Non Banking Financial Companies (NBFCs)

Non-Banking Financial Company (NBFC) –

A) Meaning of NBFC –

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 / 2013 engaged in the business of –

a) loans and advances,
b) acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities
c) leasing,
d) hire-purchase,
e) insurance business,
f) chit business

but does not include any institution whose principal business is that of

a) agriculture activity,
b) industrial activity,
c) purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.

Note –

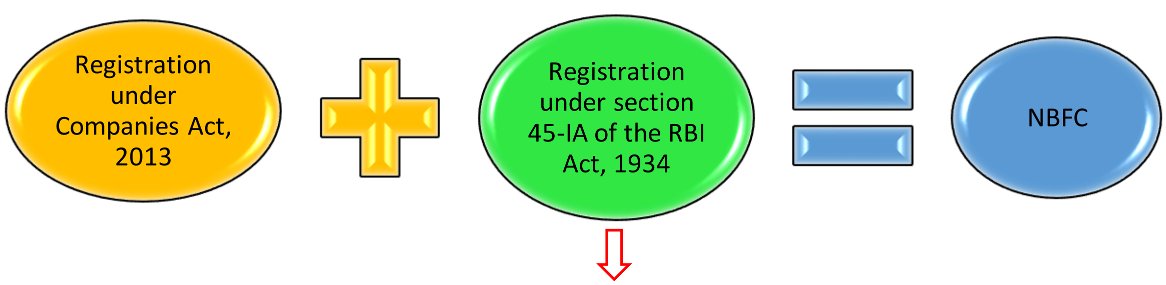
A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company.

Meaning of Financial activity as principal business – 50-50 test for NBFC's

A 50/50 test means that –

a) a firm's financial assets constitute more than 50% of the total assets; **and**
b) income from financial assets constitute more than 50% of the gross income.

A firm which fulfills both these criteria will be registered with the RBI as an NBFC. If, after registration, a firm violates the 50/50 criteria then RBI has the authority to penalize the NBFC.



For carrying on business as NBFC, a non-banking financial institution –

a) must obtain a certificate of registration from the Reserve Bank and
b) must have a Net Owned Funds of Rupees 2 crore.

Certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI –

- Venture Capital Fund/Merchant Banking companies/Stock broking companies registered with SEBI,
- Insurance Company holding a valid Certificate of Registration issued by IRDA,
- Nidhi companies,
- Chit companies as defined in Section 2(b) of the Chit Funds Act, 1982,
- Housing Finance Companies regulated by National Housing Bank,
- Stock Exchange or a Mutual Benefit company.

Difference between NBFC and Bank –

BASIS FOR COMPARISON	NBFC	BANK
Meaning	An NBFC is a company that provides banking services to people without holding a bank license.	Bank is a government authorized financial intermediary that aims at providing banking services to the general public.
Incorporated under	Companies Act 1956	Banking Regulation Act, 1949
Demand Deposit	Not Accepted	Accepted
Payment and Settlement system	Not a part of system and cannot issue cheques drawn on itself.	Integral part of the system.
Maintenance of Reserve Ratios	Not required	Compulsory
Deposit insurance facility	Not available	Available
Transaction services	Not provided by NBFC.	Provided by banks.

Types/Categories of NBFCs –

1) Asset Finance Company (AFC) –

a) An AFC is a company which 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 equipments,
- moving on own power and general purpose industrial machines.

b) Principal business for this purpose is defined as aggregate of financing real/physical assets supporting economic activity and income arising therefrom is **not less than 60% of its total assets and total income respectively.**

2) Investment Company (IC) –

IC means any company which is a financial institution carrying on as its principal business the acquisition of securities.

3) Loan Company –

LC means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own **but does not include an Asset Finance Company.**

4) Infrastructure Finance Company (IFC) –

IFC is a non-banking finance company –

a) which deploys at least 75% of its total assets in infrastructure loans,
b) has a minimum Net Owned Funds of ₹ 300 crore,
c) has a minimum credit rating of 'A' or equivalent) and a CRAR (**Compounded Rate of Annual Return**) of 15%.

