NBFC (Part-2)

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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Fresh NBFC Registration vs. Takeover of Pre-Existing NBFC

Applying for new NBFC Application is always a better option than a takeover of existing ones. The registration of NBFC is simpler than before. This is especially for Foreign Companies, who intends to enter into the Indian Financial service market.

We always advise them to apply for the new NBFC registration instead of buying existing NBFC.

Advantages of Fresh NBFC Registration above NBFC Takeover

Low Legal Risk

In case of NBFC takeover, any past Non-compliance with RBI Act may lead to cancellation of the NBFC License.

Timeline

Fresh NBFC Registration can be completed in a period of 90 to 120 days whereas an NBFC Takeover usually takes 5 to 9 Months.

Title Risk

There is no title risk of Ownership after new registration of NBFC. You are the 1st shareholder of the company at another side in acquiring an existing NBFC. You will not be able to establish the precise title of shares.

Tax Liability

Entities are responsible for a tax liability of existing NBFC they are willing to take over.

Capital

In case of new NBFC License application, you may need to block your Rs. 2 Cr / Rs. 20 Million FD in Bank Account. However, the proposed shareholders are required to submit the Bankers report in a case of the NBFC takeover. The report states that the Bank Balance is equivalent to book value of the shares.

List of Registered NBFCs

The list of registered NBFCs is available on the web site of Reserve Bank of India and can be viewed at www.rbi.org.in -> Sitemap -> NBFC List.

The instructions issued to NBFCs from time to time are also hosted at www.rbi.org.in -> Notifications -> Master Circulars -> Non-banking, besides, being issued through Official Gazette notifications and press releases.

Regulations applicable on non-deposit accepting NBFCs with asset size of less than ₹ 500 crore

The regulation on non-deposit accepting NBFCs with asset size of less than ₹ 500 crore would be as under:

- They shall not be subjected to any regulation either prudential or conduct of business regulations viz., Fair Practices Code (FPC), KYC, etc., if they have not accessed any public funds and do not have a customer interface.

- Those having customer interface will be subjected only to conduct of business regulations including FPC, KYC etc., if they are not accessing public funds.

- Those accepting public funds will be subjected to limited prudential regulations but not conduct of business regulations if they have no customer interface.

- Where both public funds are accepted and customer interface exist, such companies will be subjected both to limited prudential regulations and conduct of business regulations.

Public Funds vs. Public Deposits

Public funds are not the same as public deposits. Public funds include public deposits, inter-corporate deposits, bank finance and all funds received whether directly or indirectly from outside sources such as funds raised by issue of Commercial Papers, debentures etc. However, even though public funds include public deposits in the general course, it may be noted that CICs/CICs-ND-SI cannot accept public deposits.

Further, indirect receipt of public funds means funds received not directly but through associates and group entities which have access to public funds.

Prudential regulations applicable to NBFCs

The Bank has issued detailed directions on prudential norms; vide Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007, Non-Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015 and Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015. Applicable regulations vary based on the deposit acceptance or systemic importance of the NBFC.

The directions inter alia, prescribe guidelines on income recognition, asset classification and provisioning requirements applicable to NBFCs, exposure norms, disclosures in the balance sheet, requirement of capital adequacy, restrictions on investments in land and building and unquoted shares, loan to value (LTV) ratio for NBFCs predominantly engaged in business of lending against gold jewellery, besides others. Deposit accepting NBFCs have also to comply with the statutory liquidity requirements. Details of the prudential regulations applicable to NBFCs holding deposits and those not holding deposits is available in the section 'Regulation – Non-Banking – Notifications - Master Circulars' in the RBI website.

Owned fund and Net owned fund

- **Owned Fund** means aggregate of the paid-up equity capital, preference shares which are compulsorily convertible into equity, free reserves, balance in share premium account and capital reserves representing surplus arising out of sale proceeds of asset, excluding reserves created by revaluation of asset, after deducting there from accumulated balance of loss, deferred revenue expenditure and other intangible assets.

- **Net Owned Fund** is the amount as arrived at above, minus the amount of investments of such company in shares of its subsidiaries, companies in the same group and all other NBFCs and the book value of debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group, to the extent it exceeds 10% of the owned fund.

