NBFCs

STATUTORY FRAMEWORK – SEC. 45I

- A Non Banking Financial Institution is a `non-banking institution' (company, corporation or cooperative society) which carries on any of the following activities:
  - business of loans and advances
  - 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
  - chit business
  - Collecting money for any purpose or under any scheme in lump sum or otherwise
- But Excludes:
  - Agricultural operation, industrial activity, commodity trading, construction and sale of immovable property

EXEMPTED CATEGORIES…

- Insurance companies
- Stock broking companies registered with SEBI
- Stock exchanges
- Venture capital companies
- Merchant Banking company registered with SEBI
- Micro Finance companies registered under section 25 of companies act

PRINCIPAL BUSINESS..

- NBFC if

Financial assets > 50% of total assets

And

Income from financial assets > 50% of gross income

STATUTORY FRAMEWORK

- Sec 45 IA- Registration and Net owned fund of NBFCs
- Sec 45 IB- Maintenance of percentage of assets
- Sec 45 IC- Creation of a Reserve Fund
- Sec 45JA- Power of RBI to determine policy and issue directions
- Sec 45MA- Powers and duties of auditors
- Sec 45N- Inspection
- Sec 58B- Penalties

BANKS VS. NBFCs

- Both are financial intermediaries
- Banks can:
  - Maintain demand deposits (casa - savings / current a/c)
  - form a part of payment and settlement mechanism
- NBFCs can
  - Accept only term deposits
  - No payment mechanism

NBFCS – AS ON SEPTEMBER 30, 2012

- NBFCs more than 10% of total assets of financial system
- 12,398 registered NBFCs
  - Of which 266 accept deposits,
  - 378 are NDSI (assets > Rs 100 cr),
  - Majority of the NBFCs have assets below Rs 50 cr

Total deposit Rs. 9968 crore

- Rs.4265 cr is held by RNBCs
- The amount held by RNBCs has decreased by more than 40% in the last one year

CLASSIFICATION – ACTIVITY WISE

- Asset Finance Companies
- Loan Companies
- Investment Companies
- Infrastructure Finance Companies
- IDF-NBFCs
- Core Investment Companies (CICs)
- NBFC- MFIs
- NBFC-Factors
- Miscellaneous Non-Banking Companies
- Residuary Non-Banking Companies

IMPORTANCE OF NBFCS

- Non Banking Financial Companies (NBFCs) play a crucial role in
  - broadening access to financial services
  - enhancing competition and diversification of the financial sector
  - recognised as complementary to the banking system
  - capable of absorbing shocks
  - Bring innovation in financial services

WHY REGULATE?

- NBFCs are an integral part of financial system
  - Have a definite role – provide financial services to segments not having access to banks
  - Innovative products
  - An instrument of credit delivery
  - Protecting depositors' interest
  - Linkage to banks and markets for fulfillment of their borrowing needs
  - Bank Borrowings and debentures are the biggest sources of funds for NBFCs. Spread risks at times of financial distress which can pose systemic risk

REGULATORY METHOD:

- On site inspection
- Off site surveillance (Through various returns)
- Market intelligence (through various market reports, news media etc.)
- Statutory auditors' report (Exception reports to be given by them in case of non compliance)

STATUTORY FRAMEWORK – SEC. 45IA

- All NBFCs to register with RBI
  - Effective date 9 Jan 1997
  - New companies to commence business within six months after registration. No change of management before regularisation of COR, i.e. within next two years.
- Minimum NOF – Rs 25 lakh for NBFCs existing in 1997
  - Rs. 2 crore w.e.f April 1999
  - Other criteria
  - If registration is refused, to move away from NBFI activities

NOF

- In calculation of NOF information on the following is crucial:
  - Investment in group companies and subsidiaries
  - Investment in other NBFCs
  - Loans / advances and other exposure to subsidiaries and group companies
  - Amount of aggregate of the above in excess of 10% of Owned funds to be subtracted from owned fund to calculate NOF
- Adjusted net worth followed for CICs
  - Includes owned fund, 50% of unrealized appreciation in the book value of quoted investments and Increase in equity share capital
  - Diminution in the value of the quoted investments and reduction in share capital to be reduced to calculate adjusted net worth

