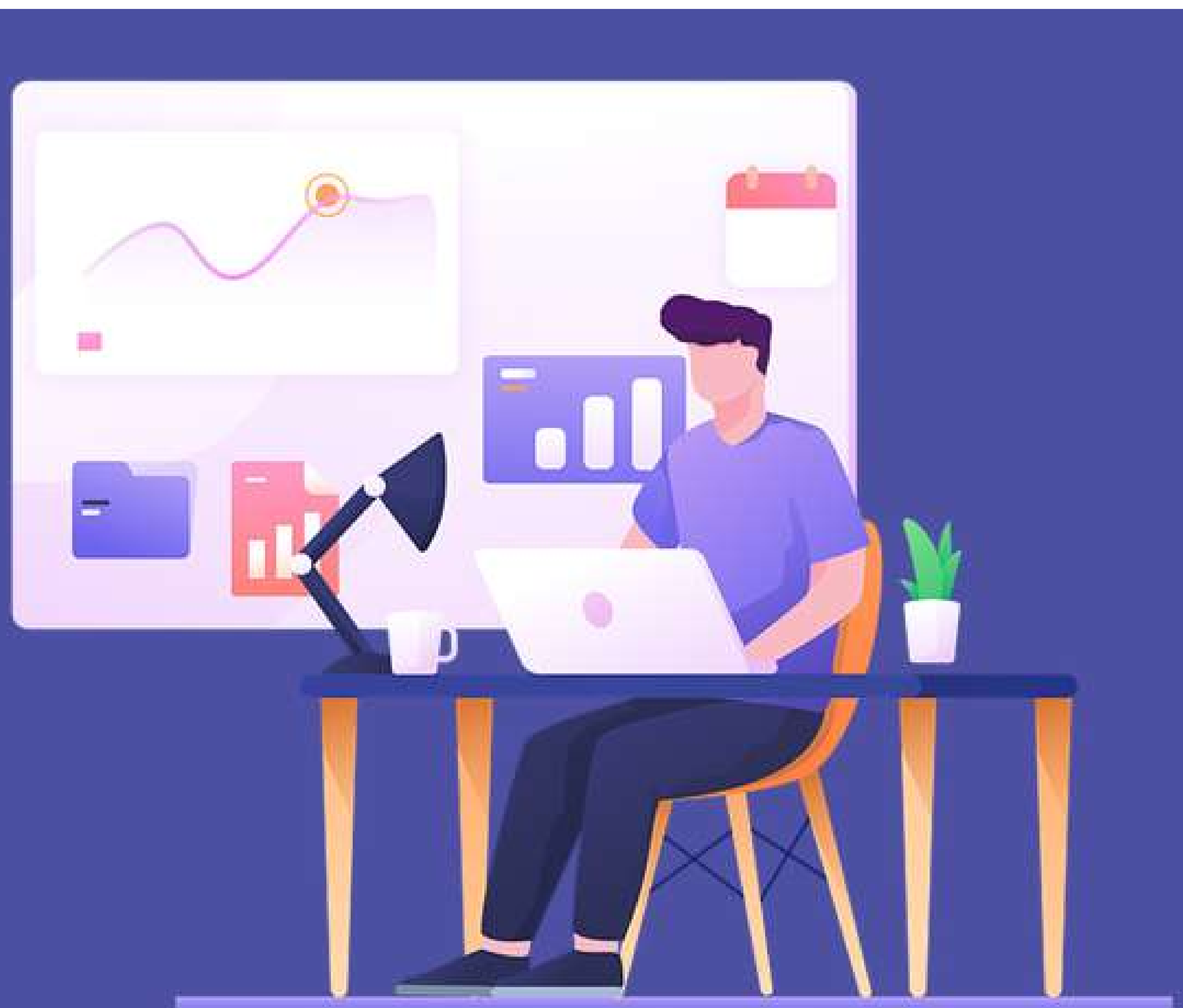
NBFC (Part-1)

NBFC (Non-Banking Financial Company) is engaged in financial activities as defined under section 45-IA of the RBI Act 1934 but does not possess a banking license.A company can offer banking services such as lending of loans, assets mortgage, insurance, hedge funds, etc after NBFC Registration.



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Introduction

NBFC (Non-Banking Financial Company) is engaged in financial activities as defined under section 45-IA of the RBI Act 1934 but does not possess a banking license. A company can offer banking services such as lending of loans, assets mortgage, insurance, hedge funds, etc after NBFC Registration.

