

Making NBFCs relevant to ‘Make-in India’& ‘Start-up India, Stand-up India’



Analysis and Report by Resurgent India

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MESSAGE

With the economic revival of the rural and suburban economies, NBFCs' contribution in deposit mobilisation and credit extension can hardly be over-emphasised. India's large un-organised markets, create a huge demand for unsecured as well as secured credit. In geographical areas where banks do not have sufficient reach, . NBFCs fill this gap. Focussing on funding sectors where there is a credit gap, the core strengths of NBFCs and Micro-finance companies lie in their strong customer relationships, understanding of regional dynamics, well-developed recovery systems, and personalised services and fast decision making.

NBFCs focus on segments neglected by banks; non-salaried professionals, individuals, traders, transporters and stock brokers. These institutions are also instrumental in generating substantial economic activity and therefore employment in these regions.

These institutions are also diversifying into new verticals, and have introduced innovative products such as second-hand vehicles financing, small personal loans, three-wheeler financing, IPO financing, finance for tyres and fuel, AMC, and insurance advisory etc. . NBFCs are even funding event-oriented specific borrowings such as IPOs. With attractively priced offerings they see an opportunity and are seeking to raise short-term funding.

I congratulate FITS for having chosen a very appropriate topic "NBFCs & Micro-finance companies : Making them relevant for Make in India, Start-up India". They have really lined up a great panel for deliberations and I am sure proceedings of the Conference and its recommendations shall be of great interest for all stakeholders.

I wish the Conference a great success.

B D NARANG

Executive Director FITS &

former CMD, OBC



Message

NBFCs form a vital part of the Indian Financial System. By providing adequate and timely credit, they play a crucial role in fueling growth and driving entrepreneurship in the country. With the banking penetration remaining low, the NBFCs have rapidly emerged as suitable option to address the debt requirements of every segment in the economy- ranging from large infrastructure financing to small microfinance. NBFCs have been effective to some extent in addressing the gap in extending credit to retail customers in underserved and unbanked areas.

The role and importance of NBFCs has been acknowledged and appreciated by all the Expert Committees and Taskforces setup by the GOI and RBI till date. NBFCs also act as suitable channel for furthering the government agenda on financial inclusion, Make in India, Start-up India and Stand-up India.

The growing recognition on the role of NBFCs and their increasing interconnectedness with the banking sector has led to fundamental shifts in the policy environment governing NBFCs. In November 2014, RBI issued a revised regulatory framework with the objective to harmonize the NBFCs with banks and Financial Institutions and address regulatory gaps and minimize risks. While the regulations, specially, asset classification norms have been made more stringent for NBFCs so as to be at par with banks, what is now required is to support NBFCs with the right tools to establish the desired parity with banks and other financial institutions. On the part of the NBFC industry, while there will be costs connected with greater regulation, but the prospect of being well regulated member in the financial industry is likely to offset the costs in the long run.

We hope the report manages to touch upon all pertinent topics for the industry, to be taken forward for larger deliberation and action.

Jyoti Prakash Gadia

Managing Director

Resurgent India Ltd

NBFC Sector Overview



NBFC Sector Overview

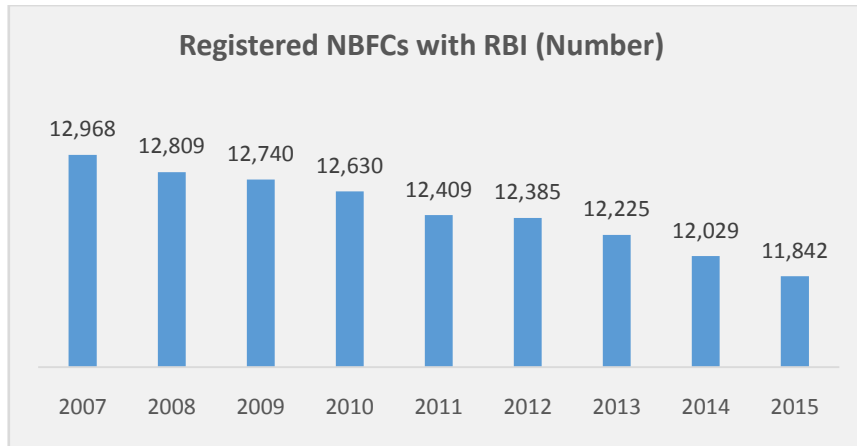
NBFCs play a vital role in promoting inclusive growth in the country, by meeting the diverse financial needs of bank excluded customers. By financing real assets and extending credit to infrastructure projects, NBFCs play a pro-active role in the development process of the country.

The importance of NBFCs to the economy is significant. There are 11,842 NBFCs registered with RBI with the combined asset size of INR 16 lakh crore. There are 202 NBFCs, classified as Non-Deposit taking Systemically Important NBFCs (NBFC-ND-SI), with a total asset size of INR 14 lakh crore. The share of NBFC assets as a percentage of scheduled commercial banks assets has increased from 7 per cent in 1998 to 14.8 per cent in March 2015.

NBFCs have steadily grown in number and market share, indicating the success of their business models and the potential of the target markets. Increased competencies in catering to market segments that are usually under-served by banks, such as the non-salaried category, low-income households, small businesses and rural areas have helped NBFCs grow faster than traditional banks.

Banks continue to remain a major funding source for NBFCs. NBFCs growing inter-connectedness with the banking sector and other segments of financial markets due to credit and other linkages increased the risk exposure on the financial system. Also, NBFCs are more prone to systemic risk on account of concentration arising from exposure to a specific sector. The increasing inter-linkage between banks and NBFCs and other associated risks prompted the RBI to introduce additional safeguards to contain systemic risks. To minimize these risks and address the regulatory gaps, RBI introduced a revised regulatory framework in November 2014. Some of the important changes in the revised framework include raising of net owned funds (NOF) for the NBFCs to 10 million by March 2016 and 20 million by March 2017, rating requirement for all unrated deposit-taking AFCs by March 31, 2016 for being eligible for acceptance of public deposits, fixing of threshold of 5 billion for all the NBFCs-ND for being considered systemically important, and harmonization of the asset classification norms for NBFCs-ND-SI and NBFCs-D in line with that of banks, in a phased manner.

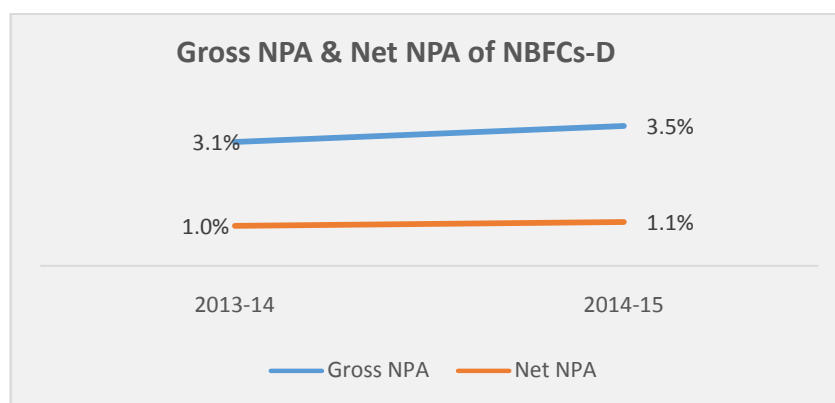
In the last few years, the NBFC sector has seen some consolidation taking place, especially in the NBFC-ND-SI segment as indicated by the consistent year on year decline in the number of registered NBFCs with the RBI. As on March 31, 2015, there were 11,842 NBFCs registered with RBI, out of which 202 were deposit-taking (NBFCs-D) and the remaining were non-deposit taking (NBFCs-ND) entities.



