Q As NBFCs become systematically important, regulation must be on a par with scheduled banks to ensure financial stability. Discuss.

Recently, due to payment defaults as NPAs and catalytic risk crises in NBFCs make RBI to regulate it to make transparency and uniformity in Banking sector.

Non-Banking Financial Company (NBFC) is a company registered under the Company Act, 1956 engage in the business of loans and advances, acquisition of shares or bonds or securities issued by government of India or local or marketable authority, but not include it by business of agri & industrial activity.

Why Regulation Required?

1. Expanded balance sheet ≈ 1/4th of balance sheet of Bank's are.
2. Giving loans to non-creditworthy / non-investment grade borrowers, too.
3. Over-indebtness and coercive recovery practice
4. Misused of "loan against property" and made it as evergreening process.
5. Lack of Co-orporate governance and default payment accounts for creating retail borrowers as in (DHFL) & (IL&FS) NBFCs.

Why Systematically important?

1. Lending for infrastructure projects.
2. Provide small ticket loans for affordable housing.
3. Promote inclusive growth.

4. Managing port folio management of stocks & shares.

5. Last resort of Borrowing.

Regulatory approach of RBI

1. Instead of light-torch regulation, provide 4-tied regulation to top-down approach.
2. Following "Fit & Proper criteria for selecting top management of NBFCs.
3. Pro-public centric monitoring of off-Balance sheets and face account monetisation.
4. Reinventing the structural form.
5. Co-mingling approach in borrowing.
6. RBI has to "Ring-fence" NBFCs by CAMELS (Capital adequacy, Asset quality, Management efficiency, Earnings, liquidity, Systems) monitoring supervision.
7. Upholding fiduciary trust of investor by quick risk mitigation procedure.

So far, RBI has to extend inch-by-inch monitory approach for NBFCs but provides some federalism in finacy regulation which is to be reserved for its maintaining unitary feature of shadow banking.