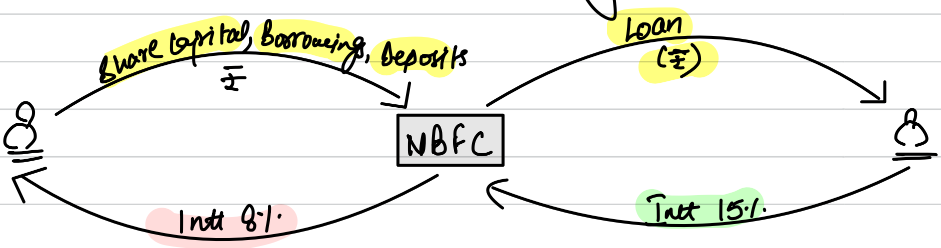
NBFC (Non-Banking Financial Co.) [Ma Khan + Scoring]



6. 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

⇓

If Both criterias fulfilled

⇓

RBI registration

II. Minimum net owned funds [capital] of ₹10cr* for Cos. currently applying for registration

[* earlier this limit was ₹2cr].

Categorisation of NBFCs

a) Deposit Acceptance — Deposit taking / Non-Deposit taking (N.D.) [Asset Size]

b) Base layer → Middle layer → Upper layer → Top layer.

c) Activities

- Investment & credit Co. [ICC] ⇒ ₹ → Credit (Lending money) / → Investment (shares, securities etc.)

- Infrastructure finance Co. (IFC): finance New infra. projects. (Roads, bridges etc.)

- Infra. Debt funds (IDF): Pays off existing debts of infra. projects completed.

- Micro finance institution (MFI): Small Business.

- Non-operating Financial Holding Co.: × operations + Holding Co.
  - 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 lender for Borrower's default.

- Peer to peer lending (P2P): [Risk] Lender $\xrightarrow{₹}$ (Agent) NBFC Platform $\xrightarrow{₹}$ Borrower [Default]

- Accounts Aggregator (AA): collects, stores & shares Bank A/c info.

- Core Investment Co. (CIC): Invests in own Group Cos. [Min. 90%] [Detail: CARO 2020].

- NBFC Factors: Buys debtors on discount.

- Standalone Primary Dealers (SPDs): Govt $\xrightarrow{\text{securities}}$ $\boxed{\text{SPDs}}$ $\xrightarrow{\text{securities}}$ Public
  - Public $\xrightarrow{₹}$ SPDs $\xrightarrow{₹}$ Govt

Difference b/w Bank & NBFC

$\boxed{\text{NBFC}}$

- ① Deposits ₹ — Demand ✗ [Saving ✗ | current ✗]
- ② DICGC (Deposit Insurance Credit Guarantee Corp.) Insurance ✗
- ③ payments ✗
- ④ Loan ✗ [Priority Sector]
  Agriculture, Education, MSME etc.

Prudential Norms

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

1. Capital Adequacy Ratio

$$= \frac{\text{Capital funds (Tier 1 + Tier 2)}}{\text{Risk weighted Assets + off. B.S. items.}}$$

high quality (Tier 1) — quality↓ (Tier 2)

[Min. 15% [Tier 1 + 2]]

Tier 1 10% ⟶ 12%

(Lending against gold jewellery such loans ≥ 50% of F.A.)

Tier 1	Tier 2 (can't exceed Tier 1 capital)

Tier 1

i) Owned funds [Equity, free reserves, cap. reserve, except revaluation reserve)

(–) Excess Investments

(Invest. in shares of other NBFCs + shares, debentures, bonds, loans, lease finance, hire purchase finance, in Subsy & group. Cos.) > 10% of owned funds.

Eg. Owned funds = 5 cr
Investment in shares of other NBFCs + Group Cos. = 2 cr.

Excess Invest. = 2 cr – 10% of 5 cr
= 2 cr – 50 Lakhs
= 1.5 cr.

[Tier 1 = 5 cr – 1.5 = 3.5 cr]

ii) Perpetual Debt Instruments (PDIs) [NBFC–N.D]
upto 15% of agg. Tier 1 capital as at 31st March of previous A/c year.

Eg. P.Y. 31st March Tier 1 capital = 3 cr
P.D.Is issued during year = 60 lakhs.

Tier 1: 60 Lakhs
3 cr × 15% = 45 Lakhs ↓ 45 Lakhs

→ Remaining 15 lakhs.

Tier 2 (can't exceed Tier 1 capital)

1. Preference Shares other than Compulsorily Convertible Pref. shares [C.C.PS]

2. Revaluation Reserve at disc. rate of 55%
   Eg. R/R 20 L ⟶ Tier 2 ₹9 L
   [20 L × 45%]

3. General provisions (including on Std. Assets) + Loss reserves upto 1.25% of Risk weighted Assets.

4. Hybrid debt instruments
   [Compound financial instruments (D/E)]

5. Subordinated debt [maturity min. 5 yrs.]

6. Perpetual Debt Instruments (PDIs) [NBFC–ND.]
   ₹15 lakhs (not covered in Tier 1)

Note: For NBFC-BL it's not allowed to include PDIs in Tier 1 & 2 capital.