Source : RBI Reports, PWC

NBFCs are classified into two broad categories: (a) Deposit taking NBFCs, and (b) Non-deposit taking NBFCs.

Deposit-taking NBFCs (NBFCs-D) – With the objective of protecting depositor’s interests, the RBI through its policies discourages these NBFCs from engaging in deposit mobilization activities. RBI has further strengthened the regulations for NBFCs-D to ensure that only the sound and well-functioning entities remain in business. For NBFCs-D, borrowings from banks constitute the largest source of funding followed by debentures, public deposits, commercial paper and borrowings from government. NBFCs-D registered a marginal decline in profitability during 2014-15 over the previous year, majorly on account of increased interest payment burden and higher operating expenses. Further, the asset quality of NBFCs-D also deteriorated as both gross and net NPAs increased during 2014-15



Source : RBI Reports

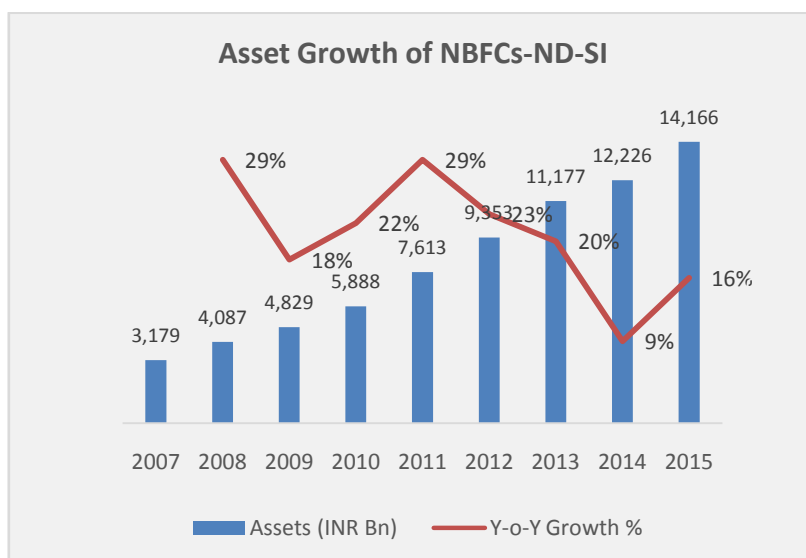
Non-deposit taking systemically important NBFCs (NBFCs-ND-SI) – Earlier, Non-deposit taking NBFCs with an asset size of INR 1 billion or more were classified as systemically important NBFCs (NBFCs-ND-SI). However, post November 2014,

with the introduction of the revised regulatory framework, the asset size criterion has been revised to INR 5 billion for classifying NBFCs-ND-SI.

During 2014-15, NBFCs-ND-SI raised funds mainly through debentures and commercial papers. Borrowings from banks, which earlier constituted the main source of funding, has progressively reduced over the years.

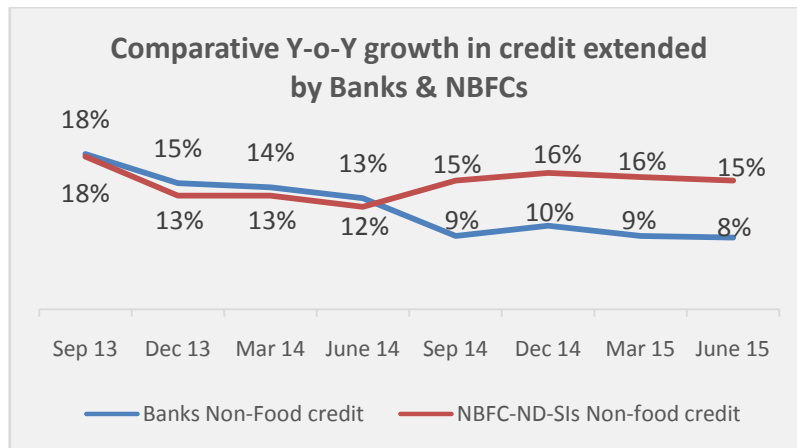
NBFCs have grown rapidly as indicated by their asset growth pattern over the years. The loans and advances extended by NBFCs-ND-SI posted significant growth at 15.5% during 2014-15, in contrast to the slowdown in commercial bank's non-food credit during the same period. The importance of NBFCs sector is underscored in their evolving role in niche areas of specialized services. Over the period, NBFCs have created product niches in sectors like infrastructure finance, automobile finance, gold loans, personal finance and capital markets. Healthy growth in credit extended by the NBFC - Infrastructure finance companies (IFCs), microfinance companies and loan companies contributed to sturdy growth in the loan portfolio of NBFCs-ND-SI. Among the sectors, infrastructure, medium and large-scale industries, and the transport sectors contributed to strong growth in credit off-take of the NBFCs-ND-SI.

However, NBFC business is likely get affected with the emergence of small finance banks (SFBs) in the second half of 2016; SFBs are likely to intensify competition in segments (higher yielding, under-served), which have traditionally been the domain of NBFCs.



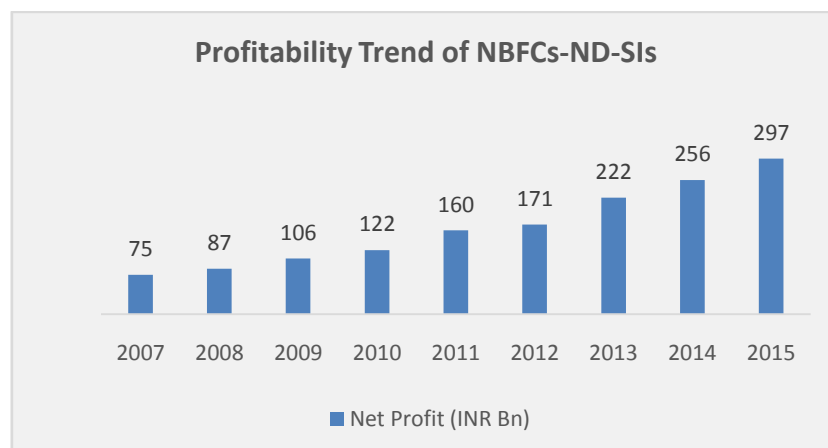
Source : RBI Reports, PWC

While the Bank credit to SMEs is witnessing a decline, the NBFCs at the same time are ramping up efforts to reach out to the SMEs. NBFCs, typically, offer loans against property, consumer durable loans and business loans, among other products, to SME customers or self-employed professionals. With the appetite of banks to extend credit likely to remain weak in the future as well, this offers opportunities to NBFCs to address the gap.



