Principal Business Criteria

There is a need for Corporates to appreciate the difference between conducting financial business vs. conducting financial business as a principal activity. RBI with an intention to emphasize on the need for NBFCs to confine their principal activities to dealing in financial products and services and to demarcate the financial sector from other sectors like agriculture or services sector, introduced the Asset Income Criterion through its Press Release dated April 8, 1999; whereby financial assets of an NBFC should constitute more than 50% of its total assets (net of intangible assets) and income from such financial assets should exceed 50% of its gross income. This criteria has been further restrictive for NBFCs operating in the Asset Finance Companies (AFC) category wherein the Press Release on December 6, 2006 stipulated that financial assets should constitute more than 60% of its total assets (net of intangible assets) and income from financial assets should exceed 60% of its gross income. RBI had prescribed the PBC for NBFCs specifically but not for NBFIs.

Though it appears that determining PBC enables easy classification of Companies undertaking financial businesses as NBFCs, there are still certain challenges faced by the regulator. Some Deposit accepting NBFCs comply with PBC and undertake non-financial activities too as a method of business diversification; not from the perspective of enhancing their profits but to retain customers through cross selling of financial products and to publicize their brand. Such loss making activities act as a drag on the financial viability of these NBFCs which may endanger the interest of depositors. Also there could be a risk of diversion of the funds raised from banks (using the advantage of being an NBFC), to other riskier non financial businesses resulting in their inability to ensure asset-liability match and timely repayment to depositors. NBFCs need to realize the importance of entering into the financial services sector and prior to entering into this business, assess their ability to toe in line with the regulator's requirements to uphold the financial stability of the country.

There are certain NBFCs which have vertically integrated their core businesses with their financial businesses by conducting NBFC activities through captive units or subsidiaries or by entering into Joint ventures and creating specialized arms by tapping the right opportunities.

The scenario is different in the case of an Non deposit accepting NBFC, which have access to public funds through private placement and/or public issues. RBI has provided various avenues for such entities to conduct allied financial activities that can enable them to specialize in financial activities and maximize their capabilities of extending credit to the lowest common denominator because of their widespread presence and ability to customize their financial products based on customer needs. Building Infrastructure, ensuring legitimate source of funds, educating customers and creating support systems to deliver these services shall be pre-requisites for all these businesses.

Considering these aspects, the PBC was further broadened when RBI decided to categorize NBFCs based on their specialized business activities. Investment companies were further categorized as Core Investment Companies which held not less than 90% of its Total Assets in the form of investment in equity shares, preference shares, debt or loans in group companies and 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 constituted not less than 60% of its Total Assets. NBFC - Factors were required to adhere to the 50-50 asset - income criterion of PBC. For Micro Finance Institutions, qualifying assets of minimum 85% was prescribed. NBFCs were categorized as Mortgage Guarantee Companies if at least 90% of their business turnover was from mortgage guarantee business or at least 90% of the gross income was from mortgage guarantee business. Various other NBFCs were categorized based on their principal business and exempted from RBI regulations as they would be better regulated by the respective arms of the financial markets regulators.

Innovation and focus on financial activities are key to success for an NBFC business. Customizing, specializing and marketing innovative financial products can enable NBFCs create a niche for themselves and demarcate their role from banks. There is then, no need to worry about getting certified on the Principal Business Criteria by the Statutory Auditors and retaining the Certificate of Registration; as they would fall under one of the specialized Non Banking financial businesses which would automatically constitute the core of their operations and make them eligible to operate as a RBI Registered NBFC.