5) Systemically Important Core Investment Company (CIC-ND-SI) –

CIC-ND-SI is an NBFC carrying on the business of acquisition of shares and securities which satisfies the following conditions:-

a) it holds not less than 90% of its Total Assets in the form of investment in equity shares, preference shares, debt or loans in group companies;
b) its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not less than 60% of its Total Assets;
c) it does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;
d) it does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the RBI Act, 1934 except investment in bank deposits, money market instruments, government securities, loans to and investments in debt issuances of group companies or guarantees issued on behalf of group companies.
e) **Its asset size is ₹ 100 crore or above** and
f) It accepts public funds

6) Infrastructure Debt Fund: Non- Banking Financial Company (IDF-NBFC) –

a) IDF-NBFC is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects.
b) IDF-NBFC raise resources through issue of Rupee or Dollar denominated bonds of minimum **5 year maturity.**
c) Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs.

7) **Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI) –**

"Non-Banking Financial Company – Micro Finance Institution (NBFC-MFI)" means a non-deposit taking NBFC (other than a company formed and registered under section 25 of the Companies Act, 1956 or Section 8 of the Companies Act, 2013) that fulfils the following conditions:

- Minimum Net Owned Funds of ₹ 5 crore. (For NBFC-MFIs registered in the North Eastern Region of the country, the minimum NOF requirement shall stand at ₹ 2 crore).
- Not less than 85% of its net assets are in the nature of "qualifying assets."

Note –

1) "Net assets" shall mean total assets other than cash and bank balances and money market instruments

2) "Qualifying assets" shall mean a loan which satisfies the following criteria:-

a. loan disbursed by an NBFC-MFI to a borrower with a rural household annual income not exceeding ₹1,25,000 or urban and semi-urban household income not exceeding ₹2,00,000;

b. loan amount does not exceed ₹75,000 in the first cycle and ₹1,25,000 in subsequent cycles;

c. total indebtedness of the borrower does not exceed ₹1,25,000; Provided that loan, if any availed towards meeting education and medical expenses shall be excluded while arriving at the total indebtedness of a borrower.

d. tenure of the loan not to be less than 24 months for loan amount in excess of ₹ 30,000 with prepayment without penalty;

e. loan to be extended without collateral;

f. aggregate amount of loans, given for income generation, is not less than 50 per cent of the total loans given by the MFIs;

g. loan is repayable on weekly, fortnightly or monthly instalments at the choice of the borrower.

8) **Non-Banking Financial Company – Factors (NBFC-Factors) –**

a) NBFC-Factor is a non-deposit taking NBFC engaged in the principal business of factoring.

b) The financial assets in the factoring business should constitute at least 50 percent of its total assets and its income derived from factoring business should not be less than 50 percent of its gross income.

9) **Mortgage Guarantee Companies –**

MGC are financial institutions for which at least 90% of the business turnover is mortgage guarantee business or at least 90% of the gross income is from mortgage guarantee business and net owned fund is ₹100 crore.

10) **NBFC- Non-Operative Financial Holding Company (NOFHC) –**

It is a financial institution through which promoter / promoter groups will be permitted to set up a new bank. It's a wholly-owned Non-Operative Financial Holding Company (NOFHC) which will hold the bank as well as all other financial services companies regulated by RBI or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.

11) **Systemically important non-deposit taking non-banking financial company –**
It means a non-banking financial company not accepting / holding public deposits and having total assets of ₹ 500 crore and above as shown in the last audited balance sheet.

Incorporation of NBFCs –

A) Incorporation as company –

a) Form RUN for approval of name should contain financing as the principal activity.
b) The principal business of NBFC mentioned in the MOA, while registering under the Companies Act shall be lending credit, making investments in various types of shares and stocks, leasing, hire-purchase, insurance business, chit business, and receiving deposits under any scheme or arrangement.