REGULATORY FRAMEWORK

- Registered NBFC categories:
  - Category A: Accepting deposits from public
  - Category B: Not accepting public deposits

REGULATORY FRAMEWORK FOR NBFC-D

- Comprehensive directions on acceptance of public deposits by NBFCs including control over opening and closing of branches, disclosure requirements to enable informed decisions, etc.
- Prior approval for change of name and management
- Prescription of prudential norms
- ALM Guidelines

REGULATORY FRAMEWORK FOR NBFC-NDSI

- NOF of Rs. 25 lakhs (Rs 200 lakhs w.e.f 21.04.1999)
- Section 45 IA of RBI Act- Compulsory registration with RBI
- Prudential norms including CRAR 15% and Exposure norms
- ALM Guidelines and reporting (Financial Buckets)
- Monthly reporting of important financial parameters
- Annual Scrutiny of books

WHAT ARE PRUDENTIAL NORMS ?

- DESIRE TO BRING IN MORE TRANSPARENCY IN THE DISCLOSED FINANCIAL STATEMENTS
- CAPITAL ADEQUACY, AND CONCENTRATION NORMS NOT APPLICABLE FOR SMALL NBFCs WITH ASSETS BELOW Rs 100 cr
- INSTRUCTIONS RELATING TO
  - CAPITAL ADEQUACY RATIO-UNIFORM AT 15%
  - RISK WEIGHT AGE OF ASSETS
  - METHOD OF RECOGNIZING INCOME
  - MAKING PROVISION FOR NON-PERFORMING ASSETS, AND
  - EXPOSURE NORMS

ACCOUNTING STANDARDS

- INCOME TO BE RECOGNIZED ONLY ON ACTUAL REALIZATION
- ACCOUNTING STANDARDS-AS PER ICAI GUIDELINES
- ACCOUNTING FOR INVESTMENTS
- CLEAR INVESTMENT POLICY BY BOARD OF DIRECTORS
- CLEAR CRITERIA FOR CLASSIFICATION INTO CURRENT AND LONG TERM INVESTMENTS
  - NO AD-HOC INTER-CLASS TRANSFER
  - TRANSFER TO BE MADE ONLY AT THE BEGINNING OF EACH HALF-YEAR WITH THE APPROVAL OF THE BOARD
  - TRANSFER ONLY SCRIP WISE AT BOOK VALUE OR MARKET VALUE, WHICHEVER IS LOWER
  - DEPRECIATION TO BE PROVIDED FOR APPRECIATION TO BE IGNORED.
  - DEPRECIATION IN ONE SCRIP NOT TO BE SET OFF AGAINST APPRECIATION IN ANOTHER SCRIP,

VALUATION OF INVESTMENTS

- **CURRENT INVESTMENTS**
  - **QUOTED - LOWER OF COST OR MARKET VALUE**
  - **UNQUOTED EQUITY SHARES -LOWER OF COST OR BREAK UP VALUE**
  - **IF THE BALANCE SHEET OF THE INVESTEE COMPANY NOT AVAILABLE FOR 2 YEARS-*VALUE AT ONE RUPEE ONLY*.**
- **LONG TERM INVESTMENT VALUED AT COST - AS 13**
- **UNQUOTED GOVERNMENT SECURITIES OR GOVERNMENT GUARANTEED BONDS - CARRYING COST.**
- **UNQUOTED MUTUAL FUND-AT NAV**
- **UNQUOTED PREFERENTIAL SHARES-LOWER OF COST OR FACE VALUE**

WHAT IS AN NPA?

