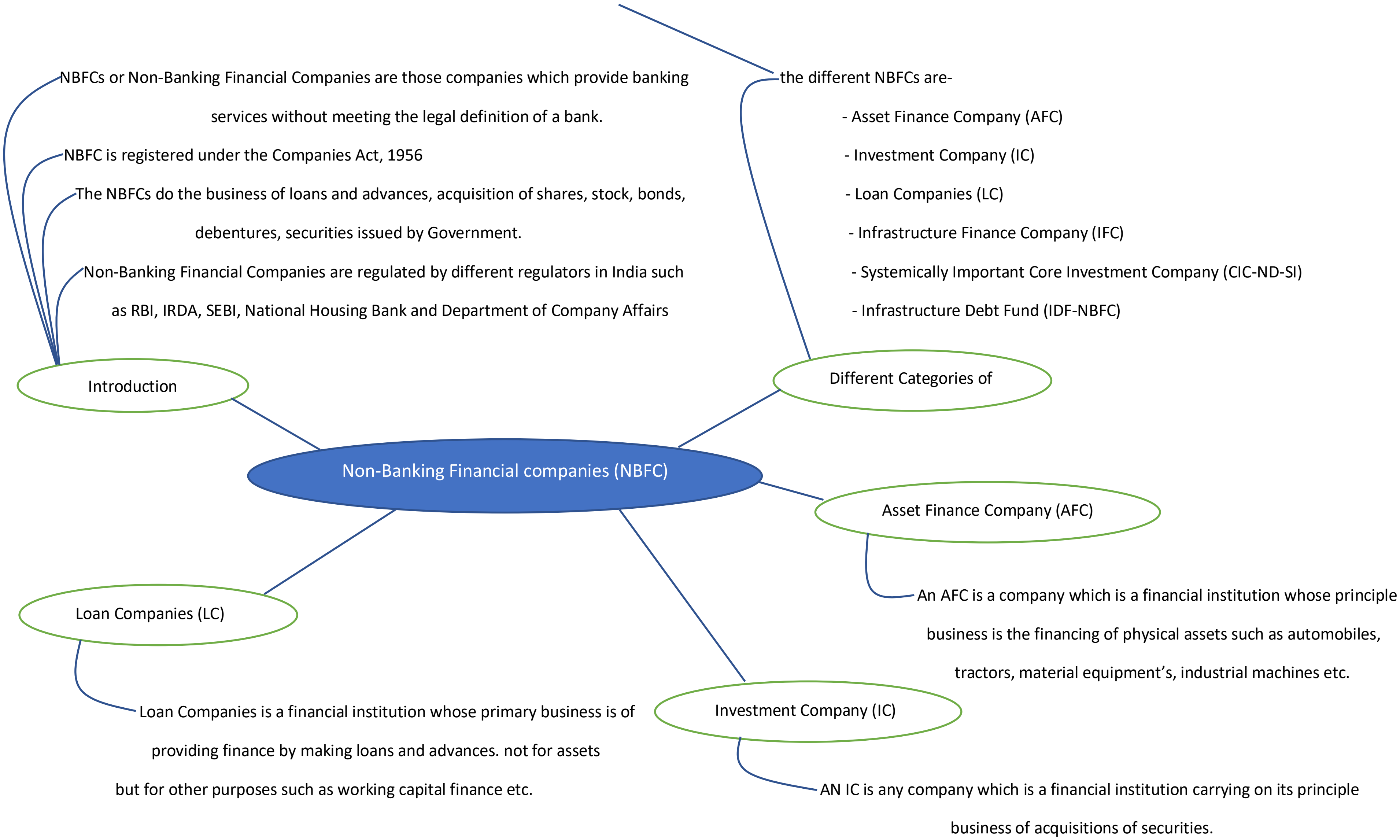
Non-Banking Financial companies (NBFC)
Introduction
NBFCs or Non-Banking Financial Companies are those companies which provide banking services without meeting the legal definition of a bank.
NBFC is registered under the Companies Act, 1956
The NBFCs do the business of loans and advances, acquisition of shares, stock, bonds, debentures, securities issued by Government.
Non-Banking Financial Companies are regulated by different regulators in India such as RBI, IRDA, SEBI, National Housing Bank and Department of Company Affairs
Different Categories of
the different NBFCs are-
- Asset Finance Company (AFC)
- Investment Company (IC)
- Loan Companies (LC)
- Infrastructure Finance Company (IFC)
- Systemically Important Core Investment Company (CIC-ND-SI)
- Infrastructure Debt Fund (IDF-NBFC)
Asset Finance Company (AFC)
An AFC is a company which is a financial institution whose principle business is the financing of physical assets such as automobiles, tractors, material equipment’s, industrial machines etc.
Loan Companies (LC)
Loan Companies is a financial institution whose primary business is of providing finance by making loans and advances. not for assets but for other purposes such as working capital finance etc.
Investment Company (IC)
AN IC is any company which is a financial institution carrying on its principle business of acquisitions of securities.

