

Under which circumstances RBI may cancel the registration of NBFC?

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Address P9/P10 Mayur Vihar 1 110091

**Contact
Person**

**Mobile
Number** 9988424211

Email nityavivekranjan@gmail.com

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The Reserve Bank of India (RBI) plays a critical role in regulating Non-Banking Financial Companies (NBFCs) to ensure their operations align with the country's financial stability. NBFCs are required to obtain a Certificate of Registration (CoR) from the RBI to function legally. However, under certain circumstances, the RBI may cancel the [NBFC Registration](#). This action is taken to safeguard the public's interests, maintain financial discipline, and ensure compliance with legal and regulatory standards.

In this article, we will delve into the circumstances under which the RBI may cancel the registration of an NBFC, the consequences of such cancellation, and the procedures involved.

1. Failure to Maintain Minimum Net Owned Funds (NOF)

One of the fundamental requirements for an NBFC is to maintain a certain level of **Net Owned Funds (NOF)**, which reflects the company's capital base. As per current RBI regulations, an NBFC must have a minimum NOF of Rs. 2 crore. If an NBFC fails to maintain this minimum capital requirement, the RBI may cancel its registration. This is because adequate capital is critical for absorbing potential financial shocks and ensuring the NBFC can meet its liabilities.

Why is NOF Important?

NOF acts as a cushion for the NBFC's operations. If the NOF falls below the prescribed threshold, it indicates the NBFC may not have sufficient financial strength to operate effectively, posing a risk to the financial system and the public. The RBI, therefore, takes this as a serious violation, leading to potential cancellation.

2. Failure to Conduct Financial Business

NBFCs are registered with the intent to engage in financial activities such as lending, asset financing, and providing credit. However, if an NBFC stops carrying out financial business, the RBI may cancel its registration. Section 45-IA of the **RBI Act, 1934** mandates that NBFCs must carry out financial activities to retain their CoR. If an NBFC is inactive for a significant period, the RBI may view it as non-compliant with its obligations and cancel its registration.

What Constitutes Inactivity?

If an NBFC fails to carry out at least 50% of its total assets as financial assets or derive 50% of its total income from financial assets, it is deemed to be non-operational. In such cases, the RBI is empowered to cancel its license as the company no longer fulfills the criteria to be categorized as an NBFC.

3. Failure to Meet Fit and Proper Criteria

The **Fit and Proper Criteria** is another critical factor in maintaining an NBFC's registration with the RBI. These criteria assess whether the promoters, directors, and key management personnel of the NBFC are credible, competent, and have a sound track record. If the management fails to meet the RBI's fit and proper standards, the regulator may cancel the NBFC's registration.

Key Aspects of Fit and Proper Criteria:

- Directors and promoters must have a clean financial and criminal record.
- They must possess the necessary qualifications and experience in the financial sector.
- Any adverse findings regarding the management's background, such as involvement in fraud or other illegal activities, can trigger cancellation.

If the RBI determines that the individuals running the NBFC are not trustworthy or capable, it can revoke the company's license.

4. Violation of RBI Guidelines and Directions

The RBI sets forth a wide array of guidelines and directions to regulate the operations of NBFCs, including

capital adequacy norms, liquidity management, prudential norms, and customer protection rules. Repeated or serious violations of these guidelines can result in the cancellation of an NBFC's registration. Some key violations that can lead to cancellation include:

- Non-compliance with **capital adequacy norms**: NBFCs must maintain a certain level of capital adequacy ratio (CAR) to mitigate financial risks.
- Failure to adhere to **liquidity norms**: NBFCs are required to manage their liquidity position efficiently to meet short-term obligations.
- Non-compliance with the **Fair Practices Code**: This code mandates NBFCs to operate with transparency and fairness, particularly in lending practices.
- Not meeting **risk management** and **internal control requirements**: NBFCs must have robust internal control systems to manage risks effectively.

Repeated violations or failure to rectify breaches after receiving notices from the RBI can result in cancellation.

5. Fraudulent Activities or Mismanagement

The RBI takes a strong stance against fraudulent activities or gross mismanagement within NBFCs. If an NBFC is found to be involved in activities that defraud customers, investors, or other stakeholders, the RBI can step in and cancel its registration. This includes cases where:

- The NBFC is involved in financial scams or Ponzi schemes.
- The company misappropriates funds or indulges in unethical lending practices.
- There are instances of large-scale customer grievances that indicate systemic fraud or mismanagement.

In such cases, the RBI may not only cancel the registration but also impose severe penalties, initiate investigations, and potentially hand over the case to law enforcement agencies.

6. Inability to Repay Depositors or Investors

NBFCs, particularly those that accept public deposits, must ensure that they can honor their commitments to depositors and investors. If an NBFC defaults on its payment obligations or shows an inability to repay deposits on maturity, the RBI can cancel its registration. The primary responsibility of an NBFC is to safeguard the interests of depositors and investors, and any failure in this regard can lead to regulatory action.

Depositor Protection

The RBI monitors the financial health of deposit-taking NBFCs closely. In cases where an NBFC becomes insolvent or mismanages its deposit schemes, leading to depositor losses, the RBI may cancel the license and intervene to prevent further losses.

7. Non-Filing of Statutory Returns

NBFCs are required to file periodic returns and reports to the RBI, including financial statements, compliance reports, and other disclosures. These filings enable the RBI to monitor the NBFC's health and ensure regulatory compliance. Non-filing or inaccurate filing of these returns is viewed as a serious breach of compliance.

- **Statutory returns** include quarterly, half-yearly, and annual financial reports that NBFCs must submit as per RBI guidelines.
- **Regular audits** must also be carried out and submitted to ensure transparency in operations.

If an NBFC consistently fails to file these returns or provides misleading information, it could lead to the cancellation of its registration.

8. Cessation of Business Activities

An NBFC that voluntarily ceases its business activities or merges with another company may have its registration canceled. If an NBFC no longer intends to continue its operations or has undergone significant restructuring that renders the license unnecessary, it can voluntarily surrender its registration. The RBI, upon reviewing the reasons and ensuring all liabilities have been settled, may accept the surrender and cancel the registration.

Procedure for Cancellation by RBI

The RBI does not cancel an NBFC's registration arbitrarily. The following steps are generally followed:

1. **Notice to NBFC:** The RBI issues a show-cause notice to the NBFC, indicating the reasons for potential cancellation.
2. **Opportunity to Respond:** The NBFC is given an opportunity to respond to the notice, presenting any defense or corrective measures.
3. **Hearing:** If required, a hearing may be conducted to review the NBFC's response.
4. **Final Decision:** If the RBI is not satisfied with the explanation or the company's actions, it proceeds to cancel the NBFC's registration.

Once the registration is cancelled, the NBFC must immediately cease operations and settle its outstanding liabilities.

Conclusion

The cancellation of an [NBFC registration](#) by the RBI is a serious action, typically reserved for cases of significant non-compliance or fraudulent activities. While the RBI ensures due process is followed before cancellation, NBFCs must remain vigilant in meeting regulatory requirements, maintaining transparency, and adhering to good governance practices. By staying compliant with RBI guidelines, an NBFC can avoid the risk of cancellation and continue contributing to the financial sector's growth.

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