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History, Evaluation of Regulatory Framework, Growth and Development of NBFCs - An Indian Context

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ABSTRACT

NBFCs play a significant role for developing in Indian economy. NBFCs are contribute of 1/5th part to the gross domestic product. The attempt has been made through this research paper to describe the history, evolution of regulatory framework, growth and development of NBFCs in India. History of NBFC are also noted in the paper from 1996 to 2016. The Regulatory bodies i.e RBI also work on new framework of regulation NBFC on October 22, 2021. New Regulatory framework structure for NBFCs comprised of four layers based on their size, activity, and perceived riskiness with three base layers. It obtains from the result that number of registration of NBFC are declined as compared to past years. Thus, it is important to analyze the fluctuation of NBFCs in India and its impact on Indian economy directly or indirectly.

Keywords : History, Evolution, Growth, Development, regulatory framework, NBFCs

1. INTRODUCTION

An NBFC is a financial institution that does not possess a bank licence but provides some banking services. As early as the 1960s, India's non-banking financial institutions (NBFCs) began as a solution to help the consumer and investor whose financial needs were not met by the banking system. Privately owned, medium and small-sized financial intermediaries, Non-Banking Financial Corporations in India provide a wide range of services, including equipment leasing, hire purchase, loans, investments and chit fund operations etc. (Uma Devi, 2014). It is also known as "Capital," "Funds," or "Finance," when discussing a company's financial demands. Financial markets, financial intermediation, and financial instruments or financial goods are all part of a country's financial system. In certain cases, all of these items can be used in conjunction with one another to expedite the transfer of money.

2. HISTORY OF NBFCs

The following for the history of NBFCs are as under

Table No. 1.1 History of NBFCs

Sr.No	*Period*	*Description*
1	**1960**	NBFCs was started in India at nearly in the 1960s. The NBFCs initially operated on a limited scale without making much impact on the financial industry. The firstly started as to amount taken as fixed deposit from investor and worked out leasing deals for big industrial firms.
2	**First stage**	The Companies Act governed finance in the early stages of growth. However, because of the unique and complicated nature of operations, as well as the fact that financial organisations act as financial intermediaries, a distinct regulatory system was proposed.
3	**As per RBI act 1934**	As a result, the Reserve Bank of India Act, 1934, incorporated Chapter III B, which gave the Bank limited authority to regulate deposit-taking enterprises. The RBI has taken steps to regulate the NBFC sector since then.
4	**1970**	During the 1970s, the Indian government asked the banking commission to investigate chit funds and non-banking financial intermediaries.
5	**1972**	The banking commission of 1972 suggested that the entire country adopt standard chit fund legislation. A draught bill to regulate the conduct of chit funds was also prepared by the RBI and referred to a research group led by James S. Raj.
6	**1974**	During the period 1974, chit scheme and other scheme was started
7	**1975**	According to the primary recommendations of the James S. Raj Study Group founded in 1975, hire purchase and

		leasing enterprises could receive deposits up to the amount of their net owned funds, which the RBI accepted and implemented. In addition, the Companies were required to keep liquid assets in the form of unencumbered certified government securities.
8	**Between 1980s to 1990s**	• With their customer-friendly reputation, NBFCs began to attract a large number of investors in the 1980s and 1990s. • Dr. Manmohan Singh, Governor of the Reserve Bank of India, convened a committee, chaired by Prof. Sukhamoy Chakravarty, to assess the operation of India's monetary system in December 1982. The Committee proposed that the Banking Sector, Non-Banking Financial Institutions, and the Unorganized Sector be assessed in order to evaluate various monetary and credit policy instruments in terms of their influence on the Credit System and the Economy. • The number of NBFCs rapidly increased from 7000 in 1981 to about 30000 in 1992, prompting the RBI to consider regulating the industry.
9	**1992**	On the period 1992, the RBI framed a one another committee which headed by the former chairman of bank of Baroda, Mr. A. C. Shah, has suggested some measures for effective regulation of the industry. The shah committee also recommendation for registration to prudential norms.
10	**1997**	In January 1997, significant amendments were made to the RBI Act, 1934, particularly Chapters III-B, III-C, and V of the Act, with the goal of establishing a comprehensive regulatory and supervisory structure that would protect the interests of NBFCs while also ensuring their smooth operation.
11	**1998**	During the period 1998, Vasudev committee framed, which is foucs on flow of credit from bank to NBFCs which is secured or unsecured deposit.
12	**1999**	In 1999, the capital requirement for fresh registration was increased from 25 lakh INR to 200 lakh INR.
13	**2006**	During the period 2006 it bridge the gap between bank and NBFCs Non deposit accepting NBFCs were futher classified into systematically NBFCs and non- systematically NBFCs classified on the bases of their assets size. It is also focus RBI to deposit and Non Deposit NBFCs in India.
14	**2008**	The true magnitude of the risks that the shadow banking sector at the global level could proffer was clearly visible in the aftermath of the global financial crises of 2008.
15	**2010**	Against the backdrop of the developments in the NBFC sector described above, the BFS (board of financial stability) in its meeting held on September 29, 2010, desired that a Working Group be constituted with experts to study the issues and concerns in the NBFC sector.
16	**2016**	In August of 2016, the union cabinet welcomed foreign direct investment (FDI) under the automatic route in regulated Non-banking financial companies.