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- Infrastructure Finance Company (IFC)
  - The Infrastructure Finance Company is yet another financial institution engaged in the principal business of infrastructure loan.
  - IFC is an NBFC which deploys 75% of its total assets in infrastructure loans and has a minimum net owned fund of Re 300 Crore.
  - The capital to risk weighted asset ratio or CRAR of the company should be at 15% with Tier-I capital at 10%.
- Systemically Important Core Investment Company (CIC-ND-SI)
  - CIC is an NBFC carrying on the business of acquisition of shares and securities.
  - It holds not less than 90% of its Total Assets in the form of investment in equity shares, preference shares, debt or loans in group companies.
  - it does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment.
- Infrastructure Debt Fund (IDF-NBFC)
  - IDFs are investment vehicles which can be sponsored by commercial banks and NBFCs in India in which domestic/offshore institutional investors, specially insurance and pension funds can invest through units and bonds issued by the IDFs.
  - IDFs would essentially act as vehicles for refinancing existing debt of infrastructure companies, thereby creating fresh headroom for banks to lend to fresh infrastructure projects.
  - IDF-NBFCs would take over loans extended to infrastructure projects which are created through the Public Private Partnership (PPP) route and have successfully completed one year of commercial production.
  - Infrastructure Debt Funds (IDFs), can be set up either as a Trust or as a Company. A trust based IDF would normally be a Mutual Fund (MF), regulated by SEBI, while a company based IDF would normally be a NBFC regulated by the Reserve Bank.

Non-Banking Financial companies (NBFC)

Importance of NBFCs

- NBFCs help attain the objective of macroeconomic policies of creating more jobs in the country by promoting Small and Medium scale Enterprises and private industries through lending them loans.
- The financial market relies heavily on non-banking financial institutions for raising capital. The start-ups and small-sized businesses are dependent on funds offered by NBFCs.
- NBFCs extend long-term credits to infrastructure, commerce and trade companies. The traditional banks expect timely, schedules and short-term repayment of loans that may not always suit the requirements of these industries.
- As NBFCs aim to build capital for several industries – private and otherwise – they aid in accumulating a capital stock for the country. This directly adds on to the National Income and results in the progression of Gross Domestic Product (GDP).

Disadvantages of NBFCs

- NBFCs cannot accept demand deposits as it falls within the realm of activity of commercial banks
- An NBFC is not a part of the payment and settlement system and as such an NBFC cannot issue cheques drawn on itself
- Deposit insurance facility is not available for NBFC depositors unlike in case of banks
- All NBFCs cannot accept deposits; only some can. Only those NBFCs holding a valid Certificate of Registration with authorisation to accept Public Deposits can accept/hold public deposits
- The regulatory mechanism for NBFCs is stringent.

There are three primary drivers of the current risk aversion for NBFCs -

The first driver relates to short-term funding being used to finance long-term assets, an asset liability mismatch (ALM).

For micro-finance, the average loan tenure ranges from eight to nine months, for commercial vehicle finance it is 16 to 18 months, while for small business finance it is 12 to 16 months. Thus, the asset side duration for these businesses is very short.

On the liabilities side, the duration either mirrors the asset side, or is longer, and generally ranges from one to two years. Thus, these small to mid-sized NBFCs run a positive ALM mismatch.

The second cause of current risk aversion towards NBFCs has to do with refinancing or rollover of short-term capital market borrowings.

This concern is linked to the ALM issue, as a smooth rollover of shorter duration liabilities when assets are of longer duration is key for business continuity.

The third cause for concern has to do with asset quality.

This primarily pertains to exposure of NBFCs to the real estate sector—either as builder funding or loan against property (LAP).

Rollover refers to the practice of “rolling over” a loan, wherein the borrower pays the lender an additional fee in order to extend the loan due date. This additional fee increases the cost of borrowing, and can lead some borrowers to become trapped in a cycle of debt, also known as a “debt trap.”

Problems Plaguing NBFCs