Financial Services Organisations

Financial Services Organisation refers to institution that provide services related to managing - Money
- Investment.

Ex: Bank, Investment firms, Brokerage firms, Insurance Co., Payment service provider Paytm, GPay

I: Non Banking Financial Company

A Company registered under CA 2013, engages in financial activities like loans & advances, lease & Hire Purchase, Insurance, etc.

For an entity to be classified as NBFC financial activity should be Principal Business, which is determined through 50-50 test
- Financial assets should be more than 50% of total assets.
- Income from financial assets should be more than 50% of gross income.
- which has a Net owned fund of ₹ 2 crore.

Difference between Bank and NBFC

1. NBFC can't accept Demand Deposit
2. NBFC can't issue Cheques.
3. Deposits under NBFC are not covered by Deposit Insurance and Credit Guarantee Corporation.

Types of NBFC on basis of deposit

- NBFC-ND [Non-deposit taking NBFC]
  - NBFC - Non Deposit - Systematically Important [NBFC-ND-SI] → NBFC who has asset size of ₹ 500 crore or more. → Strict RBI Regulation regarding prudential norms, provisioning.
  - NBFC - Non Deposit Non Systematically Important [NBFC-ND-NSI] → Assets upto ₹ 500 crore. → Lighter RBI Regulation
- NBFC-D Deposit taking NBFC → All deposit taking NBFCs are automatically considered Systematically Important. → Stricter RBI regulations

NBFC's are governed and monitored by guidelines issued by RBI.

Supreme Court in its judgement ruled that state laws like Kerala Money Lender Act 1958, can't apply to NBFC registered with RBI.

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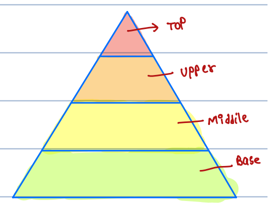
Scale Based Regulatory Framework



1. Base Layer
- which NBFC come under this
  - ↳ NBFC-ND - asset size upto ₹1000 crore.
  - ↳ Peer to Peer lending platform [Connect borrower & investor eg. Faircent]
  - ↳ Account Aggregators [collect & share financial data]
  - ↳ Non Operative Financial Holding Co. [hold control financial subsidiaries]
  - ↳ NBFC that doesn't interact with public
- Minimum regulation and simpler compliance.

2. Middle Layer
- Deposit taking NBFC
- Non deposit taking NBFC - asset size 1000 Cr or above.
- NBFC involved in
  - ↳ Standalone Primary Dealers [deal in govt securities]
  - ↳ Infrastructure Debt fund [finance long term projects]
  - ↳ Housing Finance Company
  - ↳ Infrastructure finance company [lending to infrastructure sector]

Higher Compliance and governance requirement compared to Base layer.

3. upper layer
- Top 10 NBFC by asset size will always be there.
- This NBFC require enhanced regulatory supervison.
- Strict oversight and higher compliance standard.

4. Top layer
- Top layer generally remains empty but may include NBFC from upper layer if RBI believes they pose substantial risk to economy.
- Highest level of regulation, supervision and scrutiny.

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Benefits of Incorporating NBFC

1. Competitive Interest Rate - Interest rate either equal or even lower to bank rates.

2. Quick processing - Eligibility Criteria at NBFC are flexible. This makes loan approval easier, smoother and quicker.

3. Less Rules and Regulations - Rules and regulation of lending are not as stringent (tough) as banks.

4. Last resort of borrowing - when financing needs are not met from bank, NBFC provide urgent financing needs.

5. Catering to Customer Needs - NBFC has ground level understanding of Customer's profile, and they get ability to customise their product according to client needs.

6. loan to Customers with low credit score or high risk borrower.

Imp.
Certain NBFC Exempt to register with RBI

Following are entities that provide financial services are exempt from registering as NBFC because they are regulated by other specialised authorities.

1. Housing finance Company [Regulated by National Housing Board]
2. Insurance Company [IRDAI]
3. Stock brokers, Venture Capital fund, Merchant Bankers, Mutual fund [SEBI]
4. Nidhi Company [CA 2013]
5. Chit fund Company [regulated by State govt]

Types of NBFC based on Activity

1. Asset Finance Company (AFC)
- AFC finance physical asset that supports economic activity like tractors, Industrial Machine, Vehicles, etc.
- Financial asset should be atleast 60% of total assets and income.
- Ex: Bajaj finance, Mahindra & Mahindra financial services.

2. Investment Company (IC)
- IC means NBFC company acquiring securities like shares, debentures and other financial instruments.
- Ex: Bajaj Finserv Ltd.

3. Infrastructure finance company (IFC)
- IFC deploy 75% of their assets in infrastructure loans.
- Minimum net worth of ₹ 300 crore, Credit rating of A
- CRAR [Capital to Risk-weighted Asset Ratio] of 15%.
- Ex: NBFC funding infrastructure projects like highway, airport, etc.

