Indian Financial System
M.Com Semester II

BANKING &

NON-BANKING FINANCIAL INSTITUITIONS

Dr. Geetika T. Kapoor

Department of Commerce

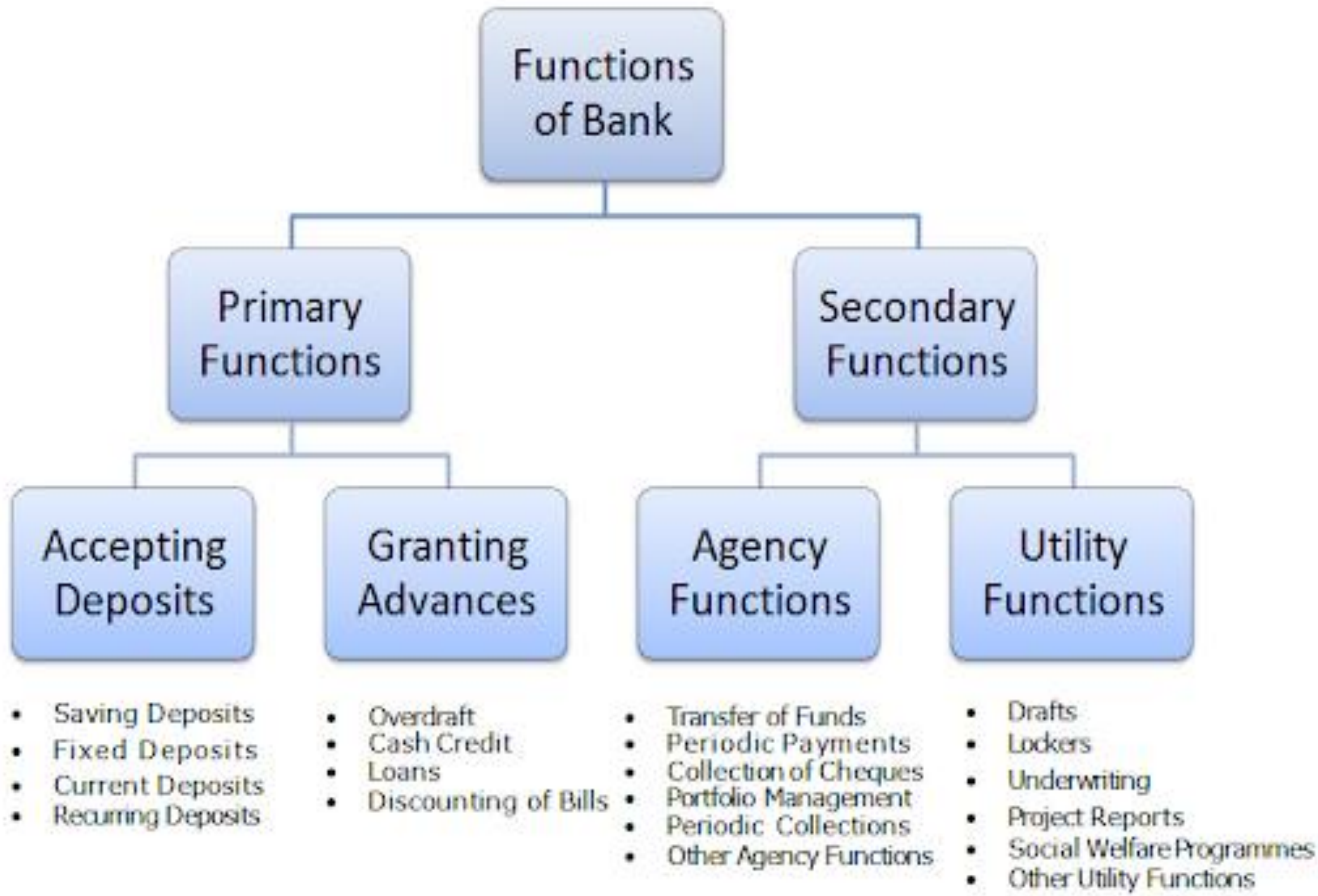
WHAT ARE BANKING INSTITUITIONS

The banking industry takes care of the finances of a country including credit. Banks are the backbone of the economy in any country and hence strict rules and regulations are imposed on the modus-operandi of banks. A **bank** is a financial institution that accepts deposits from the public and creates Demand Deposit. Lending activities can be performed either directly or indirectly through capital markets. Due to their importance in the financial stability of a country, banks are highly regulated in most countries.The major transactions that happen at banks are granting credits and accepting deposits from various entities.

DEFINITION

As **per** Section 5(b) of **Banking Regulation Act**, 1949,

- "banking" means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or other wise;
- 5 (c) "banking company" means any company which transacts the business of banking [in India]; Explanation.--Any company which is engaged in the manufacture of goods or carries on any trade and which accepts deposits of money from the public merely for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking within the meaning of this clause.


