NBFC Regulations

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Topics for discussion

Define and objectives

Functions

Characteristics

Types

Various regulations

NBFC Defined

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 2013 engaged in the business

- **Providing loans and advances**
- **Acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority**
- **Receiving term deposits in one lump sum and not on demand**
- **Undertaking leasing, hire-purchase, insurance business, chit business etc.**

NBFC Defined

Exclusion

Institutions whose principal business is that of

- **Agriculture activity,**
- **Industrial activity,**
- **Purchase or sale of goods (other than securities)**
- **Providing any services and sale /purchase/ construction of the immovable property**

Objectives

The regulatory and supervisory objective is to

- **Ensure healthy growth of financial companies**
- **Ensure that these companies function as a part of the financial system within the policy framework**
- **The quality of surveillance and supervision exercised over the NBFC's is sustained by keeping pace with the developments that take place in this sector of the financial system**

Growth of NBFCs

The key factor for the NBFC's success includes customized and personalized loan product, quick processing and a customer-friendly credit policy.

NBFC will continue to maintain its growth if the following factors are widely executed in the business.

Customized Loan Product

Personalized Customer service

Use of Digital channels to increase reach

Improved and high-level Risk management tools

Fast clearance of loans and services

Importance of NBFCs

NBFCs have played a massive role in the development of the Indian economy in the following ways:

Mobilising resources;

Capital formation;

Employment generation

Drawing foreign grants;

Providing long-term credit and specialised credit;

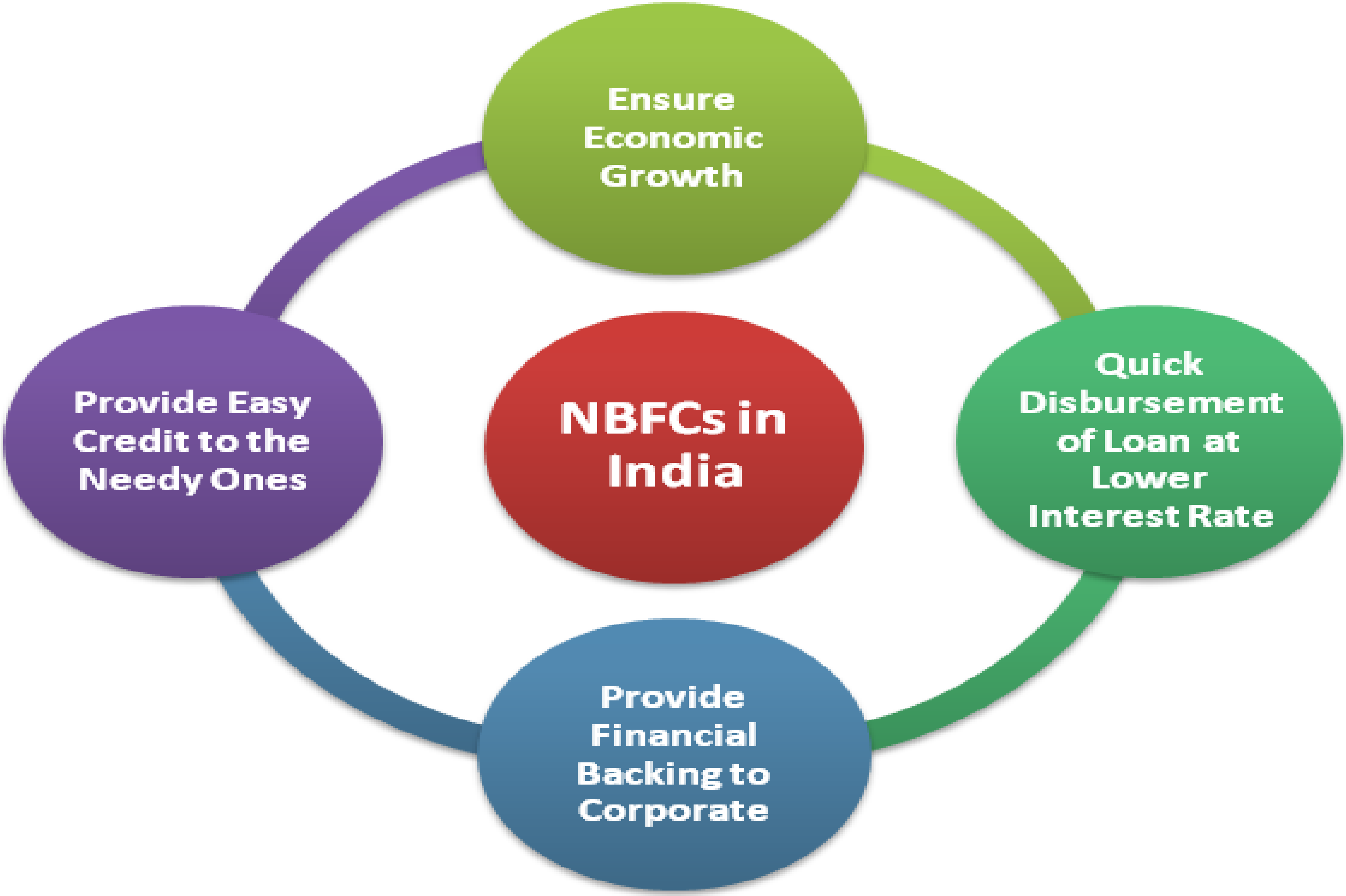
Ushering in finance to the country;

