

## P Vijaya Bhaskar: Non-banking finance companies – game changers

Speech by Mr P Vijaya Bhaskar, Executive Director of the Reserve Bank of India, at the Associated Chambers of Commerce and Industry of India (ASSOCHAM), Delhi, 23 January 2014.

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### Introduction

The Indian financial sector consists of a wide variety of institutions which cater to different market segments. At the apex level are scheduled commercial banks which follow universal banking model. Next, there is the cooperative banking sector with two different strands. While the three Tier rural co-operative structure (State/District/grassroot level outfits), takes care predominantly of agriculture and allied activities; the urban co-operative banking structure provides succour mainly to the small customers at the bottom of pyramid in urban areas. On the other hand, Non-Bank Financial Companies (NBFCs) are largely involved in serving those classes of borrowers who are generally excluded from the formal banking sector. However, progressively over the years, the exclusiveness between the banks and NBFCs has somewhat blurred. More recently, NBFCs are competing with banks in providing financial services such as infrastructure finance and housing finance among others.

NBFCs, historically are involved in providing financial services such as offering of small ticket personal loans, financing of two/three wheelers, truck financing, farm equipment financing, loans for purchase of used commercial vehicles/machinery, secured/unsecured working capital financing, etc. Further, NBFCs also often take lead role in providing innovative financial services to Micro, Small, and Medium Enterprises (MSME) most suitable to their business requirements. The characteristics of NBFC financial services include simpler processes and procedures in sanction and disbursement of credit; timely, friendly and flexible terms of repayment aligned to the unique features of its clientele, albeit at a higher cost.

There's an element of unavoidable overlap of functions, which in no way impinges on the efficiency or effectiveness of the formal financial system in the country.

The speech is organised in six sections. Section 1 provides a profile of the NBFC Sector while Section 2 deals with the extant regulatory framework for NBFCs. An analysis on business trends of the NBFC sector is given at Section 3. The important role played by NBFCs in promoting inclusive growth is the subject matter of Section 4. Section 5 highlights the imperatives to be taken care of, by the industry as also the regulators, for NBFCs to become real changers while the way forward and concluding thoughts are given in Section 6.

### Section 1: Profile of NBFC sector

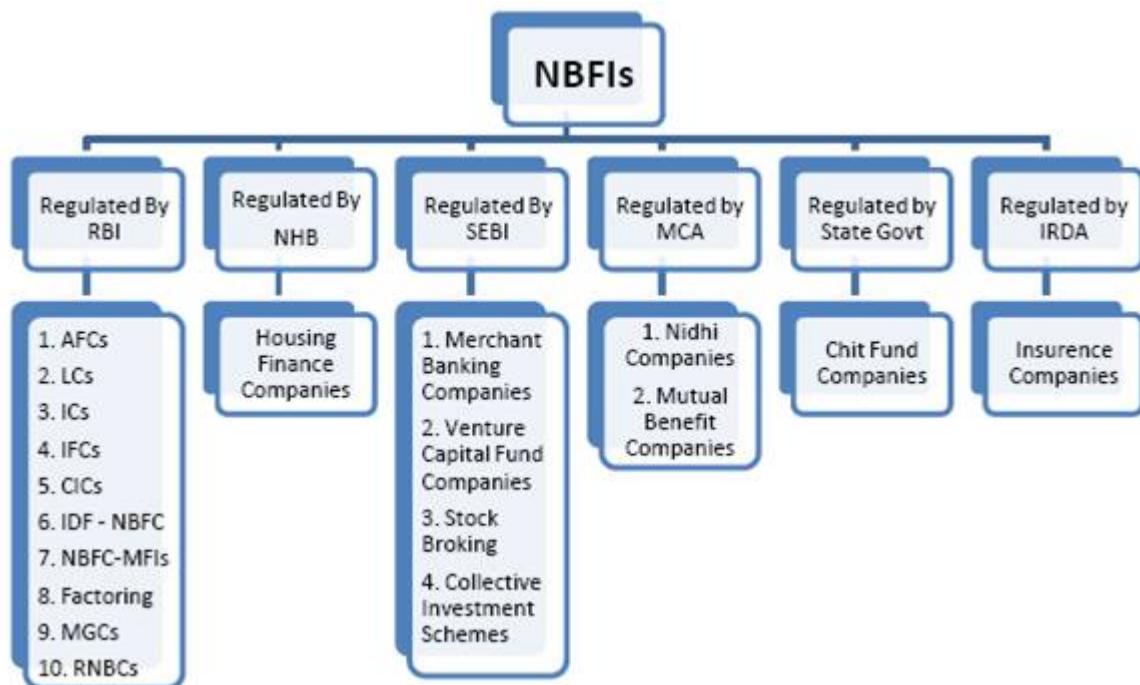
#### 1.1 Legal definition of NBFC

A company is considered as an NBFC if it carries on as its business or part of its business, any of the activities listed in Section 45 I (c) of the RBI Act, 1934, viz., business of making loans/advances or acquisition of shares / securities, etc. or hire purchase finance or insurance business or chit fund activities or lending in any manner provided the principal business of such a company does not constitute any of the following non-financial activities viz. (a) agricultural operations (b) industrial activity (c) trading in goods (other than securities) (d) providing services (e) purchase, construction or sale of immovable property. Further in terms of section 45 I (f) of the RBI Act, a company would also be an NBFC, if its principal business is that of receiving deposits under any scheme or arrangement. Thus a company

whose principal business is agricultural operations, industrial activity, trading or real estate business is not a financial institution.

The extremely diverse set of entities in the Non-Bank Finance Institution (NBFI) universe and their respective regulators are shown in Chart 1 below.

**Chart 1  
The NBFI Universe**



As depicted above, RBI classifies NBFCs into ten categories namely Asset Finance Companies (AFCs), Loan Companies (LCs), Investment Companies (ICs), Infrastructure Finance Companies (IFCs), Core Investment Companies (CICs), Infrastructure Debt Funds (IDF-NBFCs), NBFC-Microfinance Institutions (NBFC-MFIs), Factoring companies (FCs), Mortgage Guarantee Companies (MGCS) and Residuary Non-Banking Companies (RNBCs).

## **1.2 Size of the sector**

The share of NBFCs' assets in GDP (at current market prices) increased steadily from just 8.4 per cent as on March 31, 2006 to 12.5 per cent as on March 31, 2013; while the share of bank assets increased from 75.4 per cent to 95.5 per cent during the same period (Table 1). In fact, if the assets of all the NBFCs below Rs.100 crore are reckoned, the share of NBFCs' assets to GDP would go further.