Functions of Bank
Primary Functions
Secondary Functions
Accepting Deposits
Granting Advances
Agency Functions
Utility Functions
Saving Deposits
Fixed Deposits
Current Deposits
Recurring Deposits
Overdraft
Cash Credit
Loans
Discounting of Bills
Transfer of Funds
Periodic Payments
Collection of Cheques
Portfolio Management
Periodic Collections
Other Agency Functions
Drafts
Lockers
Underwriting
Project Reports
Social Welfare Programmes
Other Utility Functions

There are two broad categories under which banks are classified in India- **SCHEDULED AND NON-SCHEDULED BANKS.**

The scheduled banks include **COMMERCIAL BANKS AND COOPERATIVE BANKS**. The commercial banks include **REGIONAL RURAL BANKS, SMALL FINANCE BANK, FOREIGN BANKS, PRIVATE SECTOR BANKS, and PUBLIC SECTOR BANKS.**

PAYMENTS BANK is a new introduction to the category.

SCHEDULED BANKS are the banks which are covered under the second schedule of the Reserve Bank of India Act, 1934. To qualify for being a scheduled bank, a minimum of 5 lakh paid-up capital is required on the bank's behalf. The RBI lends loan to these banks at bank rate as and when required.

COMMERCIAL BANKS are regulated and managed under the Banking Regulation Act, 1949. These are profit making banks based on their business model. Granting loans to the government, general public, and corporate and accepting deposits counts as the primary function.

FOREIGN BANKS

A bank operating as a private entity in India but headquartered in a Foreign country is a foreign bank. They are governed by both the country they are located in as well the country they have headquarters in. Some of these are:

1. CITI BANK
2. STANDARD CHARTERED BANK
3. HSBC BANK

REGIONAL RURAL BANKS

These banks were established mainly to support the weaker and lesser fortunate section of the society like marginal farmers, labourers, small enterprises etc. they mainly operate at regional levels at different states and may have branches in urban areas as well. Their main features are:

1. Supporting rural and semi-urban region financially
2. Pension distribution and Wage disbursement of MGNREGA workers
3. Added banking facilities like locker, cards-debit, and credit

PUBLIC AND PRIVATE SECTOR BANKS

- **Public Sector Banks** are those financial institutions where maximum shares are held by the government. On the other hand, **Private Sector Banks** are the ones where the majority stake is with **private** shareholders. ... The **public sector banks** also known as government **banks** enjoy a larger customer base than **private sector banks**.

As on April 1, 20202,After the **merger**, there will be 12 PSUs - six **merged banks** and six independent **public sector banks**. -Six independent **banks - Indian** Overseas **Bank**, Uco **Bank**, **Bank of** Maharashtra, Punjab and Sind **Bank**, **Bank of India**, Central **Bank of India**

- **Top 10 Private Sector Banks in India –**
- Axis Bank.
- HDFC Bank.
- Kotak Mahindra Bank.
- ICICI Bank.
- Yes Bank.
- InduslndBank.
- Bandhan Bank.
- Federal Bank

SMALL FINANCE BANKS
These banks cater to a niche segment in the society and help with financial inclusion of sections which are not taken care of by other leading banks. They look after micro industries, unorganized sector, small farmers etc. RBI and FEMA are the governing bodies of these banks.

COOPERATIVE BANKS
Run by the elected members of a managing committee and registered under the Cooperative Societies Act, 1912 are the cooperative banks. These are no-profit, no-loss banks and mainly serve entrepreneurs, industries, small businesses, and self-employment.

PAYMENTS BANK
This is a new and upcoming model of banking in India. It has been conceptualized and signed-off by RBI with restricted operations. Maximum of Rs. One Lakh is acceptable per customer by these banks. Like other banks, they also offer para-banking services like ATM cards, Debit- Credit cards, net-banking, mobile banking Examples; Airtel **Payments Bank,** India Post **Payments Bank,**
Fino **PaymentsBank,** Jio **Payments Bank,** Paytm **Payments Bank,**
NSDL **Payments Bank.(6)**

Legal framework for banking regulation

- Banking business and related financial services are governed primarily by the Banking Regulation Act, 1949 (Banking Regulation Act).
- The Reserve Bank of India Act, 1934 (RBI Act) empowers the Reserve Bank of India (RBI) to issue rules, regulations, directions and guidelines on a wide range of issues relating to banking and the financial sector. The RBI is the central bank of India, and the primary regulatory authority for banking.
- Cross-border transactions and related activities are governed by the Foreign Exchange Management Act, 1999. This provides for, among other things, certain banking and other institutions to be licensed as authorised dealers in foreign exchange.

WHAT ARE NON-BANKING FINANCIAL COMPANIES

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 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.

Section 45-1 (f) of the RBI Act, 1934 defines Non-Banking Financial Company as below:- Non-Banking Financial Company means—

(i) a financial institution which is a company,

(ii) (ii) a non-banking institution which is a company and which has its principal business the receiving of deposits, under any scheme or arrangement or in any other manner,

(iii) (iii) such other non- banking institution or class of such institutions as the bank may, with the previous approval of the central Government and by notification in the official Gazette, specify.

An entity will be NBFC if it is;

i. A company plus a financial institution, or

ii. A Company plus a carrying on as its principal business of receiving of deposit or lending, or

iii. A corporation / co-operative society which has declared as NBFC by RBI with the previous approval of Central Government.