Importance of NBFCs

By deploying cutting-edge technology to make financial services accessible and affordable to all;

Acting as an alternative to banks

Provides various services, from helping in investing in property and trading money market instruments to funding private education, among others.


Ensure Economic Growth
Quick Disbursement of Loan at Lower Interest Rate
NBFCs in India
Provide Easy Credit to the Needy Ones
Provide Financial Backing to Corporate

Pre-Requisites for NBFC Registration

A company incorporated under the Companies Act and desirous of commencing business of non-banking financial institution as defined under Section 45 I (a) of the RBI Act, 1934 should comply with the following

1. Should be established as a company under the Companies Act 2013;

2. A minimum of 1/3rd of the Directors should hold 10 years of experience in finance, and such person should be employed as a full-time Director;

Pre-Requisites for NBFC Registration

3. The applicant company should have a detailed business plan for the next 5 years;

4. The company needs to maintain a net-owned fund to obtain the registration. Currently, the company is required to have a net-owned fund of 2 crore rupees;

5. The CIBIL score of the company, its directors and its members should be acceptable, which would mean they don't have any record of default in paying loans

6. The object clause specified in the Memorandum of Association must be in-line with the business plan;

List of documents to be submitted

Company Incorporation Certificate;
Detailed information on management;
Copy of PAN/Corporate Identity Number (CIN) of the company;
Documents of the location/address;
A Certified copy of the Memorandum & Articles of Association
List of Directors' profiles duly signed;
Qualification certificate of directors as well as their experience
CIBIL/credit reports of the Directors of the Company;
Board resolution on 'Fair Practices Code'
Certificate issued from the statutory auditor declaring that the company doesn't hold any public deposit and does not accept it;
Certificate specifying owned funds from a Statutory Auditor;
Shareholder KYC, CIBIL report, ITR and banker report;
Information on the bank account, balances, loans, credits, etc

Differences between NBFC and Banks

NBFCs lend and make investments and hence their activities are akin to that of banks. However there are a few differences as given below

- ✓ **NBFC cannot accept demand deposits**
- ✓ **NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself**
- ✓ **Deposit insurance facility is not available to depositors of NBFCs, unlike in case of banks**

Examples of NBFCs

LIC Housing Finance, Bajaj Finance, Mahindra & Mahindra Financial Services, Shriram Transport, Tata Sons, L&T Finance, Indiabulls Housing Finance, Piramal Capital & Housing Finance, Cholamandalam Investment and Finance Co., Shanghvi Finance Pvt. Ltd, Muthoot Finance, PNB Housing Finance, Tata Capital Financial Services, Aditya Birla Finance, HDB Financial Services and Bajaj Housing Finance.

