

### KEY CONCEPTS

■ Non-Banking Finance Companies (NBFCs) ■ Chit Funds ■ Housing Finance Companies ■ Asset Reconstruction Companies (ARCs) ■ Micro Finance Institutions (MFI's) ■ Nidhi ■ Payment Banks ■ Mudra Banks

### Learning Objectives

#### To understand:

- Different forms of Financial Services Organisations operating in India
- Categories of:-
  - NBFCs
  - Housing Finance Companies (HFC's)
  - Asset Reconstruction Companies (ARC's)
  - Micro Finance Institutions (MFI's)
  - Nidhi Companies and Payment Banks
  - Chit Funds
- Benefits of such Financial Services Organisation
- Procedure involved in formation of Financial Services Organisation

### Lesson Outline

- Introduction
- Non Banking Financial Company
- Scale Based Regulatory Framework For NBFCs
- Types/categories of NBFC's
- Benefits of incorporating an NBFC
- Difference between Banks & NBFCs
- Process of incorporation of NBFC
- Housing Finance Companies
- Benefits of incorporating a Housing Finance Company
- Housing Finance Company : Registration Process
- Asset Reconstruction Company (ARC)
- Benefits of incorporating an Asset Reconstruction Company (ARC)
- Asset Reconstruction Company – the Registration Process
- Micro Finance Institutions (MFI)
- Incorporation of MFI
- Nidhi and Benefits of incorporating a Nidhi
- Incorporation of a Nidhi Company
- Payment Banks
- Mudra Banks
- Chit Funds
- Lesson Round-Up
- Test Yourself
- List of Further Readings
- Other References

**REGULATORY FRAMEWORK**

- The Companies Act, 2013
  - Section 406-Nidhi Company
- Nidhi Rules, 2014
- RBI Act,1934
- National Housing Bank, 1987
- Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SRFAESI) Act, 2002
- Chit Funds Act, 1982

**INTRODUCTION**

India has a diversified financial sector undergoing rapid expansion, both in terms of strong growth of existing financial services firms and new entities entering the market. The sector comprises commercial banks, insurance companies, non-banking financial companies, co-operatives, pension funds, mutual funds and other smaller financial entities. The banking regulator has allowed new entities such as payments banks to be created recently thereby adding to the types of entities operating in the sector. However, the financial sector in India is predominantly a banking sector with commercial banks accounting for more than 64 per cent of the total assets held by the financial system.

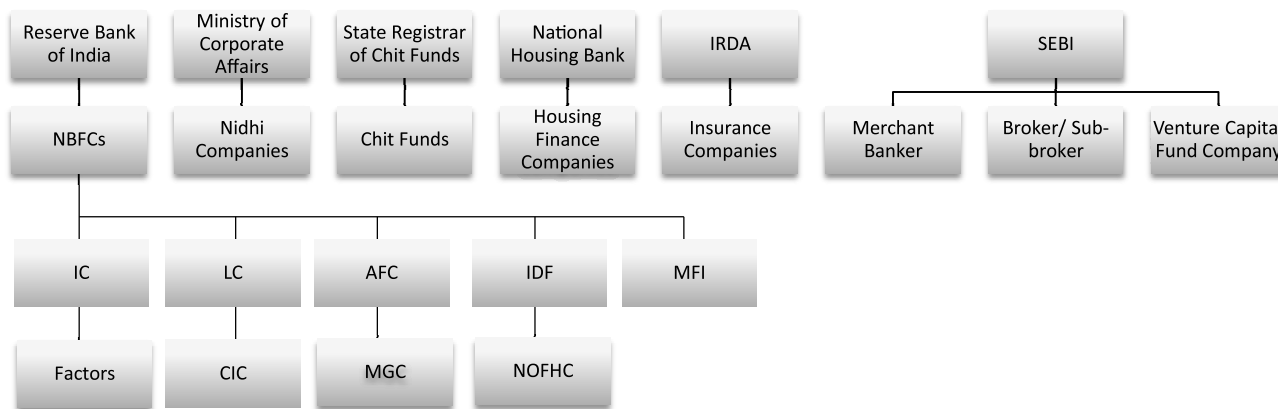
NBFC is a financial Institution that is into Lending or Investment or collecting monies under any scheme or arrangement but does not include any institutions which carry on its principal business as agriculture activity, industrial activity, trading and purchase or sale of immovable properties. A company that carries on the business of accepting deposits as its principal business is also a NBFC.

The Government of India has introduced several reforms to liberalise, regulate and enhance this industry. The Government and Reserve Bank of India (RBI) have taken various measures to facilitate easy access to finance. These measures include (to name a few) launching different categories of Non Banking Finance Companies (NBFCs), Asset Reconstruction Companies (ARCs) and Micro Finance Institutions (MFIs).With a combined push by both government and private sector, India is undoubtedly one of the world’s most vibrant capital markets.

Over the years, Non Banking Financial Companies (NBFC’S), Housing Finance Companies (HFC’s), Asset Reconstruction Companies (ARC’s), Micro Finance Institutions (MFI’s), and Nidhi Companies have played a dominant role in mobilisation and disbursal of funds.

With the advent of mobile technology and vast strides made by the country in the field of information technology, Payment Banks has emerged as a new model of banks conceptualised by the Reserve Bank of India (RBI).

**Financial Services Organisations Structure in India:**



IC – Investment Company  
 AFC- Asset Finance Company  
 LC – Loan Company  
 IFC - Infrastructure Finance Company  
 CIC - Core Investment Company  
 MGC - Mortgage Guarantee Company  
 IDF- Infrastructure Debt Fund  
 MFI – Micro Finance Institution  
 NOFHC - Non-Operative Financial Holding Company

### NON BANKING FINANCIAL COMPANY

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 2013 (or any earlier enactments) engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire- purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in instalments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

Financial activity as principal business is when a company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria will be registered as NBFC by RBI. Interestingly, this test is popularly known as 50-50 test and is applied to determine whether or not a company is into financial business.

NBFCs lend and make investments and hence their activities are akin to that of banks; however there are a few differences as given below:

- i. NBFC cannot accept demand deposits;
- ii. NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself;
- iii. deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

### Systemically important NBFCs

NBFCs whose asset size is of Rs. 500 cr or more as per last audited balance sheet are considered as systemically important NBFCs. The rationale for such classification is that the activities of such NBFCs will have a bearing on the financial stability of the overall economy.

In the wake of failure of several banks in the late 1950s and early 1960s in India, large number of ordinary depositors lost their money. At this time, the Reserve Bank did note that there were deposit taking activities undertaken by non-banking companies. Though they were not systemically as important as the banks, the Reserve Bank initiated regulating them, as they had the potential to cause pain to their depositors. These institutions have thus been under the regulatory oversight of the Reserve Bank of India since 1963. Since then regulation has generally kept pace with the dynamism displayed by the sector. Later in 1996, in the wake of the failure of a big NBFC, the Reserve Bank tightened the regulatory structure over the NBFCs, with rigorous registration requirements, enhanced reporting and supervision.

In November 2014, the entire regulatory framework was reviewed with a view to transitioning, over time, to an activity based regulation of NBFCs. As a first step in this direction, certain changes to the regulatory framework are sought to be made to:

- (a) address risks wherever they exist,
- (b) address regulatory gaps and arbitrage arising from differential regulations, both within the sector as well as *vis-a-vis* other financial institutions,
- (c) harmonise and simplify regulations to facilitate a smoother compliance culture among NBFCs, and
- (d) strengthen governance standards.

### Regulatory and Supervisory Framework

The Regulatory and Supervisory Framework of the Reserve Bank provides for, among other things, registration of NBFCs, prudential regulation of various categories of NBFC, issue of directions on acceptance of deposits by NBFCs and surveillance of the sector through off-site and on-site supervision. Deposit taking NBFCs and Systemically Important Non-Deposit Accepting Companies are subjected to a greater degree of regulation and supervision. The focus of regulation and supervision is three fold, viz.,

- a) depositor protection,
- b) consumer protection and
- c) financial stability.

The Reserve Bank has also been empowered under the RBI Act, 1934 to take punitive action which includes cancellation of Certificate of Registration, issue of prohibitory orders from accepting deposits, filing criminal cases or winding up petitions under provisions of Companies Act in extreme cases.

#### ***Nedumpilli Finance Company v. State of Kerala***

In this case, the Supreme Court of India upheld the supremacy of the Reserve Bank of India over the supervision and regulation of NBFCs registered under the RBI Act, 1934.

The legislatures of Kerala and Gujarat had sought to bring NBFCs under the ambit of their respective legislations (the Kerala Money Lenders Act, 1958 and the Gujarat Money-Lenders Act, 2011) to regulate the interest rate charged by moneylenders and protect borrowers. However, on 10th May, 2022, the Hon'ble Supreme Court held that state enactments regulating the business of moneylending would have no application on non-banking finance companies (NBFCs) registered with, and regulated by, the Reserve Bank of India (RBI).

In its final judgment, the Apex Court held that Chapter III-B of RBI Act, 1934 (dealing with NBFCs) is a complete code in itself as regards regulation of NBFCs. In addition to this, the RBI Act has provisions which override other state laws.

This implies that NBFCs are totally under the purview of the RBI Act, and only the Central bank has the powers to regulate the NBFCs registered with it. Previously, there used to be tussles between the RBI and state governments over certain aspects of NBFC regulation.

### Scale Based Regulatory Framework for NBFCs

Non-banking Finance Companies (NBFCs) plays a pivotal role in the economic growth of the country. The NBFC sector has undergone a significant transformation over the years and has created its own niche in supplying credit to retail customers in the relatively under-served and un-banked areas. In October 2021, RBI notified scale-based regulations for NBFCs, which is effective from 1st October, 2022. With these regulations, RBI aims to increase transparency in NBFC operations through greater disclosures and improved governance standards.

The revised framework envisages a progressive increase in the intensity of regulation and is thus visualized as a four-layer pyramid - a base layer, middle layer, upper layer, and top layer. With each layer, regulations become stricter.

**Base Layer:** The Base Layer shall comprise of non-deposit taking NBFCs below the asset size of Rs.1000 crore, Peer to Peer Lending Platform, Account Aggregator, Non-Operative Financial Holding Company and NBFCs not availing public funds and not having any customer interface.

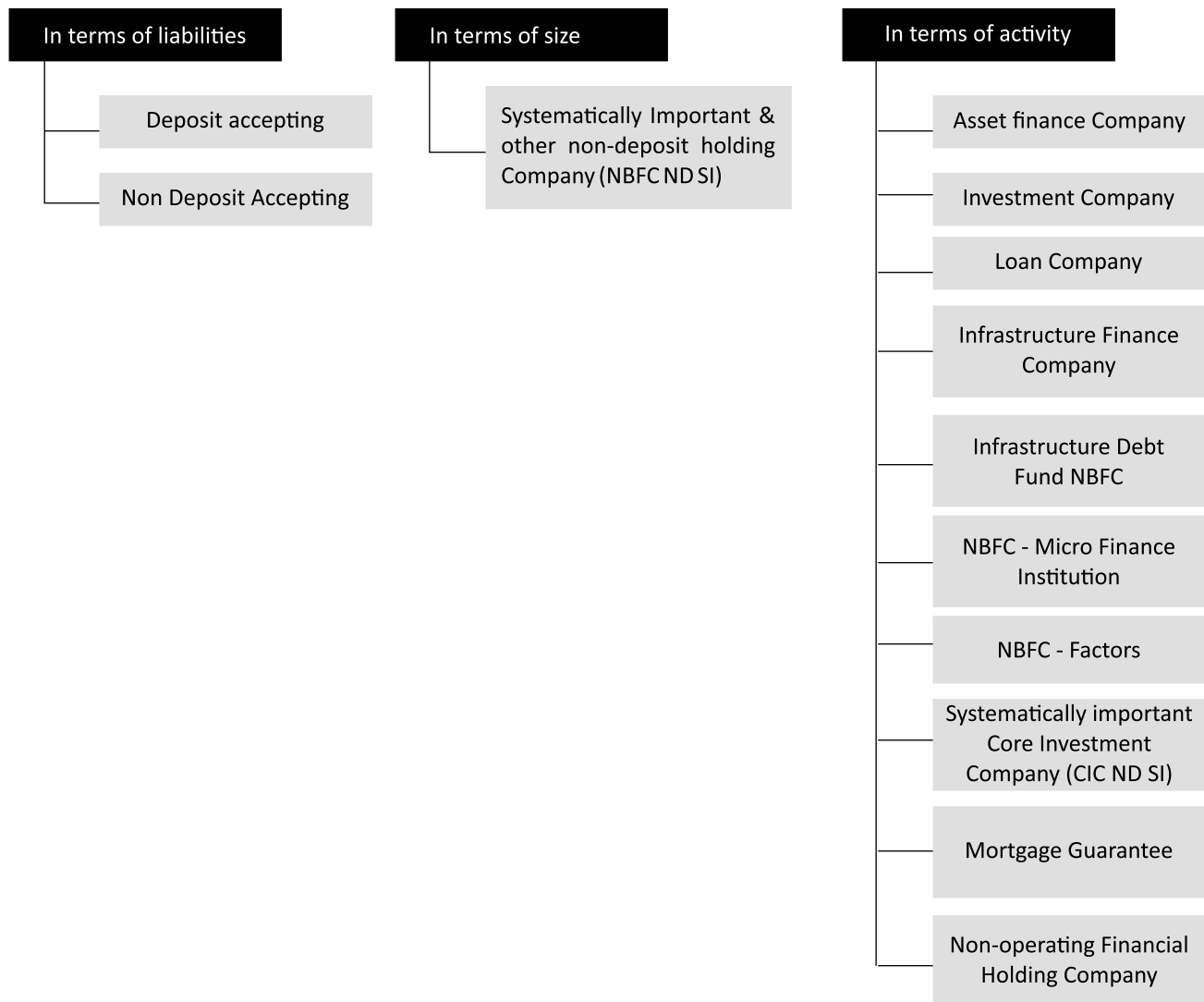
**Middle Layer:** The Middle Layer shall consist of all deposit taking NBFCs, non-deposit taking NBFCs with asset size of Rs.1000 crore and above and NBFCs undertaking the activities of Standalone Primary Dealers, Infrastructure Debt Fund, Core Investment Companies, Housing Finance Companies and Infrastructure Finance Companies.

