Regulatory Compliances for NBFCs

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COVERAGE

- Regulatory Framework
- Principal Business Criteria
- Issues on Principal Business Criteria
- Leverage Ratio
- Capital Adequacy Norms
- Income Recognition
- Asset Classification & Provisioning Norms
- Valuation Of Current Investments
- Credit Concentration Norms

COVERAGE (CONTD.)

- Policies
- Fair Practices Code
- Loan Against Shares (Las)
- Change in Control
- Core Investment Companies
- Outsourcing Norms
- Information Technology Framework
- Peer to Peer Lending Platforms
- Penal Provisions of RBI Act, 1934
- Practice Opportunities- NBFCs

Types of NBFCs

- **Borrowing**
  - Deposit Accepting NBFCs (NBFC-D)
  - Non-Deposit Accepting NBFCs
- **Asset Size**
  - Asset Size >= Rs. 500 Crores (NBFC-SI)
  - Asset Size < Rs. 500 Crores (NBFC-NSI)
- **Activity**
  - Loan Company
  - Investment Company (Type-I)
  - Asset Finance Company
  - Core Investment Company
  - NBFC-Factors
  - Infrastructure Finance Companies
  - Infrastructure Debt Funds
  - Micro-Finance Institutions
  - Mortgage Guarantee Companies
  - Account Aggregators
  - Peer to Peer Lending Platforms
  - Non-Operating Financial Holding Company

CHAPTER III-B OF THE RBI ACT, 1934

- Regulatory framework for governing Non-Banking Financial Companies
- Regulates Financial Institutions, Non-Banking Institutions accepting Deposits
- Non-Banking Institution refers to a Company, Corporation or a Co-Operative Society
- Financial Institution refers to a Non-Banking Institution doing following activities as its **Principal Business**:
  - Financing, whether by way of loans and advances or otherwise
  - Acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature
  - letting or delivering of any goods to a hirer under a hire-purchase agreement
  - the carrying on of any class of insurance business
  - Chits & Kuries

CHAPTER III-B OF THE RBI ACT, 1934 (CONTD.) (REGISTRATION)

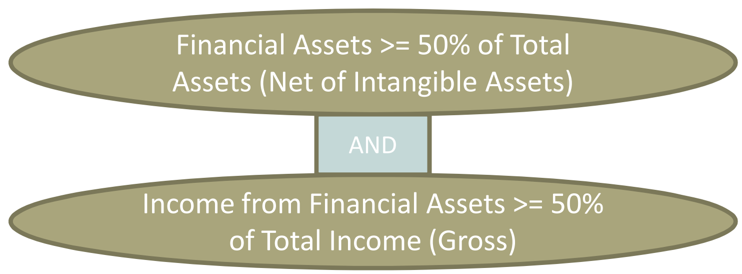
Section	Particulars
45-IA (1)(a)	Obtaining Certificate of Registration
45-IA (1)(b)	Having minimum Net Owned Fund
45-IA (2)	Application to RBI
45-IA(5)	Grant of Certificate of Registration
45-IA (6)	Conditions to cancellation of Certificate of Registration
45-IA (7)	Central Government as Appellate Authority

CHAPTER III-B OF THE RBI ACT, 1934 (CONTD.) (OTHER IMPORTANT PROVISIONS)

Section	Particulars
45-IB	Maintenance of Percentage of Assets as unencumbered approved securities (For NBFC –D)
45-IC	Transfer of 20% of PAT to Statutory Reserve.
45-MA	Power and Duties of Auditors
45-N	Power of RBI to conduct Inspection