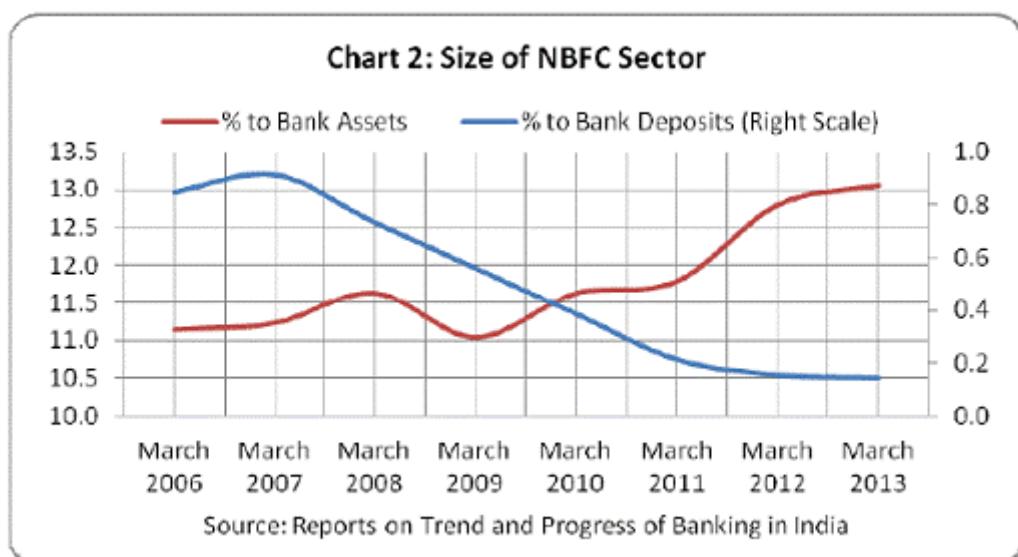
**Table 1: Assets of NBFC and Banking (SCBs) Sectors as a % to GDP**

Ratio \ Year	2006	2007	2008	2009	2010	2011	2012	2013
NBFC Assets to GDP (%)	8.4	9.1	10.1	10.3	10.8	10.9	11.9	12.5
Bank Assets to GDP (%)	75.4	80.6	86.8	93.0	93.0	92.2	92.7	95.5

Source: (i) Reports on Trend and Progress of Banking in India; (ii) Hand Book of Statistics on Indian Economy

Note: Assets of NBFC sector include assets of all deposit taking NBFCs and Non-Deposit Taking NBFCs having assets size Rs. 100 crore and above (NBFCs-ND-SI)

In comparison to assets of the banking system (Scheduled Commercial Banks-SCBs), asset size of NBFC sector was around 13 per cent; while deposits (including RNBCs) of the sector were less than 0.15 per cent of bank deposits (SCBs) as on March 31, 2013 (**Chart 2**). Public deposits held with the NBFC sector declined in line with RBI policy directions<sup>1</sup>. The decline in public deposits was largely on account of RNBCs. Due to concerted efforts of RBI, the number of deposit taking NBFCs has come down from 428 in June 2006 to 254 in June 2013.



### 1.3 Business – concentration

Unlike the banking sector, entities under NBFCs differ not only in terms of size and sophistication of operations but also in terms of activities they undertake. NBFC would include not only entities which are part of large multinational groups, but also small players with assets around Rs.25 lakhs.

The business concentration in terms of total assets and total credit based on “Herfindahl-Hirschman Index (HHI)<sup>2</sup>” indicate that competition is greater in NBFC sector as compared with banking sector, as HHI for NBFC sector was found to be on lower side for the period ended March 2012 and March 2013.

<sup>1</sup> Mid-term Review of Macro Economic and Monetary Developments: 2004–05: Internationally, acceptance of public deposits is restricted to banks, and non-banks including NBFCs raise resources from institutional sources or by accessing capital market. NBFCs are encouraged to move in this direction in line with international practices. The Reserve Bank will be holding discussions with NBFCs in regard to their plan of action for voluntarily phasing out of their acceptance of public deposits and regulations on banks' lending to NBFCs will be reviewed by RBI as appropriate.

<sup>2</sup> A commonly accepted measure of concentration. It is calculated by squaring the share of each firm in total assets (or credit), and then summing the resulting numbers. HHI result varies from 0 to 10,000, with 10,000 indicating monopoly and zero indicating perfect competition. If HHI result is less than 1,000 then the industry is considered as competitive; a result of 1,000–1,800 to be a moderately concentrated; and a result of 1,800 or greater to be a highly concentrated.

**Table 2: Herfindahl–Hirschman Index<sup>2</sup>**

Period	NBFC Sector		Banking Sector	
	Total Assets	Total Credit	Total Assets	Total Credit
March 2012	372.4	591.8	508.5	545.2
March 2013	407.2	635.1	514.0	879.5

Source: Micro level data for NBFC sector has been extracted from COSMOS database of Department of Non-Banking Supervision, while bank level data has been collected from Statistical Tables Relating to Banks in India.

#### **1.4 Non bank financial institutions – cross country analysis**

Globally, the size of non-bank financial intermediation was equivalent to 117 percent of GDP as at the end of 2012 for 20 jurisdictions and the euro area<sup>3</sup>. In absolute terms, total assets of non-bank financial intermediaries remained at around \$ 70 trillion as at end 2012.

US has the largest system of non-bank financial intermediation with assets of \$ 26 trillion, followed by the euro area (\$ 22 trillion), the UK (\$ 9 trillion) and Japan (\$ 4 trillion).

On an average, the size of non-bank financial intermediation in terms of assets was equivalent to 52 per cent of the banking system. However, there were significant cross-country differences, ranging from 10 per cent to 174 per cent.

Non-bank financial intermediation is relatively small in the case of emerging market economies compared to the level of GDP. In India, Turkey, Indonesia, Argentina, Saudi Arabia the amount of non-bank financial activity remained less than 20 per cent of the GDP as at end 2012.

As such, the size of the non-banking financial sector in India is relatively low, by global standards.

#### **Section 2: Extant regulatory framework for NBFCs**

With the objective of designing comprehensive regulatory and supervisory framework for NBFCs, Chapter IIIB, IIIC and V of the RBI Act 1934 were amended in 1997.

The principles of regulation are broadly aimed at (i) protection of interests of depositors, (ii) mitigating the systemic risks emanating from inter-connectedness with the rest of the financial system, and (iii) Consumer Protection.

The extant regulatory framework for NBFCs is detailed in Annex-I.

On implementation of UT Committee Recommendations, the regulatory framework would get further refined.

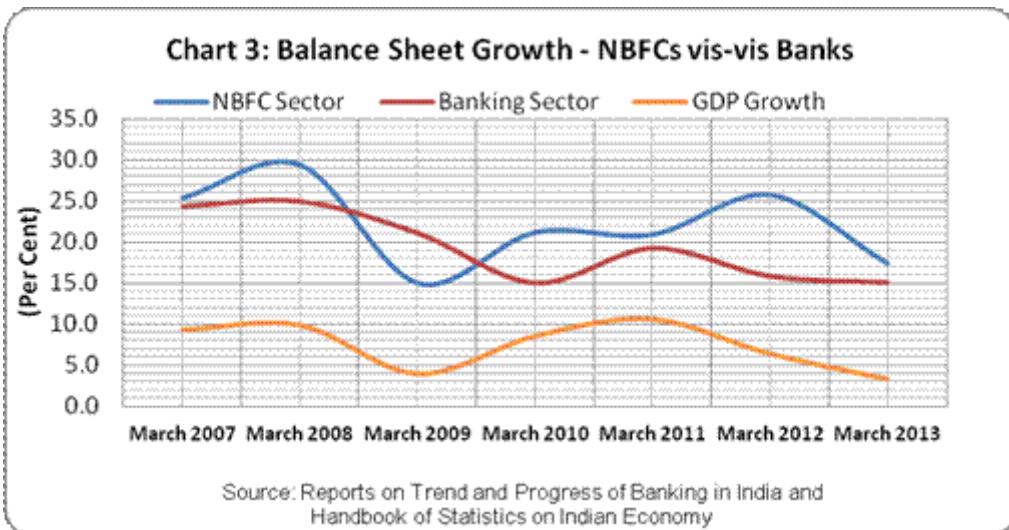
#### **Section 3: Business trends of the NBFC sector – an analysis**

##### **3.1 Balance sheet growth**

NBFC sector clocked phenomenal growth in the last ten years. The sector on an average, witnessed a Compound Annual Growth Rate (CAGR) of 22 per cent during the period between March 2006 and March 2013. Most of the years, NBFC sector grew faster than banking sector (Chart 3).