- INTEREST OVERDUE FOR 6 MONTHS OR MORE;
- INSTALLMENT OVERDUE FOR 6 MONTHS OR MORE;
- BILLS OVERDUE FOR 6 MONTHS OR MORE;
- ANY DUES ON ACCOUNT OF SALE OF ASSETS OR SERVICES RENDERED OR REIMBURSEMENT OF EXPENSES INCURRED- OVERDUE FOR 6 MONTHS OR MORE;
- LEASE RENTAL OR HP INSTALLMENTS OVERDUE FOR 12 MONTHS OR MORE

ASSET CLASSIFICATION

- CLASSIFICATION OF CREDIT ASSETS INTO
    - STANDARD ASSETS
    - SUB-STANDARD ASSETS
    - DOUBTFUL ASSETS, AND
    - LOSS ASSETS
- THESE NOT BE UPGRADED MERELY AS A RESULT OF RESCHEDULING.
- MAYBE UPGRADED AFTER SATISFACTORY PERFORMANCE OF ONE YEAR.

STANDARD ASSET

- NO DEFAULT IN REPAYMENT IS PERCEIVED
- DOES NOT DISCLOSE ANY PROBLEM
- NOR CARRY MORE THAN NORMAL RISK ATTACHED TO THE BUSINESS

ASSET CLASSIFICATION

SUB-STANDARD ASSETS

- **NON-PERFORMING ASSET FOR A PERIOD OF NOT EXCEEDING 18 MONTHS**

DOUBTFUL ASSETS

- **NPA FOR MORE THAN 18 MONTHS**
- **CREDIT WEAKNESS INHERENT**
- **RECOVERY OF DUES IS DOUBTFUL**

LOSS ASSETS

- **IDENTIFIED AS LOSS ASSET, UNCOLLECTIBLE**
- **NOT YET WRITTEN OFF WHOLLY OR PARTLY**

PROVISIONING

LOANS AND ADVANCES (CREDIT FACILITIES)

- *LOSS ASSETS*
  - FULLY WRITTEN OFF, OR
  - 100% PROVIDED FOR
- *DOUBTFUL ASSETS*
  - 100 % OF THE UNSECURED PORTION
  - FOR THE SECURED PORTION
    - UPTO 1 YEAR – 20%
    - 1 TO 3 YEAR – 30%
    - MORE THAN 3 YEARS – 50%
- *SUB-STANDARD ASSETS*
  - 10% OF THE OUTSTANDING AMOUNT
- Provisioning introduced for standard assets at 0.25%

PROVISIONING

- PROVISIONS TO BE SEPARATELY DECLARED WITHOUT NETTING
- DISTINCTLY INDICATED UNDER SEPARATE HEADS
  - PROVISIONS FOR BAD AND DOUBTFUL DEBTS
  - PROVISIONS FOR DEPRECIATION IN INVESTMENTS.
- NOT BE APPROPRIATED FROM THE GENERAL PROVISIONS AND LOSS RESERVES
- PROVISIONS FOR EACH YEAR TO BE DEBITED TO THE PROFIT AND LOSS ACCOUNT.

CAPITAL TO RISK WEIGHTED ASSETS (CRAR)

1)Tier I Capital(NOF)/Total RWA(of both on balance sheet items and off balance sheet items)

PLUS

2)Tier II Capital/ Total RWA

Total CRAR =Tier I + Tier II (any amount in Tier II in excess of Tier I is ignored)

- Tier II - preferential shares revaluation reserves ;; hybrid capital; Subordinated debt
- **Should maintain minimum CRAR of 15%**

RECENT REGULATORY CHANGES

- Revised Capital Adequacy Framework for Off-Balance Sheet Items for NBFCs (CC no 254 dated Dec 30,2011)
- Non- Reckoning Fixed Deposits with Banks as Financial Assets (CC no 259 dated Mar 15,2012)
- Loan to Value ratio (LTV) reduced to 60% for companies lending against gold
- Disclosure in the balance sheet the percentage of such loans to their total assets
- NBFCs should not grant any advance against bullion/primary gold and gold coins
- NBFCs primarily engaged in gold shall maintain a minimum tier I capital of 12 %
- Allowing NBFCs to issue Perpetual Debt Instruments which would qualify as Tier I / Tier II capital
- NBFCs allowed to be users of Credit default swaps for hedging purposes