However, they do not have permission to perform banking operations of accepting demand deposits from the public. They also cannot issue cheques drawn on it.

NBFCs are registered as per the rules and regulations prescribed under Companies Act, 2013 and the Reserve Bank of India Act, 1934. They are playing a vital role in executing financial functions in the economy. They help to meet the demand that remains unfulfilled by the traditional banking system in shorter processing time.

An NBFC can provide both secured and unsecured loans to the takers based on alternative lending models. The government has been promoting NBFC so that the unorganized money lenders and people willing to run financial services can organize their lending operations.

Roles and Functions of an NBFC

NBFCs play a significant role in conducting financial services in the Indian economy. NBFC in India have undergone too many transformations in recent years. At present, most of the NBFC Start-ups have adopted high-end tech based business model.

These NBFCs are working actively to promote financial inclusion & as well aggressively complementing the banking sector.

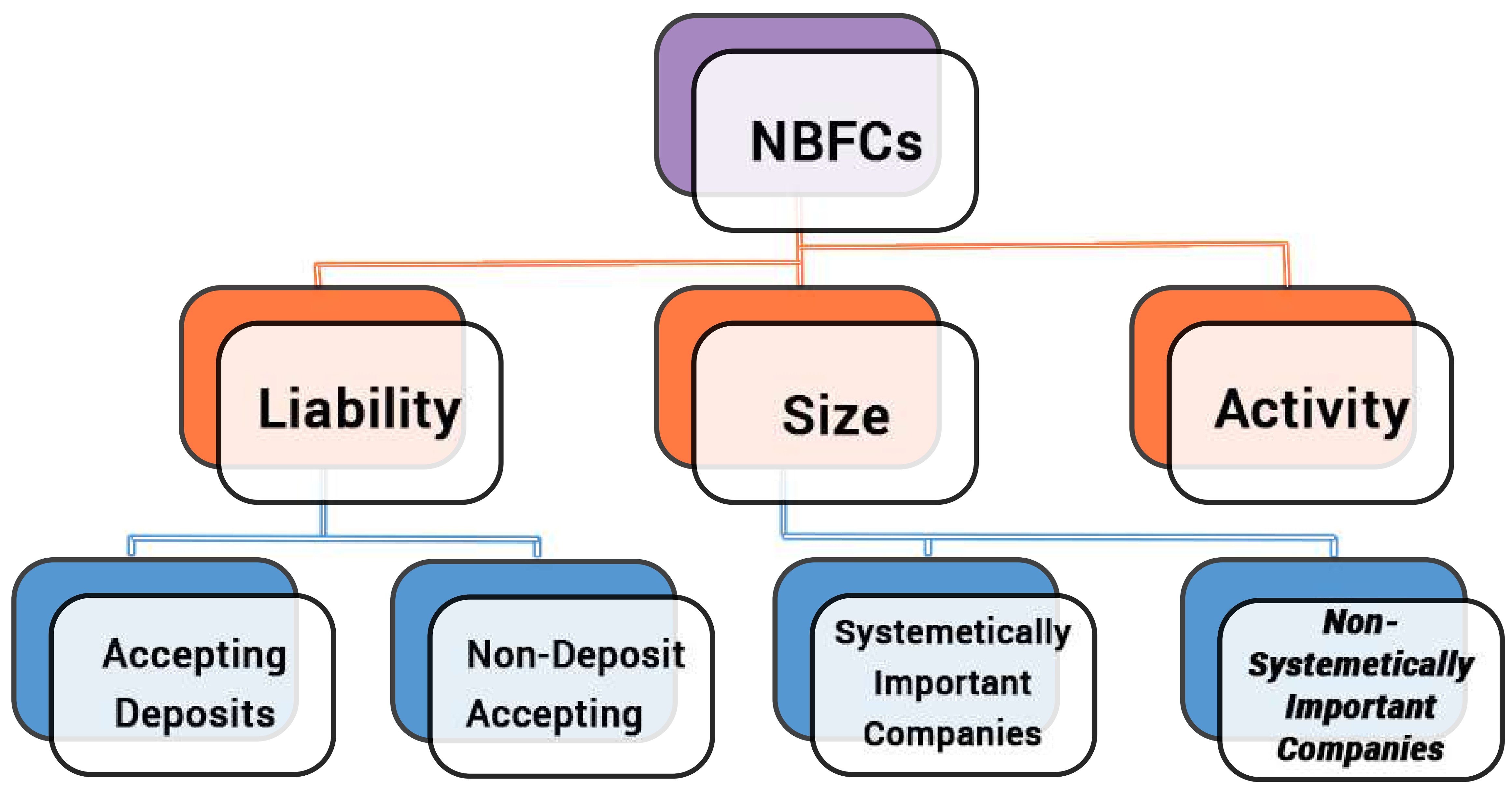
- NBFC creates a favorable balance in addressing the financial needs of the country, where a large number of applicants are turned down by traditional Banks of India.
- NBFC provides loans based on alternative credit scoring model to assess the loan application.
- Indian Fintech Start-ups have been using NBFC model to offer financial services.
- Credit growth of registered NBFCs is recorded at 24.3% per year as against 21.4% for banks.