**Upper Layer:** The Upper Layer comprise of those NBFCs which require enhanced regulatory supervision. The top ten eligible NBFCs in terms of their asset size shall always reside in the upper layer, irrespective of any other factor.

**Top Layer:** The Top Layer is empty. This layer can get populated if the Reserve Bank is of the opinion that there is a substantial increase in the potential systemic risk from specific NBFCs in the Upper Layer. Such NBFCs shall move to the Top Layer from the Upper Layer.

**TYPES/CATEGORIES OF NBFCS**

NBFCs are categorized as:



Within this broad categorization the different types of NBFCs are as follows:

**I. Asset Finance Company (AFC)**

An AFC is a company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/economic activity, such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines. Principal business for this purpose is defined as aggregate of financing real/physical assets supporting economic activity and income arising therefrom is not less than 60% of its total assets and total income respectively.

**II. Investment Company (IC)**

IC means any company which is a financial institution carrying on as its principal business the acquisition of securities.

**III. Loan Company (LC)**

LC means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.

**IV. Infrastructure Finance Company (IFC)**

IFC is a non-banking finance company -

- (a) which deploys at least 75 per cent of its total assets in infrastructure loans;
- (b) has a minimum Net Owned Funds of Rs.300 crore;
- (c) has a minimum credit rating of 'A' or equivalent; and
- (d) a CRAR of 15%.

**V. Systemically Important Core Investment Company (CIC-ND-SI)**

CIC-ND-SI is an NBFC carrying on the business of acquisition of shares and securities which satisfies the following conditions:-

- (a) 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;
- (b) its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not less than 60% of its Total Assets;
- (c) 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;
- (d) it does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the RBI Act, 1934 except investment in bank deposits, money market instruments, government securities, loans to and investments in debt issuances of group companies or guarantees issued on behalf of group companies;
- (e) Its asset size is Rs. 100 crore or above; and
- (f) It accepts public funds.

**VI. Infrastructure Debt Fund: Non-Banking Financial Company (IDF-NBFC)**

IDF-NBFC is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects. IDF-NBFC raise resources through issue of Rupee or Dollar denominated bonds of minimum 5-year maturity. Only Infrastructure Finance Companies (IFC) can sponsor IDF NBFCs.

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. Such take-over of loans from banks would be covered by a Tripartite Agreement between the IDF, Concessionaire and the Project Authority for ensuring a compulsory buyout with termination payment in the event of default in repayment by the Concessionaire.

**VII. Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI)**

“Non-Banking Financial Company – Micro Finance Institution (NBFC-MFI)” means a non-deposit taking NBFC (other than a company formed and registered under section 25 of the Companies Act, 1956 or Section 8 of the Companies Act, 2013) that fulfils the following conditions:

- (a) Reserve Bank of India specifies ten crore rupees as net owned fund (NOF) requirement for NBFC-MFI with effect from October 01, 2022. However, existing non-banking financial companies holding a certificate of registration as on October 22, 2021 issued by the Reserve Bank of India and having net owned fund of less than ten crore rupees, shall achieve the NOF of Rs.10 crore as per the following glide path:
  - Rupees 7.00 Crores by March 31, 2025
  - Rupees 10.00 Crores by March 31, 2027
- (b) Not less than 85% of its net assets are in the nature of “qualifying assets” which satisfy the following criteria:
  - i. Loan which is disbursed to a borrower with household annual income not exceeding Rs. 1,25,000 and Rs. 2,00,000 for rural and urban/semi-urban households, respectively;
  - ii. Loan amount does not exceed Rs 75,000 in the first cycle and Rs 1,25,000 in subsequent cycles;
  - iii. Total indebtedness of the borrower does not exceed Rs 1,25,000 (excluding loan for education and medical expenses);
  - iv. Minimum tenure of 24 months for loan amount exceeding Rs 30,000;
  - v. Collateral free loans without any prepayment penalty;
  - vi. Minimum 50 per cent of aggregate amount of loans for income generation activities; and
  - vii. Flexibility of repayment periodicity (weekly, fortnightly or monthly) at borrower’s choice.

**VIII. Non-Banking Financial Company – Factors (NBFC-Factors)**

NBFC-Factor is a non-deposit taking NBFC engaged in the principal business of factoring. The financial assets in the factoring business should constitute at least 50 percent of its total assets and its income derived from factoring business should not be less than 50 percent of its gross income.

**IX. Mortgage Guarantee Companies (MGC)**

MGC are financial institutions for which at least 90% of the business turnover is mortgage guarantee business or at least 90% of the gross income is from mortgage guarantee business and net owned fund is Rs 100 crore.

**X. NBFC- Non-Operative Financial Holding Company (NOFHC)** is financial institution through which promoter/ promoter groups will be permitted to set up a new bank. It's a wholly-owned Non-Operative Financial Holding Company (NOFHC) which will hold the bank as well as all other financial services companies regulated by RBI or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.

**XI. Systemically important non-deposit taking non-banking financial company** means a non-banking financial company not accepting / holding public deposits and having total assets of Rs 500 crore and above as shown in the last audited balance sheet;

**BENEFITS OF INCORPORATING AN NBFC**

According to research and studies it is proved that NBFCs are outperforming banks. The continued better performance from NBFCs has given rise to an uptick of 15% customer satisfaction as compared to the banking customers. The same is agreed by the RBI according to the recent Financial Stability Report. Banks and Non-Banking Financial Companies (NBFCs) are financial intermediaries and the services offered by them are pretty much the same as banks. However, the benefits of incorporating an NBFC and carrying on its activities are listed below:

**1. Competitive Interest Rates**

Rate of interest is one of the main aspects of all types of loans. Non-Banking Financial Sectors have started to concentrate on this area in the recent decades and have brought down the interest rates to either equal to bank lending rates or at times even lower to bank rates. With all the other benefits when rate of interest is also lowered, borrowers found this more easy and affordable. This has also resulted in lower EMI (Equated Monthly Instalment) for borrowers. Based on the income, credit scoring and repayment, rate of interest is charged on the borrowers However it is at competitive rates.

**2. Quick Processing**

At banks, it is very important that the applicant should fulfil the eligibility criteria but NBFC are lenient in this aspect. This makes loan approval easier, smoother process and quicker. Most of the times, people apply for loan when they are in immediate need of money. NBFCs have taken this as an opportunity to meet the demand by quickly processing the loans at competitive rate of interest. At times, borrowers are even ready to compromise on the interest rates if the loan amount is huge and if they could get it approved quickly.

**3. Less Rules and Regulations**

As NBFC are incorporated under the Companies Act, (though regulated by the Reserve Bank of India), the rules and regulations for lending are not as stringent as banks. This helps borrowers to get loans easily. In view of less complicated loan processing requirements, borrowers are highly satisfied. Of course, the risk of default is high with NBFC and thus interest rates and other charges will be according priced by the NBFC. Even the loan amount approved will be quite lesser than the collateral value. This is due to the high risk of default. NBFCs do not have statutory reserve ratios and can open branches at will.

#### 4. Last Resort of Borrowing

NBFCs are the largest propellants of ushering finance into the country. They are the last resorts of borrowing. Further, Agility is a key feature for NBFCs as it sets the banks apart. Banks functions slower as compared to the NBFCs.

#### 5. Caters Customer needs

Another major advantage of NBFCs is the ground level understanding of their customer's profile and the need for their credit, which gives them an edge, as their ability to customize their products according to client needs. The continued better performance from NBFCs has given rise to an uptick of 15% customer satisfaction.

#### 6. Loan available for Individuals with Poor Credit Rating

Individuals with poor credit rating generally will not get loans from banks. The reason for this is banks consider borrowers are high-risk individuals if the credit scoring is low. Unless the credit score is above 600 -650, it is very difficult to get a loan sanctioned from banks. On the other hand, loans will be offered to individuals with low credit score by NBFCs but most of the time the interest rates for such borrowers will be higher than market rates. Due to these aforementioned advantages, most of the NBFCs are growing.

With regard to offering loans, banks and NBFCs will offer business, personal and retail loans. And this is totally on the basis of the repayment capacity of the borrower. Most of the corporate sector prefers banks; however retail sector chooses NBFCs over banks. Simple loans such are vehicle financing loans, gold loans, home loans and durable loans are offered by NBFCs and customer satisfaction ratio is high here. NBFC sector is also set to expand even further in the coming days.

### DIFFERENCE BETWEEN BANKS & NBFCs

Sl. No.	Particulars	Banks	NBFCs
1.	Definition	Banking is acceptance of deposits withdrawable by cheque or demand; NBFCs cannot accept demand deposits	NBFC is a financial Institution that is into Lending or Investment or collecting monies under any scheme or arrangement
2.	Regulations	BR Act, 1949 and RBI Act, 1934 lay down stringent controls over banks	Governed by Companies Act, 2013 and RBI Act, 1934
3.	Scope	Scope of business for banks is limited by sec 6 (1) of the BR Act	There is no bar on NBFCs carrying activities other than financial activities
4.	Registration and Licensing	Licensing requirements are quite stringent. Transfer of shareholding is controlled by RBI	Formation of NBFC is easy. Acquisition of NBFCs is procedurally regulated and are subject to approval
5.	Loan Sanction Process	Comparatively Stringent	Easier and faster
6.	Restrictions on business	No non-banking activities can be carried	Cannot provide checking facilities

<b>Sl. No.</b>	<b>Particulars</b>	<b>Banks</b>	<b>NBFCs</b>
7.	Overdraft Facility	Available in some banks	Not available
8.	Privileges	Can exercise powers of recovery under SARFAESI and DRT law	None, except 196 NBFC, specified by Central Government, have powers under SARFAESI or DRT law
9.	Foreign investment	Up to 74% allowed to private sector banks	Up to 100% allowed (only 18 activities)
10.	Maintenance of Reserve Ratios	It is compulsory for banks to maintain reserve ratios	NBFC-Ds have to maintain a certain ratio of deposits in specified securities; no such requirement for non-deposit taking companies
11.	Priority sector lending requirements	Certain minimum exposure to priority sector required	Priority sector norms are not applicable to NBFCs

### INCORPORATION OF NBFCs

The enactment of Companies Act, 2013 impacted many areas including banks and NBFCs. However, there have been no major changes in incorporating the NBFCs under the new act. Accordingly, Non-Banking Financial Companies (NBFCs) are companies incorporated under Companies Act, 2013 or Companies Act, 1956.

The procedure for incorporating a Non-Banking Finance Company (NBFC) is the same as any other company through web form SPICE+. Their principal business, to be stated in the MOA, while registering under the Companies Act shall be lending credit, making investments in various types of shares and stocks, leasing, hire-purchase, insurance business, chit business, and receiving deposits under any scheme or arrangement.

### Registration Process with Reserve Bank of India

In terms of Section 45-IA of the RBI Act, 1934, no non-banking financial company shall commence or carry on the business of a non-banking financial institution without–

- (a) obtaining a certificate of registration issued by the Bank; and
- (b) having the net owned fund of twenty-five lakh rupees or such other amount, not exceeding hundred crore rupees, as the Bank may, by notification in the Official Gazette, specify.

