Deloitte.

Regulatory Impact Assessment
NBFC

January 2016
Regulatory Intelligence Group
For private circulation among delegates only

inri@deloitte.com

Contents

Preface	3
Our point of view on key RBI guidelines issued in October-December 2015	4
Contacts	9

Preface

During this quarter RBI published its half yearly financial stability report. The report carries out both qualitative and quantitative analyses of the current strength and resilience of the Indian financial system thus indicating where the financial system is and how it needs to move, to achieve its goal of supporting the real sector more effectively. The financial stability report also published certain matrices for NBFCs.

As of September 30, 2015, there were 11,781 non-banking financial companies (NBFCs) registered with the Reserve Bank, of which 212 deposit accepting (NBFCs-D) and 11,569 were non-deposit accepting (NBFCs-ND). There were 210 Systemically Important Non-Deposit accepting NBFCs (NBFCs-ND-SI).

The aggregated balance sheet of the NBFC sector expanded by 14.2 per cent on year-on-year basis in September 2015 as compared to 16.8 in March whereas the consolidated balance sheet of the all India financial institutions (AIFIs) expanded by 9 per cent during 2014-15 reflecting moderation from double-digit expansion in the previous couple of years. With the Modi government pushing for 'Make In India' campaign leading to increased demand from the corporates, the loans and advances of the NBFCs increased by 14.2 per cent, while, total borrowings increased by 14.5 per cent as NBFCs borrowed more from banks, AMCs and insurance companies.

The financial performance of the NBFC sector deteriorated during the quarter ended September 2015 as compared to March 2015 as the GNPA of the NBFC sector as a percentage of total assets increased to 3.5 per cent in September 2015 from 3.4 per cent in March. The NNPA as percentage of total assets also increased to 2.0 per cent from 1.8 per cent during the same period, the same was in line with the high level of NPAs being witnessed by the whole financial sector hence NBFCs were forced to create enough provisions to safeguard their balance sheets

Due to the high provisions, the net profit as a percentage to total income declined from 18.8 per cent to 15.0 per cent between March and September 2015 leading to reduction of ROA sharply from 2.2 per cent to 1.0 percent. The fall in ROA also signifies the challenge NBFCs face on the profitability front due to the deteriorating financial conditions of the corporates. If we look the fine-print of the financial stability report and divide the NBFCs to non-deposit taking and deposit taking, loans and advances extended by non-banking financial companies-non-deposit accepting-systemically important (NBFCs-ND-SI) posted significant growth of 15.5 per cent during 2014-15. The GNPAs of the NBFCs-ND-SI showed a marginal improvement and were primarily concentrated in infrastructure sector, transport operator segment, and medium and large scale industries. On the other hand, asset quality of non-banking financial companies- deposit accepting (NBFCs-D) deteriorated as both gross and net NPAs increased during 2014-15.

As per the extant guidelines, NBFCs are required to maintain a minimum capital consisting of Tier-I and Tier-II capital, of not less than 15 per cent of their aggregate risk-weighted assets. The CRAR of NBFCs declined to 23.8 per cent as of September 2015 from 27.3 per cent as of March 2015, though this is well above the regulatory minimum requirement, the decline signifies that due to the stress in their loan portfolio, NBFCs are facing the risk on the capital front as well and may not have sufficient funds available with them in case of any exigency if the NPA levels are not brought under control. Thus RBI has stressed the importance of monitoring the balance sheets of the corporates and identifying the stress signals much in advance in order to avoid the contagion effect.

Another interesting aspect observed in the financial stability report is the interconnectedness in the financial system where NBFCs have emerged as net receivers. As of September 2015, the banking sector had an outstanding exposure close to ₹2 trillion to NBFCs. Further, the exposure of AMC-MFs and insurance companies to NBFCs displayed an increasing trend between March 2012 and September 2015 from ₹425 billion to ₹1376 billion in case of AMC-MFs and ₹780 billion to ₹1064 billion respectively. It shows that NBFCs are moving from traditional sources of borrowing i.e banks to AMC-MFs and Insurance companies who subscribe to the commercial paper etc. issued by the NBFCs, which provides AMC-MFs and Insurance companies with high rate of returns and in turn also reduces the cost of funds for the NBFCs.

RBI has been looking at the entire financial system including NBFCs and is slowly trying to align the regulatory requirements between a bank and the NBFC to eliminate instances of regulatory arbitrage that exist right now. In the coming months we expect RBI to come up with guidelines for NBFCs which may align the NBFC regulations with that for banks. This is visible from RBI's effort to include the NBFCs in the joint lending forums and also the rationalizing the type of returns files by the NBFCs.

Our point of view on key RBI guidelines issued in October-December 2015

Non Banking Financial Company-Micro Finance Institutions (NBFC-MFIs) – Directions – Modifications

RBI Circular Reference: RBI/2015-16/196
Date of Notification: October 1, 2015
Applicable Entities: To all NBFC-MFIs

Background & Objective

The RBI, in order to ensure an all-round and a stable economic growth, plays a significant role in promoting priority sector lending. Priority sector lending through Financial Institutions (FIs) includes providing a specific portion of the FIs lending to a few specific sectors like agriculture, allied activities, micro and small enterprises and other low income groups and weaker sections.

The Government, via the National Scheduled Castes Finance & Development Corporation (NSFDC) under the Ministry of Social Justice & Empowerment, has proposed to channelize their funds through NBFC-MFIs. The increasing growth of the MFIs in India and its easy accessibility to the rural population or the target population has played a crucial role in this decision by the Government. The objective of the NSFDC is to work for the economic empowerment of persons belonging to Scheduled Castes living below the Double Poverty Line.

