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GOVERNANCE REFINEMENT WILL ENHANCE GROWTH IN NON-BANKING FINANCIAL COMPANIES [NBFCs]

Part - I

KSR & CO COMPANY SECRETARIES LLP

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GOVERNANCE REFINEMENT WILL ENHANCE GROWTH IN NON BANKING FINANCIAL COMPANIES [NBFCs]

PART I – IDENTIFICATION & CREATION OF FOCUS ON CORE BUSINESS

Contingent Existence of NBFC

Innumerable NBFCs are losing their Certificate of Registration [CoR] issued by Reserve Bank of India [RBI] under Section 45-IA (6) of RBI Act, 1934 for reasons like:-

a. Inability to infuse minimum net owned funds
b. Change in business
c. Failure to communicate details to Financial Intelligence Unit - India
d. Violation of Know Your Customer / Prevention of Money Laundering [KYC / PML] norms
e. Deviation from other regulatory requirements

Non repayment of deposits has become a less known reason for cancellation of CoRs considering only a few NBFCs are permitted to accept deposits.

Categorisation of NBFCs based on Principal Business Criteria [PBC] and their shift from one category to another results in reducing need for holding CoR [Specifically Core Investment Companies]. Many non- deposit accepting NBFCs have been inactive in conducting businesses as they have only one or two financial assets on their books from which they generate financial income and satisfy the PBC without having the intent to really span their NBFC operations in line with their objects clause. A few NBFCs have also voluntarily surrendered their CoR due to one or more of abovementioned reasons.

THOSE NBFCs HAVING GENUINE CAUSE FOR DEFAULT OR HAVE INADVERTENTLY LOST THEIR CoR CAN FILE AN APPEAL UNDER SECTION 45-IA (7) OF THE RBI ACT, 1934 WITHIN 30 DAYS OF RECEIPT OF RBI ORDER COMMUNCIATING CANCELLATION OF CoR

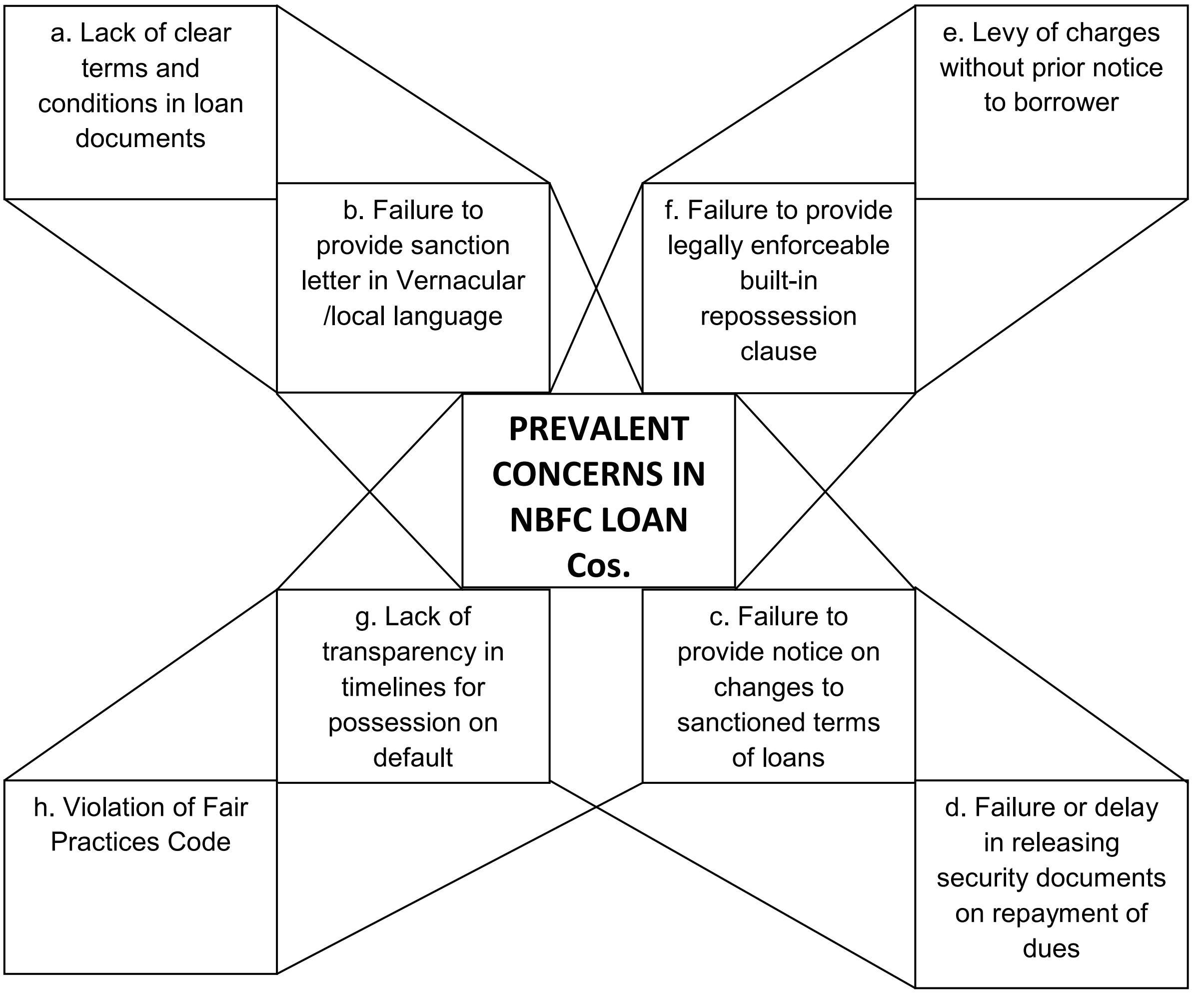
Can shadow banking return!