RECENT REGULATORY CHANGES

- Guidelines on Fair Practices Code for NBFCs (CC no 266 dated Mar 26,2012)
  - NBFCs shall mention the penal interest charged for late repayment in bold in the loan agreement
  - Board od Directors of NBFCs should lay down the appropriate grievance redressal mechanism within the organization
  - The rate of interest should be annualised rates so that the borrower is aware of the exact rates
  - NBFC-MFIs should display FPC in vernacular language in its office and branch premises
  - All NBFC-MFIs shall have a board approved, standard form of a loan agreement which should disclose the necessary terms and conditions of a loan
  - For NBFCs lending against gold jewellery, they should put in place Board approved policy for lending against gold
  - Gold pledged should be auctioned only through auctioneers approved by the board

RECENT REGULATORY CHANGES

- New category of NBFCs introduced:
  - CICs
  - IDF-NBFCs
  - NBFC-MFIs
  - NBFC-Factors
- Participation allowed in currency futures and options and opening of subsidiaries abroad
- New NBFCs not to be partners in partnership firms

DRAFT GUIDELINES ON NBFCs

- Principal Business Criteria to change to allow serious players. Bar raised to 75% for financial assets/financial income to total assets/total income
- Companies having huge financial activities in absolute terms to be brought into the ambit as well
- Total Assets criteria to be introduced for NBFCs as entry point norm
- Asset classification and provisioning norms to change
- Higher Tier I Capital for Captive NBFCs
- Total assets to be aggregated for multiple NBFCs in a group
- Government NBFC will have to comply with all the requirements
- For corporate governance, the focus is on NBFC with assets of Rs 1000 cr and above
- Smaller companies with less than 25 crore asset size will be given ample time to meet the new requirements

SECTION 45 MA

- 45MA. 1(Powers and duties of auditors.-(1) It shall be the duty of an auditor of a non- banking institution to inquire whether or not the non- banking institution has furnished to the Bank such statements, information or particulars relating to or connected with deposits received by it, as are required to be furnished under this Chapter, and the auditor shall, except where he is satisfied on such inquiry that the non- banking institution has furnished such statements, informations or particulars, make a report to the Bank giving the aggregate amount of such deposits held by the non- banking institution.
- (2) Where, in the case of a non- banking institution, being a company, the auditor has made, or intends to make, a report to the Bank under sub- section (1), he shall include in his report under sub- section (2) of section 227 of the Companies Act, 1956 (1 of 1956) the contents of the report which he has made, or intends to make, to the Bank.)

EXPECTATIONS FROM STATUTORY AUDITORS/CAs

- In case of CoR, the certificates required:
  - company is/does not accept/is not holding Public Deposit
  - company is not carrying on any NBFC activity
  - net owned fund as on date of the application
  - Details of unsecured loans if any, raised by the company from others
  - details of group/ associate/ subsidiary/ holding/ related companies
  - Stopping of NBFI activities in the event of the company carrying on the business of NBFC without RBI permission
  - Audited Financial statements of the company for the last three years

EXPECTATIONS FROM STATUTORY AUDITORS/CAS

- Exception Report in case of non compliance by the company with the directions of RBI eg.
  - non compliance of prudential norms
  - credit concentration norms
  - standard asset provisioning (non provision as well as incorrect calculation)
  - non creation of /incorrect transfer to reserve fund in terms of Sec 45 IC
  - not satisfying the principal business criteria
  - Absence of branch reporting system
- Exclusion of share application money for allotment (if more than 6 months old) in calculation of NOF
- Half yearly FDI Certificates to be submitted based on the FDI inflow received during the period
- Pointing out discrepancies as observed in the financial statements e.g. carrying on NBFI business without CoR

THANK YOU