3. EVOLUTION OF THE REGULATORY FRAMEWORK FOR NBFC’s (1964)

Reserve Bank of India Act, 1934 ('RBI Act) was amended in 1964 to grant the RBI regulatory and supervisory powers over NBFCs. Revisions to the Reserve Bank's NBFC Act in 1974 increased its authority over NBFCs, including the capacity to examine them, tougher penalties for disobeying RBI directions, and statutory auditors' responsibilities. More and more committees are saying that the NBFC business requires effective regulation due of its growing importance. In 1994, after the Shah Working Group's recommendations, prudential norms for the NBFC business were formed. (Adukia, 2014). When the RBI Act, 1934, was updated in 1997, NBFC regulation became more comprehensive. Since then, there have been a number of developments in the regulatory framework for NBFCs:

4. REGULATORY FRAMEWORK -1998

The Reserve Bank announced a new regulatory framework for NBFCs in January 1998, capitalising on newly gained authorities under the RBI Act.

As a result of the RBI Act's newly granted authority, the Reserve Bank announced in January 1998 a new regulatory framework for NBFCs.

The framework's most important characteristics were as follows: non-banking financial corporations are classified into one of two categories: those that accept public deposits and those that do not. (ii) non-public deposit taking institutions lending, investment, hire-purchase, and equipment leasing institutions, and (iii) non-public deposit taking institutions Considering core investment firms that hold at least 90% of their entire assets in securities and shares of their own group businesses but do not trade in these securities and shares; (Reserve Bank, 2009)

Clarifying the scope of the term ‘deposits’;

- "Minimum" credit rating and "calibration" of the deposit quantum based on credit rating and net owned funds
- Prohibition on NBFCs making loans secured by their own stock;

- In order for NBFCs that do not take public deposits to be exempt from prudential rules, a Board resolution must be passed every year.
- Increase the scope of the audit certificate by reporting on a variety of management issues.

5. REVISED REGULATORY FRAMEWORK IN 2014

The sector's regulatory structure was revised in 2014 in light of NBFCs' fast growth in terms of size, type of operations, and entry into other areas of financial services and products. The following were the most significant changes in the updated regulatory framework:

- For heritage NBFCs, a minimum NOF of 2 crore is required.
- Standardization of deposit acceptance standards for all NBFC types.
- Revision of the threshold of systemic importance from ☐100 crore to ☐ 500 crore and inclusion of multiple NBFCs within the same group for reckoning systemic significance threshold.
- A regulatory strategy that is differentiated based on the client interface and the source of money. Entities with assets of less than 500 crore that do not access public money and have no consumer interaction were exempted from prudential and business conduct laws at one end of the range. Entities using a consumer interface to obtain public funding, on the other hand, were subjected to a barrage of laws.
- Harmonisation of asset classification norms for Deposit taking Non-Banking Financial Company (NBFC-D) and Systemically Important Non-Deposit taking Non-Banking Financial Company (NBFC-ND-SI) with banks.
- Board Committees (Audit Committee, Nomination Committee, and Risk Management Committee) and the rotation of audit partners every three years for NBFC-D and NBFC-ND-SI are the result of a review of corporate governance and disclosure rules.