<sup>3</sup> Global Shadow Banking Monitoring Report 2013 (page no. 9).

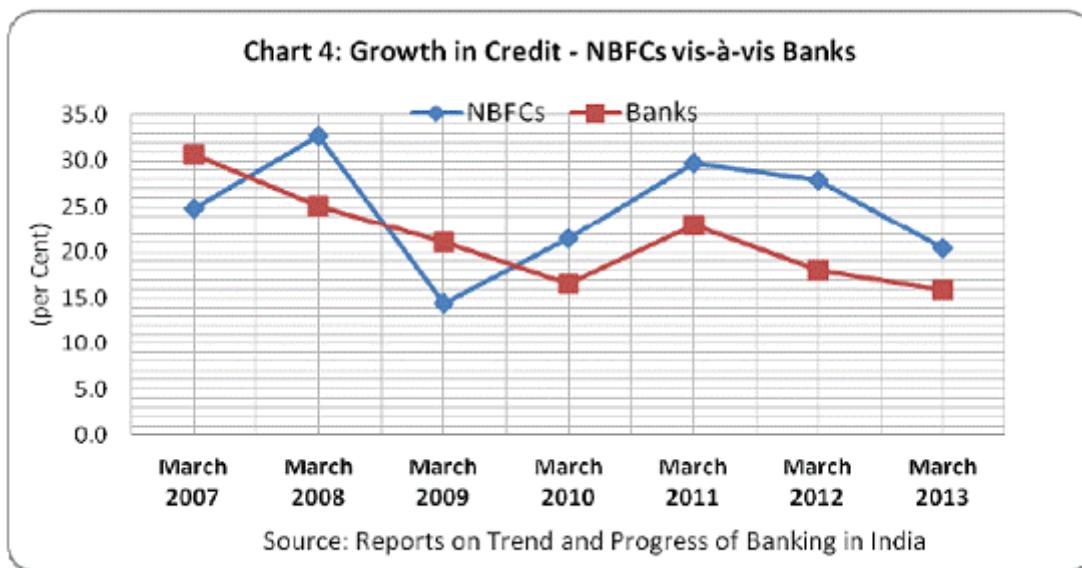
NBFC sector exhibited counter cyclical movements in 2011–12. In other words, NBFC sector clocked a growth of 25.7 per cent in 2011–12 although GDP growth decelerated to 6.3 per cent in 2011–12 from 10.5 per cent in 2010–11.



### 3.2 Credit growth

Credit growth across NBFC and banking sectors is presented in Chart 4. NBFC – credit grew more rapidly as compared with the banking sector. NBFC credit witnessed a CAGR of 24.3 per cent during the period between March 2007 and March 2013 as against 21.4 per cent by the banking sector.

Although Indian economy is slowing down in the recent past, the robust NBFC credit growth is largely on account of significant growth in infrastructure credit and retail finance.

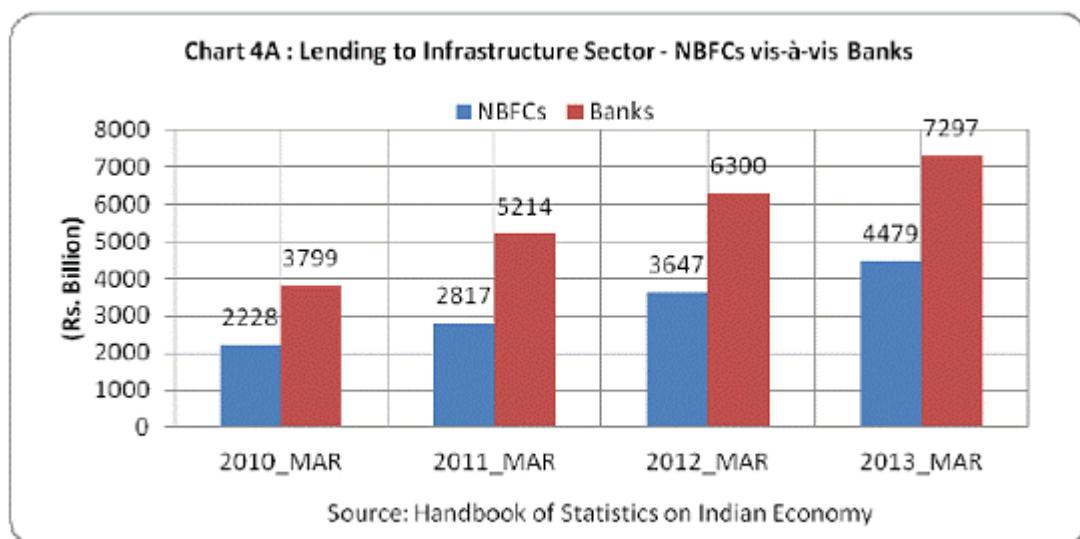


### 3.3 Financing of Infrastructure

By financing infrastructure projects, NBFCs broaden capital formation of the country and thereby contribute to the overall economic growth and development of the country.

The quantum of infrastructure finance provided by the NBFC sector witnessed a CAGR of 26.2 per cent during the period between March 31, 2010 and March 31, 2013. In absolute terms, NBFC finance to infrastructure increased from Rs.2228 billion on March 31, 2010 to Rs. 4479 billion as on March 31, 2013 (Chart 4A).

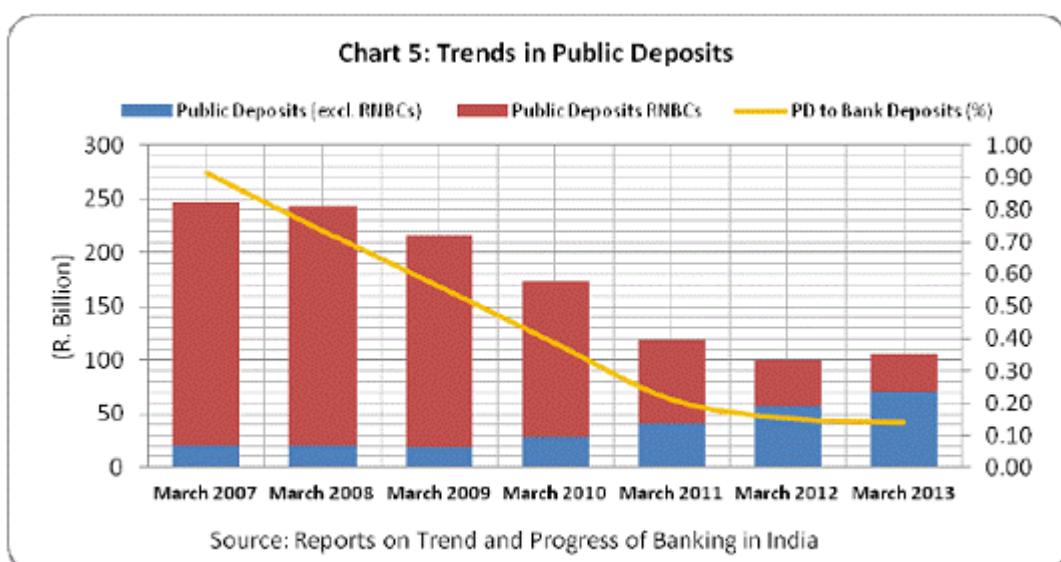
NBFC finance to infrastructure accounted for 35.8 % of their assets as on March 31, 2013 while in case of banks it was 7.6%.