One of the risks that the financial market may now face is these companies may resort to other forms of entities like partnership firms or sole proprietor concerns to conduct NBFC businesses and recreate a shadow economy. Whether they raise public deposits or not and whether their business scales up to cause systemic risk is a matter to wait and watch. There is a clear sign of wading interest of promoters in setting up a separate NBFC business due to regulatory scenario now. RBI has also started levying penalties for non compliances which are severe in nature, however non filing or delayed filing of returns etc., have not attracted penalties.

Are NBFCs ready for the pie or it fell between chairs!

On one side banks are stepping forward to share their pie with NBFCs by lending to them [based on their internal ratings and credit rating] instead of lending directly to end user. On the other side NBFCs are faltering in basic compliances, losing their status to undertake businesses of a financial institution and shrinking their market presence. Will this result in only the ''BIG & REPUTED'' NBFCs surviving?

Review of complaints or core issues that are posed by general public while dealing with NBFCs, specifically from Loan companies or Asset finance companies or Micro finance institutions, which are predominant, are mentioned below:



Such concerns are generally not found in housing finance companies as these are mostly structured and are stable as the product is market driven with very strong collateral backing. The Ombudsman Scheme introduced in February 2018, addresses similar issues as listed above. The schemev specifically excluded Infrastructure Finance Companies, Core Investment Companies, Infrastructure Debt Fund and NBFCs under liquidation from its purview.

The question is despite years of lending have these NBFCs not evolved above a mere money lending entity into a reliable channel of funding, with internal governance strong enough to resolve these basic issues?

Upscaling governance for NBFCs

The governance organs of a NBFC like any other company comprises of Board, its Committees and Senior management team. Their role and onus is very crucial compared to non finance business because of the direct impact on monetary stability of a country. Further self governance and discipline is also crucial trait for employees who operate in an NBFC.

What kind of governance can be a solution to these grievances?

Policies[1] are the major instruments that drive governance. There are still NBFC – loan companies that have not designed a **comprehensive loan policy** and nailed their business risk specifics.

Minimum Contents of a Loan policy should be the protocol guiding conduct of employees interacting with customers and should comprise of:

- Types of loan products offered
- End use of lending and quantum based on repayment ability of borrower
- Rate of Interest for Short term vs. Long term loans [Requires revision periodically[2]]
- Lending to related parties or ineligible recipients with either inability or unwillingness to repay is restrained.

[1] Relevant clauses of the policies need to be revised from time to time to suit changing market conditions and focus on profitable segments
[2] Variable aspects can be governed through issue of branch ciculars through an online repository instead of sending ongoing emails so that thse are always available for reference by employees

- Terms of lending to directors, their relatives and other employees
- Terms of lending to group companies especially when the NBFC is not a core investment company.
- Restriction on disbursal of loans in cash beyond specified limit
- Timelines and mode for repayments
- Return of security documents/collateral in case of settlement of debts, release of corporate/personal guarantees if any
- Delayed payment penalties
- Loan processing, stamping, follow up, administrative, closure/repossession charges etc.
- Right to set off loans
- Notices and actions in case of defaults
- Grievance redressal mechanism for borrowers
- Periodicity of review of loan repayments/KYC details of customers

In case of lending against gold collateral:

- Loan to value ratio
- Certificate of assayed gold
- Procedure of conducting public auctions
- Repayment of auction surplus

Policy Annexure must contain:

- Standardized forms including loan applications
- Customer due diligence in line with KYC policy
- Nomination clause
- Certificate for assayed gold
- Matrix for risk categorisation based on borrower profile
- Sanction letters based on risk categorisation
- Clauses for collateral [tangible and intangible] based lending including repossession clauses and non collateral based lending
- Based on the branches catered to the above documents translated in vernacular / local language in addition to English/Hindi
- Acknowledgement for receipt of sanction letters

Prohibitions on lending:

- to pawnbrokers
- to politically exposed person
- against stolen gold/ bullion / primary gold and gold coins
- against own shares
- against listed shares
- beyond credit concentration norms
- and charging foreclosure charges for floating rate loans
- to suspicious borrowers

Reporting Requirements pertaining to Loans:

- Credit data to Credit Information Companies
- To stock exchanges in case of lending against listed shares

BUSINESS ACHIEVEMENT IS LESS ABOUT ITS GENETICS AND MORE ABOUT RITUALS IT FOLLOWS

Note:

Part II of this Article will appear in our next newsletter.
To know more about banking and non banking financial companies regulations and updates please visit our *website www.bankingandnonbanking.com*

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