4. Infrastructure Debt fund
- Facilitate long term debt into infrastructure projects
- Raises money through issue of Rupee or Dollar denominated bond of 5 year maturity.
- Insurance and Pension fund invest money in their units and bonds.

5. Systematically Important Core Investment Company (CIC-ND-SI)
- Acquires shares and securities of group companies.
- Asset size of ₹ 100 crore or more.
- Hold atleast 90% of assets in form of equity shares, preference share, debenture or loans in group companies.
- Atleast 60% of assets in equity shares in group companies.

6. NBFC - Micro Finance Institution [NBFC-MFI]
- It is a non-deposit taking NBFC.
- Provide small loans not exceeding ₹ 125000 for Rural and 200000 for urban for households.
- Has Net owned fund of atleast ₹ 10 crore.
- of which 85% of net asset are of qualifying assets.

7. NBFC - Factor

These NBFC's are engaged in business of factoring, where they buy receivables or invoices from companies at discount.

50% of assets and income from factoring business.

8. Mortgage Guarantee Company (MGC)

- MGC provide mortgage guarantees to lenders in case borrowers default on home loans.
- Atleast 90% of business turnover is from mortgage guarantee
- business and minimum net owned fund of ₹ 100 crore.

9. Loan Company (LC)

- LC provide finance, such as loans or advances.
- LC do not include AFC.
- These NBFC gives personal loan or business loan.

10. Non Operative Financial Holding Company

- NBFC set up to hold securities of group company

11. Systematically Important Non Deposit taking NBFC [NBFC-ND-SI]

ND-NBFC with asset size ₹500 or more.

Incorporation and Registration of NBFC

1. Incorporate the company under CA 2013, with principle business in MOA as financing activity.

2. Register company with RBI u/s 45-IA of RBI Act 1934
   ↳ Qualify 50-50 test
   ↳ Have Net owned fund of ₹ 200 lakh or more

3. Registration procedure
   ↳ Submit application in specified form
   ↳ RBI may inspect books to verify compliance
   ↳ What RBI will ensure
      ↳ Directors with NBFC / Banking background
      ↳ Clean CIBIL Record
      ↳ Ability to pay Depositor
      ↳ Not conducted business in detrimental (bad) manner
      ↳ Adequate capital and earning prospects

4. RBI will issue certificate if all conditions are met, within 30 days.

Documents required for NBFC Registration

- Certificate of Incorporation
- Copy of extract of main object of MOA related to financial business.
- Board Resolution covering following points:
   - Company will not carry out NBFC activity until Registration.
   - No public deposit accepted or held [If NBFC-ND]
   - Formulated Fair Practice Code as per RBI guideline.
   - No customer interface without RBI approval.
- Copy of Fixed Deposit receipt & Banker certificate for ₹ 2 crore NOF requirement.
- Audited financial statements of past 3 years.
- Banker's report regarding details of deposit, loans, conduct of applicant company as well as group company.

II. Housing Finance Company

NBFC primarily engaged in providing home loans for purchase, construction, renovation or repairs of residential units.

Company qualifies as HFC, if
- it is a NBFC
- atleast 60% of total asset are financial asset.
- atleast 50% of total asset must be housing loans.

HFC is regulated by National Housing Board and operates under National Housing Bank Act, 1987.

Benefits of incorporating HFC

1. Housing finance creates direct and indirect jobs.
2. Boost demand for cement, brick, sanitary products and allied sectors.
3. Enhance (improves) rural infrastructure and labor migration.
4. Reducing congestion in cities through township development.
5. Better infrastructure drive creation of roads, electricity or more.
6. Rebuilding of old houses and remodelling existing one.

Registration requirement of HFC

1. Must be incorporated as company under CA 2013.
2. Register under section 29A of National Housing Bank Act, 1987.

Imp Key Eligibility Requirement

1. Registered under Companies Act
   Must be incorporated as company under CA 2013 or any early Companies Act.

2. Minimum Net owned fund
   It shall be noted that Net owned fund of HFC must be atleast ₹ 20 crore (subject to change by RBI)
   Under existing regulatory framework, National Housing Bank doesnot grant any exemption regarding minimum NOF requirement.

3. Housing finance Activity as Object clause
   Object mentioned in Object clause of MOA shall be financing housing loan, with provision for earlier prospects.

4. Management must work in good faith and in interest of company.

Condition for Cancellation of HFC license

1. Business Discontinuation - Ceases to carry on business of housing finance in India.

2. Non Compliance with NHB Terms & Condition
   - Failure to comply with Directions
   - Failure to maintain proper accounts
   - Failure to submit books & relevant documents.