### 3.4 Public deposits

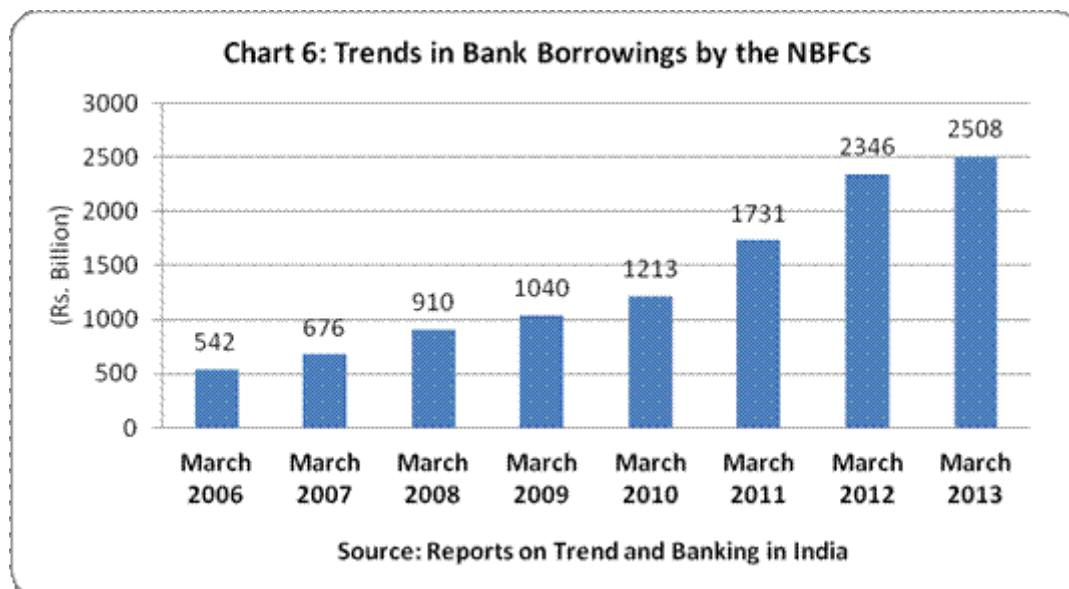
In line with RBI directions, the public deposits of NBFC sector (including RNBCs) declined considerably from Rs. 247 billion as on March 2007 to Rs.106 billion as on March 2013 (Chart 5).

The decline in public deposits is largely on account of RNBCs, which are going to exit from NBFC business model by June 2015. The public deposits of RNBCs decreased from Rs. 202 billion as on March 31, 2007 to just Rs. 35 billion as on March 31, 2013.



### **3.5 Inter-connectedness with the banking sector**

Borrowings from banks is one of the major sources of funding for the NBFCs. NBFC borrowings from the banking sector increased manifold from Rs. 542 billion as on March 31, 2006 to Rs. 2508 billion in March 31, 2013 (an increase of more than 4 times). However, growth of bank credit to NBFCs decelerated in March 2013 to 13.6 per cent<sup>4</sup> from 32.5 per cent and 42.8 per cent recorded in September 2012 and March 2012. This deceleration is attributed to lower demand for auto and consumer loans, stricter norms on lending against gold, withdrawal of priority sector status for some loans given by banks to NBFCs for on-lending for specific purposes, etc. Further, bank credit to NBFCs decelerated on account of revised DBOD guidelines<sup>5</sup>.



Macro-mapping of various financial institutions is an absolute imperative to quantify the interconnectedness among the institutions to measure systemic stability.

### **3.6 Borrowings from the markets**

Borrowings from the markets<sup>6</sup> increased from just Rs. 1009 billion as on March 31, 2006 to Rs. 4764 crore as on March 31, 2013, increased by more than 4.5 times during the period of 8 years.

Among various sources, borrowings through NCDs constitute the largest source of finance for the NBFC sector and its share in total funding sources remained at more than 30 per cent. Since March 2010, funds raised through NCDs witnessed phenomenal growth largely on account of (i) Infrastructure Finance Companies<sup>7</sup> and (ii) gold loan NBFCs.

<sup>4</sup> Source: Financial Stability Report, Issue No.7, page no.25.

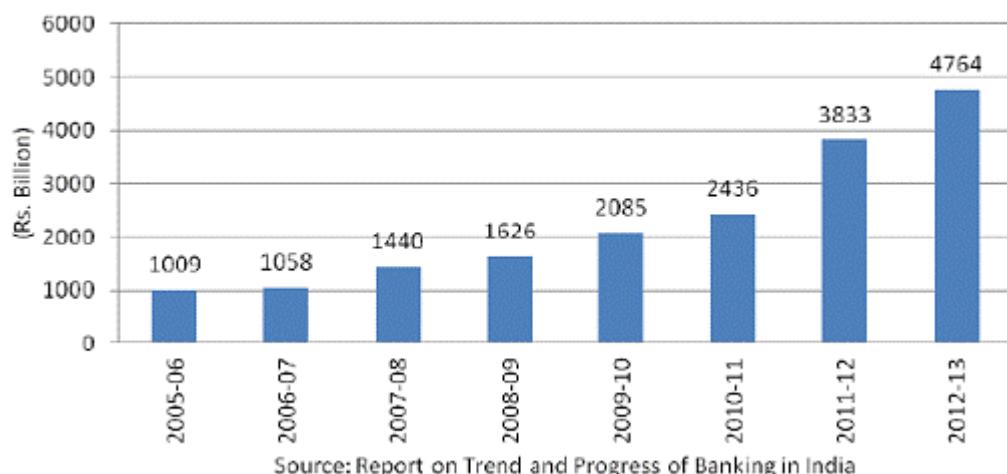
<sup>5</sup> The exposure (both lending and investment, including off balance sheet exposures) of a bank to a single NBFC which is predominantly engaged in lending against collateral of gold jewellery (i.e. such loans comprising 50 per cent or more of their financial assets), should not exceed 7.5 per cent of banks' capital funds (Source: DBOD.BP.BC.No.6/21.04.172/2013–14 dated July 1, 2013).

<sup>6</sup> Market borrowings includes borrowings by way of issuing NCDs, commercial paper and inter-corporate deposits.

<sup>7</sup> Category of IFCs has been created in Feb 2010.

The quantum of finance raised through NCDs increased from Rs. 682 billion as on March 31, 2006 to Rs.4044 billion as on March 31, 2013. In order to promote discipline in resource raising, the Bank has issued guidelines on private placement of NCDs in June 2013.