6. SCALE BASED REGULATION (SBR): A REVISED REGULATORY FRAMEWORK FOR NBFC IN 2021

An Indian Reserve Bank (RBI) Discussion Paper on revised NBFC framework for public comments was released on January 22nd, 2021, which covered a wide range of revisions in the applicable NBFC framework, including but not limited to a scale-based structure for NBFCs, net-owned fund requirements, board structure and corporate governance; capital requirements; prudential regulation; and other compliances.

On October 22, 2021, RBI released the SBR Framework for NBFCs, which included an integrated regulatory framework and timetables, after the completion of the aforementioned discussion paper. Further, the Reserve Bank of India is expected to give more comprehensive rules. On October 1, 2022, these rules will take effect.

Regulatory Structure for NBFCs

Regulatory structure for NBFCs shall comprise of four layers based on their size, activity, and perceived riskiness. NBFCs in the lowest layer shall be known as NBFC - Base Layer (NBFC-BL). NBFCs in middle layer and upper layer shall be known as NBFC - Middle Layer (NBFC-ML) and NBFC - Upper Layer (NBFC-UL) respectively. The Top Layer is ideally expected to be empty and will be known as NBFC - Top Layer (NBFC-TL).

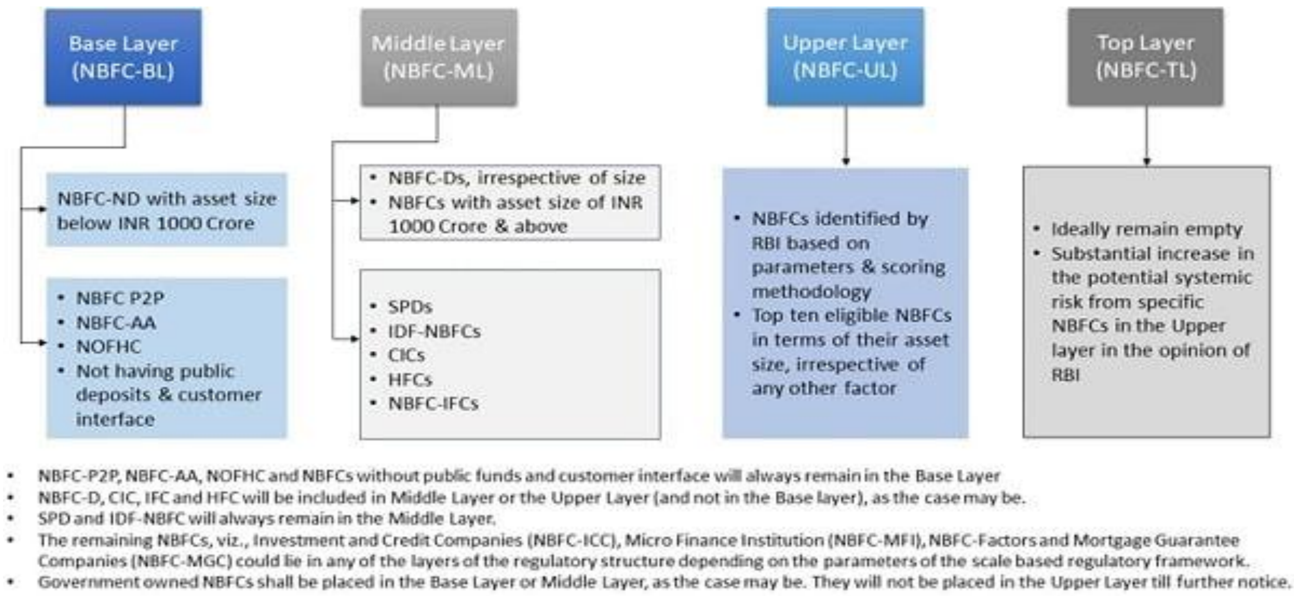
1) Base Layer : For the Base Layer, it will be need (a) NBFCs that don't take deposits and have assets under 1000 crore, (b) NBFCs that participate in the following activities, including I NBFC-Peer to Peer lending, (ii) NBFC-Account Aggregator, (iii) Non-Operative Financial Holding Company, and (iv) NBFCs that don't use public funds or have any sort of customer interface.