"Non- banking financial company" means only the non-banking institution which is a loan company or an investment company or a hire purchase finance company or an equipment leasing company or a mutual benefit finance company."

Salient Features:-

– The NBFCs are allowed to accept/renew public deposits for a minimum period of 12 months and maximum period of 60 months. They cannot accept deposits repayable on demand.

– NBFCs cannot offer interest rates higher than the ceiling rate prescribed by RBI from time to time. The present ceiling is 12.5 per cent per annum.

– NBFCs cannot offer gifts/incentives or any other additional benefit to the depositors.

– NBFCs (except certain AFCs) should have minimum investment grade credit rating.

– The deposits with NBFCs are not insured.

– The repayment of deposits by NBFCs is not guaranteed by RBI. Certain mandatory disclosures are to be made about the company in the Application Form issued by the company soliciting deposits.

Types of NBFCs:

The NBFCs can be categorised under two broad heads:

1. On the nature of their activity

    Asset Finance Company

    Loan Company

    Mortgage Guarantee Company

    Investment Company

    Core Investment Company

    Infrastructure Finance Company

    Micro Finance Company

    Housing Finance Company

2. On the basis of deposits

    Deposit accepting Non-Banking Financial Corporations

    Non-deposit accepting Non-Banking Financial Corporations

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 ₹ 300 crore, c) has a minimum credit rating of ‘A ‘or equivalent d) and 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;

VI. Infrastructure Debt Fund-NBFC: 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.

VII. **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 ₹ 100 crore.

A **guaranteed mortgage** is a home loan **guaranteed** by a third party, often a government agency that will buy the debt from the lender and take responsibility for the loan if the borrower defaults. The value of the home secures the **mortgage**. If the borrower defaults, the lender can file a claim against the guarantor.

The General Regulatory Requirements of NBFC's in India

NBFCs can commence its operations only after obtaining a "Certificate of Registration" from the **RBI**.

NBFC Registration Requirements

- The company must be registered as a public limited company or **private limited company in India**.
- The company must have a minimum **net owned fund of Rs.2 Crore**.

Provided that, net owned funds should be calculated according to the last audited balance sheet of the company.

- For a **minimum period of 12 months** and a **maximum period of 60 months**, NBFCs are allowed to accept/renew public deposits.
- NBFCs cannot accept deposits repayable on demand.
- NBFCs can offer interest rates not higher than the ceiling rate prescribed by RBI from time to time.
- Offering gifts/incentives or any other additional benefit to the depositors is not allowed.
- There is a requirement of **minimum investment-grade credit rating**.
- Repayment of deposits by NBFCs is not guaranteed by RBI.
- Furnishing hard copies of the list of documents with the regional office of the RBI.

TOP 10 NBFC'S IN 2019

- 1) Power Finance corporation Limited
- 2)Shri Ram Transport Finance Limited
- 3) Bajaj Finance Limited. ...
- 4) Mahindra & Mahindra Financial Services Limited. ...
- 5) HDB Finance Services. ...
- 6) Cholamandalam Investment and Finance Company Limited. ...
- 7) Tata Capital Financial Services Ltd. ...
- 8) L&T Finance Limited. ...
- 9) Aditya Birla Finance Limited. ...
- **10**) Muthoot Finance Ltd.

PFC

Cholamandalam

HDB

CAPITAL

BAJAJ FINSERV

Mahindra FINANCE

MANAPPURAM FINANCE LIMITED

SHRIRAM

Commercial Vehicle Finance

GETS YOU GOING

DIFFERENCE BETWEEN A BANK AND NBFC :

1. You can open a Savings or Current Account at banks. NBFCs are not licensed to open Savings or Current Accounts.
2. Fixed Deposit schemes are available from bank and NBFCs. While banks offer interest on FDs based on rates stipulated by RBI, an NBFC is free to offer higher or lower interest rates on Fixed Deposits.
3. All loans given by banks are subject to interest rates fixed by RBI. Loans from NBFCs also comply with RBI laws but have the autonomy to charge higher or lower.
4. Banks do not offer asset management services. However, banks and private companies offer the service through their Asset Management Companies.
5. Banks cannot directly offer insurance schemes. Specialized NBFCs like Life Insurance Corporation of India (LIC) and others can offer insurance policies. Banks can offer these only in collaboration with insurers.

6. Banks do not offer Mutual Funds and Systematic Investment Plans. However, NBFCs operated by banks and other companies offer Mutual Funds and SIPs for investments.

7. The deposits with banks are insured up to a maximum of Rs. 1,00,000 by Deposit Insurance and Credit Guarantee Corporation of India. Hence, RBI guarantees your money. With NBFCs, your deposits are prone to market risks and in some cases, frauds.

8. Banks have to comply with the Banking Regulation Act 1949 of India. NBFCs have to comply with Companies Act 1956.

Note: Deposit insurance scheme covers bank deposits including savings, fixed and recurring with an insured bank

This deposit guarantee can be released only if the bank gets closed.

THANK YOU