Observing Compliances a Must for NBFCs

Reserve Bank of India is entrusted with the responsibility of regulating and providing **Non-Banking Financial Company or NBFC,** the guidelines to operate. The powers are listed in Chapter III B of the **Reserve Bank of India Act, 1934.**

<u>The objective is to:</u>

- ensure the healthy growth of financial institutions.
- ensure that these companies operate within the policy framework, as a part of the financial system in such a manner that their existence and functioning do not lead to systemic aberrations.
- the quality of supervision and surveillance exercised by RBI over the NBFCs is sustained by keeping pace with the developments that take place in this segment of the financial system.

What is a NBFC

- An NBFC is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/debentures/bonds/securities but does not include an institution whose principal business is that of agriculture activity, industrial activity, providing any services and sale/purchase/construction of the immovable property or purchase or sale of goods.
- A non-banking institution which is a company and has the principal business of receiving deposits under any scheme or arrangement by way of contributions or in some other manner is also an NBFC-RNBC (Residuary non-banking company).

Difference Between Banks & NBFCs

- The functions of top NBFC in India are similar to banks. However, there are some differences between the two. For example, unlike banks, NBFCs cannot accept demand deposits.

- NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself.

- The deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of an NBFC vs bank.

Conditions, Net Owned Funds & Principal Business:

As per Section 45-IA of the RBI Act, 1934, no company can commence or carry on the business of non- banking financial activities without obtaining a certificate of registration (CoR) from RBI.

The pre-conditions for NBFC License are:

It should be a company registered u/s 3 of the Companies Act. Either 1956 or 2013. It should have a minimum net owned fund (NOF) of Rs. 2 crores.

Here, NOF is what remains after reducing the amount of investment in shares of subsidiaries, companies in the same group, and all other NBFCs, 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, from the owned funds.

Owned funds are the total of 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 an asset, excluding reserves created by revaluation of an asset, after deducting accumulated balance of loss, deferred revenue expenditure, and other intangible assets.

The Principal Business of an NBFC is determined with the help of the 50-50 rule. This means that if a company is principally engaged in financial activities with:

A) The financial assets of the company comprising at least 50% of the total assets held by the company, &
B) At least 50% of income is derived from financial assets.

A company that fulfills the above conditions requires to be registered as NBFC as per RBI Guidelines.

NBFC Registration As Per RBI Guidelines

- Acquire DSC and DIN for the Directors

- Apply for approval of Company Name

- Director's Affidavit about meeting RBI provisions

- Draft of MOA & AOA

Filing company incorporation forms with documents.

- Obtain a Certificate of Incorporation from the RoC (Registrar of Companies) Deposit NOF in the company's bank account

- Apply for NBFC Registration with RBI

- This application is filed online on the RBI website

- On successful submission, a CARN (reference number) is generated, to be used during all future inquiries Now the hard copies of all the documents and application as submitted online is sent to the regional office of RBI

- The regional office checks the accuracy of the documents

It sends the application to the head office, if ok

The central office of RBI grants NBFC License and Certificate of Registration (CoR) if the company is found to be fulfilling the requirements u/s 45-IA.The company must commence its NBFC business within 6 months from the date of CoR.

Following Returns are required to be submitted by a Non-Deposit Accepting NBFC:

- **NBS-7**: Statement of capital funds, risk-weighted assets, risk assets ratio, etc. To be filed quarterly.

- **NBS-2**: Returns on important financial parameters of the company. Filed monthly.

- **ALM Returns**: Monthly statement of short-term dynamic liquidity in form NBS-ALM-1.

- **NBS-ALM-2:** A 6-monthly statement of structural liquidity in form
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- **NBS-ALM-3**: A 6-monthly statement of interest rate sensitivity in form NBS-ALM-3.

- **Branch info return**: Returns on important financial parameters of ND-NBFCs with assets over Rs. 50 crores, but less than Rs. 100 crores. Calculated and filed monthly.

- **Basic Information Report**: Advise name & address of the company, NOF, profit/loss in the last 3-years.

