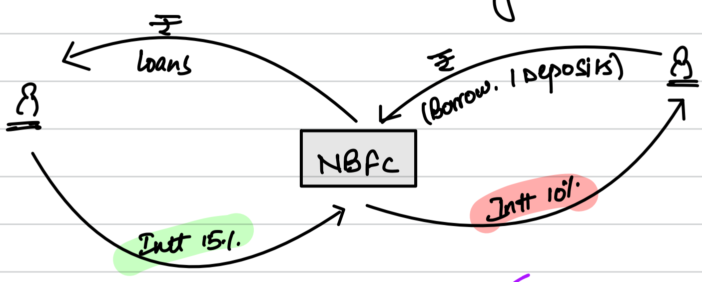
NBFC (Non-Banking financial Co.) [5-7 Marks] Easy + Scoring



- ~~Saving~~ / ~~current~~ / fixed (selected NBFCs) ✓
- issue cheques / payments ✗
- Deposits insurance ✗

Co. —— I: 50 : 50 Test + II: RBI registration (Min. Net owned funds) ——→ NBFC

I. 50:50 Test

- Financial Assets (F.A.) > 50% of [Total Assets − Intangible Assets]

&

- Income from F.A > 50% of Gross Income

↓

RBI Registration

II. Min. Net owned funds of ₹10 cr* [earlier limit was ₹2 cr)

for. Cos. currently applying for registration

* Exceptions: NBFC P2P, AA & No [Access to public funds & customer interface)

↳ NOF 2cr

- NBFC − IFC & IDF ⇒ NoF ₹300 cr

Q What about existing NBFCs?

NBFC	Current	By 31.3.25	By 31.3.27
ICC	2cr	5cr	10cr
MFI	5cr	7cr	10cr
Factor	5cr	7cr	10cr

Categorisation of NBFCs

a) Deposit Acceptance
- Deposit Taking
- Non-Deposit Taking [Assets size]

b) Base layer | Middle layer | Upper layer | Top layer

c) Activities

- $\boxed{\text{Investment}}$ & $\boxed{\text{Credit}}$ Company (ICC) → ₹
  - Invest [shares, securities etc]
  - credit (lending money)
- $\boxed{\text{Infrastructure}}$ debt fund (IDF): Pay off existing debts of infra. projects already completed.
- $\boxed{\text{Infra.}}$ finance Co.: Finance new infra. projects (Roads, Bridges etc.)
- $\boxed{\text{Micro}}$ finance Institution: Small Business.
- $\boxed{\text{Non-operating}}$ $\boxed{\text{financial}}$ $\boxed{\text{Holding}}$ Co: operations & Holding
  - S_1 Banking
  - S_2 Insurance
  - S_3 Mutual funds.
- Asset finance / Loan Co. / Mortgage Guarantee Co.
  - Asset finance → Purchase Assets on EMI
  - Loan Co. → lend money
  - Mortgage Guarantee Co. → Guarantee to lenders for borrowers default.
- Peer to Peer Lending (P2P): Lender [Risk [9-12%]] $\xrightarrow{₹}$ NBFC (Agent) [credit] $\xrightarrow{₹}$ Borrower [Defaults] (credit check)
- Account Aggregator (AA): collects & shares/stores Bank A/c info. of people.
- Core Investment Co. (CIC): Invest in own group cos. [Min. 90% of Assets]
- NBFC: Factors: Buy debtors at discount.
- Standalone Primary Dealers (SPDs): Govt $\xrightarrow{\text{securities}}$ $\boxed{\text{SPDs}}$ $\xrightarrow{\text{sec.}}$ Public; ₹ flows back from SPDs to Govt and from Public to SPDs.

NBFC Scale Based Regulation

1. **Base layer**

a) NBFC – ND Asset Size < 1,000 cr
&
b) NBFCs doing following Activities

- P2P lending (Peer to peer)
- Account Aggregator (AA)
- Non operating Financial Holding Co.
- NBFCs with No
  - Access to public funds
  - & customer interface

PAA
NOFHC — P.F.s — C.I.s

2. **Middle layer**

a) All deposit taking NBFCs [asset size doesn't matter]
+
b) NBFC-ND → Assets size ≥ 1000 cr
+
c) Activities

- Core Investment Co.
- Housing finance Co.
- Infra → finance Co. / Debt fund
- Standalone Primary Dealers.

