EVOLUTION OF REGULATORY FRAMEWORK OF NBFCS

by

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ABSTRACT

A non-banking financial Company (NBFCs) is a company registered under the Companies Act, 2013. NBFCs plays a variety of roles in developing the financial system of the country and has helped to aid economic development in various ways. The Flexibility of the operations of NBFCs has led to the increase in the no. of NBFCs operating in the country. RBI keeps on changing the framework in order to keep a strict control and supervision over them. A Non-banking financial companies have also played a pivotal role in meeting the financial needs of individuals and business that have traditionally remained un-served or underserved by banks. This paper talks about the recent changes that were made in the regulatory framework by the RBI for ensuring the decline in the NPA as well as customers satisfaction.

INTRODUCTION

A non-banking financial Company (NBFCs) is a company registered under the Companies Act, 2103 of India. It is engaged in the business of loans and advances, acquisition of shares, stock, bonds, insurance business, hire-purchase, however it does not include any company whose main business is that of agriculture or of industrial activity, purchase or sale of any goods which does not involve securities, or providing services or sale/purchase/construction relating to any immovable property.

NBFCs plays a variety of roles in developing the financial system and has helped to aid economic development in various ways. Some of the functions include:[1]

- NBFC helps in the inclusive growth of a country by fulfilling the credit needs of the bank excluded customers.
- NBFCs help in aiding the Micro, Small and Medium (MSME) enterprises through financial services suitable to their requirements.
- They help in the development of the economy by providing, employment generation, and wealth creation, bank credit in rural areas and by supporting the financially weaker sections of the society.
- They play a significant role of channelizing the scarce financial resources to capital formation.
- NBFCs help in providing financial assistance and guidance to customers in matters relating to insurance as well.

[1] Lawcutor, https://lawcutor.com/2020/06/21/role-of-non-bank-financial-institutions-nbfcs/ (28th October, 2021)

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The Flexibility of the operations of NBFCs has led to the increase in the no. of NBFCs operating in the country. NBFCs have become one of the largest net borrowers of funds with gross payable of Rs. 9.37 Lakh Crore and the gross receivables of Rs. 0.93 Lakh Crore as at the end of September, 2020.[2] They also play a crucial role by providing a wide range of financial services and low cost of the transactions.

Since 1964, NBFCs have undergone structural changes in the regulatory framework. RBI had introduced regulatory framework for NBFCs in the year 2006, which were further changed in the year 2014. Even after 2014, RBI have been carrying out modification in the regulations in order to keep in pace with the rapidly changing environment of the banking system in the country.

In the year 1964, the RBI acquired the power to supervise and regulate the NBFCs operating in the country, after the insertion of Chapter III –B in the RBI Act, 1934. The Act was again amended in the year 1974 to give RBI more powers relating to the inspection, obligation of statutory auditors, etc. in respect of NBFCs. A prudential norms were formed for the NBFCs which were based on the recommendations given by Shah working group in the year 1994.[3]

In the year 1998, RBI had led down certain regulatory framework for NBFCs. The features are as follows:

1. NBFCs to be categorised as public deposit accepting; non-public deposit accepting but engaged in investments, loans or hire purchase and: non- public deposit accepting core investment companies.
2. Prohibiting NBFCs to grant loan against securities of its own shares.
3. The scope of the word ‘deposit’ was also clarified by the RBI
4. RBI widened the scope of auditor’s certificate.

[2] https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=20316, (26th October,2021)

[3] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12179&Mode=0, (26th October,2021)

Again the regulatory framework was revised in the year 2014 due to rapid increase in NBFCs and the nature of operations they were entering. The important changes that were made in the regulation are:

1. Minimum NOF was required to be Rs. 2 Crore for NBFCs. NOF i.e., Net Owned Fund of NBFCs was defined under S-45IA of the RBI Act.
2. There would be harmonisation of deposit acceptance across NBFCs categories.
3. There would be harmonisation of asset classification norms for deposit taking NBFCs or (NBFC-D) and systematic important Non-Deposit taking NBFCs or (NBFC-ND-SI)
4. Reviewing of corporate governance and disclosure norms and rotation of auditor every 3 years applicable to NBFC-D and NBFC-ND-SI.[4]

Based on the discussion paper issued by RBI on January, 2021, RBI on 22nd October, 2021, revised the regulatory framework in regard with NBFCs. The changed regulation would come into effect from 1st October, 2022.

It is suggested that NBFCs should consist of four tier structure in order to strengthen the functioning of NBFCs. The Department of Non-Banking Supervision of RBI are entrusted with the responsibility of supervision of the NBFCs as per Chapter III B, IIIC and V of the RBI Act, 1934. The main focus of the supervision department are the depositors, customer protection and stability. They now have the power to cancel the registration of the NBFCs and issue prohibitory orders.[5]

The four tier structure as proposed by RBI will be based on their size, activities and riskiness. The lowest layer will be known as the NBFC- Base Layer (NBFC-BL). The next middle layer would be known as NBFC- Middle layer (NBFC-ML). The upper and the Top level as NBFC –Upper Layer (NBFC-UL) and NBFC- Top Layer (NBFC-TL).

Base Layer: It shall comprise of the non-deposit taking NBFCs below the asset size of Rs. 1000 Crore, NBFC- Account Aggregator, NBFCs not availing public funds and Non-operative Financial Holding Company. In this layer, least regulatory intervention is required.

[4] https://rbidocs.rbi.org.in/rdocs/notification/PDFs/RRFNC101114F.PDF, (27th October,2021)
[5] 4-Tier Structure for regulation of NBFCs, (Dristiias, 23rd January,2021), https://www.drishtiias.com/daily-updates/daily-news-analysis/4-tier-structure-for-regulation-of-nbfcs, (27th October,2021)

Middle Layer: It shall consist of all deposit taking NBFCs, non-deposit taking NBFCs with asset size of Rs. 1000 Crore or more, NBFCs engaged in Core Investment, Infrastructure Debt Fund-NBFCs, Housing Finance Companies and Infrastructure Finance Companies. The regulation of this layer is bit strict than that if the base layer.

Upper Layer: It shall consist of only those NBFCs which are identified by the RBI. The top ten NBFCs would always remain in the upper layer, irrespective of their activities and other factors. This layer requires high surveillance by the regulators.

Top Layer: This layer shall remain ideally empty. Any NBFCs which poses potential systematic risk in the upper layer, would be moved to this top layer.

Along with other regulatory framework, NBFCs have to disclose their annual financial statements from 31st March, 2023. They shall disclose:

1. Corporate governance report containing different categories of directors and non-executive directors.
2. Income and Expenditure Items of exceptional nature.
3. Disclosure of opinions given by auditors and its impact on the financial items.
4. Breaches of any covenants in respect of loans which are availed by the NBFCs including incidences of default.[6]

[6] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12179&Mode=0, (27th October,2021)

CONCLUSION

Non-banking financial companies (NBFCs) have played a pivotal role in meeting the financial needs of individuals and business that have traditionally remained un-served or underserved by banks. Despite the challenges faced, the NBFCs are still learning to evaluate the overall market scenario and by approaching the new strategies to lend to different segments. A suggestion would be that every NBFC should lay down appropriate grievance redressed mechanism within the organization to settle the disputes between the company & the customers.

Further, in light of the devastating impact of the pandemic on NBFCs, certain liquidity and prudential relief measures have been brought forth by the RBI which are likely to absorb some of the shock waves. The RBI also brought through its measures flexibility to eligible borrowers, and lending institutions, including NBFCs, on granting a moratorium of 3 months on payment of all instalments.