Financial institutions

5.61 Based on the major activity undertaken by them, Financial Institutions (FIs) get classified into three broad categories (i) term-lending institutions, whose main activity is direct lending by way of term loans and investments; (ii) refinance institutions, such as the National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI) and National Housing Bank (NHB), which mainly extend refinance to banks as well as non-banking financial institutions and; (iii) investment institutions such as Life Insurance Corporation (LIC), which deploy their assets largely in marketable securities. State/ regional level institutions form another distinct group.

5.62 The combined balance sheets of select FIs (NABARD, NHB, SIDBI and EXIM Bank) expanded sharply by 19.5 per cent during 2007-08. On the liabilities side, the resources raised by way of bonds and debentures (which form a major constituent with a share of 32.5 per cent in the total liabilities) declined by 3.5 per cent during 2007-08. However, deposits and borrowings recorded a sharp increase of 54.1 per cent and 56.7 per cent, respectively. On the assets side, loans and advances continued to expand, while the investment portfolio declined (9.3 per cent). Cash and bank balances as well as other assets registered a sharp turnaround during the year.

5.63 Resources raised by FIs during 2007-08 were considerably higher than those during the preceding year. While the long-term resources raised witnessed a sharp rise during 2007-08 as compared to 2006-07, the short-term resources raised declined. Resources raised in foreign currency and from the money market also witnessed an increase during 2007-08.

5.64 Financial assistance sanctioned by FIs accelerated sharply during 2007-08 as against the deceleration witnessed during the preceding year. The acceleration in sanctions was accounted for mainly by investment institutions (especially LIC). Notwithstanding the acceleration in sanctions, the disbursements by FIs slowed down during 2007-08. (Table 5.9)

Table 5.9: Financial assistance sanctioned and disbursed by financial institutions

(Rs. crore)

Category	Amount				Percentage variation	
	2006-07		2007-08		2007-08	
	S	D	S	D	S	D
(i) All-India term-lending Institutions*	11102	10225	16181	15098	45.7	47.6
(ii) Specialised financial institutions#	—	—	—	—	—	—
(iii) Investment institutions@	18862	27757	39617	28414	110.0	2.4
Total assistance by FIs(i+ii+iii)	29964	37982	55798	43512	86.2	14.6

Source : RBI

S : Sanctions * : Relating to SIDBI and Industrial Investment Bank of India. D : Disbursements
 # Relating to IVCF and ICICI Venture. @ : Relating to LIC and GIC & erstwhile subsidiaries — : Not Available.

Note : All data are provisional.
Data for 2006-07 has been recalculated to exclude IFCI Ltd, and Tourism Finance Corporation of India Ltd. as they are being regulated as NBFCs as on March 31, 2008.

5.65 Net interest income of FIs increased by 19.7 per cent to Rs. 2,642 crore during 2007- 08 from Rs. 2,208 crore during 2006-07. In line with the trend in the previous years, non-interest income of FIs increased significantly by 71.8 per cent during the year. However, in contrast with the decline in the preceding year, the operating expenses of FIs registered a sharp rise of 46.6 per cent during the year. The operating profit recorded an increase of 30.1 per cent during the year.

5.66 In absolute terms, net NPAs of EXIM Bank and NABARD declined during 2007-08, while that of SIDBI increased. Reflecting the improvement in asset quality, NPAs in the sub-standard and doubtful category of all FIs constituted a very small share. Also none of the FIs had any assets in the 'loss' category.The capital adequacy ratio of all the FIs continued to be significantly higher than the minimum stipulated norm of 9 per cent.

5.67 In recent years, the Reserve Bank of India has taken a number of initiatives for progressive upgradation of the regulatory norms for FIs in convergence with the norms across the financial sector. Some of these include:

- A sizeable portion of exposure of SIDBI is by way of refinance to State Finance corporations (SFCs). The poor financial health of SFCs has a spillover effect on the financial health of SIDBI as well. Therefore, the risk weight in respect of SIDBI's exposure to SFCs has been raised from 100 per cent to 125 per cent. SIDBI was also instructed not to sanction refinance to SFCs that continued to show negative net worth. These measures were taken to strengthen the regulatory focus of SIDBI over the SFCs.
- The Government of India from time to time, also issues special securities (e.g. oil bonds, fertilizer bonds) which do not qualify for meeting the SLR requirements of banks. Such Government securities are governed by a separate set of terms and conditions and entail a higher degree of liquidity spread. The issue of valuation of such special securities was re-examined and in June 2008 FIs were advised that, for the limited purpose of valuation, all special securities issued by the Government of India, directly to the beneficiary entities, which do not carry SLR status, may be valued at a spread of 25 bps above the corresponding yield on Government of India securities from the financial year 2008–09.
- With a view to enhancing credit delivery to the employment intensive micro and small enterprises (MSE) sector, it was decided on December 6, 2008 to provide refinance of Rs. 7,000 crore to SIDBI and Rs. 4,000 crore for NHB.

Non-Banking Financial Companies

5.68 Non-Banking Financial Companies (NBFCs) broadly fall into three categories, viz., (i) NBFCs accepting deposits from the public; (ii) NBFCs not accepting/holding public deposits; and (iii) core investment companies (i.e., those acquiring shares/securities of their group/holding/subsidiary companies to the extent of not less than 90 per cent of total assets and which do not accept public deposit).

5.69 Until some years back, the prudential norms applicable to banking and non-banking financial companies were not uniform. Moreover, within the

NBFC group, the prudential norms applicable to deposit taking NBFCs (NBFCs-D) were more stringent than those for non-deposit taking NBFCs (NBFCs-ND). Since the NBFCs-ND were not subjected to any exposure norms, they could take large exposures. The absence of capital adequacy requirements resulted in high leverage by the NBFCs. Therefore, since 2000, the Reserve Bank has initiated measures to reduce the scope of "regulatory arbitrage" between banks, NBFCs-D and NBFCs-ND.