Types of NBFC

Asset Finance Company (AFC) :

An AFC is a financial institution carrying on as its principal business the financing of physical assets supporting productive/economic activity such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipment, moving on own power and general purpose industrial machines

Principal business for this purpose is financing real/physical assets supporting economic activity and income arising therefrom is not less than 60% of its total assets and total income respectively

Example- Shriram Transport Finance Company

Types of NBFC

Investment Company (IC) :

IC is a financial institution carrying on as its principal business the acquisition of securities

Example- Bajaj Alliance General Insurance Company, IDFC, HDFC mutual fund are examples of some Investment company.

Types of NBFC

Loan Company (LC):

LC is a financial institution which provides finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.

Example- LIC finance ltd, PNB Housing Finance Firm, HDFC are some examples of the Loan companies

Types of NBFC

Infrastructure Finance Company (IFC):

IFC is a non-banking finance company

a) **Which deploys at least 75 per cent of its total assets in infrastructure loans,**
b) **Which has a minimum net owned funds of ₹ 300 crore,**
c) **Which has a minimum credit rating of 'A 'or equivalent**
d) **Has CAR of 15%.**

Example- India Infrastructure Financing Company Ltd (IIFC)

Types of NBFC

Systematically Important Core Investment Company

- It deploys 90% of its total assets in the form of investment in shares, stocks, debt or loan group company.
- Out of 90%, 60% should be invested in equity shares or those which compulsorily converted later in equity shares.
- Does not trade in its investments other than block sale
- It accepts public funds
- It can undertake investment in bank deposits, money market instruments, government securities
- Its asset size is ₹ 100 crore or above

Types of NBFC

Infrastructure Debt Fund: NBFC (IDF-NBFC) :

IDF-NBFC is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects.

IDF-NBFC raise resources through issue of Rupee or Dollar denominated bonds of minimum 5 year maturity.

Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs.

Types of NBFC

NBFC- Factor

Is a non-deposit taking NBFC engaged in the principal business of factoring.

The financial assets in the factoring business should constitute at least 50 percent of its total assets

Its income derived from factoring business should not be less than 50 percent of its gross income

Types of NBFC

Micro Finance Institution (NBFC-MFI):

NBFC-MFI is a non-deposit taking NBFC having not less than 85% of its assets in the nature of qualifying assets which satisfy the following criteria:

Loans rural household annual income not exceeding ₹ 1,00,000 or urban and semi-urban household income not exceeding ₹ 1,60,000

No collateral and repayment for loans above ₹ 15,000 – over 2 years

Example- Muthoot Microfin Ltd, Annapurna Finance ltd

Types of NBFC

Mortgage Guarantee Company-

Mortgage Guarantee Company refers to financial institutions for which a minimum 90% of the business turnover is mortgage guarantee business or

Where a minimum 90% of the gross income is from mortgage guarantee business,

Net owned funds are 100 crore rupees.

NBFC – Systematically Important Non-deposit and deposit taking Company (RBI Directions,2016)

- Every Systemically Important Non-Deposit and deposit taking NBFC Company to be registered with the Bank under the provisions of RBI Act, 1934;
- Every NBFC-Factor to be registered with the Bank under section 3 of the Factoring Regulation Act, 2011 and having an asset size of Rs. 500 crore and above;
- Every Infrastructure Debt Fund – NBFC (IDF-NBFC) to be registered with the Bank under the provisions of RBI Act,

NBFC – Systematically Important Non-deposit and deposit taking Company (RBI Directions,2016)

- Every NBFC – Micro Finance Institutions (NBFC-MFIs) has to be registered with the Bank under the provisions of RBI Act, 1934 and having an asset size of Rs.500 crore and above;
- Every NBFC - Infrastructure Finance Company (NBFC IFC) registered with the Bank under the provisions of RBI Act, 1934 and having an asset size of `500 crore and above.