Further, in terms of the powers given to the Reserve Bank, to obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI viz. Venture Capital Fund/Merchant Banking companies/Stock broking companies registered with SEBI, Insurance Company holding a valid Certificate of Registration issued by IRDA, Nidhi companies as notified under Section 620A of the Companies Act, 1956 or formed under section 406 of the Companies Act, 2013, Chit companies as defined in clause (b) of Section 2 of the Chit Funds Act, 1982, Housing Finance Companies regulated by National Housing Bank, Stock Exchange or a Mutual Benefit company.

**Note:** Under the Companies (Amendment) Act, 2017, Nidhi Companies are required to be notified by the Central Government as such. This is similar to the provisions of Section 620A of the Companies Act, 1956.

### Registration Procedure

After incorporation of the company, the NBFC must obtain certificate of registration. Before applying for registration, the company should ensure the following:

- (a) It should have minimum one director from NBFC background or senior Bankers as full-time director in the company
- (b) Clean CIBIL records
- (c) Understanding of NBFC / Finance business.

Every non-banking financial company shall make an application for registration to the Bank in such form as the Bank may specify.

The Bank, for the purpose of considering the application for registration, may require to be satisfied by an inspection of the books of the non-banking financial company or otherwise that the following conditions are fulfilled:—

- (a) that the non-banking financial company is or shall be in a position to pay its present or future depositors in full as and when their claims accrue;
- (b) that the affairs of the non-banking financial company are not being or are not likely to be conducted in a manner detrimental to the interest of its present or future depositors;
- (c) that the general character of the management or the proposed management of the non-banking financial company shall not be prejudicial to the public interest or the interests of its depositors;
- (d) that the non-banking financial company has adequate capital structure and earning prospects;
- (e) that the public interest shall be served by the grant of certificate of registration to the nonbanking financial company to commence or to carry on the business of India;
- (f) that the grant of certificate of registration shall not be prejudicial to the operation and consolidation of the financial sector consistent with monetary stability, and economic growth considering such other relevant factors which the Bank may, by notification in the Official Gazette, specify; and
- (g) any other condition, fulfilment of which in the opinion of the Bank, shall be necessary to ensure that the commencement of or carrying on of the business in India by a non-banking financial company shall not be prejudicial to the public interest or in the interests of the depositors.

The Bank may, after being satisfied that the above specified conditions are fulfilled, grant a certificate of registration subject to such conditions which it may consider fit to impose.

The Bank cancel a certificate of registration granted to a non-banking financial company under this section if such company—

- (i) ceases to carry on the business of a non-banking financial institution in India; or
- (ii) has failed to comply with any condition subject to which the certificate of registration had been issued to it; or
- (iii) at any time fails to fulfil any of the conditions referred to in clauses (d) to (g) of sub-section (4); or
- (iv) fails—
  - (a) to comply with any direction issued by the Bank under the provisions of this Chapter; or

- (b) to maintain accounts in accordance with the requirements of any law or any direction or order issued by the Bank under the provisions of this Chapter; or
- (c) to submit or offer for inspection its books of account and other relevant documents when so demanded by an inspecting authority of the Bank; or
- (v) has been prohibited from accepting deposit by an order made by the Bank under the provisions of this Chapter and such order has been in force for a period of not less than three months:

Provided that before cancelling a certificate of registration on the ground that the non-banking financial company has failed to comply with the provisions of clause (ii) or has failed to fulfil any of the conditions referred to in clause (iii) the Bank, unless it is of the opinion that the delay in cancelling the certificate of registration shall be prejudicial to public interest or the interest of the depositors or the non-banking financial company, shall give an opportunity to such company on such term as the Bank may specify for taking necessary steps to comply with such provision or fulfilment of such condition:

Provided further that before making any order of cancellation of certificate of registration, such company shall be given a reasonable opportunity of being heard.

A company aggrieved by the order of rejection of application for registration or cancellation of certificate of registration may prefer an Appeal, within a period of thirty days from the date on which such order of rejection or cancellation is communicated to it, to the Central Government and the decision of the Central Government where an appeal has been preferred to it, or of the Bank where no appeal has been preferred, shall be final:

Provided that before making any order of rejection of appeal, such company shall be given a reasonable opportunity of being heard.

### **Procedure for filing application with Reserve Bank of India**

1. The applicant company is required to apply online and submit a physical copy of the application along with the necessary documents to the Regional Office of the Reserve Bank of India.
2. The application can be submitted online by accessing RBI's secured website <https://cosmos.rbi.org.in>. At this stage, the applicant company will not need to log on to the COSMOS application and hence user ids are not required.
3. The company can click on "CLICK" for Company Registration on the login page of the COSMOS Application. A window showing the Excel application form available for download would be displayed. The company can then download suitable application form (i.e. NBFC or SC/RC) from the above website, key in the data and upload the application form.
4. The company may note to indicate the correct name of the Regional Office in the field "C-8" of the "Annex- Identification Particulars" in the Excel application form. The company would then get a Company Application Reference Number (CARN) for the CoR application filed on-line.
5. Thereafter, the company has to submit the hard copy of the application form (indicating the online Company Application Reference Number) along with the supporting documents, to the concerned Regional Office.
6. The company can then check the status of the application from the above mentioned secure address, by keying in the acknowledgement number.

Certain documents are also required to be filed with the application with the Reserve Bank of India for registration. These are listed below.

**Note:** The documents required may vary depending on the category of registration sought by the applicant.

### Documents required for registration as Type I - NBFC-ND

Sr. No.	<i>Requirements to be complied with and documents to be submitted to RBI by Companies for obtaining certificate and Registration from RBI as NBFC</i>
1	Certified copies of Certificate of Incorporation and Certificate of Commencement of Business in case of public limited companies.
2	Certified copies of extract of only the main object clause in the MOA relating to the financial business.
3	Board resolution stating that: <ul style="list-style-type: none"> <li>● the company is not carrying on any NBFC activity/stopped NBFC activity and will not carry on/commence the same before getting registration from RBI</li> <li>● the UIBs in the group where the director holds substantial interest or otherwise has not accepted any public deposit in the past /does not hold any public deposit as on the date and will not accept the same in future</li> <li>● the company has formulated “Fair Practices Code” as per RBI Guidelines</li> <li>● the company has not accepted public funds in the past/does not hold any public fund as on the date and will not accept the same in the future without the approval of Reserve Bank of India</li> <li>● the company does not have any customer interface as on date and will not have any customer interface in the future without the approval of Reserve Bank of India</li> </ul>
4	Copy of Fixed Deposit receipt & bankers certificate of no lien indicating balances in support of NOF
5	For companies already in existence, the Audited balance sheet and Profit & Loss account along with directors & auditors report or for the entire period the company is in existence, or for last three years, whichever is less, should be submitted
6	Banker’s report in respect of applicant company, its group/subsidiary/associate/holding company/related parties, directors of the applicant company having substantial interest in other companies. The Banker’s report should be about the dealings of these entities with these bankers as a depositing entity or a borrowing entity.  Note: Please provide bankers report from all the bankers of each of these entities and provide the report for all the entities. The details of deposits and loans balances as on the date of application and the conduct of the account should be specified.

For different forms of application as applicable to different categories of NBFC’s, please refer to the official website of the Reserve Bank of India, viz., [www.rbi.org](http://www.rbi.org).

### HOUSING FINANCE COMPANIES

Housing Finance Company (HFC) is a type of non-banking financial institution which is primarily engaged in the business of providing home loans and other related products. Unlike other Non-Banking Financial Companies which are governed under the regulatory framework of RBI, HFCs are regulated by the National Housing Bank (NHB).

Collateral securities are accepted against loans advanced by HFCs which include the property for which loan has been granted and some other collaterals as well. Since properties serve as the underlying asset on which financing is given, the amount of loan advanced depends upon the value of the collateral offered. The value of the collateral ensures that the lender is secured and has covered itself from the risk of default. Hence, correct and realistic valuation of properties or fixed assets becomes necessary at the time of advancement of loan. Further, loans given by HFCs are usually for a long period of time. Though the value of property is less volatile but there are chances that the same may fluctuate during the loan tenure. Usually after a loan has been granted, HFCs do regular property valuation to understand how the property value is changing. There is a need for revaluation at regular intervals so that the lender is assured of little or no deviation in the Loan to Value (LTV) ratio and also that the property is valued at its current fair market value.

A Housing Finance Company (HFC) is a company registered under the Companies Act, 2013 or any earlier enactment which primarily transacts or has as one of its principal objects, the transacting of the business of providing finance for housing, whether directly or indirectly. In addition to it being a company registered under the Companies Act, an HFC also requires registration with National Housing Bank (NHB) for commencing or carrying on the business of housing finance. The National Housing Bank was set up under the National Housing Bank Act, 1987. Housing Finance Companies are governed by the said Act and by Circulars, Guidelines, Notifications and Directions issued by National Housing Bank.

#### **Eligibility Criteria for Obtaining Housing Finance Company Registration**

Based on the provisions of section 29A of the National Housing Bank Act 1987, no Housing Finance Company shall start to carry out its operations of providing housing loans unless the same had met all the accompanying guidelines.

- **Must be an NBFC:** The business entity that wants to operate as a Housing Finance Company must acquire registration as the Non-Banking Financial Company from the Apex Bank, i.e. RBI.
- **Net Owned Funds:** It shall be noted that the Net owned fund of a Housing Finance Company must be at least Rs 20 Crores. Therefore, an applicant needs to satisfy the requirements of net worth for obtaining Housing Finance Company Registration.
- **Must be registered under the Companies Act 2013:** The said Company requires to satisfy the requirements of a private limited company under the provisions of the Companies Act 2013 or the Companies Act 1956.
- **Housing Finance Activities as Object Clause:** It is the last but the most important requirement of all that the objects of this type of company must mention for financing housing loans and other commercial complexes. Besides providing finance, the said company must also have the predictions of earning.

The management and operations of the company must act in good faith and in the interest of the public and other consumers. That means they need to work in the interests of the public.

The regulatory power of the Housing Finance Companies (HFCs) was transferred from National housing Bank to Reserve Bank of India by the Central Government with effect from 09 August 2019. It was further submitted that the RBI would regulate the framework for HFCs and determine the extent to which rules can be subjected to HFCs and till this particular point of time the HFCs were directed to comply with the instructions as issued by NHB.

On 22 October 2020, the RBI issued the revised regulatory framework (“Revised Framework”) for HFCs. Set out below are the key aspects of the Revised Framework:

“Housing finance company” shall mean a company incorporated under the Companies Act, 2013 that fulfils the following conditions:

- a. It is an NBFC whose financial assets, in the business of providing finance for housing, constitute at least 60% of its total assets (netted off by intangible assets).
- b. Out of the total assets (netted off by intangible assets), not less than 50% should be by way of housing financing for individuals.

“Housing Finance” shall mean financing, for purchase/ construction/ reconstruction/ renovation/ repairs of residential dwelling units, which includes:

- a. Loans to individuals or group of individuals including co-operative societies for construction/ purchase of new dwelling units.
- b. Loans to individuals or group of individuals for purchase of old dwelling units.
- c. Loans to individuals or group of individuals for purchasing old/ new dwelling units by mortgaging existing dwelling units.
- d. Loans to individuals for purchase of plots for construction of residential dwelling units provided a declaration is obtained from the borrower that he intends to construct a house on the plot within a period of three years from the date of availing of the loan.
- e. Loans to individuals or group of individuals for renovation/ reconstruction of existing dwelling units.
- f. Lending to public agencies including state housing boards for construction of residential dwelling units.
- g. Loans to corporates/ Government agencies for employee housing.
- h. Loans for construction of educational, health, social, cultural or other institutions/ centres, which are part of housing projects and which are necessary for the development of settlements or township.
- i. Loans for construction meant for improving the conditions in slum areas, for which credit may be extended directly to the slum-dwellers on the guarantee of the Central Government, or indirectly to them through the State Governments.
- j. Loans given for slum improvement schemes to be implemented by Slum Clearance Boards and other public agencies.
- k. Lending to builders for construction of residential dwelling units.

All other loans including those given for furnishing dwelling units, loans given against mortgage of property for any purpose other than buying/ construction of a new dwelling unit/s or renovation of the existing dwelling unit/s as mentioned above, will be treated as non-housing loans and will not be falling under the definition of “Housing Finance”.

