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CHANGE IN 'CONTROL' OF AN EXISTING NBFC / HOUSING FINANCE COMPANY

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NBFCs play a crucial role in the Indian economy because in a country like India, where 70% of the population lives in rural areas, NBFCs can often give credit to small businesses who do not meet the stringent criteria that banks require to lend money.

According to a report released in the beginning of 2016 by consulting firm PwC India stated that by 2020, credit lending by Indian NBFCs is estimated to account for anywhere between 18.2% and 20.9% of the total credit off-take in the country.

As per the financial stability report released by the Reserve Bank of India ("**RBI**") in 2016, NBFC loans expanded 16.6% in the year, twice as fast as the 8.8% credit growth across the banking sector on an aggregate level. The NBFC sector's performance and growth looks promising vis-à-vis banks despite the applicability of regulatory norms.

Keeping in view the growth of the NBFC Sector in the last few years, there has been a sharp increase in the transactions pertaining to acquisitions of Non-Banking Financial Companies ("**NBFC**" / "**NBFCs**"). One of the major reasons for the same could be higher return on the investment made by the investors in such NBFCs. Foreign investors are also attracted to Indian NBFCs as India has a growing customer base and more growth can be witnessed as compared to the saturated western markets which offer limited growth opportunities.

In August 2016, the union cabinet has given nod for foreign direct investment (FDI) under the automatic route in regulated NBFCs (*earlier it was allowed in 18 specified financial activities under automatic route with minimum capitalisation norms*). However, the transactions pertaining to acquisition of an existing NBFC in India may require RBI approval in some cases as explained below:

Conditions	Percentage cap
Any takeover or acquisition of '**control**' of an existing NBFC, which may or may not result in change of management	N.A. [The term '**control**' is subjective and has been analyzed below in detail].
Change in the '**shareholding'** of an existing NBFC, including progressive increases over time	Acquisition of **26% or more of the paid-up equity capital** of an existing NBFC will be deemed as change in control.
Any change in the '**management'** of an existing NBFC	Change in **more than 30% of the directors** of an existing NBFC, excluding independent directors, will be deemed as change in control.

The aforesaid criteria have also been made applicable in case of housing finance companies in terms of the provisions of Master Circular- Housing Finance Companies – Approval of Acquisition or Transfer of Control (NHB) Directions, 2016, dated July 1, 2017. However, in case of acquisition of control of housing finance company(ies), the approval of National Housing Board shall be required instead of RBI.

'**Control**'

According to the Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 - "control" shall have the same meaning as is assigned to it under clause regulation 2(1)(e) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**SEBI Regulations**").

Pursuant to the SEBI Regulations: "*control includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner:*

Provided that a director or officer of a target company shall not be considered to be in control over such target company, merely by virtue of holding such position."

SEBI Regulations:

In brief, "control" includes the right(s) to:

(i.) Appoint a majority of directors;
(ii.) Control the management; and
(iii.) Control the policy decision.

The aforesaid rights can be exercisable, directly or indirectly, by one person or by more than one person who are persons acting in concert, in any of the following manner:

(i.) Shareholding;
(ii.) Management rights;
(iii.) Shareholders agreements;
(iv.) Voting agreements; and
(v.) In any other manner.

In the matter of **Subhkam Ventures (I) Private Limited Vs Securities Exchange Board of India (Appeal No. 8 of 2009)**, the Securities Appellate Tribunal ("**SAT**") held that "*It is true that the affirmative vote of the appellant is required for the appointment of any of these key officers but even this provision does not mean that the appellant can get its candidate appointed. Affirmative vote of the investor in these matters is necessary for protecting its investment. We cannot infer from this provision that the appellant has gained control over the target company.*" Therefore, granting veto rights in the form of reserved matters would not be construed as change in control.

Subsequent to the aforesaid order of SAT, the appeal was preferred to the Hon'ble Supreme Court. However, the Hon'ble Supreme Court didn't answer the elusive question of what kind of negative rights in a company would constitute 'control' which may be due to the reason that both the parties (SEBI and Subhkam Ventures) have reached an out of court settlement in the matter. Therefore, the judgment of SAT in Subhkam Ventures will remain as a landmark judgment on the issues pertaining to change in control.

SEBI also floated a discussion paper on “**Brightline Tests for Acquisition of Control under the SEBI Takeover Regulations**” in March, 2016, wherein the term ‘control’ was analyzed and options for adopting changes with respect to the same were laid down. The said paper seeked public comments on the proposals contained therein.

On September 8, 2017, SEBI released a press note wherein it communicated that it was decided to continue with the practice of ascertaining acquisition of ‘control’ as per the extant definition in the Takeover Regulations.

Hence, the acquisition of control of an NBFC / HFC shall remain a subjective issue and will be decided on a case to case basis.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.