3. Upper layer • Top 10 NBFCs (Asset Size) + Identified by RBI

4. Top layer : [Ideally empty]

Difference b/w Bank & NBFC

₹ Deposits

① Demand x [saving / current A/c x]

② DICGC Insurance x
[Deposit Insurance credit Guarantee corporation]
Bank deposits upto ₹5L

NBFC

③ payments x

loan

④ Priority sector
[Agri/Education/MSME etc]
x

Prudential Norms

- **Capital Adequacy Ratio**
- IRAC
  - Income Recognition
  - Asset Classification
  - Provision

1. Capital Adequacy Ratio

$$= \frac{\text{Capital Funds (Tier I + II)}}{\text{Risk weighted Assets + off. B.S items}}$$

Min. 15% (Tier I + II)

Tier I 10% ⟶ 12%
lending against gold jewellery
[Such loans ≥ 50% of F.A.]

(High dealing)

Tier I	Tier II [Can't exceed Tier I cap.]
i) owned funds (Equity, free reserves, cap. reserves, except reval. reserve)	1. Preference shares other than compulsorily convertible [C.C.P.S]
(–) (Invest. in shares of other NBFCs ⊕ Shares, debentures, bonds, loans, lease finance, hire purchase finance, in subsy. & group cos.) > 10% of owned funds. — Excess investment	2. Revaluation Reserve at disc. rate of 55%. eg R/R 20lakhs ⟶ Tier II 9lakhs [20L × 45%]
eg owned fund = 5cr; Investment in share of other NBFCs + Group cos. = 2cr	3. General Provisions (Including on std. assets) + loss reserves ↓ 1.25% of Risk weighted assets.
Tier I ⇒ 5cr – Excess Investment ⇒ 5cr – 1.5cr ⇒ 3.5cr	4. Hybrid debt instruments (compound financial instruments $<^{D}_{E}$)
Excess Invest. ⇒ 2cr – 10% of 5cr ⇒ 2cr – 50lakhs ⇒ 1.5cr	5. Subordinated debt [maturing min. 5yrs.]
ii) Perpetual Debt Instruments (PDIs) [NBFC-ND] upto 15% of agg. Tier I capital as at 31st March of prev. A/c year	6. Perp. Debt Instruments (PDIs) [NBFC-ND]
eg P.Y. 31st March Tier I cap. = 3cr; PDIs issued during year = 60 lakhs	
Tier I [3cr × 15%] ⇒ 45 lakhs → Remaining 15lakhs	

Note: for NBFC-BL it is not allowed to include P.D.I in capital (Tier I & II)

1. Calculate Tier I & II Capital of ABC Pvt Ltd (NBFC-ND) with asset size of ₹1,500 Cr? ML

Items	Amount (₹' In crores)
Equity Capital	200
Free Reserves	50
Capital Reserves (Excluding Revaluation Reserves)	10
Revaluation Reserves	4
Investment in Shares of Other NBFCs	25
Investment in Group Companies (Shares, Bonds, Loans, Deposits, etc.)	20
Issued Perpetual Debt Instrument in the current year	30
Preference Shares (non-convertible)	25
General Provisions and Loss Reserves	15
Hybrid Debt Capital Instruments	35
Subordinated Debt	50

Additional Info:

- Previous year's Tier 1 Capital = ₹140 Cr
- Risk Weighted Assets: ₹800 Cr

Ans Tier I

- Owned funds
[Equity + free Reserves + Cap. Res.]
⇒ 200 + 50 + 10 ⇒ 260 cr

- Invest. in shares other NBFC
+ Group cos ⇒ 25 + 20
⇒ 45 cr

Excess Inves. ⇒ 45 cr − 10% × 260 cr
⇒ 45 − 26
= 19 cr

⇒ 260 − 19 ⇒ 241 cr

(+) Perpetual Debt Instruments
⇒ 30 cr

Limit of Tier I
(15% of P.Y. Tier I) ⇒ 21 cr
15% × 140 cr

Remaining [Tier II capital] 9 cr

$\boxed{\text{Total Tier I} \Rightarrow 241 + 21 \Rightarrow 262 \text{ cr}}$

Tier II
- Reval^n Reserve = 4 cr × 45% ⇒ 1.8 cr
- Perpetual Debt Instr. ⇒ 9 cr
- Pref shares ⇒ 25 cr
- General Prov. & loss Reserve ⇒ 10 cr
  - Actual 15 cr.
  - Limit
  - 1.25% of RWA ⇒ 10 cr
  - 1.25% × 800 cr
- Hybrid Debt Instrument 35 cr
- Subordinated debt 50 cr