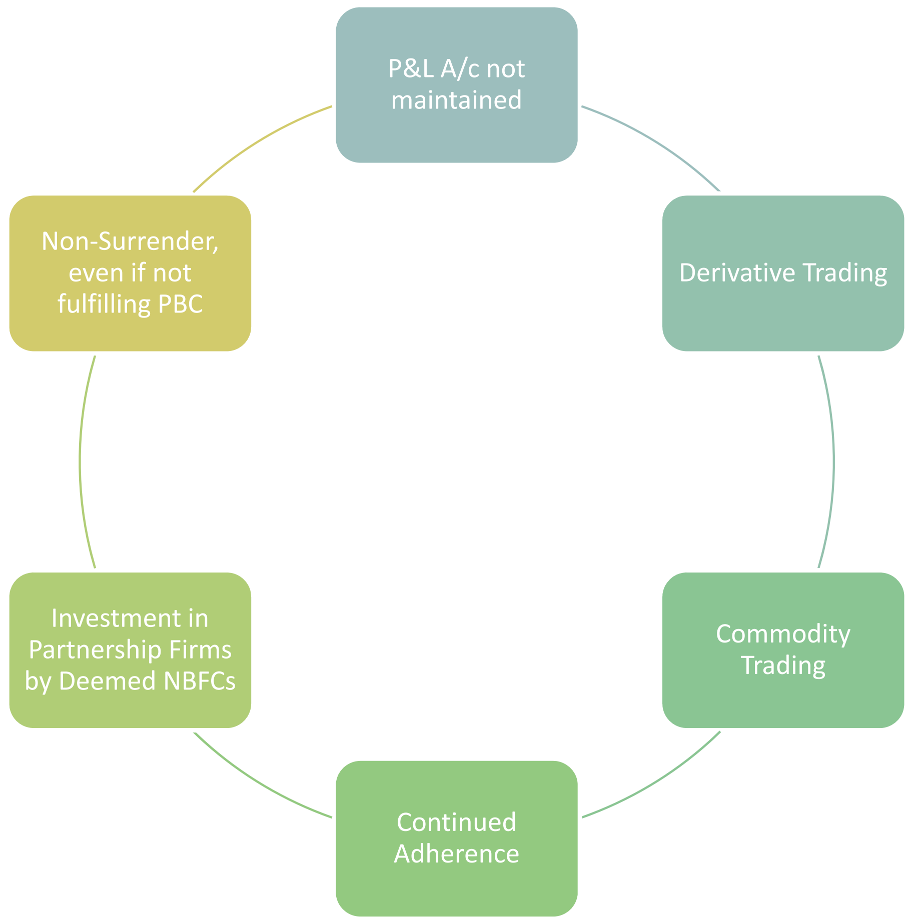
PRINCIPAL BUSINESS CRITERIA ["PBC"]

- RBI Press Release 1998-99/1269 dated 08th April 1999 read with RBI Notification DNBS (PD) C.C. No. 81/03.05.002/2006-07, Section 45-IA(1)(a) and Section 45-I(a) of the RBI Act, 1934
- Principal Business Criteria:



- Financial Assets not defined
- Lending, Investment in marketable securities, Leasing (Financial) & Hire Purchase is considered as Financial Assets in general parlance
- Fixed Deposits held with Banks are considered Non-Financial Assets

ISSUES ON PRINCIPAL BUSINESS CRITERIA



LEVERAGE RATIO

- Non-Banking Financial Company (NBFC-ND Non-SI – Except NBFC-MFI & NBFC-IFC) must, at all times, maintain such a leverage ratio, which must not exceed 7
- However,
  - A NBFC-P2P, must have a leverage ratio not exceeding 2
  - Outside Liabilities of a CIC-ND-SI shall, at no point of time, exceed 2.5 times its Adjusted Net Worth
- OCPS / Redeemable Preference Shares

Note: Leverage ratio means the total Outside Liabilities / Owned funds

CAPITAL ADEQUACY NORMS

Particulars	NBFC-ND-SI	NBFC-ND-Non SI	NBFC-D
Capital to Risk-Weighted / Adjusted Assets Ratio (CRAR) (minimum)	15%	15% (Only for MFI and IFC)	15%
Tier I Capital minimum	10%	10% (Only for IFC)	10%

Note:

- No minimum Tier I Capital has been prescribed for NBFC-MFI, with limit set on Tier II Capital being maximum 100% of Tier I Capital
- NBFCs conducting principal business of Lending against Jewellery are required to maintain a minimum Tier I Capital of 12% (Both SI and Non-SI)

INCOME RECOGNITION

- The income recognition shall be ideally based on recognized accounting principles.
- Income including interest / discount or any other charges on NPA shall be recognized only when it is actually realised.
- Income in respect of investments must be recorded on cash basis only, unless it is accrued from securities of Government body or have been declared by corporate body in its AGM.
- Unrealized accrued income on NPA is to be reversed

NON-PERFORMING ASSET

- an asset, in respect of which, interest has remained overdue for a period of six months (3 months for NBFC-ND-SI and NBFC-D) or more;
- a term loan inclusive of unpaid interest, when the instalment is overdue for a period of six months (3 months for NBFC-ND-SI and NBFC-D) or more or on which interest amount remained overdue for a period of six months or more
- a demand or call loan, which remained overdue for a period of six months (3 months for NBFC-ND-SI and NBFC-D) or more from the date of demand or call or on which interest amount remained overdue for a period of six months or more
- a bill which remains overdue for a period of six months (3 months for NBFC-ND-SI and NBFC-D) or more;
- the interest in respect of a debt or the income on receivables under the head 'other current assets' in the nature of short term loans / advances, which facility remained overdue for a period of six months (3 months for NBFC-ND-SI and NBFC-D) or more

NON-PERFORMING ASSET(CONTD.)