B) Registration Process with Reserve Bank of India –

a) After incorporation of the company, the NBFC must obtain certificate of registration.
b) For obtaining certificate of registration, NBFC should have minimum net owned fund of 2 crore rupees
c) NBFC should make an application to RBI for registration,
d) Registration of NBFC is done under section 45I-A of RBI Act, 1934

For your Knowledge –

- The applicant company is required to **apply online and submit a physical copy** of the application along with the necessary documents to the Regional Office of the Reserve Bank of India.
- The application can be submitted online by accessing RBI's secured website *https://cosmos.rbi.org.in*.

C) Prerequisite before applying for registration –

a) It should have minimum one director from NBFC background or senior Bankers as full-time director in the company
b) Clean CIBIL records
c) Understanding of NBFC / Finance business

Certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI –

- Venture Capital Fund/Merchant Banking companies/Stock broking companies registered with SEBI,
- Insurance Company holding a valid Certificate of Registration issued by IRDA,
- Nidhi companies,
- Chit companies as defined in Section 2(b) of the Chit Funds Act, 1982,
- Housing Finance Companies regulated by National Housing Bank,
- Stock Exchange or a Mutual Benefit company.

D) Conditions to be fulfilled for getting registration –

Before Granting registration to NBFC, RBI will check that the following conditions are fulfilled –

a) **NBFC is** or shall be in a position to pay its present or future depositors in full as and when their claims accrue

b) **Affairs of the NBFC** are not being or are not likely to be conducted in a manner detrimental to the interest of its present or future depositors;

c) general character of the management or the proposed management of the NBFC shall not be prejudicial to the public interest or the interests of its depositors;

d) NBFC has adequate capital structure and earning prospects;

e) Granting registration to NBFC will be in public interest;

f) Grant of registration should not be against the financial sector of the country;

g) Such other conditions as the RBI thinks fit.

If all the above conditions are satisfied then RBI will grant registration and provide license to an NBFC.

E) Cancelation of a Certificate of Registration –

RBI may cancel a certificate of registration of NBFC if such NBFC –

a) ceases to carry on the business of a non-banking financial institution in India; or

b) has failed to comply with any condition subject to which the certificate of registration had been issued to it; or

c) at any time fails to fulfil any of the conditions such as adequate capital structure and earning prospects; public interest, monetary stability, and economic growth etc. or

d) fails to comply with any direction issued by the Reserve Bank of India under the provisions of Chapter III B of RBI Act; or

e) fails to maintain accounts as per direction or order of RBI; or

f) fails to submit or offer for inspection its books of account and other relevant documents when so demanded by an inspecting authority of RBI; or

g) has been prohibited from accepting deposit by an order made by the RBI for minimum 3 months.

If any person is aggrieved by the order for cancellation of registration given by RBI then such aggrieved person may file and appeal within 30 days to central government and decision of central government shall be final.

Reserve Fund – Section 45-IC

1) Every NBFC shall create a reserve fund
2) **Amount to be deposited in reserve fund = 20% of net profit every year (Profit shall be as disclosed in the P&L Account and it should be before payment of any dividend.**
3) Reserve fund can only be used for such purpose as specified by RBI.
4) Whenever NBFC will withdraw any amount from reserve fund, it shall report to the RBI within 21 days of withdrawal.
5) Period of 21 days can be extended by RBI if there is sufficient cause.

CG has the power to exempt any NBFC from the requirements of maintaining reserve fund.

But such exemption should be given only on the recommendation of RBI.

Maintenance of Percentage of Assets – Section 45-IB

A) Percentage of assets to be maintained –

Every NBFC shall invest and maintain of continuous basis minimum 5% and maximum 20% of the deposits outstanding at the close of business on the last working day of the second preceding quarter.