Registration with RBI

In exercise of the powers conferred under clause (b) of sub-section (1) of section 45 –IA of the RBI Act, 1934 and all the powers enabling it in that behalf, the Reserve Bank, specifies two hundred lakhs rupees as the Net Owned Fund (NOF) required for a non banking financial company to commence or carry on the business of non-banking financial institution, except wherever otherwise a specific requirement as to NOF is prescribed by the Bank

Capital Requirements

Every applicable NBFC shall maintain a minimum capital ratio consisting of Tier-I and Tier II capital which shall not be less than 15 percent of its aggregate risk weighted assets on-balance sheet and of risk adjusted value of off-balance sheet items.

The Tier I capital in respect of applicable NBFCs (other than NBFC-MFI and IDFNBFC), at any point of time, shall not be less than 10% by March 31, 2017.

Applicable NBFCs primarily engaged in lending against gold jewellery (such loans comprising 50 percent or more of their financial assets) shall maintain a minimum Tier l capital of 12 percent.

Corporate Governance

Audit Committee

All applicable NBFCs shall constitute an Audit Committee, consisting of not less than three members of its Board of Directors.

Nomination Committee

All applicable NBFCs shall form a Nomination Committee to ensure 'fit and proper' status of proposed/ existing directors.

Risk Management Committee

To manage the integrated risk, all applicable NBFCs shall form a Risk Management Committee, besides the Asset Liability Management Committee

Corporate Governance

Rotation of partners of the Statutory Auditors Audit Firm

All applicable NBFCs shall rotate the partner/s of the Chartered Accountant firm conducting the audit, every three years so that same partner shall not conduct audit of the company continuously for more than a period of three years.

However, the partner so rotated shall be eligible for conducting the audit of the applicable NBFC after an interval of three years, if the applicable NBFC, so decides

Corporate Governance

Framing of Internal Guidelines

All applicable NBFCs shall frame their internal guidelines on corporate governance with the approval of the Board of Directors, and it shall be published on the company's web-site, if any, for the information of various stakeholders

Public notice for Closure of the Branch/Office

Applicable NBFCs shall give at least three months public notice prior to the date of closure of any of its branches / offices in, at least, one leading national newspaper and a leading local vernacular newspaper indicating therein the purpose and arrangements being made to service the depositors etc

Powers of RBI on NBFC

The Reserve Bank has been given the powers under the RBI Act, 1934 to register, lay down policy, issue directions, inspect, regulate, supervise and exercise surveillance over NBFCs that meet the 50-50 criteria of principal business.

The Reserve Bank can penalize NBFCs for violating the provisions of the RBI Act or the directions or orders issued by RBI under RBI Act.

The penal action can also result in RBI cancelling the Certificate of Registration issued to the NBFC, or prohibiting them from accepting deposits and alienating their assets or filing a winding up petition

NBFC Regulated by others

NBFCs exempted from the requirement of registration with RBI are

Venture Capital Fund/Merchant Banking companies/Stock broking companies - Registered with SEBI,

Insurance Company -IRDA,

Nidhi companies - Ministry of Corporate Affairs

Chit companies - Respective state governments

Housing Finance Companies regulated by NHB

Salient features of NBFC Regulations

- **The NBFCs are allowed to accept/renew public deposits for a minimum of 12 months and max period of 60 months.**

- **They cannot accept deposits repayable on demand.**

- **NBFCs cannot offer interest rates higher than the ceiling rate prescribed by RBI from time to time.**

- **The present ceiling is 12.5 per cent per annum. The interest may be paid or compounded at rests not shorter than monthly rests.**

Salient features of NBFC Regulations

- ✓ NBFCs cannot offer gifts/incentives or any other additional benefit to the depositors.
- ✓ NBFCs should have minimum investment grade credit rating.
- ✓ The deposits with NBFCs are not insured.
- ✓ The repayment of deposits by NBFCs is not guaranteed by RBI.
- ✓ Certain mandatory disclosures are to be made about the company in the Application form issued by the company soliciting deposits.

Salient features of NBFC Regulations

All NBFCs including expect Housing finance company works under the canopy of the Reserve Bank of India.

After the advent of the RBI (Amendment) act 1997, all NFBCs with net owned funds of Rs 2 Cr. and above have to avail statutory approval from the RBI

They have to build a reservoir of the fund and transfer up to extend not less than 20% of their net deposit.