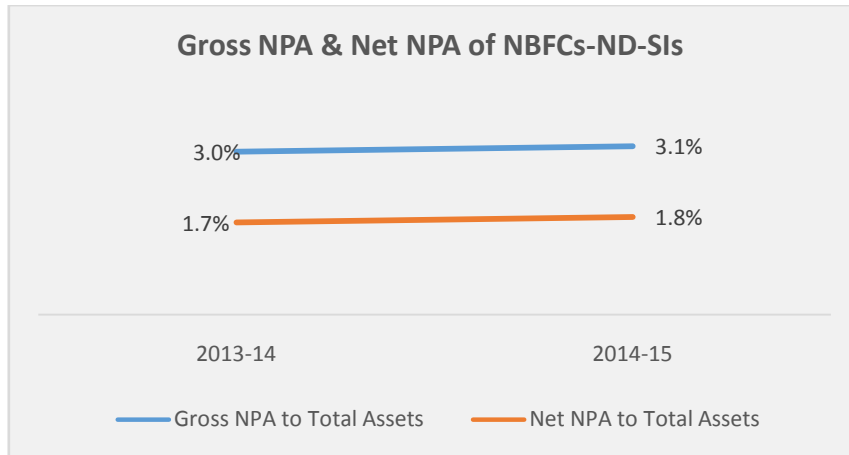
Source : RBI Reports

Profitability of the NBFCs-ND-SI has been improving progressively over the last few years. NBFCs business models are entrenched with unique strengths and thus are able to deliver superior performance consistently. However, going forward, the profitability is expected to take a hit on account of higher provisioning requirement under the new non-performing loans (NPL) recognition norms in the revised regulatory framework.



Source : RBI Reports, PWC

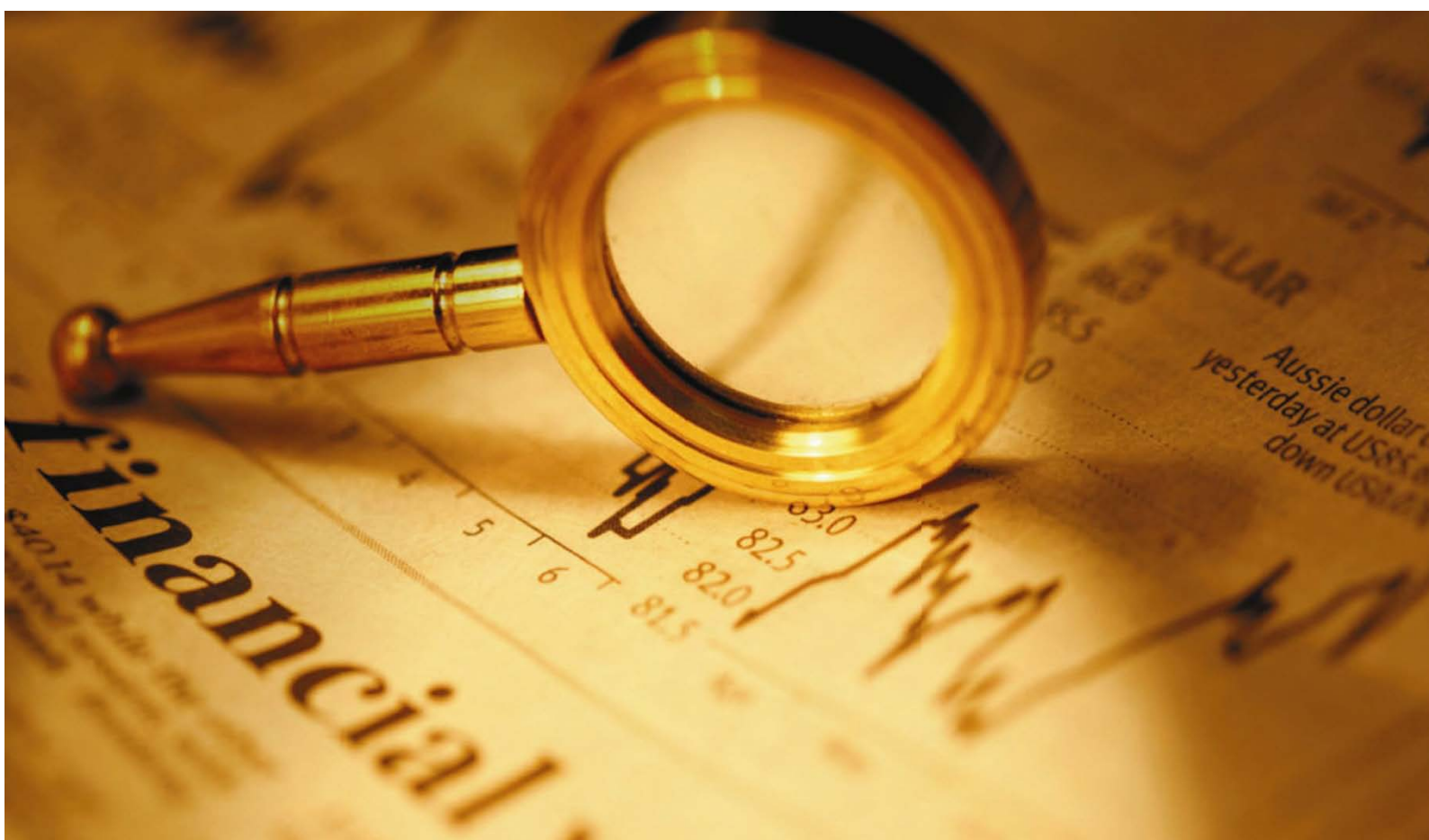
The asset quality of systemically important NBFCs has been witnessing stress over the last few years due to economic slowdown and weak operating environment. NPAs of NBFCs-ND-SI sector are primarily concentrated in infrastructure sector, transport operator segment, and medium and large scale industries. Further, given the fact that asset classification norms have been strengthened in the revised regulatory framework, one could expect to see higher NPA levels in the upcoming years.



Source : RBI Reports

A vibrant NBFC sector plays a critical role in extension of credit and deepening finance, given their expertise in developing solutions to meet the unique nature of credit demand in the country. NBFC sector has gained renewed impetus driven by RBI's focus on financial inclusion and slew of government initiatives. Initiatives such as smart cities, improvement in ease of doing business in India, Digital India, etc. are expected to push demand for credit, especially from the infrastructure sector and the SME segment.

NBFCs Role and Importance



The role of NBFCs is extremely important to an economy, when a large part of the population still lives in rural/semi-urban areas with little access to financial services and benefits. The role of NBFCs as effective intermediaries has been well recognized and in deposit mobilization and credit extension, it can hardly be overemphasized. The core strengths of NBFCs lie in strong customer relationships, astute grip on regional dynamics and personalized services. These have been ground-breaking at retail asset backed lending, lending against securities, microfinance etc. and have been extending credit to retail customers in under-served areas and to unbanked customers. They are not second fiddles anymore but are playing a complimentary strong role to banks.

