NBFCs and their regulation

June 21, 2020

NBFIs facilitate bank-related financial services, such as investment, risk pooling, contractual savings, market brokering, etc. and also offer other non-banking services.

The Reserve Bank of India Amendment Act 1997 defines Non-Banking Finance Company as:

- A financial institution which is a company registered under the companies Act, 1956/2013;
- A non-banking institution which is a company and whose principal business includes receiving of deposits under any scheme/arrangement/in any other manner or lending in any manner;
- Other non-banking institutions or class of institutions as the RBI may with the previous approval of the Central Government specify.
- The definition excludes financial institutions as well as institutions which carry on agricultural operations as their principal business.

Different types of NBFCs are as follows(list is not exhaustive):

- Investment Company (IC): IC means any company which is a financial institution carrying on as its principal business the acquisition of securities.
- 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 ₹ 300 crores, c) has a minimum credit rating of ‘A ‘or equivalent d) and a Capital to Risk-Weighted Assets Ratio (CRAR) of 15%. Systemically Important Core Investment Company: It is an NBFC carrying on the business of acquisition of shares and securities which satisfies certain conditions

stipulated by the RBI.

- 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. The IDF-NBFC raise resources through the 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 with certain conditions.
- **Regulation of NBFCs**

Registration:

Non-banking Financial company can commence or carry on business of a non-banking financial institution only after obtaining a certificate of registration from theRBI and having a Net Owned Funds of ₹ 25 lakhs (₹ Two crore since April 1999). However to avoid the problem of dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI viz. 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 the Companies Act, 1956, Chit companies as defined in the Chit Funds Act, 1982,Housing Finance Companies regulated by National Housing Bank, Stock Exchange or a Mutual Benefit company.

Hence, these sectoral regulators regulate respective entities and RBI does not regulate all the NBFCs.

Powers of RBI over NBFCs

- The Reserve Bank has been given the powers under the RBI Act 1934 to register, lay down policy, issue directions, inspect, regulate, supervise and exercise surveillance over NBFCs.
- The Reserve Bank can penalize NBFCs for violating the provisions of the RBI Act or the directions or orders issued by RBI under the RBI Act.
- The penal action can also result in RBI cancelling the Certificate of Registration issued to the NBFC, or prohibiting them from accepting deposits etc.
- It is illegal for any financial entity to make a false claim of being regulated by the Reserve Bank to mislead the public to collect deposits. They will be liable for penal action under the Indian Penal Code in such a scenario.

→NBFC which are accepting deposits have similar norms related to SLR, CRAR norms that are applicable to banks

FDI:

As per the changed FDI policy 2017, under section 47 of the Foreign Exchange Management Act, 100 percent FDI through automatic route is permitted for NBFCs.