Tier II capital 130.8 cr

→ loss money on Asset

Risk weights

0%
- Cash | Bank
- Approved Securities
- Loans / Advances (fully secured / employees)
- TDS | Advance Tax
- Govt
  - Intt. on Govt Security + S.G. Securities
  - Fund based claims to CG
  - CG guaranteed advances

20%
- Advances ↓ S.G. guarantee
  - default < 90 days
- Public Sector Bank Bonds (SBI | PNB | BoB)

50%
- Public Pvt Partnerships (PPP) & Post Commercial operations Date (P.C.OD) projects
  - ↓ over 1 year operations

125%
- consumer credit exposure (Retail Loans) [Excludes H/E/V/G/MFI SHG loans]
- Cr. card receivables.

$\boxed{\text{All others} \Rightarrow 100\%}$

Income Recognition

Standard — Accrual Basis

Non-Performing Asset (NPA) — Realisation Basis
[Intt accrued & unrealised till Asset became NPA ⇒ Reversed]
per A/C Dr.
To Acc. Intt

Asset classification

Due Date —— 180 days# ——→ NPA —— 18 | 12* months ——→

Standard | $\boxed{\text{NPA}}$ | Sub-standard | Doubtful → Loss Asset (chance of recovery 0)

* 12 months ⇒ NBFC ML & Above

\# NPA Time limit
- Current → 180 days
- By 31.3.24 → 150 days.
- By 31.3.25 → 120 days.
- By 31.3.26 → 90 days

Provisioning

Classification	Percentage of Provision
1. Standard	
• NBFC – BL	0.25%
• NBFC – ML & Above	0.40%
2. Sub-std Asset	10%
3. Doubtful	
• Secured	
upto 1 year	20%
1-3 years	30%
>3 years	50%
• Unsecured	100%
4. Loss Asset	100%

⇒ Net-off from Advances.

∴ shown under "contingent provision against std assets" in B S.

Audit Procedures

1. Ascertain business of the co.

Read
- MOA & AOA of the co.
- Business policy
- M.O.M of BODs/ Committee

} Helps to know principal Business activity ↘ As classification depends on it.

2. Evaluation of I.C System

major Risk → Defaults/ NPAs

- Understand a/c system & related ICs.
- Review effectiveness of system of recovery.
- Check whether there's system of periodical review of advances that allows monitoring & follow up.
  ✗
- Absence of this can lead to high level of NPAs.

3. Registration with RBI

- Take a copy of CoR [Certificate of Registration]

or

In case registration is pending, copy of application form filed with RBI

- Also, NBFC should comply with min. NOF requirement.
- If NBFC holds public deposits, then its reqd. to invest specified %age in liquid assets.

SLR (Banks)

&

file quarterly return with RBI

⇒ Auditor shall check above compliance.

4. NBFC Acceptance of Public Deposits (PD) (Reserve Bank) Directions 2016

- Ceiling (limit) on quantum (↑) of deposits → linked to credit rating by approved cr. rating agency.

⇒ obtain copy of cr. rating & check if P.Ds as per rating.

⇒ In case of upgrading / downgrading of cr. rating, NBFC has to increase / decrease PDs as per revised rating.

★ If downgrading is below minimum investment grade, then NBFC, regularise excess deposits as under:

[× fresh / Renew]
Stop accepting fresh deposits & renewing existing ones
↓
[Renew → consent ✓]
No matured deposit renew without consent of depositor.

[Existing — Repay to Maturity ✓]
Existing deposits run off till maturity.

[Report → RBI]
Report within 15 working days to Regional office [NBFC regd.] of RBI.

Spl. Point: for Group Holding Investment Co.
→ NBFC passed BR?
[Investment in shares of Group Cos.]
↓
Take further undertaking
× Trade in such shares
× Accept any P.Ds during year.