- any dues on account of sale of assets or services rendered or reimbursement of expenses incurred, which remained overdue for a period of six months (3 months for NBFC-ND-SI and NBFC-D) or more
- the lease rental and hire purchase instalment, which has become overdue for a period of twelve months (6 months for NBFC-ND-SI and NBFC-D) or more;
- in respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities (including accrued interest) made available to the same borrower / beneficiary when any of the above credit facilities becomes non-performing asset

Provided that in the case of lease and hire purchase transactions, an applicable NBFC shall classify each such account on the basis of its record of recovery.

ASSET CLASSIFICATION & PROVISIONING NORMS

Based on credit worthiness and availability of collateral security, all the NBFCs shall classify their assets into following categories:

- Standard Assets
- Sub-standard Assets
- Doubtful Assets
- Loss Assets

Note: Asset Classification norms are different for different types of NBFCs.

ASSET CLASSIFICATION & PROVISIONING NORMS

Class of Asset	Provision as a % of Outstanding amount of debt
Loss Asset	100%
Doubtful asset:	
a. Not covered by security	100%
b. Covered by security	Asset considered doubtful for 1 year – 20%
	Asset considered doubtful for 1 year to 3 years – 30%
	Asset considered doubtful for more than 3 years – 50%
Sub-Standard Asset	General provisioning of 10%
Standard Asset	0.25% (For NBFC-ND-SI and NBFC-D, it is 0.4%)

VALUATION OF CURRENT INVESTMENTS

Class	Valuation	
	Quoted	Unquoted
Equity Shares	Cost / Market Value, lower	Cost / Breakup Value / Fair Value, lower
Preference Shares	Cost / Market Value, lower	Cost / Face Value, lower
Debentures & Bonds	Cost / Market Value, lower	Treat as term loans
Government Securities incl. treasury bills	Cost / Market Value, lower	Carrying cost
Units of Mutual Funds	Cost / Market Value, lower	Asset value declared by Mutual Fund scheme
Others	Cost / Market Value, lower	N.A.

Note: (1) Unquoted Current Equity Shares are to be valued at Rs. 1, if the balance sheet of the investee company is not available for past two years
(2) Valuation of Non-Current Investments is to be done as per Accounting Standard issued by ICAI.

CREDIT CONCENTRATION NORMS

NBFC-ND-SIs (Accepting Public Funds) and NBFC-Ds cannot:

- Lend to:
  - A single borrower in excess of 15% of Owned Funds
  - A single group of borrowers in excess of 25% of Owned Funds
- Invest In:
  - Shares of another Company in excess of 15% of Owned Fund
  - Shares of single group of companies in excess of 25% of Owned Funds
- Lend and Invest:
  - In excess of 25% of Owned Fund to a single party
  - In excess of 40% of Owned Fund to a single group of parties

CREDIT CONCENTRATION NORMS (CONTD.)

Such Ceiling on Credit/Investment is not applicable to:

- Investment in equity shares of insurance company upto the extent permitted by RBI
- Investments/Loans to Companies in the Group to the extent they are deducted from Owned Funds to arrive at Net Owned Funds (NOF)

Applicable NBFCs are to formulate a policy in respect of exposures to a single party / single group of parties

OTHER ACCOUNTING REGULATIONS

- Transfer to Statutory Reserve U/s 45-IC of the RBI Act, 1934
- Finalization of Financial Statements on or before 30th June
- Disclosures:
  - Para 18
  - Provisioning
  - CRAR
  - Exposure to Real Estate Sector, both direct and indirect
  - Maturity Pattern of Assets and Liabilities

POLICIES

- KYC & PMLA Policy
- Fair Practices Code
- Investment Policy
- Policy on Interest Rates Charged
- Demand / Call Loan Policy
- Outsourcing Policy
- IT Policy