The purpose of these statements is to effectively manage interest rate risk and Asset Liability mismatches.

SAC: Every NBFC shall submit a Statutory Auditor Certificate, by its Statutory Auditor that it is engaged in the business of non-banking financial services and needs to hold the CoR. To be filed annually, within a month of finalizing the balance sheet, but no later than 31 Dec. It ensures continued compliance with NBFC regulation.

FDI Compliance: This certificate is to be signed by its Statutory Auditor, of NBFC having Foreign Direct Investment, certifying compliance with the existing norms of FDI. This declaration is to be submitted on a half-yearly basis, within 30 days, to the Regional Office of RBI in whose jurisdiction the registered office of the company is located. This ensures that the NBFC is following guidelines of the stipulated minimum capitalization and that its activities are confined to the activities commanded under FEMA.

Overseas Investment Return: NBFC, whether deposit accepting or not, having an overseas investment, submit this with details on overseas investment. To be submitted quarterly, within 15 days, to the Regional Office of RBI in whose jurisdiction the registered office of the company is located. And a copy to the DSIM (Department of Statistics and Information Management), Central Office, Mumbai.

Auditor's Certificate: Statutory auditors of NBFC with the overseas investment are to submit this certificate to the concerned Regional Office of RBI, certifying that it has fully complied with all RBI guidelines. To be filed annually.

CRILC: Returns by all NBFC-ND-SI, NBFC-D, and NBFC-Factors, with information on all the borrowers with them, having aggregate fund-based and non-fund based exposure of Rs. 5 crores or above, and the **SMA status** of each borrower.

On early Recognition of Stress on large accounts. "Nil" returns need not be submitted in this case. To be filed online for every quarter, within 21 days.

SMA-2: All NBFC-ND-SI, NBFC-D, and NBFC-Factors, with aggregate fund-based and non-fund based exposure of Rs. 5 crores or above, need to report all the SMA-2 accounts, so RBI can assess

Financial Distress, Prompt Steps for Resolution and Fair Recovery for Lenders. On the Friday of the week when the relevant account first came in the SMA-2 category. In case that Friday is a holiday, it has to be reported on a working day falling just before it.

Statement on Interest Rate Futures transaction: NBFCs hedging their underlying exposures and participating in IRF exchanges. It helps RBI to know the extent of participation of NBFCs in the IRF market. To submit half-yearly (within one month from the close of the half-year), to the Regional office of the DNBS (Department of

Non-Banking Supervision) of RBI in whose jurisdiction their company is registered.

NBFC Prudential Guidelines:

1. Leverage Ratio: The leverage ratio of an applicable NBFC (other than NBFC-MFIs and NBFC-IFCs) shall not be more than 7 at any point in time.
2. Accounting Standards: Accounting Standards and Guidance Notes issued by ICAI to be followed if they are not inconsistent with any of the Directions by RBI.
3. Accounting of Investments: The Board of Directors shall frame investment policy for the company and shall implement the same, including criteria to classify the investments into the current and long-term.
4. Need for Policy on Demand/Call Loans: The Board of Directors granting/intending to grant demand/call loans shall frame a policy for the company and implement the same.
5. Asset Classification: Assets to be classified as: **(i) Standard assets; (ii) Sub-standard assets; (iii) Doubtful assets; and (iv) Loss assets.**
6. Standard Asset provisioning: Every applicable NBFC shall make provision for standard assets at 0.25% of the outstanding liabilities.
7. Multiple NBFCs: All NBFCs belonging to a group shall be aggregated to check the limit of Rs. 500 crore asset size.
8. Disclosures: Every applicable NBFC shall separately disclose provisions for bad and doubtful debts and provisions for depreciation in investments, in the balance sheet.
9. Schedule: Particulars in the schedule as set out by RBI Directions, to be added to its balance sheet, by every applicable NBFC.
10. Loans against NBFCs own shares prohibited: No applicable NBFC is allowed to lend against its own shares.