2) Middle Layer : The Middle Layer will include (a) all deposit-taking NBFCs (NBFC-Ds), regardless of asset size, (b) non-deposit-taking NBFCs with assets of 1000 crore or more, and (c) NBFCs that do the following: I Standalone Primary Dealers (SPDs), (ii) Infrastructure Debt Fund - Non-Banking Financial Companies (IDF-NBFCs), (iii) Core Investment Companies (CICs (NBFC-IFCs).

3) Upper Layer: The NBFCs in the Upper Layer are those that the Reserve Bank has designated as warranting additional regulatory requirements based on a set of factors and scoring methodology detailed in the Appendix to this circular. Regardless of other factors, the top 10 qualifying NBFCs in terms of asset size will always be in the upper stratum.

4) Top Layer : The Top Layer should preferably be left blank. This layer may be filled if the Reserve Bank believes that certain NBFCs in the Upper Layer are posing a significant rise in potential systemic risk. These NBFCs will be promoted from the Upper Layer to the Top Layer.

Screen shot for Revised Regulatory Framework for SBR: 2021



Categorisation of NBFCs carrying out specific activity

As the regulatory structure envisages scale based as well as activity-based regulation, the following prescriptions shall apply in respect of the NBFCs

- NBFC-P2P, NBFC-AA, NOFHC and NBFCs without public funds and customer interface will always remain in the Base Layer of the regulatory structure.

- NBFC-D, CIC, IFC and HFC will be included in Middle Layer or the Upper Layer (and not in the Base layer), as the case may be. SPD and IDF-NBFC will always remain in the Middle Layer.

- The remaining NBFCs, viz., Investment and Credit Companies (NBFC-ICC), Micro Finance Institution (NBFC-MFI), NBFC-Factors and Mortgage Guarantee Companies (NBFC-MGC) could lie in any of the layers of the regulatory structure depending on the parameters of the scale based regulatory framework.

- Government owned NBFCs shall be placed in the Base Layer or Middle Layer, as the case may be. They will not be placed in the Upper Layer till further notice

7. GROWTH AND DEVELOPMENT OF NBFCS

Until recently, NBFCs and SGOs have been competing with and augmenting the activities of commercial banks. The evolution of a country's financial system has been seen to have a distinct stage. The evolution of a country's financial system has been seen to have a point at which it stops.

Depending on the needs of their clients, they are also available in a range of forms and sizes. As a result, in the United States, NBFC growth was more significant in the first three decades of this century, and now, two of the top five commercial lenders are NBFCs, as are three of the four largest consortium funding providers. The non-bank financial sector in India has developed significantly during the past two decades. Financial services have become more widely available to the general public via the efforts of NBFCs as a whole. (Agrawal, 2014)

Diverse savings (resource) flows and investment (purposes) in these funds - whether for present working capital requirements or long-term capital investments - are reflected in the growth, development and proliferation of financial intermediaries. Both as repositories for community savings and as providers of investment capital, they serve a diverse range of customers. (Goel, 2014).
Finance Corporation's rapid growth in states like Gujarat and Mysore has been noted by the Banking Commission (1972). (present Karnataka State). Under the Partnership Act of India, these "finance businesses" have a capital of less than Rs.1 lakh. The bulk of India's NBFCs, according to a study on the non-banking financial sector, are located in six states: Delhi, West Bengal, Maharashtra, Tamil Nadu, and Uttar Pradesh. (RANJAN SINGH, 2014)

NBFCs have developed dramatically in India over the past decade, and they are now recognised as an important part of the country's financial system. Prior to the 1980s and 1981, there were only 7063 NBFCs in existence. There are already roughly 40,000 non-bank financial institutions (NBFCs).

NBFCs can be classified as either financial or non-financial entities. Non-banking financial institutions (NBFIs) can be organised as either public or private limited corporations (PLCs). (Mondal, 2015).