B) Where investments should be made –

a) Investment should be made in unencumbered approved securities.

b) "approved securities" means securities of any State Government or of the Central Government or bonds which have full guarantee by CG or SG.

c) "unencumbered approved securities" includes the approved securities kept as security by NBFC with another financial institution for securing loan

C) Important points –

a) If the amount invested by NBFC falls below the specified rate then such company shall be liable to pay RBI a **penal interest at a rate of 3% p.a.** above the bank rate for the shortfall.

b) If the **shortfall continues in the subsequent quarters then penal interest rate will be 5% p.a. above the bank rate** for the shortfall.

c) Penal interest should be paid within 14 days

Power of Reserve Bank of India to Remove Directors from Office –

1) If RBI thinks that it is necessary to remove director of any NBFC (other than government owned NBFC) in the public interest or in the interest of deposit holders or for any other reason then RBI may remove such director from the office.
2) Before removing an opportunity of being heard should be given to such director.
3) Where any order of removal is made in respect of a director of a company , he shall cease to be a director of NBFC.
4) Once director is removed then he shall not act as director for any NBFC for such time which will be specified by NBFC but it cannot be more than 5 years.
5) Director removed cannot claim any compensation for the loss or termination from office.

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Appointment of director in place of removed director –

a) RBI may appoint a suitable person in place of director so removed.

b) Such director will hold office for maximum period of 3 years or such further periods not exceeding three years at a time;

Supersession of Board of Directors of Non-Banking Financial Company –

1) If RBI thinks that it is necessary to supersede board of directors of any NBFC (other than government owned NBFC) in the public interest or in the interest of deposit holders or for any other reason then, RBI may supersede the BOD of such NBFC.
2) Maximum time for which BOD can be superseded = Maximum 5 years.
3) After supersession of the BOD, RBI may appoint a suitable person as the Administrator.
4) Administrator will work as per the orders and directions of RBI.
5) Whenever RBI orders supersession of BOD of NBFC then the chairman, managing director and other directors should vacate their office and all the powers to manage NBFC gets transferred to RBI's Administrator.

Reserve Bank to Regulate or Prohibit Issue Of Prospectus or Advertisement Soliciting Deposits of Money – Section 45J

RBI has the power to –

a) Regulate or prohibit the issue of any prospectus or advertisement soliciting deposits of money from the public by NBFCs; and
b) specify the conditions for issuing prospectus or advertisements.

Power of Bank to Determine Policy and Issue Directions – Section 45JA

If RBI thinks that it is necessary in the public interest or in the interest of deposit holders or for any other reason then, RBI will make policies and may issue directions with to NBFCs for aspects relating to –

- income recognition,
- accounting standards
- provision for bad and doubtful debts,
- capital adequacy,
- deployment of funds, etc.

Power of Bank to Collect Information from Non-Banking Institutions as to Deposits and to Give Directions – Section 45K

1) RBI has the power to direct anytime that every NBFC shall furnish to RBI statements information or details relating to the deposits received by the NBFCs.
2) The details to be called by RBI may include –
   a) The amount of deposit;
   b) Purpose of accepting deposit;
   c) Tenure of deposits;
   d) Rate of interest; etc.
3) RBI also has the power to issue directions to NBFCs for the matters relating to –
   b) The amount of deposit;
   c) Purpose of accepting deposit;
   d) Tenure of deposits;
   e) Rate of interest; etc.

If any NBFC fails to follow the order or directions of RBI then RBI may prohibit the acceptance of deposits by that NBFC.

Power of Bank to Call for Information from Financial Institutions and to Give Directions –

If RBI thinks that for the purpose of enabling RBI to regulate the credit system of the country to its advantage it is necessary to do so, RBI may –

a) Require any NBFC or all NBFCs to submit such information as may be considered necessary by RBI and specified in the order of RBI.
b) Give directions to and NBFC or all NBFCs relating to the conduct of business by them.

Powers and Duties of Auditors –

1) It is the duty of the auditor of the NBFC to inquire whether or not the NBFC has submitted all the necessary information to the RBI
2) Auditor shall include the report made to RBI in his report made under Audit report prepared under Companies Act, 2013
3) RBI also has the power to conduct special audit of NBFC and the auditor conducting special audit shall submit report to the RBI. Remuneration of the auditor for special audit shall be fixed by RBI and shall be borne by NBFC.