Key Directives Issued by RBI

- The RBI necessitates the NBFC-MFIs to maintain a maximum variance between the minimum and maximum interest rate on loans of 4%. However, respite has been given to such NBFC-MFIs since this criteria to maintain the maximum variance will not be applicable for loans extended from the NSFDC funds.
- The guideline mandates the disbursement of such loans via direct credit, i.e. directly into the bank account of the payee.
- NBFC-MFIs shall exclude borrowing from NSFDC in arriving at the average cost of funds of the company for the purpose of pricing of credit, other than to the beneficiaries targeted by NSFDC. For the purpose of the same, the NBFC-MFIs shall maintain a proper record of funds received from NSFDC and the lending out of those funds.
- Appropriate disclosures with respect to the funds received from the NSFDC shall be made in the balance sheet of such NBFC-MFIs.
- NBFC-MFIs shall inform the concerned Regional Office of the Reserve Bank of India of their appointment as a channelizing agent by NSFDC within one month from the date of such appointment.

Implications

- The MFIs must put in place a control mechanism to continuously monitor and maintain a proper record of the funds received from NSFDC and its further utilization.
- The guideline states that the borrowings from the NSFDC should be excluded while computing the average cost of funds of the company for the purpose of pricing of credit. Hence, the RBI ensures a fair and an unbiased credit pricing across all NBFC-MFIs.
- The NBFC- MFIs must ensure that appropriate disclosures, including the quantum of funds received from NSFDC, cost of such funds, loans disbursed therefrom, the rate of interest and the number of beneficiaries, are made in the balance sheet.
- The guideline specifies that only a few select NBFC- MFIs can be selected as channelizing agents and once they are appointed, they would have to inform the same to the concerned Regional Office of the RBI within one month from such appointment. However guideline does not specify the criteria for eligibility for NBFC-MFIs to act channelizing agents, nor does it provide us with a list of such NBFC-MFIs.

Non-Banking Financial Company-Micro Finance Institutions (NBFC-MFIs) – Directions DNBS.PD.No. 234/CGM (US)-2011 dated December 2, 2011 and DNBR.CC.PD.No. 027/03.10.01/2014-15 dated April 08, 2015 – Revision of the loan amount with tenure not less than 24 months

RBI Circular Reference: RBI/2015-16/250
Date of Notification: November 26, 2015
Applicable Entities: To All NBFC-MFIs

Background & Objective

The RBI with an aim to ensure a holistic economic growth and development has been actively aiding the progress of MFIs in India. The increase in the total number of loans disbursed by 42% from Q2 of 2014-15 and the number of branches by 16.5% in the past year, is a clear indication of the significant growth in this industry over the past year.

The RBI, understanding the future scope of this industry and with an aim to supplement it's further development, has issued this guideline increasing the limit for short term loans disbursed, also ensuring that the limits are in sync with the present times. The guideline intends to boost credit to the poor.

Key Directives Issued by RBI

" In the light of the representations received from the 'sector' on the captioned subject, it is advised that limit of the loan amount, for which the tenure of the loan shall not be less than 24 months, has been raised to ` 30,000/- from the present limit of ` 15,000 . All loans necessarily be prepaid without any penalty, as hitherto".

Implications

- Since the guideline aims at enhancing the short term credit provided by the NBFC-MFIs, there would be a considerable increase in the credit risk faced by them. The NBFC-MFIs have to ensure that put in place an even more stringent policy, to continuously monitor the loans provided by in order to recover the loans disbursed and prevent any bad or stressed loans.
- An increase in the short term loans provided would lead to a significant increase in the fund requirements of the MFIs. Hence, the MFIs must ensure that they raise such additional funds in a cost effective manner.
- Further, the guideline specifies that the existing norm of no penalty for prepayment of loans will prevail.

Online Returns to be submitted by NBFCs- Revised

RBI Circular Reference: RBI/2014-15/246

Date of Notification: November 26, 2015

Applicable Entities: All Non Banking Financial Companies

Background & Objective

The RBI in its Master Circular – Return to be submitted by NBFCs dated July 01, 2015 has listed the various returns (along with the details of each) which the NBFCs have to submit. However, due to lack of clarity, the NBFCs are not submitting the returns as per the requirement of the RBI Hence with an aim to rationalize and simplify the returns to be submitted and to avoid any duplication of data, the RBI has proposed a few changes in the returns to be submitted by the NBFCs.

Key Directives Issued by RBI

The RBI has proposed the following changes in the returns to be submitted:

- There is a change in the periodicity of NDSI-500cr and ALM- 1 returns from monthly to quarterly.
- Discontinuation of NBS- 6 return as the same information is received through NBS-1 return.
- To maintain uniformity and avoid misunderstanding, it has been decided that the concerned NBFCs should report the stock data of branches as at end of every quarter rather than providing incremental number of branches during the quarter.

Implications

- The guideline states that some NBFCs are not submitting correct branch information return as per the guideline DNBS (PD).CC.No.355/03.02.02/2013-14 dated September 3, 2013. Hence the NBFCs should design a stringent control mechanism to verify the accuracy of the returns submitted to the RBI.
- The NBFCs should ensure that all the returns are submitted to the RBI as per the revised list of returns specified in the Annexure of the guideline.
- The NBFCs should update the policy with respect to the submission of returns based on the modifications suggested by the RBI.

Contacts

Muzammil Patel
Senior Director, DTTIPL
muzammilpatel@deloitte.com
+91 22 6185 5490

Vivek Iyer
Director, DTTIPL
viveki@deloitte.com
+91 22 6185 5558

Abhinava Bajpai
Director, DTTIPL
abbjpai@deloitte.com
+91 22 6185 5557

Rajeev Khare
Deputy Manager, DTTIPL
rakhare@deloitte.com
+91 22 6185 5525

For further information, send an e-mail to **inri@deloitte.com**