Non-Banking Financial Companies in India

Name- Ajit Singh. Roll number- 1801010

1.Need for NBFCs in the economy:

NBFCs (Non-Banking Financial Companies) play an important role in promoting inclusive growth in the country, by catering to the diverse financial needs of bank excluded customers. Further, NBFCs often take lead role in providing innovative financial services to Micro, Small, and Medium Enterprises (MSMEs) most suitable to their business requirements. NBFCs do play a critical role in participating in the development of an economy by providing a fillip to transportation, employment generation, wealth creation, bank credit in rural segments and to support financially weaker sections of the society. Emergency services like financial assistance and guidance is also provided to the customers in the matters pertaining to insurance.

NBFCs are financial intermediaries engaged in the business of accepting deposits delivering credit and play an important role in channelizing the scarce financial resources to capital formation. They supplement the role of the banking sector in meeting the increasing financial needs of the corporate sector, delivering credit to the **unorganized sector** and to small local borrowers. However, they do not include services related to agriculture activity, industrial activity, sale, purchase or construction of immovable property. In India, despite being different from banks, NBFC are bound by the **Indian banking industry** rules and regulations.

NBFC focuses on business related to loans and advances, acquisition of shares, stock, bonds, debentures, securities issued by government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business.

The banking sector would always be the most important sector in the field of business because of its credibility in supporting manufacturing, infrastructural development and even being the backbone for the common man's money. But despite this, the role of

NBFCs is critical and their presence in a country would only **boost the economy in the right direction.**

2.Role in the Economy:

- A non-banking financial institution (NBFI) or non-bank financial company (NBFC) does not have a full banking license but facilitate bank-related financial services like investment, contractual savings, and market brokering and risk pooling. They play a big role in strengthening the economy and have been able to carve out a place for themselves in meeting the credit needs of both wholesale and retail customers.
- NBFIs act as a supplement to banks by providing infrastructure to distribute excess resources to individuals and companies with deficits.
- NBFIs also serve the additional purpose of introducing competition in financial services.
- Unlike banks who may offer a packaged deal on a set of financial services, NBFIs offer customized services to suit the specific needs of clients NBFIs specializing in one particular sector develop an informational advantage.
- From loans and credit facilities to private education funding and retirement planning, from trading in money markets to underwriting stocks and shares, and Term Finance Certificates, NBFCs offer almost all banking services. They provide wealth management services like managing stocks and shares portfolios, discounting services like discounting of instruments and give advice on merger and acquisition activities.
- The number of NBFCs has increased greatly in the last several years due to venture capital companies, retail and industrial companies have entered the lending business. NBFCs also often support property investments in property besides preparing feasibility, market or industry studies for companies.

- NBFCs are usually not allowed to take deposits from the general public and have to find options for funding their operations.
- NBFCs do not provide cheque books nor do they provide a saving account and current account. They are only authorized to takes fixed deposit or time deposits.

Some of the key regulations for acceptance of deposits by the NBFCs are:

- They are allowed to accept or renew public deposits for a minimum period of 12 months and a maximum period of 60 months.
- They cannot accept deposits repayable on demand.
- They cannot offer interest rates higher than the ceiling rate prescribed by RBI from time to time.
- They cannot offer gifts/incentives or any other additional benefit to the depositors.
- They should have the minimum investment grade credit rating
- Their deposits are not insured.
- RBI does not guarantee the repayment of deposits by NBFCs.

3.History:

NBFCs started humbly in India in the 1960s as an alternative for savers and investors whose financial needs were not sufficiently met by the existing banking system. The NBFCs initially operated on a limited scale without making much impact on the financial industry. They invited fixed deposits from investors and worked out leasing deals for big industrial firms.

In the first stages of development, the Companies Act regulated financing. However, the unique and complex nature of operations and with financial companies acting as financial intermediaries, there was a call for a separate regulatory mechanism.

Hence, Chapter III B was included in the Reserve Bank of India Act, 1934, which assigned the Bank with limited authorities to regulate deposit-taking companies. Since then the RBI has initiated measures to regulate the NBFC sector.

The RBI accepted and implemented that hire purchase and leasing companies could accept deposits to the extent of their net owned funds, as per the key recommendations of James S. Raj Study Group formed in 1975. The Companies were also required to maintain liquid assets in the form of unencumbered approved government securities.

Between the 1980s and 1990s, NBFCs, with their customer-friendly reputation, began to attract a huge number of investors. The number of NBFCs rose swiftly from a mere 7000 in 1981 to around 30000 in 1992, which made the RBI feel the need to regulate the industry. In 1992, the RBI formed a Committee headed by the former Chairman of Bank of Baroda, Mr. A. C. Shah, to suggest measures for effective regulation of the industry. The Shah Committee's recommendations included most things from compulsory registration to prudential norms.