RBI rules their functionalities regarding issues of disclosures, credit, prudential norms investments, etc.

Salient features of NBFC Regulations

The minimum net worth funds (NOF) of two crore is required to be maintain by companies who are willing to registered NBFC in India

NBFCs ought to maintain ten percent of their deposit as liquid assets.

They are not allowed to cap the interest rate higher than ceiling rate mentioned by the Reserve bank of India.

NBFCs depositors are eligible to avail of the nomination facility

Salient features of NBFC Regulations

NBFCs, particularly the unincorporated ones, are not eligible to accept deposits from the public.

NBFC has to maintain a minimum capital adequacy ratio of eight percent risk weighted assets

NBFCs are liable to avail minimum credit rating from credit rating agencies.

NBFCs are bound to maintain a certain threshold of liquidity buffers related to the liquid asset to address the short-term liabilities.

This will empower them to counteract the liquidity crisis.

Interest Charged by NBFCs

Reserve Bank of India has deregulated interest rates to be charged to borrowers by financial institutions (other than NBFC- Micro Finance Institution).

The rate of interest to be charged by the company is governed by the terms and conditions of the loan agreement entered into between the borrower and the NBFCs.

However, the NBFCs have to be transparent and the rate of interest and manner of arriving at the rate of interest to different categories of borrowers should be disclosed to the borrower or customer in the application form and communicated explicitly in the sanction letter etc

CAR and Liquidity buffer

Capital Adequacy Ratio (CAR)

It is the measurement ratio that assesses the ability of banks to absorb losses.

It standardizes the banks' abilities to pay off its liabilities, tackle credit and operational risks.

Liquidity Buffer

These are cash reserves are used by a bank to quickly make large cash outflows if this becomes necessary. They are over and above the minimum CAR

Regulatory Framework of NBFCs

The Reserve Bank of India as per RBI Act 1934[1], reserve the right to register, issue directions, lay down policy, inspect, and conduct scrutiny over NBFCs.

The Reserve Bank of India has the authority to penalize the NBFCs for infringing the compliances of RBI Act or the directions issues by RBI under the RBI Act.

The penal action could lead the RBI to cancel the Certificate of Registration granted to the NBFC.

Regulatory Framework of NBFCs

It is illegal to pursue business without the approval from the Reserve Bank of India.

Failing to this provision can result in cancellation or levying penalties.

Every NBFC holding an asset value of Rs. 50 crore or more shall be entitled to constitute an audit committee in accordance with the last audited balance sheet.

The committee must comprise of at least three members from the BOD.

Regulatory Framework of NBFCs

The board of directors of every NBFC that is willing to confer call loans must frame the policy for the same in the first place.

NBFC must prepare Suspicious Transaction Report (STRs) in case if they have reason to believe that the specific transaction adheres to criminal activity regardless of the transaction amount.

All the NBFCs are entitled to prepare their balance sheet along with P&L account on 31st March of every year.

Regulatory Framework of NBFCs

Liquidity Coverage Ratio

Liquidity Coverage Ratio, (LCR) is the proportion of liquid assets held by the NBFCs to address short-term liabilities.

RBI also laid down certain conditions for non-deposit taking and deposit-taking NBFCs regarding the Liquidity Coverage Ratio which will come into effect from December 2020.

These conditions are as follows.

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Regulatory Framework of NBFCs

Liquidity Coverage Ratio

If the asset size of non-deposit taking NBFCs falls in the bandwidth of Rs 5,000 crore to Rs 10,000 crore then, in that case, they have to maintain 30% of liquid assets as LCR.

RBI requires deposit-taking NBFCs to maintain a certain level of liquidity as a buffer asset to overcome the liquidity crisis

NBFC – Peer to Peer Lending Platform (RBI Directions, 2017)

"Peer to Peer Lending Platform" is an intermediary providing services of loan facilitation via online medium or otherwise, to person who has entered into an arrangement with NBFC-P2P to lend on it or to avail of loan facilitation services provided by it

NBFC - Peer to Peer Lending Platform" (NBFC-P2P) means a non-banking institution which carries on the business of a Peer to Peer Lending Platform

NBFC – Peer to Peer Lending Platform (RBI Directions, 2017)

Eligibility Criteria

No non-banking institution other than a company can undertake the business of Peer to Peer Lending Platform.