The specific role and importance of NBFCs has been highlighted through broad points below:

- a. **Saving Utilization and Promotion:** NBFCs help mobilizing savings by offering attractive schemes suitable to respective target segments. This is particularly important when it helps reach sections where commercial banks have limited reach.
- b. **Easy Credit Access:** Given the universal target access, the formalities and processes at NBFCs are far simpler. It also offers financial access for unusual means like religious functions etc. which don't find mention in commercial banks product portfolio. The Banking sector has always been highly keeping pace, however easy approval procedures, flexibility in working style and timeliness in meeting the credit needs and low operation cost skew the balance in favor of NBFCs in providing funding.
- c. **Diversification:** Most NBFCs work on the principle of providing a good return on savings while reducing the risk through diversification. They provide avenues for better returns to investors, have a greater reach and flexibility in tapping resources, provide retail services to small and middle level business and road transport operators and are an integral component of a diversified financial market
- d. **Reduce Credit Funding Gap:** There is a huge latent credit demand in the country that gets aggravated for specific segments like self-employed or small businesses with little or low income proof. The gap is further compounded with public sector banks already under severe bad-debts. This impacts the credit appetite for banks in medium to short run, which is serviced by NBFCs, thereby reducing the credit funding gap.
- e. **Product Innovation and Competitiveness:** There are a range of financial products and services which were first provided by the NBFCs instead of banks, thereby pushing the envelope of financial portfolio and product development. For instance, the loans against gold were also introduced by the NBFCs much earlier than nationalized banks. In the same way, the commercial vehicle financing, in particular, were also first initiated by the NBFCs. NBFCs have also played an important role in the business of

securities- based lending such as Loan against Shares (LAS), Margin Funding, Initial Public Offering (IPO) Financing, Promoter Funding, etc.

- f. **Multi-layered Financial System:** Indian banking system alone is not equipped enough to handle current and growing credit needs. With the advent of middle class and corresponding status progression, the onus of economic development will be hinged strongly on how well their financial needs are serviced. To this end, all major banks open non-banking financial subsidiaries. These subsidiaries work as merchant banks, mutual funds, insurance companies, primary dealers and other NBFCs. Thus, NBFCs play a fundamental role in expansion access to services, enhancing competition and diversification of the sector
- g. **Provide Investment Assistance:** Mainly the investment companies render investment advice and assistance – spread risk, diversification of securities, selection of investment vehicle etc. This is critical for small investors.
- h. **Promote Economic Growth and Inclusion:** The role of NBFCs as engine of growth through creation of a multi layered finance system that enables universal access is well acknowledged. They enable small scale businesses by providing them awareness, access and diversification of securities and investment. They also have an active role in the capital markets and its stability.

Specific role in Financial Inclusion, thereby the recent Government Initiatives

NBFCs play an important role in promoting inclusive growth in the country, by catering to the diverse financial needs of bank excluded customers. The coverage of unbanked (self-employed or small businesses) provides the due impetus to government schemes like Start-up India or Make in India. Many reports on MSMEs and emerging businesses have highlighted the issue of ease and access to credit funding. By ensuring finances to such segments with low or no income proofs, NBFCs have directly or indirectly helped the economic growth and self-sustainability of the country.

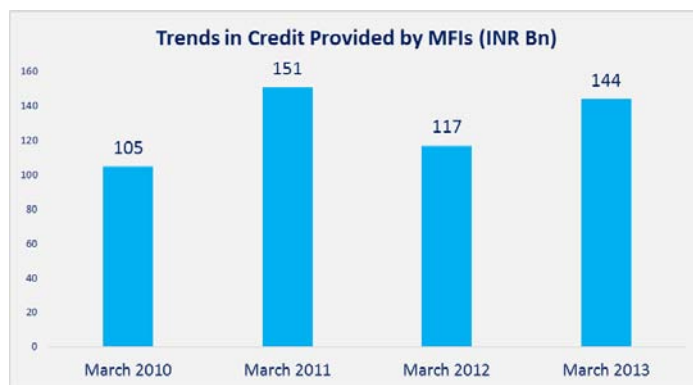
Their specific contribution for achieving inclusive growth has been highlighted through points below:

- a. **Credit to MSMEs:** MSME sector has large employment potential of 59.7 million persons over 26.1 million enterprises and is considered as an engine for economic growth and promoting financial inclusion in rural areas. The outstanding credit provided by the NBFC sector to MSMEs stood at Rs.625 billion as at end March 2013 against Rs.464 billion in the previous year.

Statistics based on 4th Census on MSME sector revealed that only 5.18% of the units (both registered and un-registered) had availed finance through institutional sources. 2.05% got finance from non-institutional sources the majority of units say 92.77% had no finance or depended on self-finance. The

fact that a large segment in the micro and small industries sector does not have access to formal credit provides a window of opportunity for the NBFCs to design suitable innovative products. [RBI Speech, 2014]

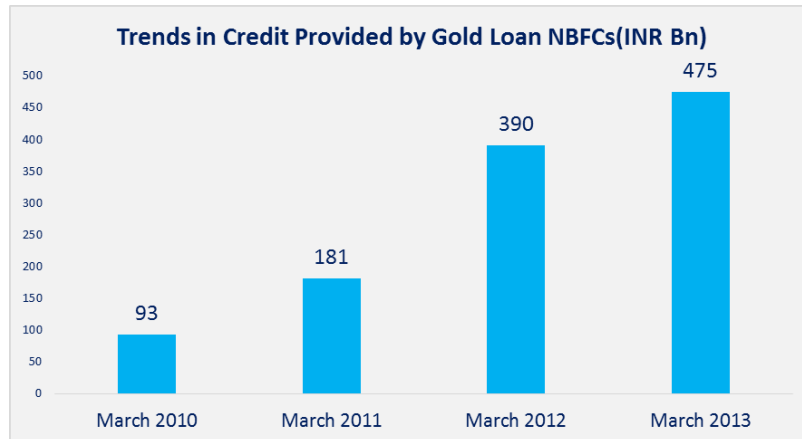
- b. **Micro Finance Institutions:** NBFC-MFIs provide access to basic financial services such as loans, savings, money transfer services, micro-insurance etc. to poor people. As per a CARE ratings report on the sector, Microfinance sector in India has gone through 3 broad risk phases in the past – high growth (till 2010), high volatility (2010 – 11), consolidation (2011 – 13) and IV phase of relative stability. The MFIs seem to have adapted to the new business environment post the AP crisis in 2010. This phase is expected to be characterized by a more stable regulatory environment, steady availability of funds, improving profitability with comfortable asset quality & capital adequacy and relatively lesser impact of concentration risk. In fact, the central bank in Sept 2015 announced a fresh set of 10 licenses for the small finance banks. Eight of them are from the microfinance industry.



Source : COSMOS Database, RBI Speech

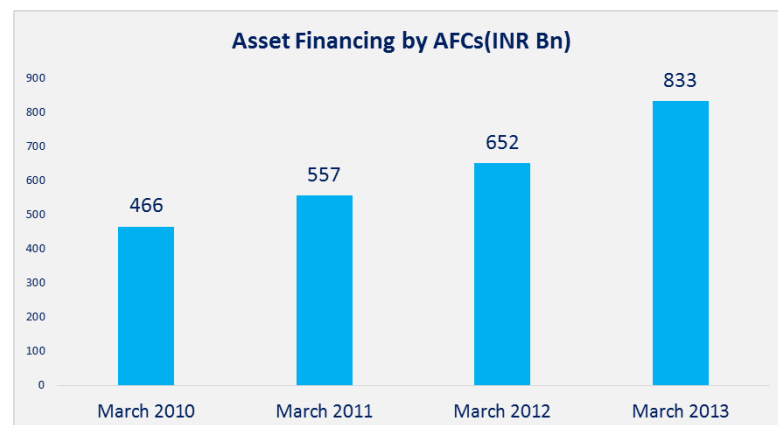
- c. **Gold Monetization:** As the name suggests, Gold loan NBFCs provide loans against security of gold jewellery. The banks are also involved in gold loan business, however NBFCs' gold loans witnessed phenomenal growth due to their customer friendly approaches like simplified sanction procedures, quick loan disbursement etc. Further, with relatively better last mile connectivity of NBFCs, they were able to target the audience better.