Legal Analysis of NBFC Annual Compliance

In recent times, RBI compliances are getting tougher for NBFCs as compared to before. There were times when Non-Banking Financial Companies had privileges over banks. In comparison to banks, compliance laid down by RBI for NBFCs were far more lenient but after the Sahara case, RBI has made new compliances for NBFCs and now it is under RBI's continuous screening. Some of the important guidelines are Securitization of Standard Assets and Guidelines for Private Placement of NBFCs. RBI is keeping making efforts for preventing speculation in NBFCs.

RBI releases notifications for the additional compliance requirement for NBFCs.

Submission of Annual Statements and Returns

NBFC-ND-SI (Non-Deposit category) are required to submit an annual statement of capital funds, risk assets ratio etc. It can be submitted electronically as well as physically.

Further Capital Adequacy, Liquidity, and other disclosure norms have been incorporated in Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.

- Capital Adequacy of 15% to be maintained.
- Disclosures in the Balances Sheet

CRAR

- Exposure to Realty Sector both direct and indirect
- Maturity Patterns for assets and liabilities

ALM Returns are required to be submitted by NBFC- ND-SI

- ALM1- Statement of short-term dynamic liquidity- Monthly
- ALM2- Statement of short-term structural liquidity- Half Yearly
- ALM3- Statement of Interest Rate Sensitivity – Half Yearly

Checklist for NBFC Non-Deposit Compliances with RBI

Annual Compliance

No.	Particulars	Time limit
1.	Unaudited March Monthly return/NBS7	on or before 30th June
2.	Audited March Monthly return/NBS7	Upon completion
3.	Statutory Auditors certificate on Income & Assets	on or before 30th June
4.	Information about Cos having FDI/Foreign Funds	on or before 30th June
5.	Resolution of Non-acceptance of Public Deposit	before the commencement of the new Financial year
6.	File Audited Annual Balance Sheet and P&L Account	One month from the date of signoff
7.	Declaration of Auditors to Act as Auditors of the Company	annual basis

Monthly compliance

Serial no.	Particulars	Time limit
1.	Monthly Return	by 7th of every month

Periodical compliances

Serial no.	Particulars	Time limit
1.	Appointment of Director	within 30 days of appointment
2.	Resignation of Director(DIR-12 + Challan Receipt)	within 30 days of resignation
3.	Adoption of any notification in the ensuing Board Meeting & filing the certified copy with RBI	

Future of NBFC in India

The NBFC sector has shown considerable growth in the last few years despite the slowdown in overall economic growth, accounting for 14% of the country's GDP by the end of March 2015. This has gone up from 8.4% in March 2006 only counting NBFCs with assets more than Rs 100 crore. If all the NBFCs are taken into consideration, the growth chart will go up further to 18 % by 2018-19.

NBFCs are proving to be a perfect alternative to mainstream banking in India as an integral part of Indian Financial System, thereby making a remarkable contribution toward the country's financial development. The Central Government and Reserve Bank of India are the major regulators of the NBFCs in India. The unorganized sector seeking loans and advances have been the most important beneficiary of NBFCs, providing easy access to the small local borrowers.

Residuary Non-Banking Companies (RNBCs)

Residuary Non-Banking Company is a class of NBFC which is a company and has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner and not being Investment, Asset Financing, Loan Company. These companies are required to maintain investments as per directions of RBI, in addition to liquid assets. The functioning of these companies is different from those of NBFCs in terms of method of mobilization of deposits and requirement of deployment of depositors' funds as per Directions. Besides, Prudential Norms Directions are applicable to these companies also.

Deposits and Public Deposits

The term 'deposit' is defined under Section 45 I(bb) of the RBI Act, 1934. '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:

- amount raised by way of share capital, or contributed as capital by partners of a firm;
- amount received from a scheduled bank, a co-operative bank, a banking company, Development bank, State Financial Corporation, IDBI or any other institution specified by RBI;
- amount received in ordinary course of business by way of security deposit, dealership deposit, earnest money, advance against orders for goods, properties or services;
- amount received by a registered money lender other than a body corporate;
- amount received by way of subscriptions in respect of a 'Chit'.

