

NBFCs: Concepts, Challenges, and Governance Insights

Non-Banking Financial Companies (NBFCs) have become a **critical pillar of India's financial architecture**, complementing banks and reaching segments where traditional banking falls short. Their journey reflects both **remarkable growth** and **serious governance failures**, making them the regulator's priority sector.

At the Mehta & Mehta webinar, senior professionals and compliance leaders dissected the **evolving RBI framework, governance imperatives, and practical challenges** that NBFCs must navigate.

1. Why NBFCs Matter More Than Ever

- **Scale of Growth:** From ₹2 trillion AUM in 2000 to **₹43 trillion by 2024**, NBFCs now outpace banks in credit growth ($\approx 12\%$ CAGR).
- **Market Role:** NBFCs provide **retail credit, microfinance, leasing, investment services, and infrastructure funding**, thereby deepening financial inclusion.
- **Systemic Importance:** Large NBFC failures (IL&FS, DHFL) proved that governance lapses can destabilize not just the entity but also the broader financial system.
- **Regulatory Shift:** RBI no longer sees NBFCs as “shadow banks” — instead, they are **quasi-banks** expected to uphold banking-grade standards of compliance and customer protection.

2. The Regulatory Heat: RBI's Focus Areas

a. KYC & Customer Onboarding

- **UCIC (Unique Customer Identification Code)** is mandatory.
- Violations in CKYC records and incomplete data are among the most penalized lapses.

b. Fair Practice Code

- Recovery agent harassment, late-night calls, and reputational damage are being tightly curbed.
- **Key Fact Statement (KFS)** must transparently disclose all charges; hidden fees are no longer tolerated.

c. Outsourcing & Fintech Partnerships

- NBFCs increasingly outsource underwriting and verification to third parties. RBI mandates **audit rights and contractual safeguards** in all such arrangements.

d. Credit Bureau Reporting

- Errors in reporting repayment delays or defaults can cause customer distress and invite RBI penalties. Reporting timelines (monthly/quarterly) are now more stringent.

e. Evergreening of Loans

- Investment through AIF structures to recycle funds back to defaulting borrowers is expressly prohibited. RBI views this as systemic risk camouflage.

f. Fraud Reporting & Committees

- Fraud must be reported within strict timelines.
- Dedicated **Fraud Monitoring Committees** are expected to operate under board oversight.

3. NBFC Classifications – Beyond Labels

By Liability:

- Deposit-taking (NBFC-D) vs. Non-deposit-taking (NBFC-ND).

By Size:

- *Systemically Important* (>₹500 crore assets).
- *Non-systemic* (<₹500 crore).

By Activity:

Asset Finance Companies, Loan Companies, Investment Companies, Core Investment Companies (CICs), Infrastructure Finance, MFIs, P2P Platforms, Account Aggregators, Mortgage Guarantors, and others.

By Regulatory Layer (SBR, 2021):

- **Base Layer:** ND-NBFCs <₹1,000 crore assets.
- **Middle Layer:** All deposit-taking NBFCs and larger ND-NBFCs.
- **Upper Layer:** Top 10 by asset size and RBI-flagged high-risk NBFCs.
- **Top Layer:** Rarely invoked; reserved for NBFCs posing extraordinary systemic risk.

4. Governance Expectations: Board Under Spotlight

- **Board Composition:** At least one director must have NBFC/banking experience.
- **Mandatory Committees:** Even private NBFCs must form Audit, Nomination & Remuneration, Risk Management, and ALM Committees.

- **Chief Compliance Officer (CCO):** Independent, empowered, reporting directly to Audit Committee.
- **Chief Risk Officer (CRO):** Expected in middle/upper layers, with independent oversight.
- **Loans to Directors:** Beyond ₹5 crore require board approval; transparency is non-negotiable.

5. Practical Pain Points Exposed in the Webinar

- **Multiplicity of NBFCs in Groups:** RBI discourages “layering” and often directs consolidation (Circular: 11 Oct 2022).
- **Legacy Compliance Gaps:** Old unresolved charge filings, pending auditor changes, or unclosed loans surface during due diligence and audits.
- **Principle-based Regulation:** Unlike SEBI’s prescriptive approach, RBI issues broad guidelines. NBFCs must assess the “spirit of regulation,” not just the letter.
- **Audits as Stress Tests:** RBI audits today are **intrusive and thematic** — from board minutes to MIS reporting, everything is under scrutiny.

6. Grey Areas & Participant Queries (from the Q&A)

- **CKYC Compliance:** Should NBFCs only store CKYC number or also download records? → Consensus: Retain complete records for audit trail.
- **Insurance Objects:** If a base-layer NBFC amends its object clause to include insurance agency business — does it need RBI approval? → RBI approval is necessary to avoid conflict with core NBFC registration.
- **Chit Funds & Investment Companies:** Are they NBFCs? → Not automatically; chit funds are governed by Chit Funds Act, but if the company’s principal business is financial investment, it may fall under NBFC norms.
- **Base Layer Governance:** Is RMC mandatory? → Yes, even base-layer NBFCs must constitute RMC as per scale-based regulations.
- **Takeovers & Mergers:** Does RBI approval precede NCLT petitions? → Yes, prior RBI nod is essential before merger filings.

7. Best Practice Safeguards

- **Audit-Ready Always:** Treat RBI inspection as ongoing, not event-based.
- **Integrated MIS:** Automate CKYC, fraud alerts, and credit bureau reporting.

- **Board Training:** Directors (especially independents) must undergo NBFC-specific compliance workshops.
- **Loan Lifecycle Compliance:** Link charge filings, satisfaction, and KFS issuance directly into loan workflows.
- **Use Digital Portals:** Daksh (inspection) and Pravaah (approvals) must become routine compliance channels.

8. Strategic Outlook – The Road Ahead

- **Convergence with Banks:** Large NBFCs (upper layer) will increasingly be regulated like banks.
- **Consumer-Centric Regulation:** RBI’s philosophy is clear — “Customers are king.” Every guideline ultimately aims at **fair treatment and transparency**.
- **Technology-Driven Oversight:** Expect more **real-time reporting portals** and cross-checks (e.g., MCA V3 integration with RBI data).
- **Consolidation Push:** Multiple small NBFCs in groups will face pressure to merge for efficiency and regulatory clarity.

Conclusion

NBFCs stand at the crossroads of **growth and governance**. They fuel credit, drive financial inclusion, and innovate through fintech collaborations but also invite regulatory fire if they fall short of compliance.

The key takeaway from the webinar: **NBFCs must stop treating RBI rules as reactive obligations. Instead, compliance and governance must become strategic enablers of trust and resilience.**

For recordings and upcoming sessions, visit:

- *“Decoding Corporate Laws with Mehta & Mehta”* (YouTube channel)