***Transition time for existing HFCs to fulfil the asset based criteria***

The Revised Framework has allowed a transition time till 31 March 2024 to the existing registered HFCs to fulfil the asset based criteria as set out above in case such HFCs proposed to continue the business as HFCs:

<b><i>Timeline</i></b>	<b><i>Minimum percentage of total assets towards housing finance</i></b>	<b><i>Minimum percentage of total assets towards housing finance for individuals</i></b>
March 31, 2022	50%	40%
March 31, 2023	55%	45%
March 31, 2024	60%	50%

Such HFCs shall be required to submit to the Reserve Bank, a Board approved plan within three months including a roadmap to fulfil the above-mentioned criteria and timeline for transition. HFCs unable to fulfil the above criteria as per the timeline shall be treated as NBFC – Investment and Credit Companies (NBFC-ICC) and they will be required to approach the Reserve Bank for conversion of their Certificate of Registration from HFC to NBFC-ICC. Application for such conversion should be submitted with all supporting documents meant for new registration together with an auditor’s certificate on principal business criteria and necessary Board resolution approving the conversion.

### **Net Owned Fund (NOF) Requirement**

In exercise of the powers conferred by clause (b) of sub-section (1) of Section 29A of the National Housing Bank Act, 1987, and all powers enabling it in that behalf, the Reserve Bank hereby specifies Rupees twenty crore as the minimum net owned funds required for a company to commence housing finance as its principal business or carry on the business of housing finance as its principal business.

Provided that a housing finance company holding a Certificate of Registration (CoR) and having net owned fund of less than Rupees twenty crore, may continue to carry on the business of housing finance, if such company achieves net owned fund of Rupees fifteen crore by March 31, 2022 and Rupees twenty crore by March 31 2023.

It will be incumbent upon such HFCs whose NOF currently stands below Rupees twenty crore, to submit a statutory auditor’s certificate to Reserve Bank within a period of one month evidencing compliance with the prescribed levels as at the end of the period indicated above. HFCs failing to achieve the prescribed level within the stipulated period shall not be eligible to hold the Certificate of Registration (CoR) as HFCs and registration for such HFCs shall be liable to be cancelled. Such companies, who wish to be treated as NBFC – Investment and Credit Companies (NBFC-ICCs), will be required to approach RBI for conversion of their CoR from HFC to NBFC- ICC. Application for such conversion should be submitted with all supporting documents meant for new registration together with an auditor’s certificate on principal business criteria (PBC) and necessary Board resolution approving the conversion.

“Net Owned Fund” means net owned fund as defined under Section 29A of the National Housing Bank Act, 1987 including paid up preference shares which are compulsorily convertible into equity.

### **Benefits of incorporating a Housing Finance Company**

1. Among the financial services, housing finance creates employment, both directly and indirectly.
2. Industries such as cement, brick manufacturing, sanitary products, electrical fittings and glass industries experience more demand due to house construction.
3. Rural housing develops not only rural areas but prevents migration of labor to urban areas.
4. Housing finance helps in creation of more houses which results in building up more infrastructure facilities, such as roads, electricity generation, drinking water facilities, etc.
5. Factories or industrial establishments create townships by providing more housing facilities to their employees. Housing finance thereby reduces congestion in urban areas.
6. Due to housing finance, there is a vertical expansion and re building of dilapidated houses and re modelling of the existing houses.
7. Housing facilities not only improve, they also reflect the culture of the country. Chandigarh city is an example for modern housing which has been built by a French architect.
8. Non conventional energy gets popularized due to modern housing facilities which is one of the major benefits of housing finance.

9. At present, the macro environment is extremely favourable for housing finance companies. The Modi government's incentives in terms of allocation related to Pradhan Mantri Awas Yojana (PMAY) of Rs. 23,000 crore would provide the much-needed momentum to the sector. The total allocation for the infrastructure sector in the Budget stood at Rs 39,6135 crore in 2017-18.
10. The holding period for capital gains tax in case of immovable properties has been reduced from three to two years. Moreover, the Finance Minister has proposed to shift the base year for indexation from 1.4.1981 to 1.4.2001 for all classes of assets, including immovable property. This step would allow more realistic calculation of the cost of acquisition of the house while claiming indexation benefits.
11. It is expected that with several associated benefits and the advantage of digital documents, the cost of finance is expected to come down, which may be passed on to the real buyers.
12. In the days to come, supported by growth drivers such as rising disposable income, personal income-tax benefits, increasing urbanisation and economic growth of tier II and tier-II cities, the sector is likely to see immense growth.

### **Housing Finance Company: Registration Process**

The following procedure must be followed by the applicant for housing finance company registration:

First the applicant has to download the application form for Housing Finance company registration from the website *nhb.org.in*.

All the documents must be attached along with the application. The demand draft in favour of the NHB also must be attached. This must be submitted in the Head Office of the NHB.

The NBH would check the authenticity of the application. If the documents provided are sufficient then the NBH would go ahead and register the housing finance company. The procedure for incorporating a Housing Finance Company (HFC) is the same as any other company.

NHB after satisfying itself on the fulfilment of following conditions provided under sub-section (4) of Section 29A of the National Housing Bank Act, 1987 may grant a Certificate of Registration:

- (i) HFC is or shall be in a position to pay its present or future depositors in full as and when their claims accrue;
- (ii) Affairs of the HFC are not being or are not likely to be conducted in a manner detrimental to the interest of its present or future depositors;
- (iii) General character of the management or the proposed management of the HFC shall not be prejudicial to the public interest or to the interests of its depositors;
- (iv) HFC has adequate capital structure and earning prospects;
- (v) Public interest shall be served by the grant of certificate of registration to the HFC to commence or carry on the business in India;
- (vi) Grant of certificate of registration shall not be prejudicial to the operation and growth of the housing finance sector of the country; and
- (vii) Any other condition, fulfilment of which in the opinion of the Reserve Bank, shall be necessary to ensure that the commencement of or carrying on the business in India by a HFC shall not be prejudicial to the public interest or in the interests of the depositors.
- (viii) The Reserve Bank may, wherever it considers necessary so to do, require the National Housing Bank to inspect the books of such housing finance institution and submit a report to the Reserve Bank for the purpose of considering the application.

- (ix) The Reserve Bank may, after being satisfied that the conditions specified in sub-section (4) are fulfilled, grant a certificate of registration subject to such conditions which it may consider fit to impose.

HFCs are categorized in terms of the type of liabilities, by NHB, into Deposit and Non-Deposit accepting HFCs and are issued Certificate of Registration accordingly.

### Net Owned Fund

According to the Explanation to Section 29A Net Owned Funds means:

- (a) The aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance sheet of the housing finance institution after deducting therefrom -
- (i) accumulated balance of loss;
  - (ii) deferred revenue expenditure, and
  - (iii) other intangible assets; and
- (b) further reduced by the amounts representing –
- (i) investments of such institution in shares of-
    - its subsidiaries;
    - companies in the same group;
    - all other housing finance institutions which are companies; and
  - (ii) the book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with,-
    - subsidiaries of such company; and
    - Companies in the same group, to the extent such amount exceeds ten per cent of (a) above;

*“subsidiaries” and “companies in the same group” shall have the same meanings assigned to them in the Companies Act.*

The applicant company is required to submit a physical copy of the application (in duplicate) along with the essentials documents to the Head Office of the National Housing Bank. Further, Company is also required to attach a Demand Draft for Rupees 10,000 favouring National Housing Bank payable at New Delhi.

A filled-in physical copy of the application form (in duplicate) along with necessary enclosures as stated in official website *“<http://www.nhb.org.in/Regulation/applicationcr.php>”* to be submitted to the Head Office of NHB.

An indicative checklist of the documents required to be submitted is also provided under the heading “Instructions for filling up the Application” in the same page.

### Conditions pertaining to the cancellation of the Housing Finance Company License

The Certificate of registration granted to a housing finance company may be cancelled in some of the circumstances subject to certain provisions, if such company:

- Ceases to carry on the business of financing in India; or
- HFC has not complied with the below-mentioned terms and condition prescribed by the NHB:
  - to comply with any direction issued by the National Housing Bank under the provisions of Chapter V of the National Housing Bank Act 1987; or

- to maintain accounts in accordance with the requirement of any law or any direction or order issued by the National Housing Bank under the provisions of Chapter V of the National Housing Bank Act 1987; or
- Mandatory to submit its books of accounts and other relevant documents as per NHB Act, when it is demanded by an inspecting authority of the National Housing Bank; or
- Has been prohibited from accepting deposit by an order made by the National Housing Bank under the provisions of this Chapter V of the National Housing Bank Act, 1987 and such order has been in force for a period of not less than 3 months.

### ASSET RECONSTRUCTION COMPANY (ARC)

India has a vast banking industry with the primary function of lending and borrowing money. Banks take all precautions to lend their money to only those customers who can repay them. However, there can be cases when a customer defaults on their payment. And the bank suffers a loss from such a customer. It creates a massive amount of defaulters with the banks or financial institutions. The majority of unsuccessful businesses have to shut down because of financial pressure.

To minimise this loss, asset reconstruction companies come into the picture. When the customer becomes a defaulter, the bank can reduce its loss by giving away such default companies to the asset reconstruction companies (ARCs) at agreed values. It helps in cleaning the balance sheets of banks and financial institutions. Asset Management Companies in other countries perform many of the same functions as ARCs in India. India's first ARC was a company named ARCIL. It has been a pioneer in this field, having established industry standards for the rest of the market to follow.

In India, the problem of recovery from Non Performing Assets (NPAs) was recognized in 1997 by Government of India. The Narasimhan Committee Report mentioned that an important aspect of the continuing reform process was to reduce the high level of NPAs as a means of banking sector reform. It was expected that with a combination of policy and institutional development, new NPAs in the future could afford to be lower. However, the huge backlog of existing NPAs continued to hound the banking sector and this impinged severely on the banks performance and any ensuing hopes of their profitability. The Report envisaged creation of an "Asset Recovery Fund" to take the NPAs off the lenders books at a discount.

Asset Reconstruction Company (Securitization Company / Reconstruction Company) is a company registered under Section 3 of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SRFAESI) Act, 2002. It is regulated by Reserve Bank of India as a Non-Banking Financial Company (u/s 45I (f) (iii) of RBI Act, 1934). RBI has exempted ARCs from the compliances under section 45-IA, 45-IB and 45-IC of the Reserve Bank Act, 1934. ARC functions like an AMC within the guidelines issued by RBI.

ARC has been set up to provide a focused approach to Non-Performing Loans resolution issue by:-

- (a) Isolating Non Performing Loans (NPLs) from the Financial System (FS),
- (b) Freeing the financial system to focus on their core activities, and
- (c) Facilitating development of market for distressed assets.

As per RBI Notification No. DNBS.2/CGM (CSM)-2003, dated April 23, 2003, ARC performs the following functions:-

- (i) Acquisition of financial assets (as defined u/s 2(L) of SRFAESI Act, 2002)
- (ii) Change or takeover of Management / Sale or Lease of Business of the Borrower
- (iii) Rescheduling of Debt

- (iv) Enforcement of Security Interest (as per section 13(4) of SRFAESI Act, 2002)
- (v) Settlement of dues payable by the borrower

Asset Reconstructions companies are created to manage and recover Non Performing Assets acquired from the banking system. Asset Reconstruction Companies are act as a bad bank by isolating Non Performing Assets from the balance sheet of bank/FII and facilitate the latter to concentrate in normal banking activities. Banks and financial institutions with a large proportion of their bad loans or Non-Performing Assets can sell to a separate entity i.e. Asset Reconstruction Company. Then Asset Reconstruction Companies recover a sum through attachment, liquidation etc. The objective is to help banks in making clean books by reducing Non Performing Assets. Asset Reconstruction Companies are also making profit by buying Non Performing Assets at a lower price.

### Asset Reconstruction

Let us understand the meaning of asset reconstruction:

- When banks grant loans, advances or are involved in lending, the bank has some right or interest in that transaction.
- When the ARCs take the bad assets, all such rights or interests are also transferred.
- The asset reconstruction company can then realise all such rights and interests.
- The financial assistance that can be over by the asset reconstruction companies is loans, advances, bonds, guarantees and other credit facilities.

**Securitisation:** When an asset reconstruction company acquires financial assets, a kind of security receipt is issued to the qualified buyers. This security receipt means an undivided interest in the financial assets.

### Benefits of incorporating an Asset Reconstruction Company (ARC)

- As the cash realisation activity from defaulting borrowers is a lengthy and cumbersome procedure, relieving banks of the burden of NPAs will allow them to focus better on managing the core business including providing new business opportunities for the ARC.
- The transfer should help restore depositor and investor confidence by ensuring the lender's financial health. The banks use it as a method to hive off the bad loans from their balance sheet. ARCs can maximize recovery value while minimizing costs.
- ARCs also helps building industry expertise in loan resolution and restructuring management, besides serving as a catalyst for important legal reforms in bankruptcy procedures and loan collection.
- ARCs play an important role in developing capital markets through secondary asset instruments.