Paragraph 2(1)(xii) of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 defines a ' public deposit' as a 'deposit' as defined under Section 45 I(bb) of the RBI Act, 1934 and further excludes the following:

- amount received from the Central/ State Government or any other source where repayment is guaranteed by Central/ State Government or any amount received from local authority or foreign government or any foreign citizen/ authority/ person;
- any amount received from financial institutions specified by RBI for this purpose;

- any amount received by a company from any other company;
- amount received by way of subscriptions to shares, stock, bonds or debentures pending allotment or by way of calls in advance if such amount is not repayable to the members under the articles of association of the company;
- amount received from directors of a company or from its shareholders by private company or by a private company which has become a public company;
- amount raised by issue of bonds or debentures secured by mortgage of any immovable property or other asset of the company subject to conditions;
- Any amount raised by issuance of non-convertible debentures with a maturity more than one year and having the minimum subscription per investor at ₹ 1 crore and above, provided it is in accordance with the guidelines issued by the Bank.
- the amount brought in by the promoters by way of unsecured loan;
- amount received from a mutual fund;
- any amount received as hybrid debt or subordinated debt;
- amount received from a relative of the director of an NBFC;
- any amount received by issuance of Commercial Paper.
- any amount received by a systemically important non-deposit taking non-banking financial company by issuance of 'perpetual debt instruments'
- any amount raised by the issue of infrastructure bonds by an Infrastructure Finance Company

Thus, the directions exclude from the definition of public deposit, amount raised from certain set of informed lenders who can make independent decision.

Entities accepting deposits from Public

- Banks, including co-operative banks, can accept deposits.
- Non-bank finance companies, which have been issued Certificate of Registration by RBI with a specific license to accept deposits, are entitled to accept public deposit.

In other words, not all NBFCs registered with the Reserve Bank are entitled to accept deposits but only those that hold a deposit accepting Certificate of Registration can accept deposits. They can, however, accept deposits, only to the extent permissible.

- Housing Finance Companies, which are again specifically authorized to collect deposits and companies authorized by Ministry of Corporate Affairs under the Companies Acceptance of Deposits Rules framed by Central Government under the Companies Act can also accept deposits also upto a certain limit.
- Cooperative Credit Societies can accept deposits from their members but not from the general public. The Reserve Bank regulates the deposit acceptance only of banks, cooperative banks and NBFCs.

It is not legally permissible for other entities to accept public deposits. Unincorporated bodies like individuals, partnership firms, and other association of individuals are prohibited from carrying on the business of acceptance of deposits as their principal business. Such unincorporated bodies are prohibited from even accepting deposits if they are carrying on financial business.

Can NBFCs accept deposits from NRIs?

Effective from April 24, 2004, NBFCs cannot accept deposits from NRIs except deposits by debit to NRO account of NRI provided such amount does not represent inward remittance or transfer from NRE/FCNR (B) account. However, the existing NRI deposits can be renewed.

NBFCs specifically authorized by RBI to accept deposits

The Reserve Bank publishes the list of NBFCs that hold a valid Certificate of Registration for accepting deposits on its website: www.rbi.org.in -> Sitemap ->NBFC List -> List of NBFCs Permitted to Accept Deposits.

At times, some companies are temporarily prohibited from accepting public deposits. The Reserve Bank publishes the list of NBFCs temporarily prohibited also on its website. The Reserve Bank keeps both these lists updated. Members of the public are advised to check both these lists before placing deposits with NBFCs.

Salient features of NBFC regulations which the depositor may note at the time of investment

Some of the important regulations relating to acceptance of deposits by NBFCs are as under:

- The NBFCs are allowed to accept/renew public deposits for a minimum period of 12 months and maximum period of 60 months. They cannot accept deposits repayable on demand.
- NBFCs cannot offer interest rates higher than the ceiling rate prescribed by RBI from time to time. The present ceiling is 12.5 per cent per annum. The interest may be paid or compounded at rests not shorter than monthly rests.
- NBFCs cannot offer gifts/incentives or any other additional benefit to the depositors.
- NBFCs should have minimum investment grade credit rating.
- The deposits with NBFCs are not insured.
- The repayment of deposits by NBFCs is not guaranteed by RBI.
- Certain mandatory disclosures are to be made about the company in the Application Form issued by the company soliciting deposits.

Precautions a depositor take before placing deposit with an NBFC

A depositor wanting to place deposit with an NBFC must take the following precautions before placing deposits:

- That the NBFC is registered with RBI and specifically authorized by the RBI to accept deposits. A list of deposit taking NBFCs entitled to accept deposits is available at www.rbi.org.in -> Sitemap -> NBFC List. The depositor should check the list of NBFCs permitted to accept public deposits and also check that it is not appearing in the list of companies prohibited from accepting deposits, which is available at www.rbi.org.in -> Sitemap -> NBFC List -> NBFCs who have been issued prohibitory orders, winding up petitions filed and legal cases under Chapter IIIB, IIIC and others.