Branches of gold loan NBFCs increased significantly during the last couple of years mostly housed at semi-urban and rural centers of the country. Credit extended by the gold loan NBFCs witnessed a CAGR of 86.7 per cent during the period March 2009 to March 2013. In absolute terms, NBFC gold loans increased from just Rs. 39 billion as on March 31, 2009 to Rs.475 billion as on March 31, 2013.



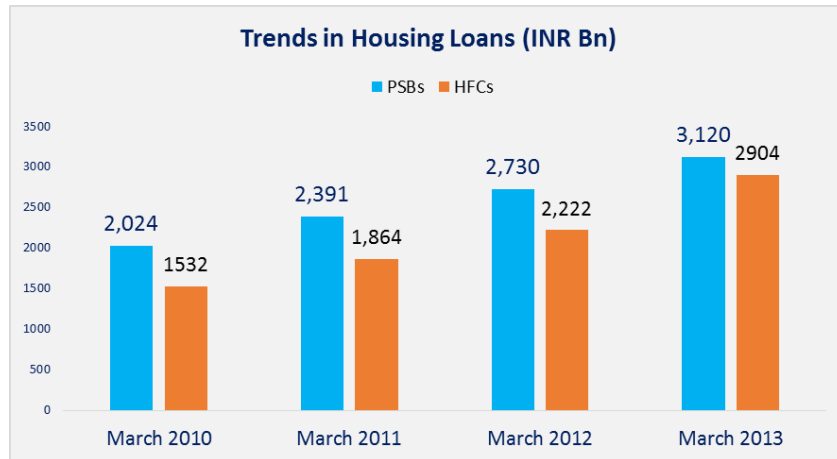
Source : COSMOS Database, RBI Speech

- d. **Second Hand Vehicle Financing:** This has been one of the products best pioneered by NBFCs. Under this, they engage in financing used/ second hand vehicles, reconditioned vehicles, construction equipment etc. This is very popular amongst new emerging businesses, as well as road transport operators.



Source : Report on Trend and Progress of Banking in India, RBI Speech

- e. **Affordable Housing:** Under this category, firms are offering small loans of Rs. 2-6 lakh to borrowers with low monthly incomes who would have found difficulty borrowing from commercial banks. The easier and simpler documentation and KYC processes also help disbursements. This segment has really been a game changer for NBFCs with almost at par quantum of housing loans provided to that of Public Sector Banks.



Source : National Housing Bank, RBI Speech

The role of NBFCs in financial inclusion is well covered above. While they have been an integral part of the growth story so far, it is important for them to take the next leap to remain truly competitive and relevant as the businesses as government policies evolve. NBFCs should strive towards a full suite of financial products going forward – both life and non-life, and look at forging specialist partnerships wherever possible, for delivering a best in class consumer experience.

Evolution of Regulatory Framework

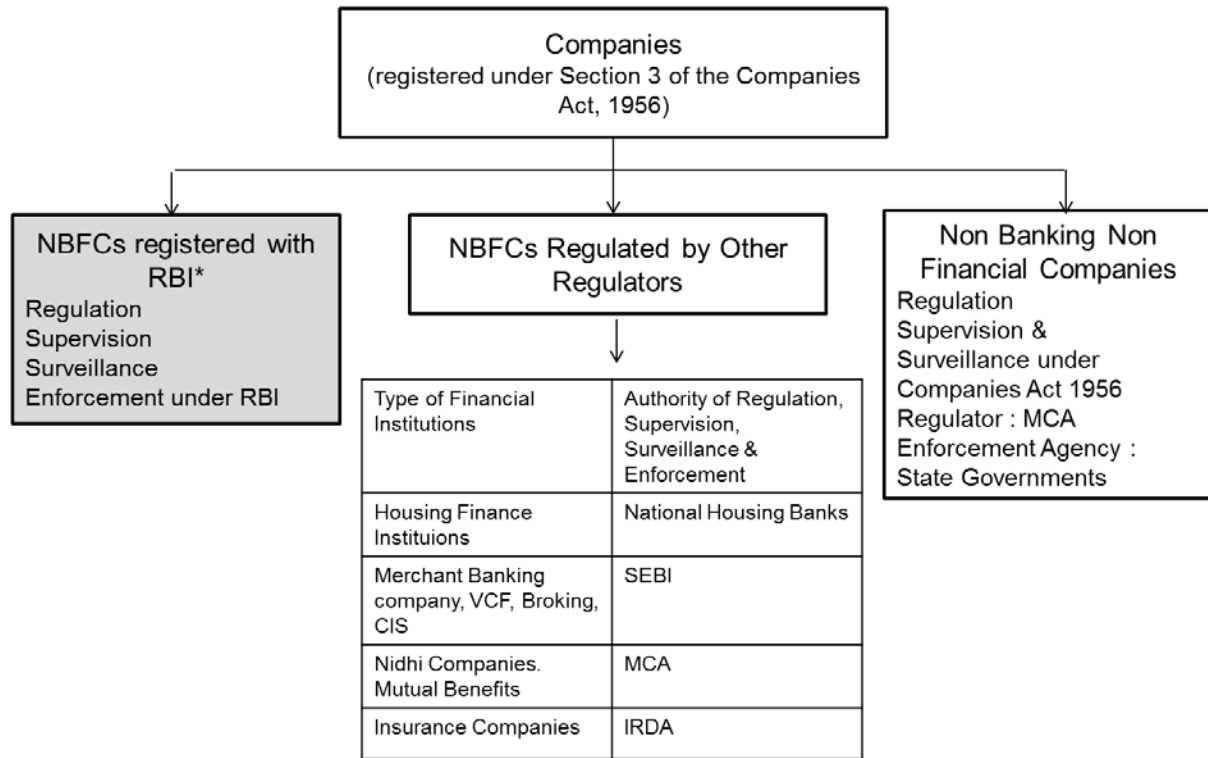


While the objective of NBFC regulations during the 20th century was predominantly to protect the interests of depositors, but as NBFCs have evolved and grown in size and become more interconnected with the banking sector, they pose a systemic risk. The NBFC sector has progressed considerably in terms of its size, operations, technology, and entry into newer areas of financial services and products. Being financial entities, they are as exposed to risks arising out of counterparty failures,

funding and asset concentration, interest rate movement and risks pertaining to liquidity and solvency, as any other financial sector player.

Given the context, a review of the entire regulatory framework for the NBFC sector has been undertaken by RBI with a view to transitioning, over time, to an activity based regulation of NBFCs.

