

## Relief to NBFCs from applicability of State Money Lenders Acts

***A recent ruling of the Supreme Court of India clarified that NBFCs are regulated by the RBI and the Money Lenders Acts promulgated by various States have no applicability to them***

### Introduction

India follows a federal constitutional structure where the power to legislate is split across three lists. There are matters on which only the Union Government can legislate (the Union List) and there are matters on which only the State Governments can legislate (the State List). There is also a third list of subject matters (the Concurrent List) on which both Union and State Governments can make laws with the legislations made by the Union Government having primacy.

The subject matter of “trading corporations including banking, insurance and financial corporations but not including co-operative societies” (**Entry 43**) is part of the Union List.

The subject matter of “money lending” is a subject in the State List and various States have made laws to regulate the business of money lending in those States. Such laws commonly seek to regulate the entities involved in the business of advancing loans towards protection of interest of the borrowers. Such laws required various approvals from the State Government and a breach of such laws may even have criminal consequences.

### A Regulatory Overlap

Non-banking financial companies (**NBFCs**) play an important role in the Indian financial system by providing multiple services which banking companies may or may



not provide. NBFCs are regulated by the Reserve Bank of India (**RBI**) under the Reserve Bank of India Act, 1934 (**RBI Act**) pursuant to the powers of the Central Government under Entry 43. However, since most of these NBFCs advance loans, a regulatory overlap existed with States contending such NBFCs also needed to comply with the State laws regulating money lending (the Kerala Money Lender Act, 1958 and the Gujarat Money Lenders Act, 2011 for example, which were examined by the Supreme Court). Failure to do so led to civil and criminal consequences for the NBFCs leading to regulatory burden and oversight.

## A Welcome Clarification

In a landmark judgement issued on May 10, 2022 in *Nedumpilli Finance Company Limited v. State of Kerala and others*, (Civil Appeal No. 5233 of 2012 – can be found at [https://main.sci.gov.in/supremecourt/2010/1744/1744\\_2010\\_10\\_1501\\_35747\\_Judgement\\_10-May-2022.pdf](https://main.sci.gov.in/supremecourt/2010/1744/1744_2010_10_1501_35747_Judgement_10-May-2022.pdf)), the Supreme Court of India provided much-needed clarity on this regulatory lay of the land.

Holding that the supervision of the RBI under the RBI Act is “from the time of birth till time of death” of the NBFCs and that RBI Act is a complete code in respect of supervision of NBFCs, the Supreme Court clarified that the State enactments regulating the business of money lending such as the Kerala Act and the Gujarat Act mentioned above have no application to the NBFCs registered under the RBI Act and regulated by the RBI. The Supreme Court also quashed the criminal proceedings initiated against certain officers of NBFCs on account of violation of such State enactments. Hence, for lending activity, one requires registration under the applicable State laws, unless one has obtained a NBFC registration with the RBI.

## Key Considerations

The stand of the Supreme Court is a welcome change for regulatory clarity for registered NBFCs. With the fast growth

seen in the financial services industry, many new players have entered the business of money lending with new and innovative business models. Several of these might be subject to the remit of the Money Lenders Acts issued by States in which they operate and any failure to comply may lead to severe consequences for the entities and their officers.

Equally, the regulatory regime, if any, for such entities is in the evolution phase and might not meet the threshold of “complete code” in itself which may be treated as a comprehensive regulatory regime made by the Central Government. In the absence of such a comprehensive and overarching legislative regime traceable to the Union List, the principles of the judgement may not apply and the entities may be subject to the State enactments. Currently, the regulatory regime for such entities is in a nascent stage in the form of the regulations and circulars issued by the RBI under the Payments and the Settlement Systems Act, 2007, or those issued by the new RBI Fintech Department in future (and potentially even by the Department of Regulation (Non-Banking) of the RBI), applicable to new age models). It is also relevant to note that the Supreme Court has not struck down such State legislations but has only clarified the applicability of such legislations to NBFCs and therefore, the ambit of regulations continues to be relevant for entities/ platforms in the business of advancing/ facilitating loans and will require closer examination of the business being operated in the background of the relevant State enactment.

Clarity on applicability to  
digital lending players would be  
useful

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