### Asset Reconstruction Company – the Registration Process

#### Conditions for Registering an Asset Reconstruction Company

There are specific conditions or eligibility criteria for registering an ARC. The following criteria have to be sufficed for this:

1. The company must be registered as a company under the Companies Act, 2013.
2. After the company is formed, it must be eligible for registration under the RBI under the respective statutory legislation.

3. There should not be any losses incurred by the company in the previous or preceding three financial years.
4. If there is a process for the realisation of assets, then sufficient arrangement must be carried out for the purpose of securitisation and asset reconstruction.
5. The ARC must be able to pay all the periodical returns.
6. The company must be capable of redeeming the amount of investment which is made by qualified buyers and other investors in the company.
7. Directors must have sufficient experience and exposure in matters related to financial affairs which include reconstruction, insolvency, financial assets and other areas related to regulation.
8. There must be no criminal convictions against the directors. The directors and shareholders should not have committed any acts which affect their moral turpitude. Any acts which would lead to prosecution would also be covered.
9. All the key management executives or individuals should pass the requirements related to the fit and proper person test in order to comply with the requirements of the act. The requirements related to the fit and proper test would be notified by the RBI from time to time. This criteria and requirement would also be applicable to the sponsors of the company.
10. The entity is responsible for complying with the financial and prudential norms as set by the RBI.
11. There are specific guidelines which have to be followed by the RBI for registration of Asset Reconstruction Company in India.

As long as the above criteria or requirements have been met by the asset reconstruction company, the applicant could go ahead with the process of registration.

#### **Documents Required for Registration of an Asset Reconstruction Company**

The following documents are required for registering an ARC:

1. Certificate of Incorporation of the Company
2. Memorandum of Association and Articles of Association of the Company
3. Resolutions stating that the company has not taken or accepted any form of deposits. These resolutions would be applicable by the board of the company
4. Information that the directors are not disqualified as per the provisions of the Companies Act
5. Information and profiles related to the sponsors of the company
6. Information related to the management of the company. The management of the company would include the shareholders and directors of the company
7. Certified Copy related to the certificate of audit by the auditor of the company
8. Copy of the audited balance sheet of the company
9. Copy of the directors and auditor's report of the company
10. Net Owned Funds of the Company
11. Detailed Information on Related Party Transactions (RPT).

Asset Reconstruction companies (ARCS) are governed by the Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003 issued by the Reserve Bank of India as amended from time to time.

- (i) Every ARC shall apply for registration in the form of application specified vide Notification No.DNBS.1/CGM (CSM)-2003 dated March 7, 2003 issued by the Reserve Bank of India and obtain a certificate of registration from the Bank as provided under Section 3 of the SARFAESI Act, 2002.
- (ii) The ARCs seeking registration from the RBI shall submit their application in the format (Annexed to Notification No. DNBS.1/CGM(CSM)-2003 dated March 7, 2003) specified by the Bank, duly filled in with all the relevant annexures / supporting documents to the Chief General Manager-in-Charge, Department of Non- Banking Regulation, Central Office, Reserve Bank of India, Centre 1, World Trade Centre, Cuffe Parade, Colaba, Mumbai 400 005.
- (iii) An ARC, which has obtained a certificate of registration issued by the Bank under Section 3 of the Act, can undertake both securitisation and asset reconstruction activities.
- (iv) An ARC shall commence business within six months from the date of grant of Certificate of Registration by the Bank; RBI may grant extension for further period not exceeding 12 months.

Provisions of section 45 -IA, 45-IB and 45-IC of RBI Act,1934 shall not apply to non-banking financial company, which is an ARC registered with the Bank under Section 3 of the SARFAESI Act, 2002.

In April 2021, the Reserve Bank of India (RBI) formed committee to comprehensively review the functioning of Asset Reconstruction Companies and suggest suitable measures to enhance their role play in absorbing stressed assets of the system. The Committee submitted a set of recommendations in September 2021. This was probably one of the most comprehensive documents relating to the ARC sector, after reasoned discussions with all stakeholders.

Based on the above report, the RBI came out with a set of guidelines for ARCs in October 2022. Some of the guidelines issued now have no connection with the said report and primarily meant for improvement of controls and governance framework, which is great for orderly development of the sector.

The prescribed minimum Net Owned Fund applicable to ARCs, till 2016, was only Rs 2 crore. This was increased to Rs100 crore in 2017. Now again it is further raised to Rs 300 crore by March 2026. In effect, the NOF requirement for an ARC has increased 150 times in just 10 years, from 2017 to 2026. And this comes now, when minimum investment in Security Receipts by ARCs has been reduced from 15% to 2.5% in cases where they (ARCs) are able to give full cash exit to seller (rest 97.5% coming from other investors, eligible Qualified Buyers).

Development of a sector, particularly a regulated entity, depends on a conducive framework that is aligned to operating business dynamics. Business models become unsustainable if the framework becomes too prescriptive. This will make attracting investors into the sector exceedingly difficult.

The ARC Committee had recommended various positive measures for deepening the distressed debt market and enhancing role play of ARCs. Based on the recommendations, ARCs were expecting their '1991 moment' of liberalisation and measures leading to the ease of doing business. What has come, so far, is too late, too little. They are now waiting for the balance set of regulations based on residual recommendations of ARC Committee referred to above, which may possibly bring a whiff of new life for ARCs.

## MICRO FINANCE INSTITUTIONS (MFI)

As the name implies, microfinance institutions are bankers and lenders who provide microfinance services, such as deposits, loans, payment services, money transfers, and insurance. Basically, a micro finance institution is an organization that offers financial services to low income populations. Almost all give loans to their members, and many offer insurance, deposit and other services. Organisations which finance on a larger scale are regarded as microfinance institutes. They are those that offer credits and other financial services

to the representatives of poor strata of population (except for extremely poor strata). An increasing number of microfinance institutions (MFIs) are seeking non-banking finance company (NBFC) status from RBI to get wide access to funding, including bank finance.

NABARD has defined microfinance as “provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban and urban areas provided to customers to meet their financial needs; with only qualification that (1) transactions value is small and (2) customers are poor.”

Due to low security and increasing operating costs, many traditional banks were not willing to provide loans to the poor in India. This led to the development & growth of microfinance institutions in the country.

### Characteristics of a Micro Finance Institution

- (1) Micro finance provides financial services to those whose income is small and unstable. These people are in need of credit facilities for several reasons. To name a few:
  - (a) their needs are small and arise suddenly.
  - (b) the institutional providers of finance, namely, the banks, demand collateral security which they cannot provide.
  - (c) most of the time, they are in urgent need of funds to meet their consumption demands, for example, to meet expenses related to education, illness, funerals, weddings for which it is difficult to obtain institution finance.
  - (d) for purpose of investment in income generating activities.
- (2) Concept of Self Help Group (SHGs) is the most exciting discovery in the context of microfinance. The Indian microfinance scene is dominated by SHGs and their linkage with banks. This has helped in empowerment of women and eradication of poverty among people with low income.
- (3) Microfinance provides a greater menu of options whereby the small loan can be garnered not just from the external sources but also through self-mobilization, by way of saving and sale of assets.
- (4) The biggest flexibility in the case of microfinance is the lack of any physical collateral, even in case of loan from the bank.

The characteristics of MFIs may be summarised as under:

- i. The size of the loan given by the MFI is small.
- ii. The repayment period is short.
- iii. MFI can mobilise resources both from internal and external sources.
- iv. No collateral for loan is required.
- v. the purpose of end use of loan is flexible.
- vi. loans given are mostly group loans, trickling down to individuals.
- vii. Transaction cost is low, due to group lending.

### Incorporation of MFI

Firstly, a company has to be incorporated under the Companies Act, 2013. The company may be a private company or a public company.

Secondly, after incorporation, the company has to register itself with the Reserve Bank of India, since a Micro Finance Institution (hereinafter referred to as MFI) is regulated by the Reserve Bank of India.

The list of documents to be filed with RBI for registration are given below:

1	Certified copies of Certificate of Incorporation.
2	Certified copies of extract of only the main object clause in the MOA relating to the financial business.
3	Board resolution stating that: <ul style="list-style-type: none"> <li>● the company is not carrying on any NBFC activity/stopped NBFC activity and will not carry on/commence the same before getting registration from RBI</li> <li>● the company has not accepted any public deposit, in the past (specify period)/does not hold any public deposit as on the date and will not accept the same in future without the prior approval of Reserve Bank of India</li> <li>● the UIBs in the group where the director holds substantial interest or otherwise has not accepted any public deposit in the past /does not hold any public deposit as on the date and will not accept the same in future</li> <li>● the company has formulated “Fair Practices Code” as per RBI Guidelines.</li> </ul>
4	Copy of Fixed Deposit receipt & bankers certificate of no lien indicating balances in support of NOF.
5	For companies already in existence, the Audited balance sheet and Profit & Loss account along with directors & auditors report or for the entire period the company is in existence, or for last three years, whichever is less, should be submitted.
6	Copy of the certificate of highest educational and professional qualification in respect of all the directors.
7	Copy of experience certificate, if any, in the Financial Services Sector (including Banking Sector) in respect of all the directors.
8	Banker’s report in respect of applicant company, its group/subsidiary/associate/holding company/related parties, directors of the applicant company having substantial interest in other companies. The Banker’s report should be about the dealings of these entities with these bankers as a depositing entity or a borrowing entity.  <i>Note:</i> Please provide bankers report from all the bankers of each of these entities and provide the report for all the entities. The details of deposits and loans balances as on the date of application and the conduct of the account should be specified.

In addition to the documents required for registration as Type II-NBFC-ND, following list of documents / information to be submitted by the NBFC-MFI applicant:

- (i) Board resolution stating that:
  - (a) the company will be a member of all the Credit Information Companies and will be a member of at least one Self-Regulatory Organisation
  - (b) the company will adhere to the regulations regarding pricing of credit, Fair Practices in lending and non-coercive method of recovery as per RBI Guidelines
  - (c) the company has fixed internal exposure limits to avoid any undesirable concentration in specific geographical locations

(d) the company is not licensed under Section 25 of the Companies Act, 1956 / Section 8 of the Companies Act, 2013.

(ii) Roadmap for achieving 85% qualifying assets.

In the developmental paradigm, microfinance has evolved as a need-based policy program to cater to the so far neglected target groups (women, poor, rural, deprived, etc.). Its evolution is based on the concern of all developing countries for empowerment of the poor and the alleviation of poverty. Microfinance programmes in the recent past have become one of the more promising ways to use scarce development funds to achieve the objectives of poverty alleviation.

## NIDHI

Nidhi Companies have been in existence since centuries. They existed even prior to the existence of the Companies Act, 1956.

A Nidhi Company, is one that belongs to the non-banking finance sector and is recognized under section 406 of the Companies Act, 2013. Their core business is borrowing and lending money between their members. They are also known as Permanent Fund, Benefit Funds, Mutual Benefit Funds and Mutual Benefit Company. They are regulated by the Ministry of Corporate Affairs, Government of India and are registered under the Companies Act, 2013 (or any earlier enactments). Nidhis are more popular in South India and are highly localized single office institutions. They are mutual benefit societies, because their dealings are restricted only to the members; and membership is limited to individuals. The principal source of funds is the contribution from the members. The loans are given to the members at relatively reasonable rates for purposes such as house construction or repairs and are generally secured. The deposits mobilized by Nidhis are not much when compared to the organized banking sector.

Nidhi company is governed by Nidhi Rules, 2014. They are incorporated in the nature of Public Limited Company and hence, they have to comply with two set of norms, one of Public limited company as per Companies Act, 2013 and another is the Nidhi Rules, 2014. No RBI approval is necessary to register the company, as RBI has specifically exempted this category of NBFC in India to comply its core provisions such as registration with RBI etc. Even though Nidhis are regulated by the provisions of the Companies Act, 2013, they are exempted from certain provisions of the Act, as applicable to other companies, due to limiting their operations within members. The exemptions are contained in the Notification F. No. 2/11/2014-CL.V dated June 5, 2015 issued by the Ministry of Corporate Affairs.

The Ministry of Corporate Affairs on 19<sup>th</sup> April, 2022 tightened compliance requirements governing Nidhi companies.

Accordingly, a public company set up as a Nidhi with share capital of Rs. 10 lakhs needs to first get itself declared as a Nidhi from the central government. This can be done by filing an application showing a minimum membership of 200 (only individual members) and net owned funds of Rs 20 lakhs within 120 days of its incorporation.

Also, the promoters and directors of the company would be required to meet the criteria of fit and proper person as laid down in the rules. In order to make sure that applications for certification as Nidhi companies are processed timely, the new rules introduce the concept of deemed approval i.e. if no decision on the application is conveyed to the company within 45 days of filing the application, approval would be deemed as granted.