Overview of Regulators of Non Banking Companies



While drawing the revised regulatory framework for NBFCs, RBI pulled support from the recommendations made by various key committees like Usha Thorat and Dr. Nachiket Mor. The amendments made have been captured below:

Amendment	Details			
1. Requirement of Minimum NOF(Net Owned Fund) of Rs. 200 lakh	<table border="1"> <tr> <td>INR</td> <td>Companies applying for CoR (Certificate of Registration) after Apr 21,1999</td> <td>Companies that existed before Apr 21,1999</td> </tr> </table>	INR	Companies applying for CoR (Certificate of Registration) after Apr 21,1999	Companies that existed before Apr 21,1999
INR	Companies applying for CoR (Certificate of Registration) after Apr 21,1999	Companies that existed before Apr 21,1999		

Existing Requirement	200 L	25 L
Revised requirement by end of 2016	200 L	100 L
Revised requirement by end of 2017	200 L	200 L

It will be incumbent upon such NBFCs, the NOF of which currently falls below Rs. 200 lakh, to submit a statutory auditor's certificate certifying compliance to the revised levels at the end of each of the two financial years as given above.

2. Deposit Acceptance

NBFC Asset Finance Company	Existing Limits	Revised Limits
Unrated AFCs	Lower of 1.5 times of NOF or INR 100MM	To get rated by March 2016
Rated AFCs	4 times of NOF	1.5 times of NOF

- a. Those AFCs that do not get an investment grade rating by March 31, 2016, will not be allowed to renew existing or accept fresh deposits thereafter. In the intervening period, i.e. till March 31, 2016, unrated AFCs or those with a sub-investment grade rating can only renew existing deposits on maturity, and not accept fresh deposits, till they obtain an investment grade rating.
- b. While AFCs holding deposits in excess of the revised limit should not access fresh deposits or renew existing ones till they conform to the new limit, the existing deposits will be allowed to run off till maturity.

3. Systemic Significance

Categories/ INR	Existing Asset Size	Revised Asset Size
NBFC-ND	Less than 1000 MM	Less than 5000 MM
NBFC-ND-SI	1000 MM and above	5000 MM and above

- a. The total assets of NBFCs in a group including deposit

taking NBFCs, if any, will be aggregated to determine if such consolidation falls within the asset sizes of the two categories mentioned above.

4. Prudential Norms and business regulations

Categories	Prudential Norms	Conduct of Business Regulations
NBFC-ND	Applicable if public funds accessed	Applicable in case of customer interface
NBFC-ND-SI	Applicable	Applicable in case of customer interface

5. Prudential Norms for NBFC-ND

- a. Exempted from maintaining CRAR (Capital to Risk Weighted Assets Ratio) and complying with Credit Concentration Norms.
- b. A leverage ratio of 7 introduced to link their asset growth with the capital they hold. For this purpose, leverage ratio is defined as Total Outside Liabilities / Owned Funds.

6. Prudential Norms for NBFC-ND-SI

- a. Tier 1 Capital: Current requirement to have minimum CRAR of 15% remains unchanged. Consequently, Tier 1 capital cannot be less than 7.5%. For Infrastructure Finance Companies (IFCs), however, Tier 1 capital cannot be less than 10%. Similarly, NBFCs primarily engaged in lending against gold jewellery have to maintain a minimum Tier 1 capital of 12% w.e.f. April 01, 2014. As revised, all NBFC-D and NBFC=ND-SI, shall maintain minimum Tier 1 Capital of 10%. The compliance to the revised Tier 1 capital will be phased in as follows:
 - 8.5% by end of March 2016.
 - 10% by end of March 2017.
- b. Asset Classification:

Asset Categories	Classification	Existing (in months)	Revised		
			Year ending Mar 31,16	Year ending Mar 31,17	Year ending Mar 31,18

Lease Rental and Hire Purchase	NPA	12	9	6	3
Other than Lease Rental and Hire Purchase	NPA	6	5	4	3
Loan and Hire purchase and lease assets	Sub- standard	<18	<16	<14	<12
Loan and Hire purchase and lease assets	Doubtful	>18	>16	>14	>12

c. Provisioning of Standard Assets: The provision for standard assets for NBFCs-ND-SI and for all NBFCs-D, is being increased to 0.40% from current 0.25%. The compliance to the revised norm will be phased: • 0.30% by the end of March 2016 • 0.35% by the end of March 2017 • 0.40% by the end of March 2018

d. Credit Concentration and Disclosure Norms : Brought in line with other NBFCs with immediate effect.

a. Committee:

7. Corporate Governance and Disclosure norms

Requirements	Existing				Revised	
	NBFC-D*	NBFC-D**	NBFC-ND***	NBFC-ND****	NBFC-D	NBFC-ND-SI
Audit Committee	Reqd.	Reqd.	Reqd.	Reqd.	Reqd.	Reqd.
Nomination Committee	Recco	Recco	--	Recco	Reqd.	Reqd.
Risk management Committee	Recco	Recco	--	Recco	Reqd.	Reqd.
Rotation of Audit Partners every 3 years	--	Recco	--	--	Reqd.	Reqd.

* Deposits ≥ INR 200 MM, ** Deposits ≥ INR 500 MM

*** Assets ≥ INR 500 MM, **** Assets ≥ INR 1000 MM

b. Fit and Proper Criteria for Director: The following additional requirements shall be applicable to all NBFCs-ND-SI and all NBFCs-D, with effect from March 31, 2015.

- i. NBFCs shall ensure that there is a policy put in place for ascertaining the fit and proper criteria at the time of appointment
- ii. A declaration and undertaking shall be obtained from the Directors. In addition, the Directors shall sign a Deed of Covenant
- iii. NBFCs shall furnish to the Reserve Bank a quarterly statement on change of Directors certified by the auditors and a certificate from the Managing Director that fit and proper criteria in selection of directors have been followed. The statement must reach the Regional Office concerned of the Reserve Bank within 15 days of the close of the quarter.

c. Disclosure of Financial Statements: The existing disclosures shall now be applicable for NBFC-ND-SI and for all NBFC-D. From Mar 31,15, all banks shall additionally disclose: Registration, Credit Ratings, Penalties if any, Asset liability profile, extent of financing, NPAs and movement of NPAs etc.

8. Off-site Reporting

NBFCs-ND, with assets less than Rs. 500 crore, including investment companies, shall henceforth be required to submit only a simplified Annual Return, the details of which shall be separately communicated by RBI

9. Applicability to NBFC-MFI and CIC

The revisions brought shall be applicable except wherever in conflict with the provision of Non-Banking Financial Company-Micro Finance Institutions and CIC directions, 2011.

Issues and Challenges



The dynamic and evolving NBFC sector necessitates reforms and evolution to ensure orderly growth. While NBFCs have been on the growth trajectory over the years, there are few areas of concern which need to be addressed. The key challenges have been highlighted below:

