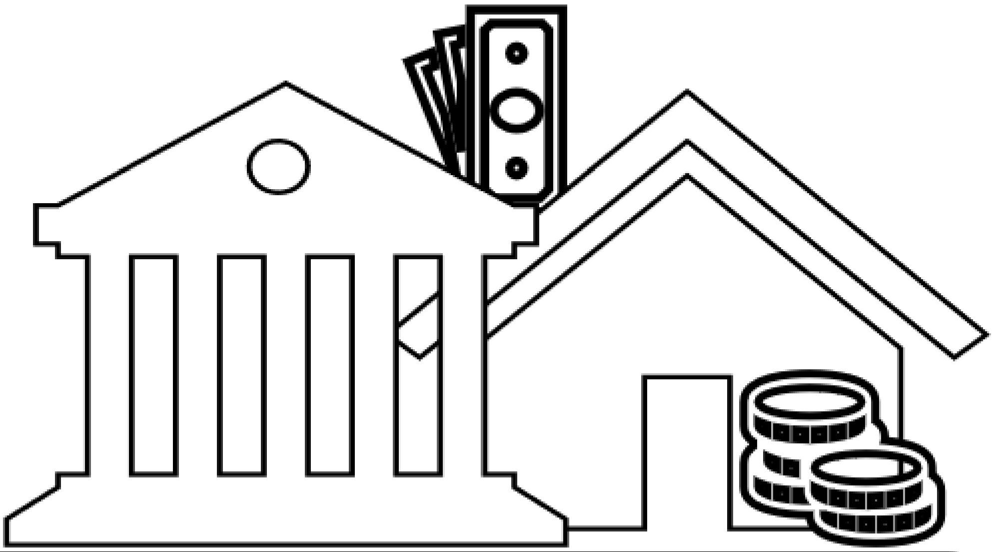

NBFC : AN OVERVIEW

Introduction:

As we all must have heard about the term NBFC (Non-Banking Financial Corporation), Nowadays, in corporate world, it is one of the eminent ways of doing business. Many of the corporate leaders are moving towards dealing in business line such as advancing loans, acquisition of shares/ stocks/ bonds/ debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business. NBFC may bear a resemblance to Banks but has different financial services i.e., these institutions are not allowed to take traditional demand deposits, also they do not form a part of the payment and settlement system and cannot issue cheques drawn on itself.

A Non-Banking Financial Company (NBFC) is a company incorporated under the Companies Act of 1956 / 2013 that engages in the following activities:

- Business of Loans and Advances,

- Acquiring shares, stocks, bonds, debentures, securities issued by Government or local authority,
- or other marketable securities of a like nature as above,
- Leasing,
- Hire purchasing,
- Insurance business,
- Chit business.

but excludes such institutions whose primary business are:

- Agriculture activities,
- Industrial activity,
- The purchase or sale of any goods (except securities) or the provision of any services or activities such as sales, purchases, and construction pertaining to the Immovable properties.

Timeline of what you would get to know about the term NBFC:

1. What distinguishes an NBFC from a bank?

2. What does term "principal business" necessarily mean?

3. Is it mandatory for every NBFC to be registered with the RBI?

4. What are the prerequisites for registration in the RBI?

5. Brief steps involved in NBFC Registration with the Reserve Bank.

6. Types of NBFC.

7. Functions of NBFC.

8. What does the RBI do to protect NBFC depositors' interests?

9. What measures should a depositor take before depositing with a non-banking financial institution (NBFC)?

What distinguishes an NBFC from a bank?

NBFC mainly deal in lending and investment, so their operations are similar to those of banks; however, there are a few differences, as listed below:

- NBFCs cannot to accept demand deposits.

- As a matter of the fact, since NBFCs are not a part of the payment and settlement system, they are unable to issue checks drawn on themselves.
- Unlike banks, NBFC depositors do not have access to the Deposit Insurance and Credit Guarantee Corporation's deposit insurance facility.

What does term "principal business" necessarily mean?

- A test, which is known as the 50-50 test, is used to determine whether or not a company is in the financial business.
- When a company's financial assets constitute more than 50% (Fifty Percentage) of total assets and income from financial assets accounts for more than 50% (Fifty Percentage) of gross income, it is classified as a principal business. RBI would accept the application to register a company as an NBFC and would issue a Certificate of Registration to the concerned entity only if it meets both of the aforesaid criteria.
- The Reserve Bank of India Act, 1934; does not define the term "principal business."
- Companies that are primarily engaged in financial activities only are required to register with the Reserve Bank of India and would be regulated and supervised by the apex bank.
- As a result, companies that are primarily engaged in agricultural operations, industrial activity, the purchase and sale of goods, providing services, or the purchase, sale, or construction of immovable properties and are also engaged in some financial business will not be regulated by the Reserve Bank.