5.70 Total number of NBFCs registered with the Reserve Bank, consisting of NBFCs-D (deposit-taking NBFCs), Residual Non-Banking Companies (RNBCs, Mutual Benefit Companies (MBCs), Miscellaneous Non-Banking Companies (MNBCs) and Nidhi companies, declined from 12,968 at end-June 2007 to 12,809 at end-June 2008. The number of NBFCs-D has shown a steady decline to 364 at end-June 2008, mainly due to the exit of many NBFCs from deposit taking activity (Table 5.10). The number of RNBCs declined to two at end-March 2008. Even though the public deposits declined in 2007-08 over the previous year, partly reflecting the decline in number of reporting NBFCs, total assets increased significantly by Rs. 23,019 crore (32.1 per cent), while net owned funds increased by Rs. 3,974 crore (48.0 per cent) during the same period.

5.71 Continuing the trend of the preceding year, public deposits held by all groups of NBFCs taken together, declined moderately during 2007-08. The outstanding borrowings by NBFCs increased during 2007-08. Borrowings by NBFCs were mainly from banks and financial institutions and by way of bonds and debentures and "other sources" (which include miscellaneous sources including money borrowed from other companies, unsecured loans from directors/ promoters, commercial paper, borrowings from mutual funds and any other type of funds which are not treated as public deposits). Financial performance of NBFCs improved during 2007-08 due to increases in fund-based and fee-based incomes . Continuing the trend witnessed during the last few years, gross Non Performing Assets (NPAs) as well as net NPAs (as percentage of gross advances and net advances, respectively) of reporting NBFCs declined further during the year ended March 2008.

Table 5.10 : Number of Non-banking financial companies registered with RBI

End-June	Number of registered NBFCs	NBFCs accepting public deposits	Column 3 as per cent of column 2
2003	13,849	710	5.1
2004	13,764	604	4.4
2005	13,261	507	3.8
2006	13,014	428	3.3
2007	12,968	401	3.1
2008	12,809	364	2.8

Source : RBI

5.72 Capital to risk-weighted assets ratio (CRAR) norms were made applicable to NBFCs in 1998, in terms of which, every deposit taking NBFC is required to maintain a minimum capital, consisting of Tier-I and Tier-II capital, of not less than 12 per cent (15 per cent in the case of unrated deposit-taking loan/ investment companies) of its aggregate risk-weighted assets and of risk-adjusted value of off-balance sheet items. The number of NBFCs with less than the minimum regulatory CRAR of 12 per cent increased to 44 at end-March 2008 from 20 at end-March 2007. At end-March 2008, 276 out of 320 NBFCs had CRAR of 12 per cent or more as against 354 out of 374 NBFCs at end-March 2007. The number of NBFCs with CRAR more than 30 also declined to 238 at end-March 2008 from 305 at end-March 2007. Notwithstanding this, it is noteworthy that the NBFC sector is witnessing a consolidation process in the last few years, wherein the weaker NBFCs are gradually exiting, paving the way for a stronger NBFC sector.

5.73 With a view to protecting the interests of depositors, regulatory attention was mostly focused on NBFCs accepting public deposits (NBFCs-D) until recently. Over the last few years however, this regulatory framework has undergone a significant change, with increasingly more attention now being paid to non-deposit taking NBFCs (NBFCs-ND) as well. This change was necessitated mainly on account of a significant increase in both the number and balance sheet size of NBFCs-ND segment which gave rise to systemic concerns. To address this issue, NBFCs-ND with asset size of Rs.100 crore and above were classified as systemically important NBFCs (NBFCs-ND-SI) and were subjected to "limited regulations". The NBFCs-NDSI are now subject to CRAR and exposure norms prescribed by the Reserve Bank. The CRAR prescription for such companies has been raised to 12 per cent from March 31, 2009 and further to 15 per cent by March 31, 2010.

5.74 SEBI has permitted Fixed Income Money Market and Derivatives Association of India (FIMMDA) to set up its reporting platform for corporate bonds. It has also been mandated to aggregate the trades reported on its platform as well as those reported on BSE and NSE with appropriate value addition. The FIMMDA platform has gone live with effect from September 1, 2007. All NBFCs are required to report their secondary market transactions in corporate bonds in the OTC market on FIMMDA's reporting platform since September 1, 2007.

5.75 In the wake of emergent tight liquidity scenario, the Reserve Bank of India had on October 15, 2008 announced, purely as a temporary measure, that banks may avail of additional liquidity support exclusively for the purpose of meeting the liquidity requirements of NBFCs/mutual funds (MFs) to the extent of up to 0.5 per cent of their NDTL. Further, on a purely temporary and ad hoc basis, subject to review, the banks were allowed to avail liquidity support under the LAF through relaxation in the maintenance of SLR to the extent of up to 1.5 per cent of their NDTL. This relaxation in SLR was to be used exclusively for the purpose of meeting the funding requirements of NBFCs and MFs.

5.76 Taking into consideration the need for enhanced funds for increasing business and meeting regulatory requirements, NBFCs-NDSI were permitted to augment their capital funds by issue of Perpetual Debt Instruments (PDI). PDIs could be issued in Indian rupees only and the aggregate amount to be raised by issue of such instruments has to be within the overall limits of Tier I and Tier II capital. Further as a temporary measure, NBFCs-NDSI have been permitted to raise short-term foreign currency borrowings under the approval route, subject to certain conditions like eligibility of borrowers and lenders, end-use of funds, maturity, etc. The maximum amount should not exceed 50 per cent of the net-owned funds or US$ 10 million (or its equivalent), whichever is higher.