Chapter 3: An Overview of Non-Banking Financial Companies Sector

3.1 It is more than three decades since RBI has started regulating and supervising the functioning of the NBFC sector in India. The evolution, phases of growth, reasons for rapid increase in number of entities and volume of resources at their command, and importance of this sector in the Indian financial system have been amply elucidated by various Committees appointed by RBI and the Government of India in the past. Similarly, RBI has also been responsive to various phases of development of this sector and it has been modifying its regulatory policy and supervisory strategy from time to time keeping in tune with the changing panorama. It is now well appreciated by all concerned that presently the two most important agenda of the RBI’s policy are: (i) providing indirect protection to the depositors, and (ii) creating an environment wherein the NBFCs will be functioning on sound lines.

3.2 In Indian multi-tier financial system, the NBFC sector stands apart for more than one reason. Though the sector is essentially doing the job of financial intermediation, it is still not fully comparable with the other segments of the Indian financial system. This is so in view of the wide variations in the profile of the players in this sector in terms of their nature of activity (lending, investment, lease, hire purchase, chit fund, pure deposit mobilisation, fee based activity, etc.), the volume of activity, the sources of funding they rely on (public deposits and non-public deposits), method of raising resources, deployment pattern, etc. This has naturally resulted in the creation of multifarious categories of NBFCs and therefore, diverse regulatory dispensation by RBI. While there are no two opinions on the desirability of bringing in a sort of homogenity among the players in the sector, the Committee appreciates that it has to be primarily triggered by the market requirements. In fact, the Working Group headed by Shri A.C.Shah, way back in 1992, had observed that classifying NBFCs into various categories had become out of date and it was time to bring in uniform regulations as far as possible for all NBFCs. This Committee is aware that RBI is seized of this issue and it is hoped that after the completion of the present consolidation process a concrete picture in this regard would emerge in this sector.

3.3 With the amendment of RBI Act, 1934 in the year 1997 and subsequent framing of directions under the enhanced powers relating to deposits, prudential norms and statutory audit, the regulatory role of the RBI has become more pronounced than ever in the past. While the deposit directions have been rationalised substantially with more focus on regulation of acceptance of public deposits, another set of directions has been issued to the NBFCs with regard to prudential norms on income recognition, asset classification, provisioning for bad and doubtful debts, capital adequacy ratio, etc., to bring in more transparency and to strengthen the financial position of the NBFCs. A direction has also been issued to the statutory auditors of the NBFCs (under the recently acquired powers through the 1997 amendments to RBI Act) to report on regulatory compliance by NBFCs.

3.4 The deposit directions issued by RBI in January 1998 have introduced several new approaches to the regulation of acceptance of public deposits by NBFCs. It broadly segregates NBFCs into two categories viz. ‘public deposit taking’ and ‘non-public deposit taking'. The companies belonging to the latter type are exempted from all the provisions of the deposit directions. All NBFCs (excluding the Residuary Non-Banking Companies) having net owned fund (NOF) of less than Rs. 25 lakh have been prohibited from accepting public deposits. Minimum investment grade credit rating for fixed deposit from any of the four accredited rating agencies (CARE, CRISIL, ICRA and Duff & Phelps) was made compulsory for accepting public deposits. This, however, has been subsequently relaxed in respect of Equipment Leasing and Hire Purchase Finance Companies. The deposit ceilings have been rationalised substantially and revised ceilings have been fixed with respect to public deposits. Sufficient time has also been given to NBFCs to bring down the excess deposits within the revised ceilings.

3.5 Although the deposit directions were well intended with main thrust at protecting the depositors, there was a perception in a section of the industry that the regulatory prescriptions were somewhat over-restrictive and stunted the growth of reasonably good and healthy NBFCs. To look into the issues arising out of this feeling and other related issues, Government of India had appointed a Task Force (Chairman:Shri C.M.Vasudev). In pursuance of the recommendations of the Task Force, RBI, on December 18, 1998, has made certain relaxations, especially in respect of Equipment Leasing and Hire Purchase Finance Companies, with regard to ceilings on deposits and compulsory credit rating. RBI also accepted the other recommendations of the Task Force and implemented them including those which are structural in nature. It is understood that RBI is in dialogue with Government of India for bringing in certain legislative changes required to give effect to other recommendations of the Task Force.

3.6 After the passage of the RBI (Amendment) Act of 1997 and the introduction of the revised deposit directions, there are signals suggesting negative growth in the level of outstanding public deposits with NBFCs. A quick survey of deposits with NBFCs as of March 31, 1998 reveals that 1724 reporting NBFCs had public deposit of Rs. 20,237 crore constituting 3.3 per cent of the aggregate public deposits held by the banks.

3.7 This Committee has been informed that the mandatory prior registration and minimum NOF requirements prescribed in the Amendment Act and tightening of regulatory prescriptions under the deposit directions have resulted in substantial reduction in the number of new NBFCs entering this sector. Further, the statutory requirement of minimum net owned fund of Rs.25 lakh in terms of the RBI (Amendment) Act, 1997 for obtaining a Certificate of Registration from the RBI for commencing the business of an NBFC, has since been raised to Rs. 200 lakh. This would further restrict new NBFCs entering the system. Thus, RBI's objective of consolidating the NBFC sector through these measures has been set in motion. Similarly, the Committee has also been informed that RBI is also initiating necessary measures to further consolidate the existing NBFCs. As on June 30, 1999, out of 37,445 applications for registration received by the Bank, only 10,399 forming 27.89 per cent of the applications received had NOF of Rs. 25 lakh and above; RBI took up processing of such applications (i.e., applications with NOF of Rs. 25 lakh and above) and as at the end of June 1999, it has approved applications for Certificates of Registration in respect of 7,661 companies (including 607 deposit-taking companies) and rejected applications in respect of as many as 1,104 companies. The companies, which are having NOF of less than Rs. 25 lakh, have been advised to increase the same to the minimum level by January 8, 2000, which is the deadline prescribed in the RBI Act. The above measures are expected to result in the strengthening of not only the individual NBFCs but also the Indian financial system.