Is it mandatory for every NBFC to be registered with the RBI?

- According to the Section 45-IA of the RBI Act, 1934, no non-banking financial company can start or continue to operation as a non-banking financial institution without first obtaining a certificate of registration from the Reserve Bank and having a Net-Owned Funds as prescribed by the Reserve Bank of India for various types of NBFCs.

- Certain types of NBFCs that are regulated by other regulators, such as Venture Capital Funds/Merchant Banking Companies/Stock Broking Companies registered with SEBI, Insurance Companies holding a valid Certificate of Registration issued by IRDA, Nidhi companies as notified under the specified Section of the Companies Act and Chit Funds, are exempted from the requirement of registration with RBI under the powers given to the Bank to avoid dual regulation.

- Housing Finance Companies are regulated by the National Housing Bank, Stock Exchange, or a Mutual Benefit Company, and Chit fund companies are regulated by the Chit Funds Act, 1982.

What are the pre-requisites for registration in the RBI?

A company formed under the Companies Act, 1956 or 2013 that wishes to operate as a non-banking financial institution as defined by Section 45 I(a) of the RBI Act, 1934 must satisfy the following requirements:

- Company must hold a valid Certificate of Incorporation issued by the competent authority i.e., Ministry of Corporate Affairs.
- Memorandum of Company must involve the financial Services as its primary object.
- It must have a net-owned fund of at least Rs 2 crore though the limit has been revised via its notification vide RBI/2021-22/112, DOR.CRE.REC.No.60/03.10.001/2021-22, dated: 22/10/2021 which would be effective from 01/10/2022.
- Net Owned Fund –
  I. Before April 1999 -Rs. 25 Lakh
  II. After April 1999 - Rs. 2 Crore
  III. Regulatory minimum Net Owned Fund (NOF) for NBFC-ICC (Investment and Credit Companies), NBFC-MFI (Micro Finance Institution) and NBFC-Factors has been increased to INR 10 (Ten) Crore.

The Reserve Bank of India has issued a path for the existing NBFCs to achieve the NOF of INR 10 (Ten) Crore:

NBFCs	Current NOF	By March 31, 2025	By March 31, 2027
NBFC-ICC	Rs. 2 Crore	Rs. 5 Crore	Rs. 10 Crore
NBFC-MFI	Rs. 5 Crore (Rs. 2 Crore in North East Region)	Rs. 7 Crore (Rs. 5 Crore in North East Region)	Rs. 10 Crore
NBFC-Factors	Rs. 5 Crore	Rs. 7 Crore	Rs. 10 Crore

However, for NBFC- Peer to Peer Lending platform (NBFC-P2P), NBFC - Account Aggregators (AA), and NBFCs with no public funds and no customer interface, the NOF shall remain to be INR 2 crore. It is clarified that there is no change in the existing regulatory minimum NOF for Infrastructure Debt Fund (NBFC-IDF), Infrastructure Finance Companies (IFCs), Mortgage Guarantee Companies, HFC, and SPD.

Brief steps involved in NBFC Registration with the Reserve Bank of India:

- Registration of Entity under Companies Act.
- Entity must maintain the company's minimum Net-owned funds according to the NBFC type, as per recent update RBI has only receiving the application for registration of NBFCs which has INR 10 (Ten) Crore as its Net Owned Fund.
- Prospective companies seeking the CoR from RBI to function as NBFC may send their brief profile introduction through email to concerned Email Ids.
- Along with the application, one must submit the specified details and documentation required for such registration related to the company as well as of its prospective director and shareholders.
- After proper submission of the application, a CARN number would be generated, which will allow entity to track the status of their application and for further communication.
- A hard copy of application also required to be submitted to the regional branch as well.
- CoR would be granted, if application for NBFC Registration meets the regulatory authority's requirements.

Different Types of NBFC:

As the number of NBFCs in India has grown, so has the categorization of NBFCs. NBFCs are now classed using below mentioned methods:

a) The type of liabilities and asset size of the NBFC; and
b) The nature of the NBFC's activities.
c) Scale based Categorisation.

On the Basis of their assets and liabilities

- Deposit taking Non-Banking Financial Companies (Deposit NBFCs) are NBFCs that take public deposits.
- Non-deposit taking NBFCs are non-banking financial companies that do not take public deposits.