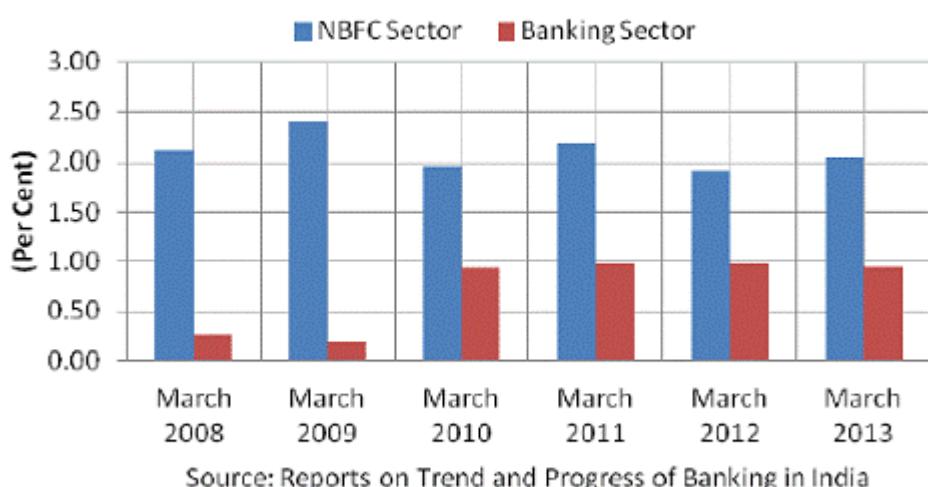
**Chart 7: Trends in Market Borrowings by the NBFCs**



### 3.7 Profitability

Trends in Return on Assets (RoA) of NBFC sector are furnished in Chart 8; comparative figures for banks are also indicated for banking sector. The RoA of NBFC sector is always found to be on the higher side as compared with that of the banking sector largely on account of lower operating costs and also, NBFCs do not have statutory pre-emptions like CRR and SLR.

**Chart 8: Trends in Return on Assets - NBFCs vis-a-vis Banks**



### **3.8 Summary**

To sum up, the NBFC sector has exhibited robust growth in the face of declining GDP by resorting to higher market borrowings, predominantly NCDs; while public deposits have declined in tandem with RBI policy. The sector's profitability continues to be consistently higher than that of the banking sector. Simultaneously, inter-connectedness with the banking sector and other segments of financial markets has increased due to credit and other linkages, which needs to be watched closely by regulators in the context of financial stability.

## **Section 4: Role of NBFCs in promoting inclusive growth**

NBFCs play an important role in promoting inclusive growth in the country, by catering to the diverse financial needs of bank excluded customers. By financing real assets and extending credit to infrastructure projects, NBFCs play a pro-active role in the development process of the country. Activities undertaken by the NBFCs for achieving inclusive growth in the country are described below:

### **4.1 Credit to MSMEs**

MSME sector has large employment potential of 59.7 million persons over 26.1 million enterprises and is considered as an engine for economic growth and promoting financial inclusion in rural areas. The outstanding credit provided by the NBFC sector to MSMEs stood at Rs.625 billion as at end March 2013<sup>8</sup> (Rs.464 billion in the previous year). The figures for banking sector were at Rs.22,302 billion as at end March 2013<sup>9</sup> (Rs.19,374 in the previous year).

Statistics based on 4th Census on MSME sector revealed that only 5.18% of the units (both registered and un-registered) had availed finance through institutional sources. 2.05% got finance from non-institutional sources the majority of units say 92.77% had no finance or depended on self-finance.

The fact that a large segment in the micro and small industries sector does not have access to formal credit provides a window of opportunity for the NBFCs to design suitable innovative products.

### **4.2 Micro finance institutions**

NBFC-MFIs provide access to basic financial services such as loans, savings, money transfer services, micro-insurance etc. to poor people and attempt to fill the void left between the mainstream commercial banks and money lenders.

Over the last few years NBFC-MFIs have emerged as a fast growing enablers in providing the financial services to the poor people by providing capital inputs to poor which generates self-employment, and thereby promotes inclusive growth.

The credit provided by the NBFCs – MFIs<sup>10</sup> increased from just Rs. 105 billion as on March 2010 to Rs.151 billion as on March 2011 and declined to Rs.117 billion on account of the ordinance passed by the AP Government that stopped all MFIs from collecting payments by force or even disbursing loans by the MFIs. However, in March 2013, the outstanding credit disbursed by the MFIs increased to Rs.144 billion due to partial resumption of MFI activities,

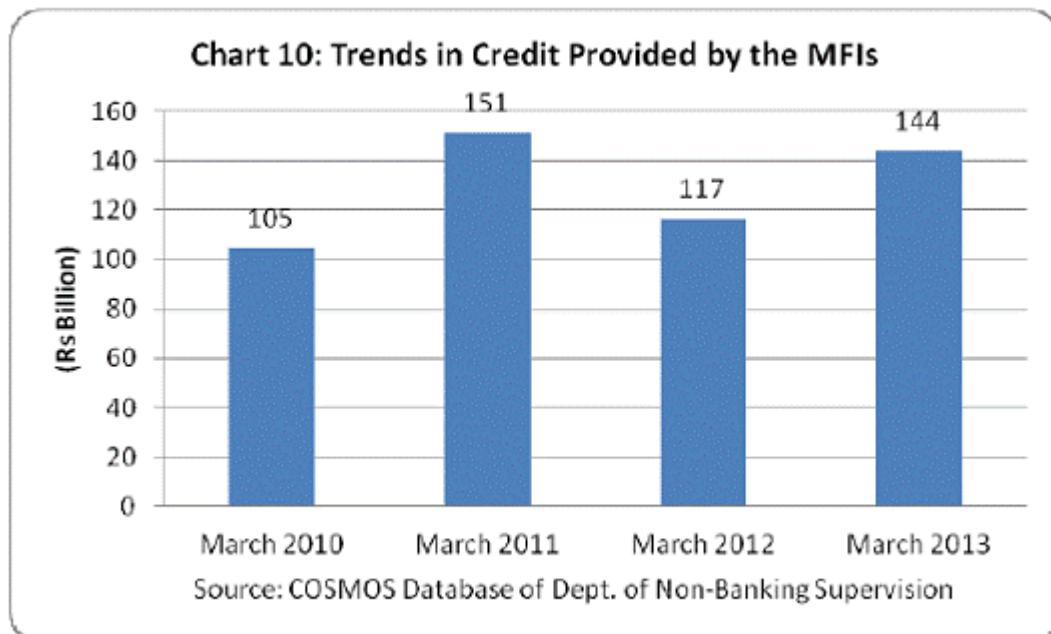
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<sup>8</sup> Source: Consolidated based on the returns submitted by the NBFCs to Dept. of Non-Banking Supervision, Reserve Bank of India.

<sup>9</sup> Source: Handbook of Statistics on Indian Economy.

<sup>10</sup> Data pertains to NBFCs which are predominantly engaged in Micro Finance activities have been consolidated based on the returns submitted by them to Dept. of Non-Banking Supervision.

owing to implementation of the Malegam Committee recommendations and certain Supreme Court orders favourable for MFIs.



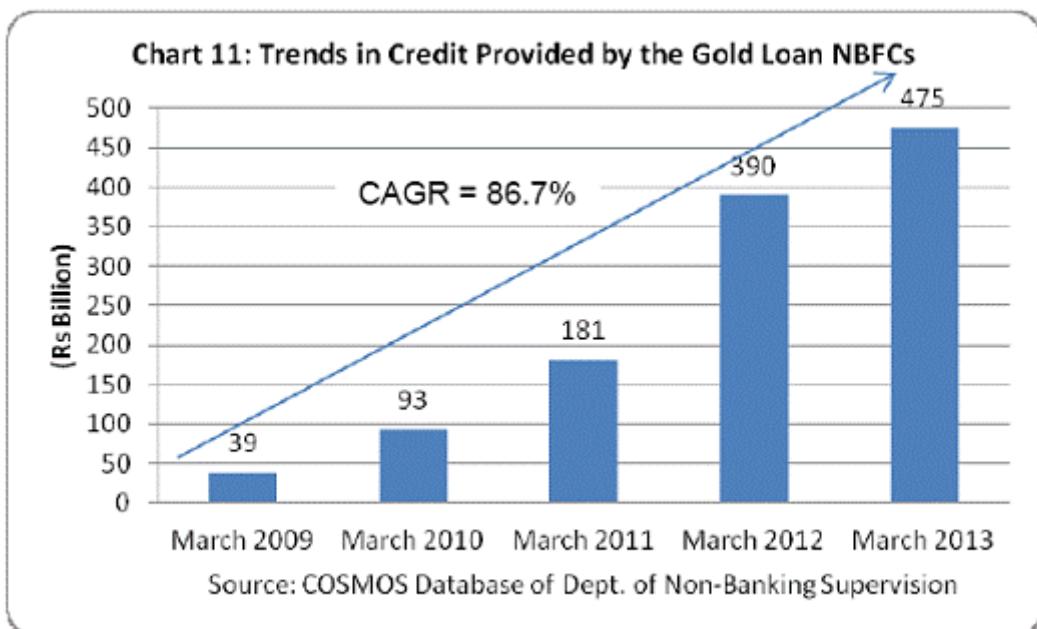
To encourage MFIs, as per the Malegam committee recommendations, RBI has created separate category under NBFCs. As on date, around 33 MFIs have been registered with RBI.