Question 5

Qura Capital Ltd., a Non-Banking Financial Company (NBFC) classified under the Scale-Based Regulation framework, is required to maintain a minimum capital ratio of 15% of its aggregate risk-weighted assets (RWA) and risk-adjusted off-balance sheet items. The company has provided the following financial data for computing of its Tier 1 and Tier 2 capital as per the RBI Master Directions:

Particulars	Amount in ₹
Owned Fund	₹ 1,000 crore
Investment in shares of other NBFCs and in group companies (exceeding 10% of owned fund)	₹ 150 crore
Perpetual Debt Instruments issued by Qura Finance Ltd.	₹ 120 crore
Preference Shares (not compulsorily convertible into equity)	₹ 80 crore
Revaluation Reserves	₹ 200 crore
General Provisions & Loss Reserves	₹ 50 crore
Hybrid Debt Capital Instruments	₹ 90 crore
Subordinated Debt	₹ 140 crore
Risk-Weighted Assets (RWA)	₹ 8,000 crore

Considering that Qura Finance Ltd. is neither an NBFC-MFI nor primarily engaged in lending against gold jewellery, compute the following:

- Tier 1 capital of Qura Finance Ltd. as per RBI guidelines.
- Tier 2 capital, ensuring it does not exceed the Tier 1 capital.

Also, determine whether Qura Finance Ltd. meets the minimum capital adequacy requirement of 15% of RWA. (MTP May'25)

Tier 1 capital	₹ cr.
• Owned funds	1000
(-) Excess investments	(150)
	850
• Perpetual Debt Instrument*	120
	970

*Assumption: • It's NBFC-ND.
• PDIs issued are within limits of Tier 1 capital.

Tier 2 capital	₹ cr
• Preference Shares	80
• Revaluation reserve. (55% discount) [200 cr × 45%]	90
• General provisions & loss reserves - Actual 50 cr - 1.25% of RWA 100 cr [1.25% × 8000 cr]	50
• Hybrid debt instrument	90
• Subordinated debt	140
	450

[can't exceed Tier 1 capital]

$$\text{Capital Adequacy Ratio} = \frac{\text{Tier 1} + \text{Tier 2}}{\text{Risk weighted Assets}} = \frac{970 + 450}{8000} = 17.75\%.$$

Yes, it meets minimum capital adequacy requirement of 15%.

Asset classification

Due date — 180 days. → Standard | 18/12* months → Sub-standard | Doubtful → Hope → Loss Asset

N.P.A [Non performing Asset.

* 12 months : NBFC ML & Above

Provisioning

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

⇒ Advances ⇒ Net off

Shown under "Contingent provision against std. assets" in BS.

H.W Past Exams Q 1, 2, 4

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

- ceiling [Limit] on quantum (₹) of deposits is → linked to credit rating by approved cr. rating agency.

  ⇒ obtain copy of cr. rating & check if PDs as per the 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, (Danger level↓)
  then NBFC (ICC/factor), regularise excess deposits as under:

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

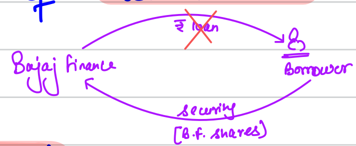
[Existing < Repay ×, Maturity ✓]
Existing deposits run off till maturity

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

Audit of compliance with 'Prudential Norms'

① check compliance with Prud. norms of.

- Capital adequacy
- IRAC
  - Income Recognition
  - Asset Classification
    ↓
    Provision
- A/c Std.
- Prohibition to grant loans against security of own shares.



② verify that advances are properly classified as
- Std
- Sub Std
- doubtful
- loss Asset
  ↓
  (NPAs)

& proper provision is made

(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 a/cs classified as NPA in P.Y. continue in C.Y. also.
⇒ If not, whether it has become regular as (Std)

per directions.

* ⑤ For NBFCs, granting | intending to grant, demand | call loans, ensure that BOD framed & implemented policy for Co.

Quiz

Audit check list [NBFC - ICC]

Shares

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

② [Depository → conf.]
for shares with depository, obtain confirmation. [CDSL | NSDL]

③ [Broker]
Test check Bills | contract notes recd. from Broker w.r.t. stock ex. prices.

Investments.

④ Board minutes (LT / ST)
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 2 Peer Lending)

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

verify Board policy for.

② Eligibility criteria for participants

③ pricing of services

④ grievance redressal & complaints

[RBI]

⑤ verify COR from RBI for P2P Business
↓
⑥ Compliance with RBI guidelines for lending & Borrowing
↓
⑦ 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 [50:50]
- NOF criteria?

31st March of year

Stat. auditor's certificate

- position at end of FY [31st March]

Submit? Regional office (Deptt of Non Banking Supervision] (RBI)

By when? 5 working days from date of A/R

Max. by 31st Dec. of same year.

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?

Violation / default

- violated → Restriction on accepting of P.D.?
- Default → paying (int/principal) due?

Returns

- Liquid Assets → NBS 3?
- Deposits → DNBS 01?
- Prud. norms → Qtr. Return? + compliance

Branches

- opening / closing / Agent appointed
  ↳ comply with directions?

Non-Deposit

Basic/Specific

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

General

- comply with prud. norms?
- CRAR
  → correct + comply min requirement?
  → Annual statement
  - cap. funds
  - Risk asset Ratio (NBS-7)

Add

- correctly classified as MFI?

SA 705 D/A/R → Basis? (Reason)

Division II vs. Division III [NBFC]

B.S. → P&L

1. Allowed to present in order of liquidity → 2. Revenue / OCI → items → P&L face + Notes

Trade Receivables → 5. Other Income / Exp. > 1% of Total Income

3. Credit Risk ↑ & Cr. Impaired.

4. LLP where Director is partner / member.

Balance (Reserve)

6. Cond^n / Restrictions for distribution of reserves.

✓: