one way or the other to the Indian situation; a study of the same would enable one to understand their characteristics and draw lessons for NBFCs in India.

Informal Advisory Group on NBFCs:

An Informal Advisory Group for NBFCs was set up by the Reserve Bank in January 1998 to monitor the implementation of the regulations issued, and to suggest remedial measures for mitigating the hardships of the NBFCs during the period of transition. The meetings of the Group have provided important inputs for effecting changes in the directions of the Reserve Bank so as to impart greater policy focus and market-orientation.

Committee for Designing the Financial Statement for NBFCs

Committee with representatives from the Reserve Bank and ICAI has been established to design and suggest a separate balance sheet, profit and loss account and disclosure norms for NBFCs. The committee submitted its report in September 1999. It is expected that the format of the proposed balance sheet and profit and loss account will seek to enhance transparency of operations of NBFCs and address some of the major concerns of the supervisory authorities.

The Reserve Bank has been entrusted with the implementation of the provisions of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 and the Chit Funds Act, 1982 in coordination with the respective State Governments. Besides, the implementation of the provisions of Chapter IIIC of the RBI Act where concurrent powers have been vested with the State Governments is also overseen by the Reserve Bank. Moreover, the Reserve Bank also maintains close interface with State Governments, Department of Company Affairs, Securities and Exchange Board of India and other regulatory authorities

8. Economic Times, dated 20 May, 1997.

9. Adopted from Appendix IV of Shah Committee Report.

for implementation of the provisions of RBI Act over various entities whose activities fall within the purview of multiple regulators. The regional offices are in constant touch

with the State authorities for initiating action against some of the unincorporated bodies engaged in financial business and mobilizing public deposits in violation of the statute¹⁰.

**BAR ASSOCIATION AND PROFESSIONAL ETHICS : A STUDY
IN THE LIGHT OF SUPREME COURT'S DECISION
IN A.S. MOHAMMED RAFI'S CASE, AIR 2011 SC 308***

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1. The legality of the Bar Association resolution that none of its members will appear for an accused came up for consideration in *A.S. Mohammed Rafi's* case¹.

2. It has been noticed that several Bar Associations have passed resolutions in the past as follows²:

- (i) That they will not defend a particular person or persons in a particular case;
- (ii) When there are clashes between the policemen and lawyers, that no one will defend the policemen in the criminal case;
- (iii) (a) That they will not defend a person who is alleged to be a terrorist or
- (b) a person accused of a brutal or heinous crime; or
- (c) involved in a rape case

3. The Supreme Court referred to several historic cases such as³

- (i) Revolutionary writer *Thomas Paine* who was jailed and tried for treason in England in 1792. *Thomas Erskine*, an advocate was briefed to defend him, when at a time he was the Attorney General for the Prince of Wales. The advocate was warned, that if he accepts the brief, he will be dismissed from service. He accepted and eventually dismissed from service. However his observations are very relevant. "From the moment that any advocate can be permitted to say that he will or will not stand between the crown and the subject arraigned in Court, where he daily sits to practice, from that moment the liberty of England are at an end".
- (ii) Indian cases similar to one of the English case has been referred to such as
 - (a) The revolutionaries in Bengal during British Rule were defended by lawyers;
 - (b) Indian communists were defended in the Meerut conspiracy case;

10. Reserve Bank of India Discussion paper on NBFCs 1999.

* *A.S. Mohammed Rafi v. State of Tamil Nadu*, AIR 2011 SC P.308

1. Supra

2. Supra Para 15

3. Supra Para 19