In January 1997 there were huge changes in the RBI Act, 1934, especially the Chapters III-B, III-C, and V of the Act seeking to put in place a complete regulatory and supervisory structure, which would protect the interests and also ensure the smooth functioning of NBFCs.

After the amendment of the Act in 1997, the NBFCs have grown significantly in terms of operations, range of instruments and market products, technological advancement, among others.

In the last 20 years, the NBFCs have gained prominence and added depth to the financial sector. In August 2016, the union cabinet gave the go-ahead for foreign direct investment (FDI) under the automatic route in regulated NBFCs. Today, the biggest players in the NBFC domain are companies like Power Finance Corporation limited, Bajaj Finance Limited, Muthoot Finance, HDFC finance, etc.

4.Changes in Management:

Change in management of NBFC happens now and then, due to situations such as resignation, death, retirement or takeover. Thus, change in management in NBFC requires Strategic review of the proposal, the Due diligence of the target company, MoU between the target company and acquirer, Nod from RBI for Change in management and MCA Compliance for Change in management.

Before any change in the management, Reserve bank specifies the conditions for which prior approval of the bank is required:

- Any takeover or acquisition of NBFCs, resulting in a change of management;
- Any change in the shareholding pattern resulting in acquisition/transfer of 26% or more of the paid-equity capital.
- More than 30 % change of directors, excluding independent directors.

The above conditions are subject to the following exceptions:

- When there is a change in shareholding, due to the order of competent authority, it is mandatory for a company to inform RBI within 30 days of the occurrence.
- When the director of the company gets re-elected by rotation, then prior approval is not required.

Further, RBI states that all NBFCs shall intimate regarding the change in management as required by law.

NBFCs Change in Management:

Where there is any change in management, NBFC is required to submit an application to Reserve Bank of India on the letterhead of the Company, along with the requisite documents:

- Information about change of proposed directors/ shareholders;
- Detail of source of fund for acquiring the shares in NBFC of the proposed shareholder;
- The proposed director/shareholder must provide a statement no criminal record, or offenses under section 138 of the Negotiable Instrument Act.
- The proposed director/shareholder must provide a statement for non-involvement with a company whose application for Certificate of Registration was rejected by RBI;
- Proposed directors/ shareholders banker's report

The requirement of Public Notice in case of Change in Management:

When there is any sale, transfer of ownership, merger or any Change in Managements of NBFCs, a public notice shall be given at least 30 days prior. Such public notice shall be given by the concerned NBFC as well as the other party to the transaction. The notice should be published in 2 newspapers, of which one should be in the English language and other in a regional language where the registered office of the company is situated. The Notice should clearly specify the intention of such a change in management.

Information to be provided to the Reserve Bank of India:

The proposed directors/shareholders of the company should provide appropriate information in Annexures provided by the Reserve bank of India. This information should be completely and accurately filled. Any incomplete information will be rejected and the approval process may be delayed.

The objective of the Reserve bank of India is to attain maximum transparency and efficiency in the workings of the financial market. Previous written consent of the Reserve Bank is a need for any takeover or acquisition of control of an NBFC, which may or may not result in a change of management. **Due to the rise of NBFCs in the financial and credit market, RBI plays pivotal role assuring the workings are uninterrupted.**

5.Some key differences between Commercial banks and NBFCs:

- A government authorised financial intermediary that aims at providing banking services to the general public is called the bank. An NBFC is a company that provides banking services to people without holding a bank license.
- An NBFC is incorporated under the Indian Companies Act, 1956 whereas a bank is registered under Banking Regulation Act, 1949.
- NBFC is not allowed to accept such deposits which are repayable on demand. Unlike banks, which accepts demand deposits.
- Foreign Investments up to 100% is allowed in NBFC. On the other hand, only banks of the private sector are eligible for foreign investment, and that would be not more than 74%.
- Banks are an integral part of payment and settlement cycle while NBFC, is not a part of the system.
- It is mandatory for bank maintain reserve ratios like CRR or SLR. As opposed to NBFC, which does not require to maintain reserve ratios.
- The deposit insurance facility is allowed to the depositors of banks by Deposit Insurance and Credit Guarantee Corporation (DICGC). Such facility is unavailable in the case of NBFC.
- Banks create credit, whereas NBFC is not involved in the creation of credit.
- Banks provide transaction services to the customers, such as providing overdraft facility, the issue of traveller’s cheque, transfer of funds, etc. Such services are not provided by NBFC.