No NBFC-P2P can commence or carry on the business of a Peer to Peer Lending Platform without obtaining a Certificate of Registration from the Bank.

Every company seeking registration with the Bank as an NBFC-P2P is required to have a net owned fund of not less than rupees twenty million or such higher amount as the Bank may specify.

NBFC – Peer to Peer Lending Platform (RBI Directions, 2017)

Prudential Norms

1. NBFC-P2P shall maintain a Leverage Ratio not exceeding 2
2. The aggregate exposure of a lender to all borrowers at any point of time, across all P2Ps, shall be subject to a cap of Rs. 10,00,000/-.
3. The aggregate loans taken by a borrower at any point of time, across all P2Ps, shall be subject to a cap of Rs. 10,00,000/-.
4. The exposure of a single lender to the same borrower, across all P2Ps, shall not exceed Rs. 50,000/-.
5. The maturity of the loans shall not exceed 36 months.

Latest guidelines

Scalar Based Regulatory Framework – 2021
PCA framework- 2022

Scalar Based Regulatory Framework - 2021

On October 22, 2021, the Reserve Bank of India announced a scale-based revised regulatory framework for NBFCs with a view to having a tight oversight of the sector.

As per the scale-based regulatory framework for Non-Banking Financial Companies, there will be more categories of NBFCs as per their activity with stringent rules.

Scalar Based Regulatory Framework - 2021

The key highlights of the revision are as follows:

There will be a ceiling of 1 crore rupees per borrower for financing subscriptions to IPO.

The regulatory structure of the NBFCs will include 4 layers:

- **Base Layer- Comprising non-deposit taking NBFCs below asset size of 1000 crore rupees;**
- **Middle Layer- Comprising all deposit-taking NBFCs, non-deposit-taking NBFCs with an asset size of 1000 crore rupees and more;**
- **Upper Layer- The top 10 eligible NBFCs in terms of asset size will reside in this layer;**

Scalar Based Regulatory Framework - 2021

- **Upper Layer- The top 10 eligible NBFCs in terms of asset size will reside in this layer;**

- **Top Layer- This layer can get populated if the regulator believes that there is a substantial increase in potential risk from specific NBFCs in the upper layer.**

- **The net owned fund requirement is hiked for all NBFCs to 10 crore Rupees with certain exceptions-**

Prompt Corrective Action Framework / Regulations of RBI on NBFCs

PCA Regulations - 2022

The PCA Framework for NBFCs, comes into effect from October 1, 2022, based on, audited Annual Financial Results and/or the Supervisory Assessment made by the RBI on or after March 31, 2022.

A. The PCA Framework is applicable to the following category of NBFCs:

a. All Deposit Taking NBFCs [Excluding Government Companies] (NBFCs-D)

b. All Non-Deposit Taking NBFCs in Middle, Upper and Top Layers3 (NBFCs-ND);

PCA Regulations - 2022

Includes

i. Investment and Credit Companies,
ii. Core Investment Companies (CICs),
iii. Infrastructure Debt Funds, Infrastructure Finance Companies, Micro Finance Institutions and Factors

Excludes

(i) NBFCs not accepting/not intending to accept public funds;
(ii) Government Companies,
(iii) Primary Dealers
(iv) Housing Finance Companies

PCA Regulations - 2022

B. For NBFCs-D and NBFCs-ND, Capital , Asset Quality, Capital to Risk Weighted Assets Ratio (CRAR), Tier I Capital Ratio and Net NPA Ratio (NNPA) would be the key areas for monitoring in PCA Framework.

C. For CICs, Capital, Leverage ,Asset Quality Adjusted Net Worth/Aggregate Risk Weighted Assets, Leverage Ratio and NNPA would be the key areas for monitoring in PCA Framework

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Concluded