FAIR PRACTICES CODE

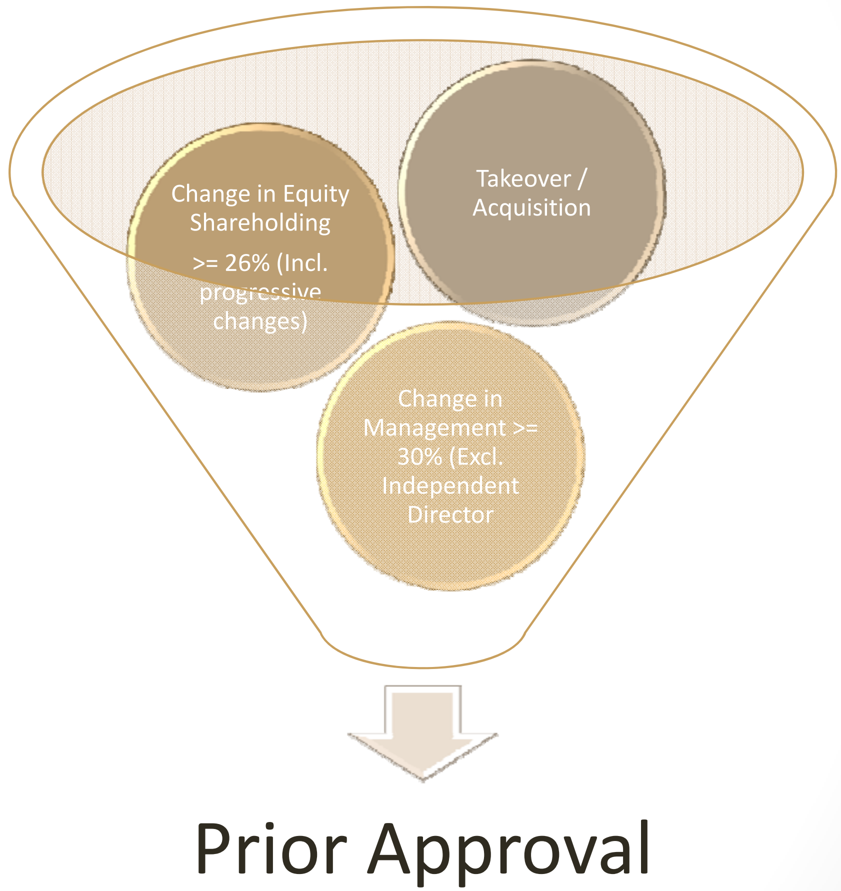
- For Loans:
  i. Application for loan and processing
  ii. Loan appraisal and terms/condition
  iii. Disbursement of loan
- Grievance Redressal mechanism
- Non-coercive method of recovery
- Language and mode of FPC
- Not to charge excessive interest rates
- Prohibition on foreclosure charges for floating interest rate term loans
- Not Applicable to NBFCs not having Customer Interface

LOAN AGAINST SHARES (LAS)

NBFCs having asset size above Rs. 100 crore and lending against collateral of listed shares have to:

- Maintain LTV of 50% at all times. Lowering of LTV due to price fluctuations is to be made good within 7 working days
- For lending for **investment in capital markets**, only Group 1 securities can be accepted as collateral for value of loan above Rs. 5 lakhs
- Report online to stock exchanges on quarterly basis the information of shares pledged in the prescribed format

CHANGE IN CONTROL



Note:

- Any change in management must be intimated to RBI
- A prior public notice of 30 days for change in control, shall be given.

CORE INVESTMENT COMPANIES

The Directions apply to every CIC that satisfies the following conditions:

i. it holds not less than 90% of its net assets in the form of investment in equity shares, preference shares, bonds, debentures, debt or loans in group companies;

ii. its investments in the equity shares (including compulsorily convertible equity shares within a period not exceeding 10 years from the date of issue) in group companies and units of InvITs constitute not less than 60% of its net assets as mentioned in clause (i) above;

iii. it does not trade in its investments in shares, bonds, debentures, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;

CORE INVESTMENT COMPANIES (CONTD.)

iv. it does not carry on any other financial activity referred to in Section 45I(c) and 45I (f) of the Reserve Bank of India Act, 1934 except:

a. Investment in bank deposits, government instruments, money market instruments and bonds and debenture of group companies
b. granting of loans to group companies; and
c. issuing guarantees on behalf of group companies.