- NBFCs have to prominently display the Certificate of Registration (CoR) issued by the Reserve Bank on its site. This certificate should also reflect that the NBFC has been specifically authorized by RBI to accept deposits. Depositors must scrutinize the certificate to ensure that the NBFC is authorized to accept deposits.

- The maximum interest rate that an NBFC can pay to a depositor should not exceed 12.5%. The Reserve Bank keeps altering the interest rates depending on the macro-economic environment. The Reserve Bank publishes the change in the interest rates on www.rbi.org.in -> Sitemap -> NBFC List -> FAQs.

- The depositor must insist on a proper receipt for every amount of deposit placed with the company. The receipt should be duly signed by an officer authorized by the company and should state the date of the deposit, the name of the depositor, the amount in words and figures, rate of interest payable, maturity date and amount.

- In the case of brokers/agents etc collecting public deposits on behalf of NBFCs, the depositors should satisfy themselves that the brokers/agents are duly authorized by the NBFC.

- The depositor must bear in mind that public deposits are unsecured and Deposit Insurance facility is not available to depositors of NBFCs.

- The Reserve Bank of India does not accept any responsibility or guarantee about the present position as to the financial soundness of the company or for the correctness of any of the statements or representations made or opinions expressed by the company and for repayment of deposits/discharge of the liabilities by the company.

Why is venture funding important in NBFC?

Any NBFC startup which is registered under RBI to serve its business objective needs fundraising. NBFC is always one of the most popular sectors for the investor as if you manage NBFC by use of technology and big data the risk in business reduce to 5%. Whenever a venture capitalist starts funding for a startup at SEED stage or startup stage or later stage, the financing plan depends on the current market scenario and business growth expected by the founders.

In the modern NBFC business, funding and fundraising act as the major resource which supports the growth of a startup. To achieve the goal of a startup, it is important to ensure the right allocation of fund to each business segment. Fundraising agenda needs to be carried by founder on a regular basis. There is no end of fundraising process for a startup.

Why Every NBFC startup raises foreign funding?

- Meeting the financial objective of a startup.
- Remove glitches from the path of success.
- Removing all the financial blockages from the path of success of startups.
- Matching the business standards and high level of competition.

100% foreign funding is allowed without any restriction in all type of NBFC other than Deposit taking NBFC.

- Investment advisory services.
- Financial consultancy.
- For-ex broking.
- Money changing business.
- Credit rating agencies.
- Loan Company
- Assets Finance company

NBFC Takeover

RBI has simplified the NBFC takeover can process and a takeover deal can be executed in 45 to 60 working days. Takeover of NBFC is easier than Fresh registration of NBFC.

Acquirer of NBFC should first conduct due diligence and overview the financials of the target company. Once The target NBFC is go to go and to execute acquisition of the said NBFC, MOU to be signed with some advance money.

What is Takeovers?

In the financial terms, means the purchase of one business entity by another. This can be either friendly takeover, wherein the seller entity consents to sell its assets to the acquirer entity. Or on the other hand, this can take form of hostile takeovers, where the acquirer entity deliberately and secretly acquires the control of the other entity. In both the conditions, the balance sheet of the seller entity stands nulls after all its assets and liabilities are transferred to the acquirer.

The concept of mergers and takeovers is not new to the economic world. Many business houses have experienced either a remarkable success or disheartening breakdown after such arrangements. NBFCs, being considered as near substitute to the conventional banks, have also not been left untouched by the takeover and acquisition drives. The Reserve Bank of India laid down the procedure for the Takeover of NBFCs so as to prescribe a systematic system eliminating every bias and ambiguity.

In case of the friendly takeovers of the NBFCs, the first step in the process is to sign the MOU with the proposed company after the decision for NBFC takeover is been approved by the Board of both the companies. Once the Board has consented for the aforesaid takeover, the next step in the process is to seek RBI’s approval for the subject.

The whole process of NBFCs takeover is governed by the RBI regulations and the notifications issued by it from time to time in this regard. Although the concept of NBFCs takeovers is still in its infant stage, but the RBI has ensured that the process to be followed shall be systematic and comprehensive. All the compliances, as prescribed in this behalf shall be duly satisfied. The acquirer shall be well-versed with all the information connected with the transferor in order to avoid any delay in the process.

Thank You!