5. Audit of compliance with "Prudential Norms"

(Basic)
① check compliance with Prudential Norms of:

- Capital Adequacy
- IRAC
  - Income Recognition
  - Asset classification
    - P.D.D.
    - ↓
- A/c Stds
- Prohibition to grant loans against security of own shares

Bajaj finance → loan → Shareholder
Prohibited ×
Security [B.F. Shares]

② verify that advances properly classified as
- Std.
- Sub Std
- doubtful
- loss asset

&

proper provision is made.

→ [NPAs]

AS 9 certainty

[Unrealised income → ~~P&L~~ (Accrual)]

③ for NPAs, income recognised on realisation basis.
⇒ Unrealised income not taken to P&L on accrual basis.

[P.Y. NPA → C.Y. NPA ?]

④ check if all NPA a/cs in P.Y. continue in C.Y. also,
⇒ if Not, whether it has become regular as per directions.
Std

⑤ for NBFCs, granting / intending to grant Demand / Call loans
↓
ensure that BoD framed & implemented policy for Co.

Audit check list [NBFC - ICC]

Shares

① physically verify shares held
↓
if with Bank, then verify certificate of Bank.

② (Depository → conf.)
for shares with depository, obtain confirmation

③ (Broker)
Test check Bills / contract notes recd. from Brokers w.r.t stock mkt prices.

Investments

④ Board minutes < ST / LT
verify Board minutes for purchase / sale of investments
↓
verify B.R. / W.R that Inv. is ST/LT.

⑤ [AS-13]
check whether AS-13 complied or any other applicable a/c std.

NBFC — P2P (Peer to Peer lending)

① Understand Business
- of providing marketplace to participants for lending & borrowing.
- No. lending on its own.

B → ₹ → NBFC P2P → ₹ → B
= L

Verify Board Approved Policy for

② Eligibility criteria for participants i.e. lender & borrower.

③ Grievance Redressal & compliance

[RBI]

④ Verify COR from RBI for P2P business
↓
⑤ Compliance with lending & Borrowing guidelines of RBI
↓
⑥ Compliance with Reporting requirements of RBI

Auditor's Duty to Report to BoD [Para 3]

All NBFCs

- Co. → CoR?
  ↓
  Yes
  - Entitled to hold as per Principal Business criteria? [31st March of year]
  - NOF criteria?

Deposit taking

Limit

- P.D. → within limit?
- > Quantum → Regularised?
- P.D. Accepted ⇒ Min. Investment grade rating?
  ↓
- Cr. rating (F.D scheme) in force?
  +
- Agg. O/S deposits > limit cr. rating agency?

Non-Deposit

Basic

- B.R passed [Not accepting P.Ds]?
- Accepted any P.Ds during year?

General

- Comply with pru. norms?
- CRAR → correct + comply min req.?
  ↳ Annual Statement
  - Cap. funds
  - Risk Asset Ratio (NBS-7)

Stat. auditor's certificate

- position at end of F.Y. [31st March]
- Submit? Regional office [Dept of Non Banking Supervision] (RBI)
- By when? 5 working days from date of A/R
  Not. by 31st Dec of same year.

Violation / Default

- Violated → Restriction of accepting P.D?
- Default → paying (int + principal) due?

odd

Correctly classified as NFI?

Returns

- Liquid assets → NBS 3?
- Deposits → DNBS 01?
- Pru. norms → O/s Return? + compliance

Branches

- Opening / closing / appoint. agent
  ↳ comply with Directions?

Rough SA 705 Modified opinion (D/A/Q)
↳ Reason?
Basis for modified opinion para

Exception Report to RBI [5*]

[When?] If any statement in Para 3, if it's unfavourable / qualified

or

if NBFC has not complied with

Chapter IIIB of RBI Act [Act 2] of 1934. | NBFC Acceptance of P.D. Directions 2016 | Master-Directions - RBI [NBFC Scale Based Regulation] 2023

[Where?] Make report about non-compliance to Regional office of Dept of Non-Banking Supervision of RBI under whose jurisdiction Regd. office of NBFC is situated.

[Only contraventions] Report only contraventions of RBI Act & Directions, not any statement of compliance with any provision.

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