Note: A CIC which is not systemically important (asset size is below 100 crore or not accepting public funds) are exempted from the requirement of Section 45-IA (Registration and NOF)

CORE INVESTMENT COMPANIES (CONTD.)

- Stringent Asset Classification and Provision norms for CIC-ND-SI having asset size more than Rs. 500 Crores
- CIC-ND-SI's 60% criteria to be inclusive of investment as a sponsor in INVITs
- Essential for creating effective holding structure
- Essential for minimising risks to the group assets
- Succession planning
- More than one CICs in Group

OUTSOURCING NORMS

- Restrictions on Outsourcing following activities:
  i. Strategic and Compliance functions
  ii. Decision-making functions
- Further, the directions suggest that outsourcing of any activity by an NBFC does not diminish its obligations, with end responsibility of NBFC
- The NBFCs are also responsible for carrying on the due diligence in relation of outsourcing.

OUTSOURCING NORMS (CONTD.)

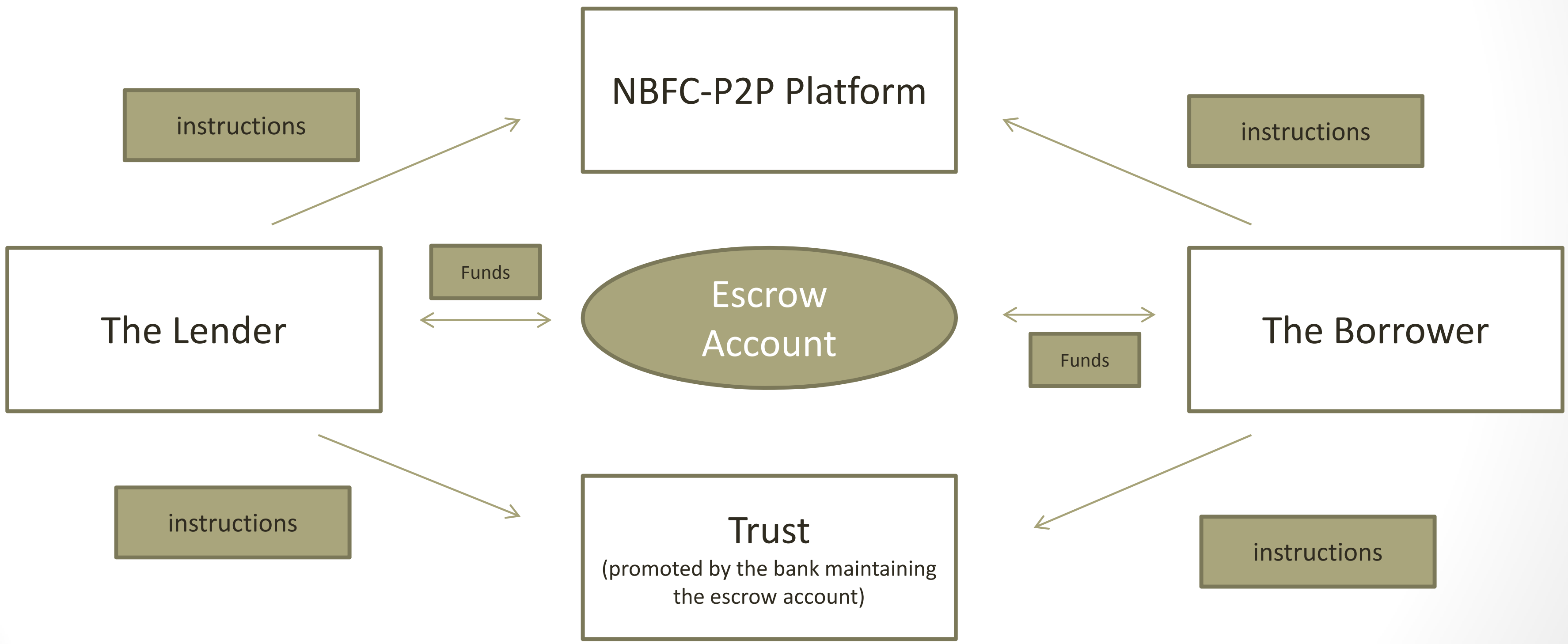
In terms of outsourcing activities, the NBFC must consider the following points:

- Evaluation of risk involved and capability of service provider
- Draft a proper Outsourcing agreement
- The confidentiality and security of customer’s information is not at risk
- Proper monitoring and control of outsourced activities

IT FRAMEWORK

- GAP analysis to the Board on or before 30th September 2017
- Compliance by NBFC-ND-SI by 30th June 2018 – Section A
- Compliance by NBFC-ND-Non SI by 30th September 2018 – Section B
- Section A compliance compulsory for NBFC-P2P and NBFC-AA
- Focus on:
  - IT Governance
  - IT Policy
  - Information & Cyber Security
  - IT Operations
  - IS Audit
  - Business Continuity Planning
  - IT Services Outsourcing

PEER TO PEER LENDING PLATFORMS



PEER TO PEER LENDING PLATFORMS (CONTD.)

- Definition of Peer-to-Peer Lending Platform:
- "It is an intermediary providing the services of loan facilitation via online medium or otherwise, to the participants"
- In other words, P2P lending is a method of debt financing that enables entities to borrow and lend money. P2P platforms connect borrowers to investors with attractive interest rates.
- Platforms assisting only banks, NBFCs and other regulated AIFIs to identify borrowers are not to be treated as P2P platforms

PEER TO PEER LENDING PLATFORMS (CONTD.)

- The Directions on NBFC-P2P restrict the scope of activity of P2P to:

  i. act only as an intermediary

  ii. not lend on its own

  iii. not permit secured loans

  iv. not permitted to undertake borrowing / lending activities in their own books

  v. not allow international flow of funds

  vi. undertake due diligence of the participants

  vii. undertake documentation of loan agreements and other related documents

  viii. render services for recovery of loans originated on the platform

- Exposure limit of Rs. 10 lakhs for borrowing and lending from a single borrower and lenders has been prescribed.
- The transfer of fund must happen through Escrow Account.

PENAL PROVISIONS OF RBI ACT, 1934 (PENALTIES)

Section	Particulars	Penal Provision
58B(2)	Failure of submission	Fine upto Rs. 2,000 for each offence, further extending to Rs. 100 per day after the first during which offence continues
58B(4A)	Violation of Section 45-IA	Imprisonment from 1 to 3 years and fine from Rs. 1 lakh to Rs. 5 lakh
58B(4AA)	Failure of compliance U/s 45MA (Auditors)	Fine extending to Rs. 5,000
58B(5)(a)	Receives deposit in contravention of Chapter III-B	Fine to twice the amount of deposit
58B(5)(aa)	Failure of compliance with directions prescribed under Chapter III-B	
58B(5)(b)	Issue of prospectus other than as per 45NA / 45J	Fine upto twice the amount of deposit called for in the prospectus
58B(5A)	Contravention of Section 45S	Imprisonment upto 2 years and / or fine of twice the amount of deposit (minimum Rs. 2,000/-)

PENAL PROVISIONS OF RBI ACT, 1934 (OFFENCES BY COMPANIES)

Section	Particulars	Penal Provision
58C(1)	Where default U/s 58B is a Company	Every person who, at the time the contravention or default was was responsible to the company for the conduct of the business of the company, as well as the company, shall be deemed to be gulity of the contravention
58C(2)	Offence by Company as consent or connivance of or is attributable to any neglect on the part of a person associated with the entity	Such person is deemed to be guilty of the offence
58G(1)	Where default U/s 58B is a NBFC	1. Penalty not exceeding Rs. 5000 2. Default U/s 58B(4A) / 58B(5)(a / aa) – Penalty not exceeding Rs. 5 Lakhs or twice the amount involved, if quantifiable (Whichever is more). Where it is continuing in nature, further penalty Rs. 25,000 per day
58G(2)	Issue of Show Cause Notice by RBI	RBI to issue Show Cause Notice before imposing penalty
58G(3)	Penalty to be paid	Within 30 days from date of penalty notice
58G(5)	No compliant against NBFC	No Compliant against NBFC can be filed in court of law for violations, where penalty has been imposed by RBI U/s 58G

PRACTICE OPPORTUNITIES– NBFC

- Operational / Documentation Aspects
- Setting up of NBFCs on a turnkey basis (Incl. Financial Modeling)
- Issue based consultancy
- Internal Audits to Control definition and control settings / Risk Management
- Activity based consultancy in addition to sector based consultancy
- Product Specific Consultancy
- Auditing / Certification
- Consultancy on Fintech models

Regulatory Compliances for NBFCs

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