3. Prohibition on acceptance of deposits and prohibition has been in force for 3 months.

III. Asset Reconstruction Company (ARC)

ARC is a bad bank, isolating NPA (Non Performing Assets) from bank's balancesheet, acquiring them at discounted price and recovering them through enforcement, settlement or liquidation.

This process is called "Securitisation".

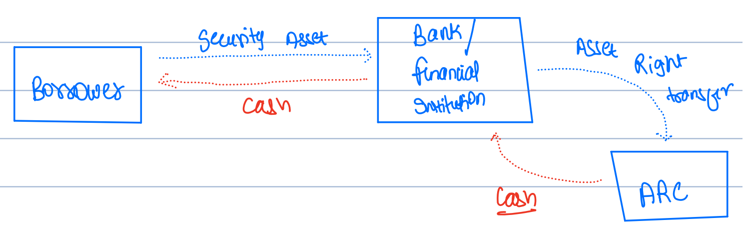
ARC should have minimum Net owned fund of ₹ 300 crore.

What is Securitisation?

Securitisation is the process whereby originator (Bank in our case) pools a group of financial assets (like loans, receivables) and transfer them to a legally separate entity (ARC in our case), typically a Special Purpose Vehicle (SPV), which then issues securities to investors.

ARC acquire bad loans / assets from banks. Then ARC issues Security receipts (SR) to investors. SR represents share of overall pool of these bad assets. This allow ARC to raise money from investor.

How ARC operate?



Banks sell NPA to ARC at discount.

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ARC recover through various methods
- Reschedule debt
- Selling or leasing assets
- Changing management
- Enforce security, take possession of assets.

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They also Negotiate with borrower for dues settlement.

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Recover more than purchase price, generate profit.

Imp. Contribution of ARC in improving health of bank
OR
functions of ARC

1. Improved banking system : ARC buys bad loans, allow them to focus on core activities.

2. Clean Bank Balancesheet : Stronger financial system with reduced NPA.

3. Strengthen Liquidity and Economy : By selling NPA, banks recieve immediate funds for fresh lending and other productive purposes.

4. Expertise in Loan Resolution & Restructuring : ARC being industry expertise in resolving and restructuring loans.

5. Maximised Recovery Value : ARC work efficiently to maximise recovery value while minimising cost

6. Profit opportunity : ARC buys NPAs cheap and recover more through their expertise

IV. Micro finance Institution [MFI]

MFI are those institutions that provide small financial services such as loans, deposits, money transfers and insurance
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to low income populations (annual income upto ₹300000), helping them access financial services that traditional banks often do not offer due to high risk involved.

MFI must have minimum Net Owned fund of ₹ 10 crore.

Amount of loan – upto ₹ 1,25,000 for Rural household.
upto ₹ 2,00,000 for Urban household.

Characteristics of MFI

1. Size of loan by MFI is small.
2. Repayment Period is short.
3. No collateral for loan required.
4. Purpose of use of loan is flexible.
5. Loan are usually given to group then money distributed within group (eg- given to Company → employees).
6. Transaction cost is low, due to group lending.
7. MFI raises funds from internal sources (capital, profit or external sources (loans, investment).

V. Nidhi Company

Pursuant to section 406 of CA 2013, Nidhi is a company incorporated with objective of :

- Cultivating habit of thrift (carefulness) and savings amongs its members.
- Receiving deposits from its members,
- Providing loans to its members for mutual benefit.

Characteristics of Nidhi Company

1. Business only with members, to become member, subscribe shares worth ₹ 100.
2. Preference shares can't be issued.
3. Branch Operation – apply Rule 10 (chapter 2)
   - upto 3 branch within district no approval
   - more than 3 or outside district, prior approval of Regional Director (RD) is required.
   - Can't open branch outside state.
   - RD approval for closing branch.
4. Register as Public Company with minimum paid up equity of ₹ 10,00,000.
5. Loans and Deposit only from / to member.
6. Director must be member with maximum term of 10 consecutive years (2 years cooling before reappointment)
7. Dividend – declare maximum 25% dividend on Net profit.

Restrictions or Prohibition on Nidhi

1. Nidhi shall not engage in other business like Chit fund, hire purchase, insurance, investment.
2. Nidhi shall not open any current account.
3. Shall not acquire another company unless special resolution is passed and approval from RD is obtained.
4. Shall not carry another business.
5. Nidhi shall not deal with non-members.
6. Shall not issue advertisement for soliciting deposit.
7. Pledge any of asset lodged by member as security.

V.Imp

Benefits of Incorporating a Nidhi Company

1. Mobilizes (Pool) small saving
   - Caters to middle class, encourage saving.
   - Speedy loan disbursement, especially for urgent needs.
2. Guaranteed Repayment
   - loans are secured, minimizing default risk.
   - Peer pressure ensures borrowers repay on time.
3. Attractive Investment Opportunity
   - Higher rate on deposit compared to bank, appealing for senior citizen.
4. Credibility of leadership / professional management
   - Board comprises experienced & respected persons.
   - Builds trust and confidence among borrower and depositors.