#### **4.3 Monetisation of gold**

Gold loan NBFCs provide loans against security of gold jewellery. Although banks are also involved in gold loan business, NBFCs' gold loans witnessed phenomenal growth due to their customer friendly approaches like simplified sanction procedures, quick loan disbursement etc.

Branches of gold loan NBFCs increased significantly during the last couple of years mostly housed at semi-urban and rural centres of the country.

Gold loan NBFCs help in monetisation of idle gold stocks in the country and facilitate in creating productive resources. Credit extended by the gold loan NBFCs witnessed a CAGR of 86.7 per cent during the period March 2009 to March 2013. In absolute terms, NBFC gold loans increased from just Rs. 39 billion as on March 31, 2009 to Rs.475 billion as on March 31, 2013.

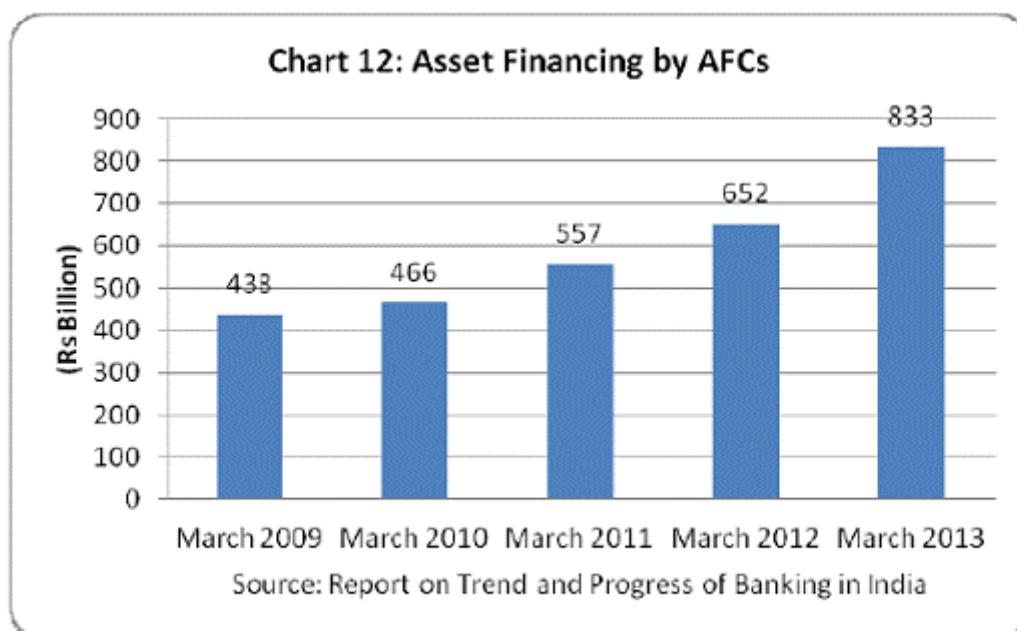


To study the issues related to the gold loans by NBFCs a working group was set up under the chairmanship of K.U.B. Rao which submitted its report in January 2013. Several recommendations have since been accepted and acted upon.

#### **4.4 Second hand vehicle financing**

Apart from providing loan against property, NBFCs also engage in financing used/ second hand vehicles, reconditioned vehicle, three-wheelers, construction equipment besides secured/unsecured working capital financing etc.

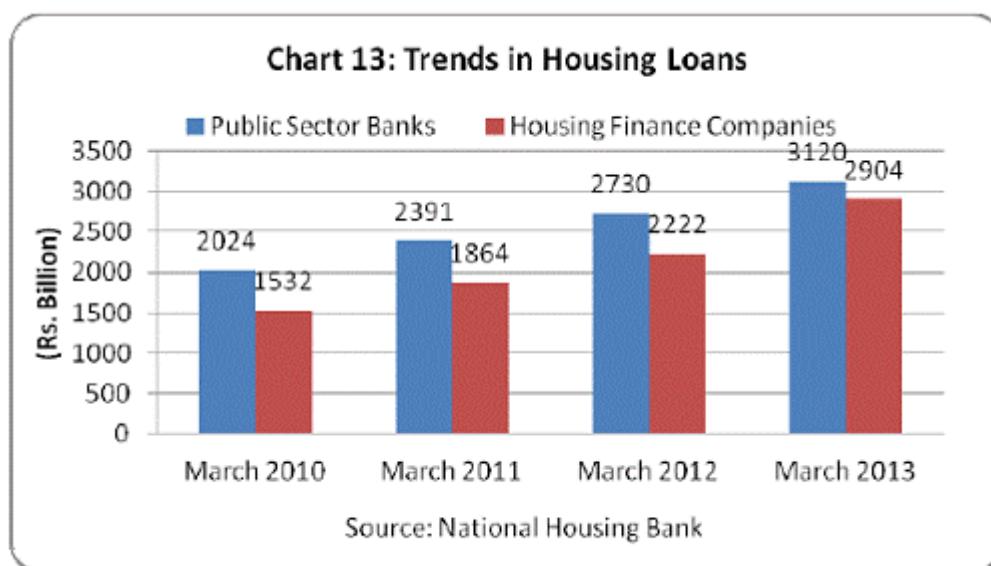
Incidentally, in India except NBFCs no other financial sector player finance second hand vehicles; which are very popular with road transport operators essentially in the self-employed segment.



#### **4.5 Affordable housing**

Another area where NBFCs are participating in the inclusive growth agenda is affordable housing. Large NBFCs are setting up units to extend small-ticket loans to home buyers targeting low-income customers across the country. Firms are offering loans of Rs. 2–6 lakh to borrowers with monthly income of Rs.6000 – 12000 who find it difficult to borrow from the commercial banks. Firms offer easier know-your customer (KYC) norms such as relaxation in documentation requirements to facilitate easy access to low-income borrowers. The trends in housing loans provided by the Housing Finance NBFCs are furnished below.

Housing finance NBFCs are real game changers in terms of providing housing loans at par with Public Sector Banks (PSB). The quantum of housing loans provided by the housing finance NBFCs is almost the same although they are comparatively far smaller than PSBs (Chart 13).



#### **4.6 Summary**

To sum up, NBFCs' role in financial inclusion as explained above, indicate the fact that they have been game changers in certain areas like financial inclusion especially micro finance, affordable housing, second-hand vehicle finance, gold loans and infrastructure finance.

NBFCs can truly become game changers provided they exhibit the requisite nimbleness and innovative zeal in reaching a complete suite of financial products such as shares, mutual funds, depository services etc., as also insurance products – both life and non-life together with their current product offerings, to the common man.

In respect of MSMEs, NBFCs can become game changers by providing factoring and bill payment services which are of crucial importance at the present juncture of financial sector development.

### **Section 5: Imperatives for NBFCs to become real game changers**

#### **A. Action points for the industry**

The following issues need to be addressed on priority basis in order to morph themselves as real game changers.

### **5.1 Customer protection issues**

Protection of customers against unfair, deceptive or fraudulent practices has become top priority internationally after the crisis. Incidentally, the Bank has received and is receiving number of complaints against charging of exorbitant interest rates, raising of surrogate deposits under the garb of non-convertible debentures, various types of preference shares, Tier II Bonds, etc. Aggressive practices in re-possessing of automobiles in the case of auto loans and improper/opaque practices in selling the underlying gold jewellery in the case of gold loans are the two categories in which relatively more complaints are received / are being received by the Reserve Bank. NBFCs are often found not to practice Fair Practices Code (FPC) in letter and spirit. Developing a responsive and proper grievance redressal mechanism is the more important agenda in the context of this action point.

### **5.2 Camouflaging public deposits**

NBFCs have been prone to adopt variety of instruments/ways of accepting camouflaged public deposits for resource mobilisation viz., use of Cumulative Redeemable Preference Shares (CRPS)/ Convertible Preference Shares (CCPS) / NCDs / Tier 2 capitals. These instruments are generally marketed as any other deposit products mostly by agents.

Regulators should distinguish tiny differences in a clear manner to check and control NBFCs which are raising resources through camouflaged public deposits.

Furthermore, complaints are received that deposit receipts issued to customers reveal that the deposits are accepted on behalf of other group companies, whose operations are neither known / are opaque.

### **5.3 Improving corporate governance standards**

To become real game changers, business transparency is inevitable for any financial entity. In the case of NBFCs, there is an imperative for adopting good corporate governance practices. RBI has already prescribed a governance code for NBFCs as part of their best practices; these include constitution of Risk Management, Audit and Nomination Committees, disclosure and transparency. When due diligence was undertaken on significant shareholders and directors at the time of registration it was observed there are no prescriptions for qualifications for directors, change in directors etc.

### **5.4 Capacity building**

NBFCs on both individual and collective basis need to work towards building a responsive ecosystem for capacity building; since in the medium to long term, it is the quality of staff which to a large extent, determines the health of the sector.

### **5.5 Greater innovation**

Although NBFCs have been designing innovative products to suit the client and market conditions, the sophistication of financial services has been gradually increasing in the recent past. There is an imperative need for NBFCs to aggressively involve in designing innovative products to become real game changers in the economy.

In this context, a cue may be taken from the description of daily financial lives of poor people given in detail in "Portfolios of the Poor," a prominent investigation into the everyday problems which they face (Collins, Kulkarni and Gavron (2009)). It is stated therein that typical low income families used some 10 different financial instruments, several channels of transport for money and multiple ways of keeping money safe. Their fundamental protection against financial risk is diversification, knowledge about counterparties and the judicious exploitation of relationships that are expected to last. NBFCs should closely study such behaviour of poor people taking advantage of the last mile connectivity which they do possess, to craft innovative products.

### **5.6 White label ATMs**

As NBFCs already have significant business presence in semi-urban and rural centres, there is a case for them to explore business potential by establishing white label ATMs in such areas.

### **5.7 Need for a single representative body for the industry**

In the case of NBFCs, there are multiple representative bodies such as “Finance Industry Development Council (FIDC) for Assets Finance Companies”, “Association of Gold Loan Companies (AGLOC) for Gold Loan NBFCs”, etc. In addition, RBI has recently issued guidelines for “Self-Regulatory Organisation for Micro Finance Institutions”. At this stage of development of the NBFC sector, in the interests of harmonious development of all its segments, establishing one representative body for the entire sector would be an idea worth exploring by subsuming the existing bodies. However, care should be taken to ensure that all segments are adequately represented in such an apex body, to promote harmonious and balanced growth of the sector and avoid internecine conflicts.

### **5.8 Coparcener with RBI and other regulators**

NBFCs should become coparcener with RBI and other regulators and disclose the challenges they are confronting in the markets and provide valuable inputs to regulators for developing conducive regulatory environment.

## **B. Role of Regulators**

Regulators too need to act on certain issues to enable the NBFC sector to become Real Game Changers.

### **5.9 Regulators as consumer advocates and as also prudential regulators**

In the context of NBFCs, customer protection issues take the centre stage as can be seen from paragraphs 5.1 to 5.3 above. Hence regulators need to wear two hats in the context of NBFCs viz. being consumer advocates as also prudential regulators.

The need to become consumer advocates need hardly any overemphasis in the context of the various issues highlighted in paragraphs 5.1 to 5.3 above.

As regards the role of a prudential regulator, they need to take care of individual NBFCs (micro prudential) as also the system as a whole (macro prudential regulations).

### **5.10 Enhanced monitoring**

The regulators should have a hands-on approach in unearthing the activities of unauthorised entities as also authorised entities undertaking non-permitted activities. In this context, wherever possible, laws may need to be amended to bestow the requisite regulatory and supervisory powers to the respective regulators.

### **5.11 Regulatory convergence**

All the concerned regulators should bring about regulatory convergence among themselves, to avoid any possible regulatory arbitrage by the players.

### **5.12 Higher level of co-ordination**

All the regulators should actively strive to bring about higher level co-ordination amongst themselves on a continuous basis, so that regulatory gaps and overlaps could be identified at the very earliest and immediate corrective action taken thereon.

## **Section 6: The way forward & concluding thoughts**

NBFCs are already game changers, as can be seen from the analysis above in areas of financial inclusion, especially micro finance, affordable housing, second hand vehicle finance, gold loans and infrastructure finance. NBFCs can play a vital role going forward, in closing the loop as regards financial inclusion for individuals and MSMEs. As regards individuals, NBFCs can reach various financial products offered by the securities industry, viz., shares, mutual funds, depository services etc., as also insurance products both life and non-life together with their current product offerings. As regards MSMEs, NBFCs can become game changers by providing factoring and bill payment service which are of critical importance at the present juncture.

The way forward is to ensure that both the NBFI sector and all the concerned regulators play an active part in attending on the imperatives mentioned at Section 5 above. The complimentary role of the financial sector and all the regulators hardly needs overemphasis in the context of NBFCs morphing as game changers for providing the last mile connectivity and closing the loop as regards financial inclusion. In this context, NBFCs have a special responsibility against the background of the need to improve the customer service by conducting their operations as per the best practices of corporate governance. In the ultimate analysis, adhering to best corporate governance and ethical practices is the only way for gaining the confidence of their customers in particular, and the society in general. Consequently, the NBFC sector would be able to garner greater trust of both its customers and the society. That would provide the springboard for increasing their business levels in the process of fulfilling their role as game changers in the areas mentioned above. NBFCs becoming true game changers would be a sweetener for financial inclusion efforts in our country.

Thank you.

## Annex-I: Extant Regulatory Framework for NBFCs

<b>Subject</b>	<b>Regulation / Guidelines</b>
Certificate of Registration	No company can carryout NBFC business without obtaining Certificate of Registration from RBI Minimum Net Owned Fund = Rs. 2 crore <sup>12</sup> For NBFC-MFI minimum NoF = Rs. 5 crore <sup>13</sup> For NBFC-Factor minimum NoF = Rs. 5 crore <sup>14</sup> For mortgage guarantee company minimum NoF = Rs. 100 crore <sup>15</sup>
Maintenance of Liquid Assets	Deposit accepting NBFCs have to invest 15% of their public deposits in statutory liquid assets. Of 15%, 10% in unencumbered approved securities and the remaining 5% in term deposits with Scheduled Commercial Banks
Reserve Fund	As per section 45-IC of RBI Act 1934, every non-banking financial company shall create a reserve fund and transfer thereto a sum not less than 20 per cent of its net profit every year as disclosed in the profit and loss account before declaring any dividend
Ceiling on Public Deposits	AFCs (without credit rating) can accept Public deposits to the tune of 1.5 times of its NoF or public deposits up to 10 crore whichever is lower AFCs (with minimum credit rating) can accept public deposits up to 4 times of its NoF. Loan / Investment Companies (with credit rating and minimum CRAR of 15%) can accept public deposits up to 1.5 times of its NoF Loan / Investment Companies (with AA credit rating and not having minimum CRAR of 15%) can accept public deposits up to its NoF Loan / Investment Companies (with A credit rating and not having minimum CRAR of 15%) can accept public deposits up to 50 per cent of its NoF
Ceiling on Deposit Rates	Maximum interest rate payable on public deposits by NBFCs should be 12.5 per cent per annum
CRAR	All deposit taking NBFCs and non-deposit taking systemically important NBFCs should maintain minimum CRAR of 15 per cent w.e.f March 31, 2011
ALM Guidelines	The mismatched (negative gap i.e Inflows - outflows) during 1-30/31 days in normal course may not exceed 15% of the cash outflows in this time bucket
Concentration Norms	<u>Single Borrower</u> - Credit - 15% of Owned Fund; Investment - 15% of Owned Fund <u>Group Borrower</u> - Credit - 25% of Owned Fund; Investment - 25% of Owned Fund Composite (credit + investment) Single Borrower - 25% of Owned Fund and Group Borrower – 40% of Owned Fund

<sup>12</sup>For companies registered prior to April 21, 1999, the minimum NoF was Rs. 25 lakhs. However, directions issued for strengthening the financials of all deposit taking NBFCs by increasing their NOF to a minimum of Rs.200 lakh in a gradual, non-disruptive and non-discriminatory manner

<sup>13</sup>Existing NBFCs intending to convert NBFC-MFI shall maintain minimum NoF at Rs. 3 crore by March 31, 2013 and at Rs. 5 crore by March 31, 2014. To encourage NBFCs operating in North-Eastern region, the minimum NoF is to be maintained at Rs. 1 crore by March 31, 2012 and at Rs. 2 crore by March 31, 2014. All new companies desiring NBFC-MFI registration will need to a minimum NoF of Rs. 5 crore except those in the North Eastern Region of the country which will require NoF of Rs.2 crore till further notice (Source: DNBS (PD) CC.No.300 /03.10.038/2012-13 dated Aug 03, 2012).

<sup>14</sup>Existing companies seeking registration as NBFC-Factor but do not fulfill the NOF criterion of Rs.5 crore may approach the Bank for time to comply with the requirement (Source: DNBS (PD) CC No.348/ 03.02.001/2013-14 dated July 1, 2013)

<sup>15</sup> Source: DNBS (PD-MGC) C.C. No. 14/23.11.001/2013-14 dated July 1, 2013

	Infrastructure Related Activities: Single – Additional 5% of Owned Fund and Group – Additional 10% of Owned Fund Asset Finance Activities: Single party and single group of parties up to further 5% of their Owned Fund
Disclosure in the Balance Sheet	NBFCs-ND-SI shall make additional disclosures in their balance sheets w.e.f March 31, 2009 on the following items Capital to Risk Weighted Assets Ratio Exposure to real estate sector, both direct and indirect; and Exposure to real estate sector, both direct and indirect; and
Asset Classification	All forms of credit (including receivables) to be classified as standard, sub-standard, doubtful as loss assets. Sub-standard asset means, an asset which has been classified as Non-Performing Asset <sup>16</sup> for a period not exceeding 18 months. Doubtful asset means, an asset which remained as a sub-standard asset for a period exceeding 18 months. Loss asset means, an asset which has been identified as loss asset by the NBFC or its internal or external auditor or by the RBI during the inspection of the NBFC
Provisioning Norms	Standard Assets = 0.25% Sub-Standard Assets = 10% of outstanding balance Doubtful Assets = 100% on un-secured portion and on secured portion 20,30 and 50% depending on the age of doubtful assets Loss Assets = 100% of the outstanding balance
Risk Weights	Value of each asset requires to be multiplied by the relevant risk weights to arrive at risk adjusted value of assets. Depending on the riskiness of assets risk weights vary from 0%, 20% and 100%. Off-balance sheet items first multiplied with conversion factor at 50 or 100% and then apply risk weight to arrive at risk adjusted value of assets.
LTV Ratio	NBFCs are required to maintain LTV ratio not exceeding 75 per cent for loans granted against the collateral of gold jewellery
Guidelines on Corporate Governance	In order to enable NBFCs to adopt best practices and greater transparency in their operations, RBI issued guidelines on corporate governance. All deposit taking NBFCs with deposit size of Rs.20 crore and above and all non-deposit taking NBFCs with assets size Rs. 100 crore and above should comply with these guidelines.
Guidelines on KYC	NBFCs have been advised to ensure that a proper policy framework on 'Know Your Customer' and Anti-Money Laundering measures with the approval of the Board is formulated and put in place.
Guidelines on Fair Practices Code	The Reserve Bank issued guidelines on Fair Practices Code (FPC) for all NBFCs to be adopted by them while doing lending business. The guidelines cover general principles on adequate disclosures on the terms and conditions of a loan and also adopting a non-coercive recovery method.
Introduction of Interest Rate Futures	NBFCs may participate in the designated interest rate futures exchanges recognized by SEBI, as clients, subject to RBI / SEBI guidelines in the matter, for the purpose of hedging their underlying exposures.
Compliance with FDI norms-Half yearly certificate from Statutory Auditors of NBFCs	NBFCs having FDI whether under automatic route or under approval route have to comply with the stipulated minimum capitalisation norms and other relevant terms and conditions, as amended from time to time under which FDI is permitted.
Participation in Currency Futures	It was decided that all NBFCs excluding RNBCs may participate in the designated currency futures exchanges recognized by SEBI as

<sup>16</sup> NPA means an asset, in respect of which, interest has remained overdue for a period of six months or more

	clients, subject to RBI (Foreign Exchange Department) guidelines in the matter, only for the purpose of hedging their underlying forex exposures.
Credit Default Swaps – NBFCs as Users	NBFCs shall only participate in CDS market as users. As users, they would be permitted to buy credit protection only to hedge their credit risk on corporate bonds they hold. They are not permitted to sell protection and hence not permitted to enter into short positions in the CDS contracts. However, they are permitted to exit their bought CDS positions by unwinding them with the original counterparty or by assigning them in favour of buyer of the underlying bond.
Raising Money through Private Placement by NBFCs-Debentures	(i) Private placement by all NBFCs shall be restricted to not more than 49 investors, identified upfront by the NBFC, (ii)The minimum subscription amount for a single investor shall be Rs. 25 lakh and in multiples of Rs.10 lakh thereafter. (iii) There should be a minimum time gap of at least six months between two private placements (iv) An NBFC shall not extend loans against the security of its own debentures (issued either by way of private placement or public issue).
Opening of Branches	Gold loan companies require prior approval of RBI for opening more than 1000 branches.