Declaration of Dividend by NBFCs

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In news

Recently, the Reserve Bank of India (RBI) released a draft circular on distribution of dividend by non-banking financial companies (NBFCs)

Key highlights of the circular

Eligibility criteria for declaration of dividend

Only those NBFCs, which comply with the following minimum prudential requirements, would be eligible to declare dividend:

- **Capital Adequacy and Leverage:** NBFCs should comply with the prescribed minimum capital adequacy and leverage ratio as under:
  - **Deposit taking Non-Banking Financial Company (NBFC-D) and Systemically Important Non-Deposit taking Non-Banking Financial Company (NBFC-ND-SI)** should have CRARCapital to Risk (Weighted) Assets Ratio (**CRAR**) of at least 15% for last 3 years, including the accounting year for which it proposes to declare dividend.
  - **Non-Systemically Important Non-Deposit taking Non-Banking Financial Company (NBFC-ND)** should have leverage ratio of less than 7 for the last 3 years, including the accounting year for which it proposes to declare dividend.
  - **Core Investment Company (CIC)** should have **Adjusted Net Worth (ANW)** of at least 30% of its aggregate risk weighted assets on balance sheet and risk adjusted value of off-balance sheet items for the

last 3 years, including the accounting year for which it proposes to declare dividend.

- **Non-Performing Assets (NPA):** The net NPA ratio should be less than 6% in each of the last three years, including the accounting year for which it proposes to declare dividend.
- **Declaring dividend:** NBFCs may be eligible to declare dividend even if the above criteria are not met for the previous two years, provided:
  - the norm for capital adequacy is achieved, and
  - net NPA is less than 4%, for the year for which dividend is proposed to be declared.
- **Amount of dividend payable:**
  - As per the draft circular, the maximum dividend payout ratio that will be permitted for various combinations of capital adequacy and net NPA.
  - NBFCs achieving higher capital adequacy ratio and lower net NPA will be allowed to declare a greater proportion of their net profit as dividend (dividend pay-out ratio).
  - The permissible pay-out ratio ranges from 10% to 50%.
- Restrictions on dividend pay-out ratio do not apply to NBFCs that don’t access or intend to access public funds, or interface with customers (Type I NBFC).
- **Applicability:** If notified, the circular would be applicable for dividend to be declared for financial year 2020-21 onwards

What is a Non-Banking financial company (NBFC)?

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the 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 but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company)

NBFCs are doing functions similar to banks. What is the difference between banks & NBFCs?

NBFCs lend and make investments and hence their activities are akin to that of banks; however there are a few differences as given below:

- NBFC cannot accept demand deposits
- NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself
- Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.