1. **High cost of funds for lack of re-financing option:** Banks have access to refinancing through various means like RBI, EXIM Bank, NABARD and SIDBI. Similarly, Housing Finance Corporations regularly obtain refinance from National Housing Bank (NHB), who is also the regulator for HFCs. NBFCs on the other hand have to depend on competitors, banks, or the capital markets for raising resources at all points of time. This can prove detrimental to the sustainability of their growth as in the case of any distress, flow of funds for them from above sources could dry up without much notice.
2. **Lack of Flexibility in Classification of loan NPAs:** The NPA norms are very relevant for large corporate. But for business with irregular cash flow, it could mean a cascading impact of all the delays in payments. The assumption of “one-size fits- all” doesn’t work for NBFCs. While there have been asset re-categorizations in the revised regulations, greater flexibility with respect to scheduling and classification under NPA is required -- The NPA classification norms should be based on the borrowers profile and the assets being financed instead of uniform system of asset classification.
3. **Lack of pass through to securitization trusts:** While the asset classification norms have been revised to be at par with banks, what is lacking are the tools for recovery at par with banks. Today NBFCs do not have any statutory recovery tool available.
4. **Multiple representative bodies for the Industry:** At this stage of development of the NBFC sector, in the interests of harmonious development of all its segments, establishing one representative body might be healthier alternative. However, care should be taken to ensure that all segments are adequately represented in such an apex body, to promote balanced growth of the sector without any inner conflicts. Right now, there are multiple representative bodies such as ‘Finance Industry Development Council (FIDC) for Assets Finance Companies’, ‘Association of Gold Loan Companies (AGLOC) for Gold Loan NBFCs’, etc.
5. **Need for Capacity Building:** NBFCs on both individual and collective basis need to work towards building a responsive ecosystem for capacity building. To keep up with the growth trajectory laden with increased regulations in the medium to long term, it is the quality of staff which to a large extent, will help determine the health of the sector.
6. **Leverage Ratio of 7 for NBFCs- ND with Assets Size of Less Than Rs. 500 cr.**
– Small NBFCs have been exempted from the requirement of maintaining Capital Adequacy Ratio (CRAR). However, they are required not to exceed the leverage ratio beyond 7. The capping of leverage ratio to 7 seems

restrictive. Further, these companies borrow largely from banks and financial institutions which in turn carry out due diligence on the borrowing NBFCs.

7. **Withdrawal of Priority Sector Status to Bank Lending to NBFCs for On-lending To Priority Sector:** The priority sector status should be restored given the complementary strengths of Banks and NBFCs in delivering the last mile connectivity to the unbanked. Thus, the “wholesaler/retailer” collaboration model between the banks and NBFCs has ensured increased flow of credit to under-served sections of society, which in turn has helped significantly in creation of assets and wealth in rural and semi urban parts of the country. However, RBI may stipulate a cap whereby a maximum of fixed percentage of total bank lending to priority sector may be routed through NBFCs.
8. **Lack of Defaulter Database:** NBFCs do not receive defaulter lists from Banks. Non-sharing of defaulter databases leave NBFCs vulnerable to credit risk on account of absence of critical information. Further, there is a need to bring the necessary legislative changes so that NBFCs can leverage the utility payments database in the credit assessment process.
9. **Disparate Tax treatment:** Various industry reports on NBFCs have mentioned disparity in tax structures for NBFCs vs. Banks, specially pertaining to tax deduction at source, income recognition on NPAs, and dual taxation on lease/hire purchase. In the case of NBFCs, the current legal framework does not allow tax deduction on the provision made for non-performing assets. However, banks are permitted to claim tax deductions for such provisioning. This has put NBFCs at a disadvantage. Additionally, the matter on Double Taxation issue in ‘Pass Through Certificates’ needs to be resolved at the earliest.
10. **Minimum mandatory credit rating for deposit taking NBFCs** - Under the revised regulatory framework, the deposit taking NBFCs have to mandatorily get investment grade credit rating for being eligible to accept public deposits by any of the six rating agencies namely, CRISIL, CARE, ICRA, FITCH Ratings India Pvt. Ltd, Brickwork Ratings India Pvt. Ltd. and SMERA. The existing unrated deposit taking NBFCs have to mandatorily get themselves rated by March 31, 2016, failing which they will not be allowed to renew existing or accept fresh deposits. Further, if the rating of an NBFC is downgraded to below minimum investment grade rating, it has to stop accepting public deposits, report the position within fifteen working days to the RBI and bring within three years from the date of such downgrading of credit rating, the amount of public deposit to nil. These conditions may be restrictive, as all deposit taking NBFCs may not be able to secure the minimum required rating and hence may lose out on business.

Recommendations



NBFC sector has garnered a lot of interest and deliberations of late with recommendations being made in the Committee reports or representations made by the NBFC industry players for the benefit of the NBFC sector as a whole. We have analyzed many of such reports and surveys to present the most pressing of such recommendations below:

REGULATORY

1. **Availability of Re-financing:** Opening up of refinance windows and credit insurance support to NBFCs will help them raise low cost funds and increase their lending penetration. RBI permitting to re-cast infrastructure loans is a step in the right direction towards a level playing field for NBFCs.
2. **Income Tax benefits to be at par with Banks:** As detailed out in the issues section, Income Tax Benefits should also be at Par with Banks. There is a need to bring parity with banks in matters relating to recovery and taxation also in addition to parity in regulation.
3. **Flexible NPA Classification Norms:** The classification norms should be based on the borrowers profile and the assets under classification. A uniform system of classification may work for large corporates with steady income streams but not for NBFC borrower profile where a delay in cash stream may cascade into delay in loan payments.
4. **Restoration of Priority Sector Status:** The partnership between banks and NBFCs has been an advantageous one. It helped the banks meet their statutory priority sector lending target, provided NBFCs a regular and a dependable source of funds for onward lending to the priority sectors and helped financial penetration to the under banked. A change in priority sector status is likely to disturb the working. It is therefore important that the priority sector status be restored. The RBI may stipulate a cap whereby a maximum of specified percentage of total bank lending to priority sector may be through NBFCs
5. While SARFAESI benefits have been extended to NBFCs, it has brought about only partial happiness to the sector. The industry has been lobbying for the securitization trusts to get the relief in the budget 2015 which hasn't been covered. We recommend the same getting covered in following proposals.
6. The regulator should offer some flexibility to the deposit taking NBFCs on the **minimum credit rating parameter**. Though the endeavor of the regulator is to protect depositors' interest, it should also be considerate of the fact, that all deposit taking NBFCs may not be able to secure the minimum required rating and hence may lose out on business.

OPERATIONAL

7. **Digitization:** As financial reach deepens, the traditional sources of advantage for NBFCs will start to wane. It is critical that NBFCs evolve by leveraging technology and the web of partnerships to come up with new models of working. This can have an impact across the working structure – a. Product Design b. Product Delivery c. Consumer Interface d. Advanced credit and collection processes e. Pricing Systems f. Organization Structures etc.
8. **Greater Product Innovation:** While NBFCs have been offering custom-made innovative products to suit the client and market conditions, the financial services have significantly evolved over time. It thus becomes important for the NBFCs to invest aggressively behind designing innovative products and remaining ahead of the curve. The challenge will be to ensure the basic business line synergies are harnessed, and it manages to remain lean with no excess cost overheads.
9. **MSME Focused Growth Strategy:** The substantial funding gap in case of MSMEs is likely to continue, posing opportunities for NBFCs to tap into. For an effective MSME centric growth strategy, it may cover: a. Alignment to government initiatives b. Cluster-specific product innovation and delivery

OTHERS

10. **Skill and Capacity Building Initiatives:** Parallel to the apex body, the NBFCs can be involved in technical skills and capacity building training. A select few recognized as well-governed and highly rated, could be set up as “Capacity Building Champions” for MSMEs thereby helping build relevance and penetration as well.
11. **Forging specialist partnerships:** Currently, all the banks offer a bundled set of services – savings, investments, borrowings, payments etc. With the advent of specialized players like payment banks, m-wallets, bill payment service providers; the value chain in banking will be deconstructed. This offers a chance to NBFCs to partner with specialists for a “holistic best-in-class” service experience to its consumers.