VI. Payment Bank

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Meaning (Introduction)

- A new banking model in India by Reserve Bank of India (RBI) to widen access to financial services.
- These banks can accept restricted deposit, which is currently limited to ₹ 2 lakh and may be increased further.
- Bank can pay interest on these deposits just like saving a/c.
- Both current account and saving account can be operated.
- Payment banks have different bank license than a commercial bank license, in particular they can't lend (loan) or issue credit card.
- It can provide services like ATM, Debit card, Net banking, mobile banking.
- Main objective of payment bank is to widen spread of financial services to small business, low income household through use of technology driven environment.
- To open a bank account, application process of PB is very easy. Accounts can be instantly opened by providing details like Aadhar Number with KYC.

Example: Paytm Payment Bank, Airtel Payment Bank, Jio payment bank

Incorporation and Registration of Payment Bank

1. Incorporate a company under Company Act 2013.
2. Application with RBI for payment bank license.

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Terms and Conditions for running Payment Bank

1. Public company registered under Companies Act 2013.
2. Minimum capital of ₹ 100 crore.
3. Payment bank can't form subsidiaries.
4. For first 5 years, promoters ownership must remain 40% minimum.
5. Foreign shareholding permitted as per FDI norms.
6. Any share acquisition more than 5% require RBI approval.
7. Lending activity not allowed.
8. Use of "Payment bank" term is mandatory.
9. Atleast 25% of branches must be in unbanked rural areas.

VII. Mudra Banks (Micro Unit Development and Refinance Agency Bank)

Mudra Bank is public sector financial institution providing low interest loan to Micro finance Institution and NBFC

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which then lends to MSME.

Pradhan Mantri Mudra Yojna (PMMY) launched by Narendra Modi on 8th Apr 2015.

Flow of loan process

Stage 1	→	Stage 2	→	Stage 3
MSME apply for loan to MFI, NBFC or Bank under PMMY scheme.		MFI, NBFC, Bank accept the application and disburse loan to MSME from their own funds.		Once they disburse loan, apply to Mudra bank for refinancing.

Under Mudra Scheme, Govt aims to support young, skilled workers and entrepreneurs.

There are three loan categories
- Shishu - Loan upto ₹ 50,000
- Kishore - Loan upto ₹ 5,00,000
- Tarun - Loan upto ₹ 10,00,000

Eligible for this scheme
- Small and New Business
- age 18 years minimum
- loans only for commercial / business use

Imp.

Mudra Card

- Mudra Card is debit card issued against mudra loan a/c specifically for working capital loan.
- It allows borrower to make multiple withdrawal and credit to manage working capital efficiently while keeping interest burden minimum.
- It can be used across country to withdraw cash from any ATM and make payment through any point of sale (POS) machine.

Purpose (use) of Mudra Loan

(1) Business loan
(2) Working Capital loan
(3) Agri Allied loan
(4) Equipment Finance
(5) Transport Vehicle Loans

VIII. Chit Funds

A chit fund is saving scheme where group of investors pool their money together, with promise of guaranteed return within specific time frame.

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Relevant Statute governing Chit Funds

1. Chit funds Act 1982
2. Tamil Nadu Chit funds Act, 1961
3. The Chit funds (Karnataka) Rules, 1983
4. Delhi Chit fund Rules, 2007
5. Maharashtra chit fund Act, 1975
6. West Bengal Protection of Interest of Depositors in Financial Establishment Bill, 2013
7. Prize Chits and Money Circulation Schemes (Banning) Act 1978

V.Imp.

Restrictions imposed by RBI on Chit fund Business

1. It should be a company incorporated under companies Act 2013. No partnership firm or family can run chit fund business.
2. Chit fund company must be registered with Chit funds Act 1982 and Registrar of Chit Company in every state.
3. Maximum discount that could be taken in bid was restricted to 40% of total chit amount.
4. Mandatory to keep one month's chit amount of all subscribers with RBI till end of particular chit.
5. Details of each and every chit must be furnished to RBI along with personal particulars of subscribers.

V.Imp.

Calculation of Net Owned Formula

According to explanation, Net Owned fund means

(a) Aggregate of Paid up equity capital and free reserves as disclosed in latest balancesheet, after deducting therefrom
   (i) accumulated balance of loss
   (ii) deferred revenue expenditure
   (iii) Other intangible assets

(b) further reduced by amounts representing
   (i) Investment in shares of - its subsidiaries
   - Company in same group
   - all other HFC

   (ii) book value of debenture, bond, advances, deposit made with subsidiary or other group company

to the extent such amount exceeds 10% of (a) above.