NBFC vs. Bank - What is the Difference between an NBFC and Bank?

Banks are similar to an NBFC, but they perform extra banking functions. Member of both the categories is counted among the top finance companies in India.

Basis	NBFC	Bank
Meaning	NBFC provides banking services to people without holding a bank license	Bank is a government authorized financial intermediary which provides banking services to the general public
Incorporated under	Companies Act 1956 and 2013	Banking Regulation Act, 1949
Demand Deposit	Not Accepted	Accepted
Foreign Investment	Allowed up to 100%	Allowed up to 74% for private sector banks
Payment and Settlement system	Not a part of system.	Integral part of the system.
Deposit insurance facility	Not available	Available
Credit creation	NBFC do not create credit.	Banks create credit.
Transaction services	Not provided by NBFC.	Provided by banks.

Types of NBFC in India



Deposit Accepting NBFC's:

All NBFCs are not entitled to accept public deposits. Only those NBFCs holding a valid CoR with authorization to accept Public Deposits can accept/hold public deposits. Section 45I(bb) of the RBI Act, 1934 defines the term deposits as - "deposit" includes and shall be deemed always to have included any receipt of money by way of deposit or loan or in any other form, but does not include,–

- amounts raised by way of share capital;
- amounts contributed as capital by partners of a firm;
- amounts received from a scheduled bank or a co-operative bank or any other banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;
- any amount received from,– (b) a State Financial Corporation, (c) any financial institution specified in or under section 6A of the IDBI Act, 1964, or (d) any other institution that may be specified by the Bank in this behalf:

- amounts received in the ordinary course of business, by way of– NBFCs Liability Deposit accepting Non-Deposit accepting Size Systemically important NBFCs Non Systemically important NBFCs Activity Figure 5 10 (a) security deposit, (b) dealership deposit, (c) earnest money, (d) advance against orders for goods, properties or services,

- any amount received from an individual or a firm or an association of individuals not being a body corporate, registered under any enactment relating to money lending which is for the time being in force in any State; and

- Any amount received by way of subscriptions in respect of a chit. Further, exclusions are provided under Para 2(1) (Xii) of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998.

Systematically Important NBFCs

NBFCs whose asset size are of Rs. 500 crore or more as per last audited balance sheet are considered as systemically important NBFCs. The rationale for such classification is that the activities of such NBFCs will have a bearing on the financial stability of the overall economy.

NBFCs based on their activities

- Non-Banking Financial Company – Investment and Credit Company
- Infrastructure Debt Fund (IDF-NBFC)
- Non-Banking Financial Company – Factors (NBFC-Factors)
- Peer to Peer Lending Marketplace.
- Infrastructure Finance Company
- Core Investment Company.
- Non-Banking Financial Company-Micro Finance Institution (NBFC-MFI)
- Mortgage Guarantee Company.
- Housing Finance Company
- Chit Fund Company
- Mutual Benefit Finance Company
- Core Investment Company

Few Important Categories and Terms

Asset Finance Company (AFC):

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. 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.

Investment Company (IC):

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

Loan Company (LC):

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.

Infrastructure Finance Company (IFC):

IFC is a non-banking finance company

a) which deploys at least 75 per cent of its total assets in infrastructure loans,
b) has a minimum Net Owned Funds of Rs. 300 crore,
c) has a minimum credit rating of 'A 'or equivalent
d) and a CRAR of 15%.

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 Rs. 100 crore or above and

f) It accepts public funds

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

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

Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI):

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

a) loan disbursed by an NBFC-MFI to a borrower with a rural household annual income not exceeding Rs. 1,00,000 or urban and semi-urban household income not exceeding Rs. 1,60,000;

b) loan amount does not exceed Rs. 50,000 in the first cycle and Rs. 1,00,000 in subsequent cycles;

c) total indebtedness of the borrower does not exceed Rs. 1,00,000;

d) tenure of the loan not to be less than 24 months for loan amount in excess of Rs. 15,000 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 installments at the choice of the borrower

Non-Banking Financial Company – Factors (NBFC-Factors):

NBFC-Factor is a non-deposit taking NBFC engaged in the principal business of factoring. The financial assets in the factoring business should constitute at least 50 percent of its total assets and its income derived from factoring business should not be less than 50 percent of its gross income.

Mortgage Guarantee Companies (MGC):

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 Rs. 100 crore.

NBFC- Non-Operative Financial Holding Company (NOFHC) is 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.

50-50 Criteria

RBI vide its press release 1998-99/1269 dated April 8, 19995, laid down the criteria for determining the principality of business (popularly known as 50-50 principal business criteria). The asset and income pattern as evidenced from the last audited balance sheet of the company shall be considered.

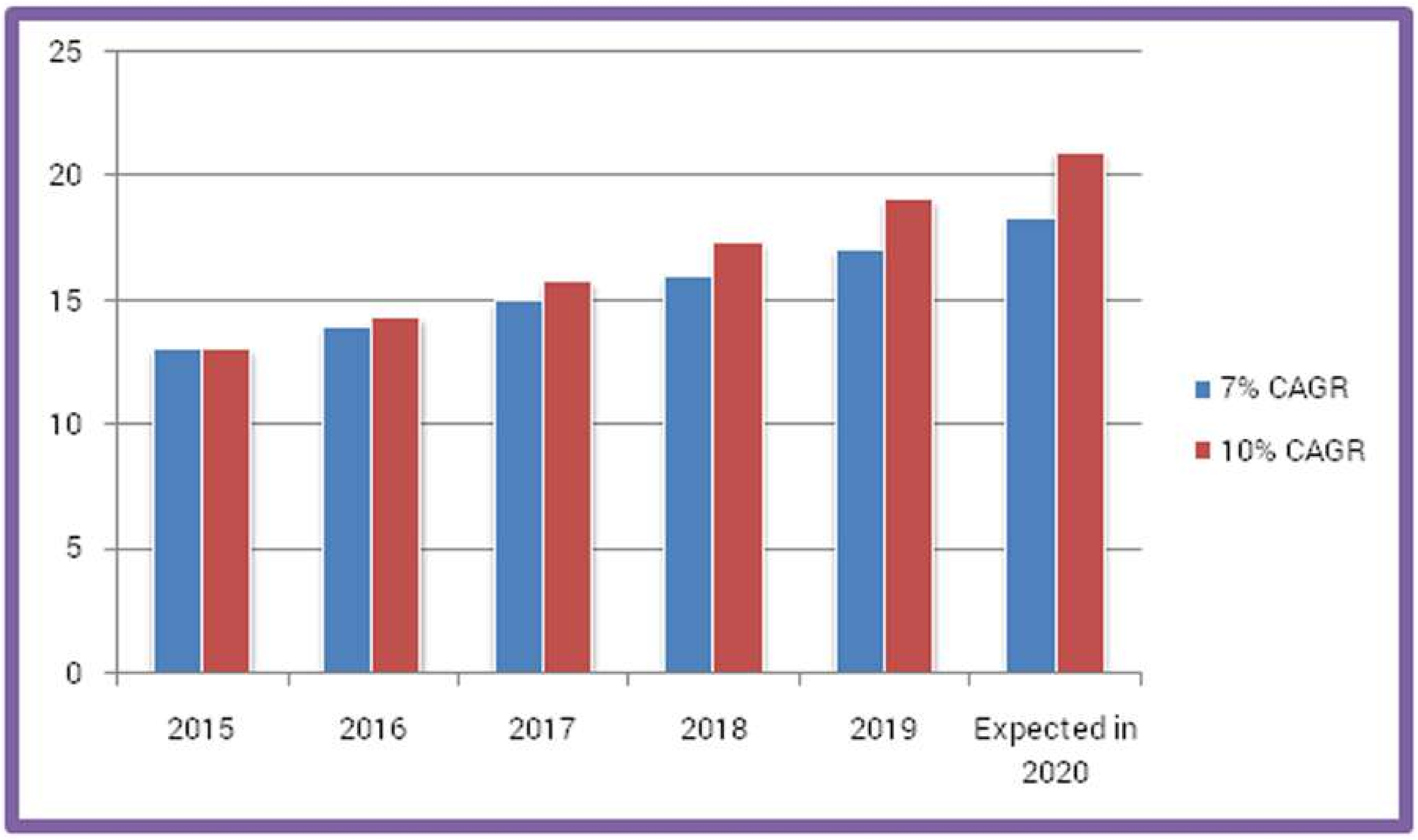
The following criteria shall be satisfied by a company to be known as an NBFC

- financial assets are more than 50 per cent of its total assets (netted off by intangible assets) and
- Income from financial assets should be more than 50 per cent of the gross income.

The aforementioned criteria are a thumb rule for determining whether a company qualifies to be an NBFC. The conditions are cumulative, that is, both the tests are required to be satisfied simultaneously as the determinant factor for principal business of a company.

Based on the above press release, the RBI came with another circular no. DNBS (PD) C.C. No. 81/03.05.002/2006-07 dated October 18, 20066, insisting NBFCs to obtain an annual certificate from the auditor of the company certifying that the company continues to carry on the business of NBFI and is fulfilling the criteria of the principal business as detailed in the press release dated April 8, 1999.

Credit Growth at NBFC as a % of total growth



Factors contributing to the growth of NBFCs

- Stress on public sector units (PSUs).
- Latent credit demand
- Digital disruption, especially for micro, small and medium enterprises (MSMEs) and small and medium enterprises (SMEs).
- Increased consumption
- Distribution reach and sectors where traditional banks do not lend

NBFC Registration Departments

The founders are required to follow both online as well offline NBFC application process to obtain the NBFC license. The Reserve bank of India is an autonomous body, and it has two departments to regulate and supervise the function of an NBFC.

DNBR (Department of Non-banking Regulation)

The DNBR is responsible for conducting the Fresh NBFC Registration process as well for preparing the regulation for the NBFC. The DNBR has transparent as well innovative assessment process of NBFC Application.

The DNBR will email you or send you a formal notice if they need of any additional documents during the NBFC registration process. The RBI expects your submission/response to a notice within 30 days as per the NBFC regulations.

DNBS (Department of Non-Banking Supervision)

DNBS is responsible for post-registration compliance and other administrative issues about NBFCs.

Applicants can expect an NBFC license in 90 to 120 days after successful acceptance of an NBFC application.

NBFC Compulsory Registration with RBI

In terms of Section 45-IA of the RBI Act, 1934,

- ***No Non-banking Financial company can commence or carry on business of a non-banking financial institution without obtaining a certificate of registration from the Bank***
- ***No NBFC can commence business without having Net Owned Funds of Rs. 2 Crore.***

However, in terms of the powers given to the Bank, to prevent dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI like:

- 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 as notified under Companies Act, 1956/2013
- Chit companies as defined in clause (b) of Section 2 of the Chit Funds Act, 1982,
- Housing Finance Companies regulated by National Housing Bank, Stock Exchange or a Mutual Benefit company.

Requirements for Registration with RBI

A company incorporated under the Companies Act, 1956 or 2013 and is desirous of commencing business of non-banking financial institution as defined under Section 45 I (a) of the RBI Act, 1934 should comply with the following:

- It should be a company registered under Companies Act, 2013
- It should have a minimum net owned fund of Rs. 2 crores
- Create a Fixed Deposit of Rs. 2 crore
- FDI Compliance as per FEMA Act - In the case of foreign investment
- Complete documentation for an NBFC license
- Submission of necessary documents with FD receipt before RBI

Procedure for application to the Reserve Bank for Registration

- 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 .
- Now the applicant company will not need to log on to the COSMOS application and hence user ids are not required.
- The company can click on "CLICK" for Company Registration on the login page of the COSMOS Application.
- A window showing the Excel application form available for download would be displayed.
- The company can then download suitable application form (i.e. NBFC or SC/RC) from the above website, key in the data and upload the application form.
- The company may note to indicate the correct name of the Regional Office in the field "C-8" of the "Annex-I dentification Particulars" in the Excel application form.
- The company would then get a Company Application Reference Number for the CoR application filed on-line.
- Thereafter, the company has to submit the hard copy of the application form (indicating the online Company Application Reference Number, along with the supporting documents, to the concerned Regional Office.

- The company can then check the status of the application from the above mentioned secure address, by keying in the acknowledgement number.

- The application form and an indicative checklist of the documents required to be submitted along with the application is available at www.rbi.org.in ⊠ Site Map ⊠ NBFC List ⊠ Forms/ Returns.

Thank You!