It is important that the aforementioned suggestions are deliberated upon towards a clear roadmap that can be taken forward with the regulator for further action. This will facilitate a healthy growth of the NBFC sector and justify RBI’s role not only as a regulator but also as a developer of NBFCs.

Conclusion



The acknowledgement of NBFCs growing role and importance in the Indian financial system is indicated by the recent policy action of the RBI. Restrictions on debentures funding, securitization and loss of Priority Sector status to on-lending through NBFCs will continue to constrain the funding ability of the NBFCs. In order to address the funding issues, some NBFCs may consider converting to universal or small banks; this will also help them expand their reach in terms of market access and customer base.

Further, NBFCs will continue to leverage their competencies to tap market segments that are usually under-served by banks, such as the non-salaried category, low-income households and small businesses. In the backdrop of a growing economy, NBFCs will continue to grow in the financial ecosystem and create meaningful financial inclusion and further the government agenda of 'Make in India' and 'Start-Up India'

The challenge before the NBFC sector is to grow in a prudential manner. It is essential to have in place adequate risk management systems and procedures before entering into risky areas. For RBI, the endeavor should be to enable prudential growth of the sector, keeping in view the multiple objectives of financial stability, consumer and depositor protection, addressing regulatory concerns while not forgetting the uniqueness of NBFC sector.

An Overview of Non Banking Financial Companies



CA Vijay Sharma

General Secy. FITS

Non Banking Financial Companies (NBFCs) been one of the financial intermediaries have a definite and a significant role in the financial sector, particularly in India where 70% of the population lives in rural areas their role becomes even more important to the economy. The NBFC sector has continuously played a critical role in encouraging growth of our economy and hence needs to be nurtured appropriately. NBFCs play an important role in promoting inclusive growth by catering to diverse financial needs of bank excluded customers. They also take a lead role in providing innovative financial services to micro, small, and medium enterprises (MSMEs) as per their business requirements. In a developing country like India.

In times when 'Inter-dependence', 'Innovation', 'Initiative for Ease of doing Business' and 'Start Up' are being perceived as reality, the Non Banking Companies have a pro-active role to play in defining the road map of progress. Gone are the days when these entities were contained to play the role of a spare wheel in an economy. In the present era they are ready to occupy the position of its steering wheel! They are playing a dominant role in promoting the economic development by mobilizing the financial resources of the community and making them flow into the desired channels at a low cost.

Strengths of NBFCs:

Because of their special character, NBFCs have some distinctive strengths. They are:

1. Coverage of far-flung areas
2. An ability to fulfill demand for unsecured credit due to lesser regulatory requirements and organizational control
3. Easy and convenient mode of delivery at the doorstep and at intervals convenient to the borrower which makes them more attractive than the formal sector.
4. More convenient system for recovering loan according to the cash-flow of the borrower in comparison to the rigid system in commercial banks
5. Better knowledge of customer preferences and priorities in rural and semi-urban areas.
6. Multiple verticals and diverse product lines.
7. Product innovation-Because the decision makers in NBFCs sit near the location of the customers and therefore are in a better position to appreciate their needs, they can develop products as per their requirements.

Challenges faced by NBFCs

Challenges faced by NBFCs can broadly be studied as under:

1. Dependence on Banks for Resources
2. No Access to Refinance
3. No Access to SARFAESI for Recovery from Bad Loans
4. No Insurance of Public Deposits held by NBFCs
5. Limited Capital Enhancing Options
6. Additional Registration by some State Governments
7. Restrictions on NBFC-MFIs for Raising Capital
8. Restriction on usage of ECB Funds
9. Discriminatory tax treatment

In view of the importance of role played by NBFCs in the economic development, it is imperative that the growth and development of the sector be accorded highest degree of priority. Recognition of their role in promoting the growth of Indian economy is the need of the hour. A roadmap for development of NBFCs should be put in place by the government and RBI after due consultation with their representative bodies. There is a need to realign the regulatory regime realistically with a long term interest for NBFCs. The traditional role of the regulatory authority needs to metamorphose to encompass both the roles of a regulator as well as a growth enabler of the industry. For realizing the dream of 'Make in India' & 'Start Up' inequitable restrictions on NBFCs need to be removed and road blocks in the form of aforementioned challenges must be addressed.

As NBFCs primarily provide credit to economically weaker sections of the society, which is the first to be affected in case of any economic downturn, there is a compelling case for extending the benefits of potent recovery tools like SARFAESI uniformly to NBFCs as well. Also, NBFCs should be granted access to Debt Recovery Tribunals (DRTs) for faster resolution of cases. Insurance cover for public deposits held by NBFCs so that they can assure the public regarding timely repayment and payment of interest is also a dire need. An unlimited access to ECB funding would help address funding cost and tenure issues. A fair tax treatment at par with other lending agencies will also go a long way in the growth of NBFCs.

On the other hand, there is an imperative need for NBFCs to involve aggressively in designing innovative products so as to become real game changers in the economy. Developing a responsive and proper grievance redress mechanism to protect customers against unfair, deceptive or fraudulent practices like charging of exorbitant interest rates, raising of surrogate deposits under the garb of non-convertible debentures etc. should be the top priority

About FITS

Federation of industry, trade & services (FITS) is a proactive and dynamic national chamber working at the ground level with established national and international linkages.

FITS tends to act as a catalyst in the promotion of all sectors of our economy viz; manufacturing, trade and services. It favours research-based and time-tested policy initiatives for positive impact on the economic growth and development of the nation. During the last two decades, the Government has been focusing on achieving inclusive and sustainable growth by undertaking vast infrastructure development projects cutting across sectors, creating an enabling environment for inviting greater private sector participation through regulatory reforms, improving the delivery of public services and stressing for e-governance and skill development. These measures have started showing results and in the process the international community too has shown a keen interest in being a part of this growth momentum.



With over 1.2 billion population, we are the fourth largest economy of the world with most number of young , English- speaking and technically sound workforce. We have grown to be a global agriculture power-house after being dependent on the out-side world for green imports for so many years. Life expectancy and literacy rates in our country have almost doubled and quadrupled in last few years.

FITS being a body of the Industry, Trade and Services stands for the Govt.'s call for 'Skilling India for Global Competitiveness' and thus contribute to socio-economic development and capacity building in different domains. Through its 1200+ direct and indirect associates spread –over in public and private sectors, MSMEs, and large corporates, FITS is destined to play its crucial role in the nation building.

As a policy, **FITS** engages with Ministries/Deptts. of Govt. of India and state Govts. on issues which directly or indirectly impacts the industry and trade. It strives for skill development thus enhancing efficiency, a greater feeling of focusing competitiveness and multiplying business opportunities for growth. We associate with different Govt. agencies, autonomous bodies, National & International NGOs, Knowledge partners, RWAs and civil society institutions for effecting improvements in Corporate social Responsibility, healthcare sector, Waste management, homeland security, social and domain reforms, education and sanitation etc. to name a few with special thrust for the most vulnerable sections of the society be it women security and police reforms..

FITS is of the considered opinion that the pro-active support and role of the Central and State Govts. is crucial for creating a resurgent India . The current political and economic scenario expects all political formations of the country to join-hand to support the young generation's aspirations for economic growth.



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