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RBI releases Report of the Working Group on the Issues and Concerns in the NBFC Sector

The Reserve Bank of India today placed on its website the Report of the Working Group on the Issues and Concerns in the NBFC Sector**,** chaired by Smt. Usha Thorat, Director, Centre for Advanced Financial Research and Learning (CAFRAL). Other members of the Group were Sanjay Labroo, Rajiv Lall, Bharat Doshi, Pratip Kar and Uma Subramaniam (Member secretary). Comments on the Report may please be emailed or forwarded by end-September 2011 to the Chief General Manager-in-Charge, Department of Non-Banking Supervision, Reserve Bank of India, Central Office, WTC, Cuffe Parade, Mumbai 400 005.

It may be recalled that the Working Group was constituted to review the existing regulatory and supervisory framework of non-banking finance companies (NBFCs) with special focus on the risks in the sector. The Working Group was also to recommend appropriate regulatory and supervisory measures to address these risks, with the aim of creating a strong and resilient financial sector, vital for all round economic growth of the country.

The basic considerations underlying the approach of the Working Group were:

(i) recognition that registration as NBFC with RBI provides comfort to lenders and investors and enables leveraging of public funds;

(ii) simplification and rationalization of the scope of regulation and registration so as to focus on risk based regulation of non deposit taking entities, as risk on account of deposit taking entities had been largely dealt with earlier;

(iii) retaining the innovative nature of NBFCs engaged in productive sectors while placing buffers to cushion risk on account of (a) concentration and funding pattern inherent in the business model and (b) exposure to sensitive sectors;

(iv) dealing with regulatory arbitrage while not recommending completely bank like policies and regulation for NBFCs; and

(v) strengthening governance, disclosure and supervision to ensure that the changes recommended cause minimum disruption to NBFCs, adequate transition time for compliance to the recommendations has been provided, except where expressly specified.

Key recommendations of the Working Group are:

1. The minimum net owned fund (NOF) requirement for all new NBFCs wanting to register with the Reserve Bank could be retained at the present Rs. 2 crore till the Reserve Bank of India Act is amended. The Reserve Bank of India should, however, insist on a minimum asset size of more than Rs. 50 crore for registering any new NBFC. Existing NBFCs below this limit may deregister or be asked to seek a fresh certificate of registration at the end of two years;
2. NBFCs not accessing public funds may be exempted from registration provided their assets are below Rs. 1000 crore;
3. Any transfer of shareholding, direct or indirect, of 25 per cent and above, change in control, merger or acquisition of any registered NBFC should have prior approval of the Reserve Bank;
4. The twin-criterion of assets and income for determining the principal business of an NBFC should be increased to 75 per cent of the total asset and 75 per cent of the total income, respectively. A time period of three years may be given to fulfil revised principal business criteria;

5. Tier I capital for Capital to Risk Weighted Assets Ratio (CRAR) purposes may be specified at 12 per cent to be achieved in three years for all registered deposit taking and non-deposit taking NBFCs;
6. Liquidity ratio may be introduced for all registered NBFCs such that cash, bank balances and holdings of government securities fully cover the gaps, if any, between cumulative outflows and cumulative inflows for the first 30 days;
7. Asset classification and provisioning norms similar to banks to be brought in phased manner for NBFCs. Suitable income tax deduction akin to banks may be allowed for provisions made under the regulations. Accounting norms applicable to banks may be applied to NBFCs;
8. NBFCs may be subject to regulations similar to banks while lending to stock brokers and merchant banks and similar to stock brokers, as specified by the Securities and Exchange Board of India (SEBI), while undertaking margin financing;
9. Financial conglomerate approach may be adopted for supervision of larger NBFCs that have stock brokers and merchant bankers in the group;
10. Government owned entities that qualify as NBFCs may comply with the regulatory framework applicable to NBFCs at the earliest.
11. Board approved limits for bank's exposure to real estate may be made applicable for the bank group as a whole, where there is an NBFC in the group. The risk weights for NBFCs that are not sponsored by banks or that do not have any bank as part of the group may be raised to 150 per cent for capital market exposures and 125 per cent for Commercial Real Estate (CRE) exposures. In case of bank sponsored NBFCs, the risk weights for Capital Market Exposures (CME) and CRE may be the same as specified for banks;
12. NBFCs may be given the benefit under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002;
13. Captive NBFCs, the business models of which focus mainly (90 per cent and above) on financing parent company's products, may maintain Tier I capital at 12 per cent from the time of registration. Supervisory risk assessment of such companies should take into account the risk of the parent company;

14. For the purpose of applicability of registration and supervision, the total assets of all NBFCs in a group should be taken together to determine the cut off limit of Rs. 100 crore;

15. All NBFCs with assets of Rs.1000 crore and above, whether listed or not, should be required to comply with Clause 49 of SEBI Listing Agreements including mandatory disclosures;

16. Disclosure for NBFCs with assets over Rs 100 crore may include provision coverage ratio, liquidity ratio, asset liability profile, extent of financing of parent company products, mo vement of non-performing assets (NPAs), off-balance sheet exposures, structured products and securitisations/assignments.

17. NBFCs with assets of Rs. 1000 crore and above should be inspected comprehensively on an annual basis with an annual stress test carried out to ascertain their vulnerability.

Alpana Killawala
Chief General Manager

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