### Characteristics of a Nidhi Company

The characteristics of a Nidhi Company may be summarised below:

- (1) It is allowed to transact business only with its members and with nobody else. Hence, in case a person wishes to place deposit with a Nidhi or borrow money from a Nidhi, he must first become a member (shareholder) of the Nidhi by subscribing to 10 equity shares or shares equivalent to Rs. 100.
- (2) After commencement of the Companies Act, 2013, no Nidhi shall issue preference shares.
- (3) They are allowed to open branches subject to compliance with Rule 10 of the Nidhi Rules, 2014, but do not operate on a pan India basis.
- (4) They are incorporated as public companies with a minimum paid up equity share capital of Rs. 10,00,000.
- (5) Loans may be provided only to its members and should be fully secured.
- (6) A director of a Nidhi shall be a member and shall hold office for a term upto 10 consecutive years on the Board of a Nidhi.
- (7) Nidhi can declare dividend not exceeding 25% and any higher amount shall be specifically approved by the Regional Director.
- (8) Nidhi shall adhere to the prudential norms for revenue recognition and classification of assets in respect of mortgage loans or jewel loans as provided in Rule 20 of the Nidhi Rules, 2014.

### General restrictions or prohibitions on Nidhis (Rule 6)

No Nidhi shall –

- carry on the business of chit fund, hire purchase finance, leasing finance, insurance or acquisition of securities issued by any body corporate;
- issue preference shares, debentures or any other debt instrument by any name or in any form whatsoever;
- open any current account with its members;
- acquire another company by purchase of securities or control the composition of the Board of Directors of any other company in any manner whatsoever or enter into any arrangement for the change of its management, unless it has passed a special resolution in its general meeting and also obtained the previous approval of the Regional Director having jurisdiction over such Nidhi;
- carry on any business other than the business of borrowing or lending in its own name. Nidhis which have adhered to all the provisions of these rules may provide locker facilities on rent to its members subject to the rental income from such facilities not exceeding twenty per cent of the gross income of the Nidhi at any point of time during a financial year;
- accept deposits from or lend to any person, other than its members;
- pledge any of the assets lodged by its members as security;
- take deposits from or lend money to any body corporate;
- enter into any partnership arrangement in its borrowing or lending activities;
- issue or cause to be issued any advertisement in any form for soliciting deposit;
- private circulation of the details of fixed deposit Schemes among the members of the Nidhi carrying the words "for private circulation to members only" shall not be considered to be an advertisement for soliciting deposits.

- pay any brokerage or incentive for mobilising deposits from members or for deployment of funds or for granting loans.

### Benefits of incorporating a Nidhi Company

1. A Nidhi mobilises small savings, mostly of the middle class and disburses loans to eligible borrowers. Owing to their small size and closeness to the customers, disbursement of loans is speedy. This is especially useful in case the borrower is in urgent needs of funds.
2. The repayment is guaranteed, as the loans are secured and due to peer pressure, borrowers ensure that loan is repaid on due dates.
3. Nidhis offer a higher rate of interest on deposits. This makes it an attractive investment opportunity for people, especially the senior citizens.
4. The Board of Directors of a Nidhi normally consists of senior persons who have experience in handling finances and who are well respected in social circles. This lends credibility to the institution and instills confidence in the minds of borrowers and depositors.

### Incorporation of a Nidhi Company

For incorporation, the normal procedure for incorporating a public company is required to be complied with, such as obtaining availability of name, filing of Memorandum and Articles of Association and other related documents. Care must be taken to see that the Objects Clause of the Memorandum should restrict itself to the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from and lending to its members only for their mutual benefit and for other permitted purposes. The name of the company should end with the words “Nidhi Limited”.

1. On and after commencement of Nidhi (Amendment) Rules, 2022, a public company desirous to be declared as a Nidhi shall apply, in Form NDH-4, within a period of one hundred twenty days of its incorporation for declaration as Nidhi, if it fulfils the following conditions, namely:-
  - (I) it has not less than two hundred members; and
  - (II) it has Net Owned Funds of twenty lakh rupees or more.
2. The company shall also attach, alongwith Form NDH-4, the declaration with regard to fulfilment of fit and proper person criteria, as per this sub-rule, by all the promoters and directors of the company.
3. For the purpose of determining as to whether any promoter or director is a ‘fit and proper person’, the following shall be taken into account, namely:-
  - a. integrity, honesty, ethical behaviour, reputation, fairness and character of the person; and
  - b. the person not incurring any of the following disqualifications, namely:-
    - i. criminal complaint or information under section 154 of the Code of Criminal Procedure, 1973 (2 of 1974) has been filed by a person authorised by the Central Government against such person and which is pending;
    - ii. charge sheet has been filed against such person by any enforcement agency in matters concerning economic offences which is pending;
    - iii. an order of restraint, prohibition or debarment has been passed against such person by any regulatory authority or enforcement agency in any matter concerning company law, securities laws or financial markets which is in force;
    - iv. an order of conviction has been passed against such person by a court for any offence involving moral turpitude;

- v. such person has been declared insolvent and not been discharged;
  - vi. such person has been found to be of unsound mind by a court of competent jurisdiction and the finding is in force;
  - vii. such person has been categorised as a willful defaulter;
  - viii. such person has been declared a fugitive economic offender;
  - ix. such person is a director in five or more companies incorporated or declared as Nidhi, or is a promoter of three or more companies incorporated or declared as Nidhi.
4. The Central Government, shall examine the application filed in Form NDH-4 and convey its decision within a period of forty five days to the company:
- Provided that in case a decision on an application filed in form NDH-4 is not taken by the Central Government within the aforesaid period of receipt of such application, the same shall be deemed as approved.
5. On being satisfied that the company meets the above requirements as set out under point (2) and (3), the Central Government, shall notify in the Official Gazette, declaring it as a Nidhi or Mutual Benefit Society, as the case may be:
- Provided that the decision of the Central Government approving the application, shall be filed by the company with the Registrar.
- Provided further that such company shall commence its business only once the decision of the Central Government approving its application is obtained from the Central Government pursuant to the declaration given under rule 12 of the Companies (Incorporation) Rules, 2014.
6. In case a company does not comply with the requirements of the criteria as set out in point (1), it shall not be allowed to file Form No. SH-7 (Notice to Registrar of any alteration of share capital) and Form PAS-3 (Return of allotment).
7. The above provisions as set out in Nidhi (Amendment) Rules, 2022 shall not be applicable to a public company incorporated under the Act before the date of commencement of the said Rule.

## PAYMENT BANKS

Payment banks is a new model of banks conceptualised by the Reserve Bank of India (RBI). These banks can accept a restricted deposit, which is currently limited to Rupees 1 lakh per customer and may be increased further. They can pay interest on these deposits just like savings bank account. Both current account and savings accounts can be operated by such banks. Payments banks can issue services like ATM cards, debit cards, net-banking, third party transfers and mobile-banking and offer remittance services. These banks cannot grant loans or issue credit cards.

On 7th April, 2021, in order to expand the ability of payments banks to cater to the growing needs of their customers, the current limit on maximum end of day balance of Rs.1 lakh per individual customer was increased to Rs.2 lakh.

A committee headed by Dr. Nachiket Mor recommended setting up of 'Payments Bank' to cater to the lower income groups and small businesses. There are two kinds of banking licences that are granted by the Reserve Bank of India - universal bank licence and differentiated bank licence.

Payments bank comes under a differentiated bank licence since it cannot offer all the services that a commercial bank offers. In particular, a payments bank cannot lend.

The main objective of payments bank is to widen the spread of payment and financial services to small business, low-income households, migrant labour workforce in secured technology-driven environment.

With payments banks, RBI seeks to increase the penetration level of financial services to the remote areas of the country.

To open a bank account and the application process of payments bank is made very easy as compared to other banks. These bank accounts can be opened instantly through their respective mobile apps just by providing details like Aadhar number with KYC verification.

Most of the payment banks have a non-NBFC heritage and will use payment bank as a customer retention and acquisition mechanism.

### Regulations

Payment Banks are regulated by the Reserve Bank of India. It released Guidelines for Licensing of Payment Banks on November 27, 2014 and Operating Guidelines for Payment Banks on October 6, 2016.

An application has to be filed with Reserve Bank of India in Form III under Section 22 of the Banking Regulation Act, 1949 for a licence to commence banking business by a company incorporated in India and desiring to commence banking business.

In July 2014, the RBI released the draft guidelines for payment banks, seeking comments from interested entities and public at large. After taking in to account suggestions from respondents in November 2014, RBI released the final guidelines for payment banks and invited applications for opening such banks from interested parties, subject to the guidelines enunciated. There were 41 applications from various applicants including some corporate houses. After a due process of vetting these applications through an External Advisory Committee headed by Mr. Nachiket Mor, in August 2015, the RBI accorded 'in-principle' licences to the following eleven entities to launch payments banks within a period of 18 months.

1. Aditya Birla Nuvo Limited
2. Airtel M Commerce Services Limited
3. Cholamandalam Distribution Services Limited
4. India Post Limited
5. FinoPayTech Limited
6. National Securities Depository Limited
7. Reliance Industries Limited
8. Vodafone M-Pesa Limited
9. Paytm Limited
10. Tech Mahindra Limited
11. Sun Pharmaceuticals Limited.

Within this period of 18 months, these entities were to comply with requirements regarding capital funds of Rs. 100 crores. The "in-principle" license was valid for 18 months within which the entities must fulfill the requirements and they were not allowed to engage in banking activities within the period. The RBI will grant full licenses under Section 22 of the Banking Regulation Act, 1949 after it is satisfied that requirements/conditions have been fulfilled.

The other terms and conditions are as follows:

- To be registered as a public limited company under the Companies Act, 2013.
- Payment Banks cannot form subsidiaries.
- For the first five years, the promoters stake to remain at 40% at minimum.
- Foreign shareholding will be allowed in these banks as per extant FDI norms.
- The voting rights will be regulated as per provisions of The Banking Regulation Act 1949. [Voting rights are restricted at 10% for any one share holder. RBI has the discretion to raise this to 26% on merits].
- If there is any acquisition of more than 5% shares this will require prior RBI approval.
- The majority of the bank's board of directors should consist of independent directors, appointed according to RBI guidelines.
- The bank should be fully networked from the beginning. Initially, the deposits will be capped at Rs. 1,00,000 per customer, but later it may be raised on the basis of performance of the bank.
- No lending activity is permitted. Bank can accept utility bills.
- A quarter of its branches should be in unbanked rural areas.

The list of Payment Banks operating in India are –

1. Airtel Payments Bank Ltd.
2. India Post Payments Bank Ltd.
3. FINO Payments Bank Ltd.
4. Paytm Payments Bank Ltd.
5. Jio Payments Bank Ltd.
6. NSDL Payments Bank Ltd.

Payment Banks can be promoted by:

- i. Existing non-bank Pre-paid Payment Instrument (PPI) issuers;
- ii. Individuals/professionals;
- iii. NBFCs, Corporate Business Correspondents(BCs);
- iv. Mobile telephone companies;
- v. Super-market chain;
- vi. Companies;
- vii. Real sector cooperatives; that are owned and controlled by residents; and
- viii. Public sector entities.

A promoter/promoter group can have a joint venture with an existing scheduled commercial bank to set up a payments bank. Scheduled commercial banks can take equity stake as permitted under Section 19 (2) of the Banking Regulation Act, 1949. Promoter/promoter groups should be 'fit and proper' with a sound track record of professional experience or running their businesses for at least a period of five years in order to be eligible to promote payments banks. PBs can accept demand deposits and they will initially be restricted to hold a maximum balance of Rs. 100,000 per individual customer.

PBs are also permitted to issue ATM/debit cards (but cannot issue credit cards); offer Payments and remittance services through various channels; function as Business Correspondent of another bank as per RBI guidelines; distribute non-risk sharing products like mutual fund units and insurance products, etc.

PBs cannot undertake lending activities. Apart from maintaining CRR with the RBI, a PB is required to invest minimum 75% of its “demand deposit balances” in SLR securities with maturity up to one year and hold maximum 25% in current and time/fixed deposits with other Scheduled Commercial banks for operational and liquidity management.

Right from the beginning a PB should be “fully networked and technology driven” as per the standards generally accepted and norms. Should also have a high powered Customer Grievances Cell to handle customer complaints. Procedure for granting license and its validity is similar to that of SFBs.