Power to Take Action against Auditors –

where any auditor fails to comply with any direction given or order made by the RBI then RBI may remove or debar the auditor from exercising the duties as auditor of any of the Reserve Bank regulated entities for a maximum period of three years, at a time.

Power of Bank to Prohibit Acceptance of Deposit and Alienation of Assets –

1) If any NBFC violates the provisions of any section or fails to comply with any direction or order given by the RBI then RBI may prohibit the NBFC from accepting any deposit.
2) If RBI thinks that it is necessary in the public interest or in the interest of deposit holders then RBI may order to the NBFC against whom an order for prohibition to accept deposit has already been passed that such NBFC shall not sell, transfer or create charge or mortgage on the property or assets of the NBFC without prior permission of RBI and such order will be valid for maximum 6 months.

Resolution of NBFC – Section 45MABA

A) If RBI thinks that it is necessary in the public interest or in the interest of deposit holders or for any other reason then, RBI will order –
   - **a) Amalgamation of two or more NBFCs**
   - **b)** reconstruction of the NBFCs
   - **c)** splitting the NBFC in different units.

RBI can also order for establishment of Bridge institutions.
Now, what is Bridge institutions?
"Bridge Institutions" mean temporary institutional arrangement made under the scheme to preserve the continuity of the activities of a NBFC that are critical to the functioning of the financial system.

B) RBI may also provide for –

1) reduction of the pay and allowances of the chief executive officer, managing director, chairman or any officer in the senior management of the NBFC;
2) cancellation of all or some of the shares of the non-banking financial company held by the chief executive officer, managing director, chairman or any officer in the senior management of the nonbanking financial company or their relatives;
3) sale of any of the assets of the NBFC.

Power of Reserve Bank to File Winding Up Petition – Section 45MC

If the RBI is satisfied that an NBFC –

- is unable to pay its debt; or
- has become disqualified to carry on the business of a nonbanking financial institution; or
- has been prohibited by the Reserve Bank from receiving deposit for minimum 3 months; or
- the continuance of the NBFC will be against the public interest.

Then RBI will file an application for winding up of such NBFC under Companies Act.

Note –

A NBFC will deemed to be unable to pay its debt if it has refused or has failed to meet within five working days any lawful demand made and the RBI certifies in writing that such company is unable to pay its debt.

Chapter IIIB OF RBI Act to Override Other Laws –

the provisions of this Chapter IIIB of RBI Act shall have overriding effect on other laws

Returns to be submitted by deposit taking NBFCs –

Situations	Forms
Quarterly Returns on deposits in First Schedule.	**NBS-1**
Quarterly return on Prudential Norms is required to be submitted by NBFC accepting public deposits.	**NBS-2**
Quarterly return on Liquid Assets by deposit taking NBFC	**NBS-3**
Annual return of critical parameters by a rejected company holding public deposits	**NBS-4**
Monthly return on exposure to capital market by deposit taking NBFC with total assets of ` 100 crore and above.	**NBS-6**
NBFC holding public deposits of more than ` 20 crore or asset size of more than ` 100 crore	**NBFC holding public deposits of more than ` 20 crore or asset size of more than ` 100 crore**

Note –

In addition to above returns, NBFCS should also submit –

a) **Audited Balance sheet and Auditor's Report**
b) **Branch Info Return**

Returns to be submitted by NBFCS-ND-SI –

1) NBS-7 A Quarterly statement of capital funds, risk weighted assets, risk asset ratio etc., for NBFC-NDSI.
2) Monthly Return on Important Financial Parameters of NBFCs-ND-SI.
3) ALM returns –
   a) Statement of short-term dynamic liquidity in format ALM [NBS-ALM1] -Monthly,
   b) Statement of structural liquidity in format ALM [NBS-ALM2] Half yearly,
   c) Statement of Interest Rate Sensitivity in format ALM -[NBS-ALM3], Half yearly
4) Branch Info return.