- Further NBFC has been categorised under 2 sub-heads:
    - Systemically Important: NBFCs have assets of INR 500 crore or higher as per last audited balance sheet.
    - Others: Entities not falling under the aforesaid category.

On the Basis of their activities

- ***Investment and Credit Company***
  Means any company which is a financial institution carrying on as its principal business - asset finance, the providing of finance whether by making loans or advances or otherwise for any activity other than its own and the acquisition of securities.
  RBI has amalgamated three categories of NBFCs, i) Asset Company, ii) Investment Company, and iii) Loan Company, into one, i.e., the investment and credit company for the purpose of greater operational flexibility.

- ***Mortgage Guarantee Company***
  Mortgage Guarantee Company refers to financial companies with a minimum 90 percent mortgage guarantee business turnover or a minimum 90 percent gross income from mortgage guarantee business, and net owned funds of INR 100 crore.

- ***Infrastructure Financing Company***
  It is an NBFC with that invests at least 75% of its total assets in infrastructure loans having the minimum net owned funds of Rupees 300 crore along with the Capital-to-Risk weighted Assets Ratio (CRAR) of 15%

- ***Non-Operative Financial Holding Company (NOFHC)***
  It is a financial entity that allows a promoter or a group of promoters to establish a new bank. It is a completely owned NOFHC that holds banks and other financial services companies that are regulated by the Reserve Bank or other financial sector regulators to the extent allowed by the applicable regulatory prescriptions.

- ***Microfinance Institutions***
  A Micro Finance Company performs the same tasks as a bank. They make loans to small enterprises that are underserved or ineligible for traditional bank loans. 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 certain criteria as prescribed by the RBI.

- ***NBFC Factors***
  It's an NBFC that doesn't take deposits. NBFCs are involved in the Factoring business. The NBFC factor's financial assets must account for at least half of its overall assets. Furthermore, the revenue from the factoring business must account for more than half of the company's gross income.

- ***Infrastructure Debt Fund NBFCs***
  This is a sort of non-bank financial institution that allows the flow of long-term debt into infrastructure projects. Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs.

- ***Account Aggregator NBFCs***
  The RBI has given NBFC Account Aggregators permission to act as account aggregators for consumers. NBFC account aggregators keep records in a specific format. AA helps an individual securely and digitally access and share information from one financial institution they have an account with to any other regulated financial institution in the AA network.

- ***Peer To Peer Lending Platform- P2P NBFC***
  It's a digital lending marketplace that connects borrowers and lenders. The arduous loan processing procedure in the country has been made easier by the introduction of NBFC P2P.

- ***House finance Company-HFCs***
  Housing Finance Companies or HFCs, are non-bank financial institutions that specialise in financing the purchase or building of houses.

- ***CIC-ND-SI (Systemically Important Core Investment Company)***
  CIC-ND-SI is a non-banking financial company that buys stocks and bonds and other types of Securities which satisfy the specific conditions as prescribed by the RBI.

Scale Based Categorisation

RBI has distributed the NBFCs on the basis of their size, activity, and perceived riskiness.

Following are the 4 Tier of NBFCs:

1. **Base Layer**

The Base Layer shall comprise of:

(a) Non-deposit taking NBFCs having the asset size below, INR 1000 Crore and

(b) NBFCs undertaking the following activities-

(i) NBFC-Peer to Peer Lending Platform (NBFC-P2P),

(ii) NBFC-Account Aggregator (NBFC-AA),

(iii) Non-Operative Financial Holding Company (NOFHC) and

(iv) NBFCs not availing public funds and not having any customer interface.

2. Middle Layer

The Middle Layer shall consist of:

(a) All deposit taking NBFCs (NBFC-Ds), irrespective of asset size;

(b) Non-deposit taking NBFCs with asset size of INR 1,000 Crore and above;

(c) NBFCs undertaking the following activities:

(i) Standalone Primary Dealers (SPDs),

(ii) Infrastructure Debt Fund - Non-Banking Financial Companies (IDF-NBFCs),

(iii) Core Investment Companies (CICs),

(iv) Housing Finance Companies (HFCs) and

(v) Infrastructure Finance Companies (NBFC-IFCs).

3. Upper Layer

The Upper Layer shall comprise of those NBFCs which are specifically identified by the Reserve Bank of India as warranting enhanced regulatory requirement based on a set of parameters and scoring methodology.

The top 10 eligible NBFCs in terms of their asset size shall always reside in the upper layer, irrespective of any other factor.

4. Top Layer

The Top Layer will ideally remain empty. If Reserve Bank is of the opinion that there is a substantial increase in the potential systemic risk from specific NBFCs in the Upper Layer, Top layer can be populated; Such NBFCs shall move to the Top Layer from the Upper Layer.