Over the past decade, the percentage of NBFCs contributing to the economy has risen from 8.4% in 2006 to more than 14% in March 2015. Financial assets of NBFCs have expanded at a CAGR of 21.9 percent over the past five years, accounting for 13 percent of total credit and predicted to rise to over 18 percent by 2018-19. This might be because of their superior product lines, lower costs, a wider and more effective reach, more sophisticated risk management abilities to avoid and control bad loans, and a complete grasp of their client categories that NBFCs have been so successful. In addition to better macroeconomic conditions, greater credit penetration, rising spending, and disruptive, digital banks, NBFC credit will rise at a respectable rate of 7 to 10% over the next five years. (Acharya, 2014) .

The number of NBFCs has increased dramatically over the previous two decades. Table No. 1 shows that the number of NBFCs rose from 7,063 in 1981 to 33,520 in 1991 and 55,995 in 1995. The liberalization-driven boom was the driving force behind the remarkable rise of NBFCs. In addition to fund-based operations, NBFCs have ventured into merchant banking. Almost everyone wanted to create and operate a financial firm because of the high demand for money and the low entrance barriers.

TABLE NO. 2: NUMBER OF NON-BANKING FINANCIAL COMPANIES (1981-1996)

Year	No. of financial company	Year	No. of financial company
1981	7,063	1989	21,106
1982	8,974	1990	24,009
1983	11,100	1991	33,520
1984	13,519	1992	35,832
1985	15,358	1993	43,835
1986	17,356	1994	48,969
1987	19,618	1995	55,995
1988	19,311	1996	51,929

Source: *RBI Bulletin, LI (8), Aug. 1997. P: 591 and RBI Bulletin, LII (2), Feb. 1998. P: 71*

In 1996, there were 51,929 NBFCs in existence. The RBI Act was revised on January 9th, 1997, in response to the collapse of CRB Capital Markets Ltd. and other NBFIs that year. The Amendment Act mandated that all NBFCs be registered. The number of NBFCs registered with the RBI following the Act's amendment is shown in Table No. 2.

TABLE NO. 3: THE NUMBER OF NBFCS REGISTERED WITH THE RBI (1999 – 2020)

End June	All NBFCs	NBFCs Accepting Public Deposits
1999	7,855	624
2000	8,451	679
2001	13,815	776
2002	14,077	784
2003	13,849	710
2004	13,764	604
2005	13,261	507
2006	13,014	428
2007	12,968	401
2008	12,809	364
2009	12,740	336
2010	12,630	308
2011	12,409	297
2012	12,385	271
2013	12,225	254
2014	12,029	241
2015	11,842	220
2016	11,682	202
2017	11,522	178
2018	11,402	156
2019	9659	88
2020	9618	64

Source*: Report on Trend and Progress of Banking in India, from 1999-00 to 2019-20.*

According to Table No. 2, the number of NBFCs has decreased dramatically from 51,929 in 1996 to 7,855 in June 1999. The RBI's new regulatory procedures are largely to blame for the precipitous drop in the number of NBFCs. Only 624 of the 7,855 NBFIs registered with the RBI in 1999 were allowed to take deposits. By the end of June 2009, there were 12,740 NBFCs registered with the RBI, with 336 of them taking public deposits. Table 2 also shows that the number of NBFCs registered with the RBI increased from 1999 to 2002, after which there was a marginal decrease in the number of NBFCs registered from 2002 to 2016. From 2002 to 2016, the number of NBFCs registered with the RBI decreased from 14,077 to 11,682, and the number of NBFCs accepting fixed deposits declined from 710 to 202. However, during the current financial year 2016-17, the number of NBFCs in India has decreased by 11522, and accepting deposits has also decreased by 178, which is not good for the Reserve Bank of India. From 2017-18 to 2019-20, the number of NBFCs has decreased by 11402 to 9618, and accepting deposits has decreased by 156 to 64, which has a direct impact on NBFCs in India.

CONCLUSION

The RBI being the highest monetary authority in India. So RBI should proper care of the NBFCs also. NBFCs are major financial organization in the Indian economy for to assume imperative job opportunities and developed for financial framework. RBI has also regulate new and revised framework and increased a credit facilities so small business man and large enterprise can take a benefit from it and financial formwork for Indian economy are increased.

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