Key issues which require compliance by an applicant company are summarised below:

1. The minimum capital requirement is Rupees 100 crore. For the first five years, the stake of the promoter should remain at least 40%.
2. Foreign shareholding will be allowed in these banks as per the rules for FDI in private banks in India.
3. The voting rights will be regulated by the Banking Regulation Act, 1949. The voting right of any shareholder is capped at 10%, which can be raised to 26% by Reserve Bank of India. Any acquisition of more than 5% will require approval of the RBI.
4. The majority of the bank’s board of directors should consist of independent directors, appointed according to RBI guidelines.
5. The bank should be fully networked from the beginning. The bank can accept utility bills. It cannot form subsidiaries to undertake non-banking activities.
6. Initially, the deposits will be capped at Rs. 100,000 per customer, but it may be raised by the RBI based on the performance of the bank.
7. The bank cannot undertake lending activities. 25% of its branches must be in the unbanked rural area.
8. The bank must use the term “payments bank” in its name to differentiate it from other types of bank.
9. The banks will be licensed as payments banks under Section 22 of the Banking Regulation Act, 1949.
10. It will be registered as public limited company under the Companies Act, 2013.

## MUDRA BANKS

Micro Units Development and Refinance Agency Bank (or MUDRA Bank) is a public sector financial institution in India. It provides loans at low rates to micro-finance institutions and non-banking financial institutions which then provide credit to MSMEs. It was launched by Prime Minister Narendra Modi on 8 April 2015.

MUDRA provides refinance support to Banks / Micro Finance Institutions (MFIs) for lending to micro units having loan requirement up to Rs. 10 lakh. MUDRA provides refinance to micro business under the Scheme of Pradhan Mantri MUDRA Yojana. The other products are for development support to the sector. It targets mainstream young, educated or skilled workers and entrepreneurs who cannot have access to credit from regular banking system.

It will provide its services to small entrepreneurs outside the service area of regular banks, by using last mile agents. About 5.77crore (57.6million) small business have been identified as target clients using the NSSO survey of 2013. Only 4% of these businesses get finance from regular banks. The bank will also ensure that its clients do not fall into indebtedness and will lend responsibly.

The bank will classify its clients into three categories and the maximum allowed loan sums will be based on the category:

Shishu: Allowed loans up to Rs.50,000 (US\$780)

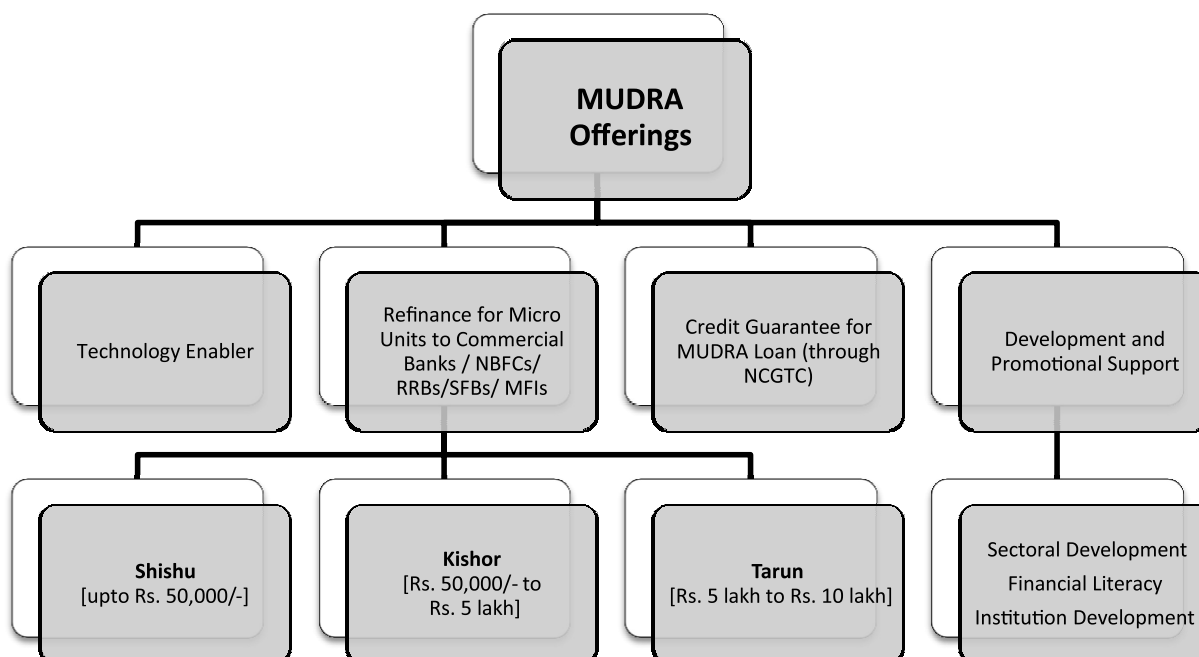
Kishore: Allowed loans up to Rs.5 lakh (US\$7,800)

Tarun: Allowed loans up to Rs.10 lakh (US\$16,000)

Those eligible to borrow from MUDRA bank are:

- Small manufacturing unit
- Shopkeepers
- Fruit and vegetable vendors
- Artisans.

The basic criteria of age should be 18 years old. Loan under the scheme of the Pradhan Mantri Mudra Bank Loan will be available if and only if it is for commercial and business purposes and not for personal purposes. At the most, borrower can buy vehicle from mudra loan, given that it is used for commercial purposes. Lastly, this loan is for new business and is only applicable for small business owners.



Source: <https://www.mudra.org.in/offerings>

### Procedure for loan

Once the beneficiary identifies an idea and comes up with a business plan, he is supposed to select the business category under which he wishes to avail the loan (Shishu, Kishor or Tarun).

The beneficiary can contact the nearest Public/ Private sector bank where he/ she can apply for business under PMMY. The list of institutions partnering in the MUDRA initiative is available on the MUDRA portal.

An application form under this scheme will be available with each of the above listed institutions. This application form has to be submitted along with the following documents for the approval of the loan:

- Proof of Identity (Self attested Voter ID/Driving License/PAN Card/ Aadhaar Card/Passport/any other Photo ID issued by Government)
- Proof of Residence(Recent Telephone Bill/Electricity Bill/Property Tax Receipt (not older than 2 months)/ Voter ID Card/Aadhaar Card/Passport/Domicile Certificate/Certificate Issued by a local authority)
- Applicant's recent photograph(not older than 6 months)
- Quotation of Machinery/other items to be purchases
- Name of the Supplier/Details of Machinery/Price of Machinery
- Proof of Identity/Address of the Business Enterprise(relevant licenses & certificates)
- Proof of Category (SC/ST/OBC/Minority etc.)

Apart from the above mentioned documents, individual banks could ask for other documents as needed. The Banks are not supposed to take any processing fee and are not supposed to ask for any collateral. The repayment period is also extended to 5 years. But it is also made clear that the applicant should not be a defaulter to any Bank or financial institution.

MUDRA Bank is not a separate bank (like SBI etc). It is a government financing scheme to provide business loan to new small businesses in India. To get business loan under PPMY the candidate has to contact the nearest Public/ Private sector bank. MUDRA will be operating as a refinancing institution through State / Regional level intermediaries.

MUDRA's delivery channel is conceived to be through the route of refinance primarily to NBFCs / MFIs, besides other intermediaries including Banks, Primary Lending Institutions etc. The rate of interest will be fixed by the institutions time to time based on guidelines from the RBI.

Mudra loan is extended for a variety of purposes which result in income generation and employment creation. The loans are extended mainly for:

- Business loan for Vendors, Traders, Shopkeepers and other Service Sector activities
- Working capital loan through MUDRA Cards
- Equipment Finance for Micro Units
- Transport Vehicle loans – for commercial use only
- Loans for agri-allied non-farm income generating activities, e.g. pisciculture. bee keeping, poultry farming, etc.
- Tractors, tillers as well as two wheelers used for commercial purposes only.

Following is an illustrative list of the activities that can be covered under MUDRA loans:

**1) Transport Vehicle**

Purchase of transport vehicles for transportation of goods and passengers such as auto rickshaws, small goods transport vehicles, 3 wheelers, e-rickshaws, taxis, etc. Tractors/Tractor Trolleys/Power Tillers used only for commercial purposes are also eligible for assistance under PPMY. Two Wheelers used for commercial purposes are also eligible for coverage under PPMY.

**2) Community, Social & Personal Service Activities**

Salons, beauty parlours, gymnasium, boutiques, tailoring shops, dry cleaning, cycle and motorcycle repair shops, DTP and Photocopying Facilities, Medicine Shops, Courier Agents, etc.

**3) Food Products Sector**

Activities such as papad making, achar making, jam/jelly making, agricultural produce preservation at rural level, sweet shops, small service food stalls and day to day catering / canteen services, cold chain vehicles, cold storages, ice making units, ice cream making units, biscuit, bread and bun making, etc.

**4) Textile Products Sector / Activity**

Handloom, powerloom, khadi activity, chikan work, zari and zardozi work, traditional embroidery and hand work, traditional dyeing and printing, apparel design, knitting, cotton ginning, computerized embroidery, stitching and other textile non garment products such as bags, vehicle accessories, furnishing accessories, etc.

**5) Business loans for Traders and Shopkeepers**

Financial support for on lending to individuals for running their shops / trading & business activities / service enterprises and non-farm income generating activities with beneficiary loan size of up to 10 lakh per enterprise / borrower.

**6) Equipment Finance Scheme for Micro Units**

Setting up micro enterprises by purchasing necessary machinery / equipments with per beneficiary loan size of upto 10 lakh.

**7) Activities allied to agriculture**

'Activities allied to agriculture', e.g. pisciculture, bee keeping, poultry, livestock-rearing, grading, sorting, aggregation agro industries, dairy, fishery, agri-clinics and agribusiness centres, food & agro-processing, etc. (excluding crop loans, land improvement such as canal, irrigation and wells) and services supporting these, which promote livelihood or are income generating shall be eligible for coverage under PMMY in 2016-17.

**MUDRA Card**

MUDRA Card is a debit card issued against the MUDRA loan account, for working capital portion of the loan. The borrower can make use of MUDRA Card in multiple drawals and credits, so as to manage the working capital limit in cost-efficient manner and keep the interest burden minimum. MUDRA Card also helps in digitalization of MUDRA transactions and creating credit history for the borrower. MUDRA Card can be operated across the country for withdrawal of cash from any ATM / micro ATM and also make payment through any 'Point of Sale' machines.

**Types of funding support from MUDRA**

1. Micro Credit Scheme (MCS) for loans up to 1 lakh finance through MFIs.
  2. Refinance Scheme for Commercial Banks / Regional Rural Banks (RRBs) / Scheduled Co-operative Banks.
  3. Women Enterprise programme.
  4. Securitization of loan portfolio.
1. **Micro Credit Scheme:** It is offered mainly through Micro Finance Institutions (MFIs), which deliver the credit up to Rs.1 lakh, for various micro enterprise activities. Although, the mode of delivery may be through groups like SHGs/JLGs, the loans are given to the individuals for specific income generating micro enterprise activity. The MFIs for availing financial support need to enroll with MUDRA by complying to some of the requirements as notified by MUDRA, from time to time.

2. **Refinance scheme for Banks:** Different banks like Commercial Banks, Regional Rural Banks and Scheduled Cooperative Banks are eligible to avail of refinance support from MUDRA for financing micro enterprise activities. The refinance is available for term loan and working capital loans, up to an amount of 10 lakh per unit. The eligible banks, who have enrolled with MUDRA by complying to the requirements as notified, can avail of refinance from MUDRA for the loan issued under Shishu, Kishor and Tarun categories.
3. **Women Enterprise programme:** To encourage women entrepreneurs, the financing banks / MFIs may consider extending additional facilities, including interest reduction on their loan. At present, MUDRA extends a reduction of 25bps in its interest rates to MFIs / NBFCs, who are providing loans to women entrepreneurs.
4. **Securitization of loan portfolio:** MUDRA also supports Banks / NBFCs / MFIs for raising funds for financing micro enterprises by participating in securitization of their loan assets against micro enterprise portfolio, by providing second loss default guarantee, for credit enhancement and participating in investment of Pass Through Certificate (PTCs) either as Senior or Junior investor. PTC is a certificate that is given to an investor against certain mortgaged backed securities that lie with the issuer.

## CHIT FUNDS

Section 2(b) of Chit Fund Act 1982 defines it as a rotating savings and credit association system, a popular practice in India. Chit fund schemes may be organized by financial institutions and unorganized money market industries or informally among friends, relatives, or neighbors. In some variations of chit funds, the savings are for a specific purpose. It's mostly popular in the areas where people have limited access to banking facilities therefore they prefer to invest their money in a Chit fund.

In a chit fund, a specific number of investors invest their money with a promise that their investment will be multiplied within a short span of time with surety and guaranteed return. Under this type of saving arrangement, a specific number of subscribers contribute payments in installment over a defined period of time.

A chit fund works in such a manner which comprises a group of members, called subscribers. An organizer, a company or a trusted relative or neighbor, brings the group together and administers the activities of the group. For their efforts, the organizer is either compensated each month or at withdrawal time. The fee may be omitted in informal situations.