PTN: As per the RBI notification, dated: 22/10/2021,From October 01, 2022, all references to NBFC-ND would mean NBFC-BL and all references to NBFC-D and NBFC-ND-SI shall mean NBFC-ML or NBFC-UL, as the case may be.

Functions of NBFC:

A person who wants to conduct a finance business in India must register oneself with the RBI as an NBFC. NBFCs serve a wide spectrum of consumers and give loans to the poorest members of society, including both urban and rural areas, contributing to the country's progress. NBFCs lend towards infrastructure projects which is necessary for developing countries like India. NBFCs in India cater to both rural and urban areas as they fund the projects of both small and large-scale businesses. It ensures all-inclusive growth. Furthermore, an NBFC can set its interest rate while advancing a loan, as long as it follows RBI criteria.

NBFC's functions are as Follows:

- Offering personalised loan solutions and providing leasing services;
- Using innovative technology, and using the digital platform to provide loans and related services;
- Loans are processed more quickly;
- Hire purchase Services and retail financing;
- Funding of infrastructure projects;
- Asset financing, and Acquisition of Securities

Some of the important restrictions regulating the acceptance of deposits by NBFCs are as follows:

- NBFCs are not permitted to accept and renew public deposits for a term less than 12 months and more than of 60 months. NBFCs cannot to accept the demand deposits.
- NBFCs are not allowed to offer interest rates higher than the RBI's ceiling rate as prescribed by the RBI time to time. Interest may be paid or compounded at intervals not shorter than monthly intervals.
- Depositors cannot receive gifts, incentives, or any other additional benefit from NBFCs.
- NBFCs should have minimum investment grade credit rating.
- Deposits in non-banking financial institutions (NBFCs) are not insured.
- Its Deposit’s repayment is not guaranteed by the RBI.

What does the RBI do to protect NBFCs depositors' interests?

- To ensure that NBFCs operate on sound lines, RBI has issued detailed regulations on deposit acceptance, including the quantum of deposits that can be collected, mandatory credit rating, mandatory maintenance of liquid assets for repayment to depositors, manner of deposit book maintenance, prudential regulations including maintenance of adequate capital, limitations on exposures, and inspection of NBFCs, among other things.

- If RBI notices that a particular NBFC is not complying with RBI directions via an inspection or audit of that NBFC, or through complaints or market intelligence, it may prohibit the NBFC from accepting further deposits and prohibit it from selling its assets.

- More importantly, based on Market Intelligence reports, complaints, exception reports from statutory auditors of the companies, RBI can take prompt action, including imposing penalties and taking legal action against companies found to be violating RBI's instructions/norms. The Reserve Bank immediately shares such information with coordination committees, also to all financial sector regulators and enforcement agencies.

What measures should a depositor take before depositing with a non-banking financial institution (NBFC)?

A depositor who wishes to place deposit with an NBFC should take the following safeguards before doing so:

- That the NBFC is registered with the RBI and has been granted permission to receive deposits by the RBI at its official site: www.rbi.org.in , and not prohibited to take deposit from general public.

- NBFCs must prominently display the Reserve Bank's Certificate of Registration (CoR) on their websites. This certificate should also state that the NBFC has received RBI approval to take deposits. The certificate must be examined by depositors to determine that the NBFC is permitted to receive deposits.

- An NBFC's highest interest rate to a depositor should not be more than the specified percentage set up by the RBI from time to Time.

- For every amount of money deposited with the company, the depositor must insist on a suitable receipt. The receipt must be duly signed by a corporate officer and must include the date of the deposit, the depositor's name, the amount in words and figures, the rate of interest payable, and the maturity date and amount and other details as prescribed.

- When public deposits are collected on behalf of NBFCs by brokers/agents, depositors should ensure that the brokers/agents are duly authorised by the NBFC.

- The depositor should be aware that public deposits are unsecured, and NBFC depositors do not have access to the Deposit Insurance programme.

- The Reserve Bank of India does not take any responsibility or guarantee for the firm's current financial soundness, the accuracy of any claims or representations made or opinions expressed by the company, or for the company's repayment of deposits/discharge of liabilities.

Conclusion:

Reserve Bank of India, has already been stringent towards the provisions and norms regulating the financial institutions such as Banks and Non-Banking Institution inclusive of the NBFCs, one must check out the List of NBFCs registered with the RBI from its official site before engaging with the NBFC for any formal dealings, Various new provisions and past provisions being made stringent to cope up and save the hard-earned money of the people of India and to make economy glide in a smooth way.