### Features of Chit Funds

1. They have a predetermined value and duration.
2. They work like microfinance institutions.
3. They combine both, credits and savings in a single scheme.
4. They cater to the financial needs of low income households.
5. They allow the deposits made by the contributors to be turned into a lump sum. This is done by three mechanisms.
6. **Safe Deposits:** A person can deposit the money in the present and enjoy the lump sum in future.
7. **Loans:** A person can take a loan in the present and continue to make payments in the future.
8. **Insurance:** Allows the depositor to enjoy the lump sum in case of an emergency.
9. They offer loan at a lower interest rate than moneylenders.

### Relevant Statute Governing Chit Funds

Chit funds companies in India are governed by various State or Central laws. Organized chit fund schemes are required to be registered with the Registrar of Firms, Societies, and Chits. The chit funds are governed according to the following laws:

1. Union Government – Chit Funds Act, 1982 (Except the State of Jammu and Kashmir)
2. Tamil Nadu Chit Funds Act, 1961
3. The Chit Funds (Karnataka) Rules, 1983
4. Delhi Chit Funds Rules, 2007
5. Maharashtra Chit Fund Act, 1975
6. West Bengal Protection of Interest of Depositors in Financial Establishments Bill, 2013
7. Prize Chits and Money Circulation Schemes (Banning) Act, 1978.

The Reserve Bank of India (RBI) is the regulator of banks and other non-banking financial companies, but it does not control the chit fund business. Despite the fact that chit funds are accepting deposits, the term ‘deposit’ as defined by the Reserve Bank of India Act, 1934 does not comprise the subscription to chits. However, the RBI can always guide State Governments on the regulatory aspects of the creation of rules or exemption of certain chit funds. The latest guidelines provided by the RBI regarding the Chit are given in RBI/2014-15/636.

Although, SEBI as the regulator and controller of the securities market regulates and manages collective investment schemes. But the SEBI Act, 1992 specifically precludes chit funds from their definition of collective investment schemes

Prevention of Money Laundering (Amendment) Act, 2012 has recognized Chit Funds in Section 2(l).

Under Prize Chits and Money Circulation Scheme (Banning) Act, 1978 (PCMCS) ‘Conventional Chit’ i.e. the chit mentioned above has been defined in Section 2(a). In this act, another type of chit has also been defined under Section 2(e) named as ‘Prize Chit’ and it is banned in the territory of India. Prize chit is different from conventional chit as prize chit involves the sale of certificates, units, and other instruments and there is an admission fee also, whereas, conventional chit does not contain any of those features.

### Chit Funds Act, 1982

#### Important definitions in the Act

- **Chit Agreement:** It is defined as a document which contains the articles of agreement between the foreman and the subscribers of the chit.
- **Gross Chit Amount:** It is the sum-total of all the subscriptions payable by all the subscribers for any instalment of a chit without any deduction of discount.
- **Discount:** It is the sum of money which a prized subscriber is, under the terms of the chit agreement, required to forego and which is set apart under the said agreement to meet the expenses of running the chit or for distribution among the subscribers or for both.
- **Foreman:** The person who under the chit agreement is responsible for the conduct of the chit and includes any person discharging the functions of the foreman under section 39 of the Act.

#### Key points of the Act

1. The Act states that all registered chit funds should contain either of the words “chit fund”, “chitty”, or “Kuri” as part of their name. These names can only be used by chit funds, no other person or entity has the right to use these names.

2. Registered chit funds are not allowed to conduct any business other than chit businesses.
3. The foreman is allowed to start or run several chits simultaneously. However, prior approval of the state government is required before starting each chitty.
4. It prohibits every kind of fund that does not have prior permission of the respective state government.
5. The foreman needs to deposit 100% of the chit value with the Registrar of Chits prior to the commencement of the chit scheme. This deposit will be refunded to the foreman on the successful completion of the chit cycle.
6. All Chit funds registered under this Act needs to have its accounts audited by a qualified Chartered Accountant.
7. The Act requires that all registered chit funds impose a 40% cap on the bidding amount. This 40% is calculated on the chit value of the scheme. This bid-cap is administered to ensure that the bid does not rise uncontrollably leading to subsequent default by the bidder.

### Types of Chit Funds

Chit funds are of different kinds. These are:

1. **Organized Chit Funds:** In northern India, a common type of chit fund is where small paper chits with each member's names are gathered in a box. When all the members come together for a monthly gathering, the person who is in charge in front of all the present members picks a chit from the box. The member so selected gets to take home the day's collection. Afterwards, that person's chit is removed from the box. The person who was previously selected comes to the meetings and pays his/her share, but his/her name will not be selected again.
2. **Special Purpose Funds:** Some chit funds are organized for a specific purpose. For example, Christmas gifts fund which has a very specific end date which is about a week before Christmas. Such a fund can reduce the cost and relieves the members from extra work in the busy festival season. Nowadays, such special purpose chit funds are conducted by, ladies wear shops, jewellers etc. to promote their goods.
3. **Online Chit Funds:** With the popularity of e-commerce, Chit funds are being organized online as well. Online chit funds are conducted online, and contributors can make their monthly contributions and receive the prize through online transactions including electronic funds transfer system. Each member gets his or her own online account to manage and circulate chit funds.
4. **Registered Chit Funds:** Registered chit funds are those funds which are registered with the state government under the Chit Funds Act, 1982. There are over 10,000 registered chit funds in India.
5. **Unregistered Chit Funds:** Unregistered funds are those which are not registered with any state government. They are not regulated under any law.

### Registration of Chit Funds

The Chit Fund Act, 1982 regulates the Chit Fund business in India. According to the Act, a "chit" means a transaction whether it is called chit, chit fund, chitty, kuri or by any other name by or under which a person enters into an agreement with a specified number of individual that every one of them will subscribe to a certain sum of money (or instead a certain quantity of grain) by way of periodical installments over a definite time period and that each such subscriber will, in her/his turn, as determined by lot or by auction or by tender or in such other manner as may be specified in chit agreement, be entitled to prize amount.

A transaction cannot be called as a chit unless the members will not subscribe and pay for it to be entitled for the prize money. If some alone, but not all, of subscribers get the prize amount without any liability to pay the future subscriptions or all the subscribers get the chit amount by turns with a liability to pay future subscriptions, it can't be a chit fund.

Though the chit fund companies are the type of a Non-Banking Financial Companies (NBFC), they are exempted from being registered with the Reserve Bank of India. The chit funds are a category of NBFC which are regulated by the other regulators and hence exempt from the requirement of registration under RBI Act.

To start this business in India, it is recommended that the promoters of the chit fund company should first incorporate a Private Limited Company with the objective of operating a chit fund business. Once a private limited company is constituted, the company then applies with the appropriate Chit Fund Registrar of the State to obtain the registration for operating a Chit fund company. A chit fund business can only be started after obtaining the chit fund business registration from the relevant Registrar of the State.

The registration will not be given to:

1. Any individual or entity convicted of any offence under the Chit Fund Act or under any other Act regulating the business and sentenced to imprisonment for any such offence; or
2. Any individual or entity who had defaulted in payment of the fees or the filing of any statement or the record required to be paid or filed under this Act or had previously violated any of the provisions of this Act or the rules made thereunder; or
3. Any individual or entity had been convicted of any offence that involves moral turpitude and had been sentenced to imprisonment for any such offence unless a period of five years has elapsed since his/her release.

#### Restrictions imposed by RBI on chit fund business

- Chit fund business can be conducted only by a registered company. Running of Chit business by family and partnership firms are restricted.
- Chit companies must register with the Registrar of Chit Company in every state, furnishing full particulars about their chit company.
- The maximum discount that could be taken in a bid was restricted to 30% of the total chit amount. However, in 2001, the same has been enhanced to 40% (in the case of a chit for Rs. 1 lakh, not more than Rs. 40,000/- can be the bid amount).
- Details of each and every chit must be furnished to Reserve Bank of India along with the personal particulars of the subscribers.
- It is mandatory to keep one month's chit amount of all the subscribers/members with the Reserve Bank of India till the end of a particular chit.

#### LESSON ROUND-UP

- The financial sector comprises commercial banks, insurance companies, non-banking financial companies, co-operatives, pension funds, mutual funds and other smaller financial entities.
- Over the years, Non Banking Finance Companies (NBFCs), Housing Finance Companies (HFCs), Asset Reconstruction Companies (ARCs), Micro Finance Institutions (MFIs), and Nidhi Companies have played a dominant role in mobilisation and disbursal of funds.

- A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 2013 (or any earlier enactments) engaged in the business of loans and advances, acquisition of shares/ stocks/ bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/ construction of immovable property.
- Different types of NBFCs are Asset Finance Company, Investment Company, Loan Company, Infrastructure Finance Company, Systemically Important Core Investment Company, Infrastructure Debt Fund: Non-Banking Financial Company (IDF-NBFC), Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI), Non-Banking Financial Company – Factors (NBFC-Factors), Mortgage Guarantee Companies (MGC), NBFC- Non-Operative Financial Holding Company (NOFHC).
- Banks and Non-Banking Financial Companies (NBFCs) are financial intermediaries and the services offered by them are pretty much the same as banks. However, the benefits of incorporating an NBFC and carrying on its activities are different.
- For incorporation of NBFCs, the process is same as that of any other company. Apart from incorporation process, it requires registration with RBI.
- Housing Finance Company (HFC) is a type of non-banking financial institution which is primarily engaged in the business of providing home loans and other related products.
- Unlike other Non-Banking Financial Companies which are governed under the regulatory framework of RBI, HFCs are regulated by the National Housing Bank (NHB).
- Asset Reconstruction Company (Securitization Company / Reconstruction Company) is a company registered under Section 3 of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SRFAESI) Act, 2002. It is regulated by Reserve Bank of India as a Non Banking Financial Company (u/s 45I (f) (iii) of RBI Act, 1934).
- A microfinance institution is an organization that offers financial services to low income populations. NABARD has defined microfinance as “provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban and urban areas provided to customers to meet their financial needs; with only qualification that (1) transactions value is small and (2) customers are poor.”
- A Nidhi Company, is one that belongs to the non-banking finance sector and is recognized under section 406 of the Companies Act, 2013.
- Payments banks is a new model of banks conceptualised by the Reserve Bank of India (RBI). These banks can accept a restricted deposit, which is currently limited to Rs. 1 lakh per customer and may be increased further.
- Payment Banks are regulated by the Reserve Bank of India. It released Guidelines for Licensing of Payment Banks on November 27, 2014 and Operating Guidelines for Payment Banks on October 6, 2016.
- Micro Units Development and Refinance Agency Bank (or MUDRA Bank) is a public sector financial institution in India. It provides loans at low rates to micro-finance institutions and non-banking financial institutions which then provide credit to MSMEs. It was launched by Prime Minister Narendra Modi on 8 April 2015.
- In a chit fund, a specific number of investors invest their money with a promise that their investment will be multiplied within a short span of time with surety and guaranteed return. Under this type of saving arrangement, a specific number of subscribers contribute payments in installment over a defined period of time.

**TEST YOURSELF**

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. Explain the various types of Financial Services Organisations operating in India.
2. List and briefly explain the various categories of Non- Banking Financial Companies.
3. Explain the role of Asset Reconstruction Companies and how far they have been successful in resolving the issue of stressed assets of banks.
4. ARCs can maximize recovery value with minimum cost. Explain the benefits of incorporating an Asset Reconstruction Company (ARC).
5. What is a Payment Bank? What are the key issues to be kept in mind in the compliance requirement of a Payment Bank.
6. Shivani and her six more relatives & friends want to incorporate a Nidhi Company. They seek your advice on the following issues with respect to the formation of company:
  - (i) Whether Nidhi Company can be formed as a private company? Is there any specific law for the Nidhi Companies?
  - (ii) Whether the approval of Reserve Bank of India (RBI) is required?
  - (iii) Whether Nidhi is allowed to raise funds through issue of equity shares and preference shares?
  - (iv) Whether Nidhi is allowed to carry on business other than the business of borrowing or lending in its own name?

As a practising Company Secretary, advise with reference to the provisions of the Companies Act, 2013.

**LIST OF FURTHER READINGS**

- ICSI Premier on Company Law
- Bare Act- Companies Act, 2013 and Rules made thereunder
- RBI Act, 1934
- National Housing Bank, 1987
- Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SRFAESI) Act, 2002
- Nidhi Rules, 2014

**OTHER REFERENCES (Including Websites and Video Links)**

- <https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==>
- <https://www.rbi.org.in/>
- <https://nhb.org.in/en/>
- <https://blog.ipleaders.in/need-know-chit-funds/>