FIDC NEWS
Finance Industry Development Council
(A Self-Regulatory Organisation for Non-Banking Finance Companies (NBFCs) registered with RBI)

JANUARY-MARCH – 2013 VOLUME – 4 NO. – 4 FOR PRIVATE CIRCULATION

Allow NBFCs to pursue financial inclusion agenda

It is undisputed fact that NBFCs are playing a very crucial role in Financial Inclusion agenda of the Nation. It caters to the financial need of Lower Income Group (LIG) and Middle Income Group (MIG), many of whom are unbanked, through various innovative products and in turn, support entrepreneurship of millions of small businessmen and create huge employment opportunities.. On the other hand, NBFCs also support manufacturers of vehicles, equipments etc. in creating demand for their products by providing finance to the buyers.

Currently, as per RBI report, around 12300 NBFCs are registered with RBI which were almost thirty to forty thousands in number before the registration was made mandatory by RBI. NBFCs manage around 5% of the total funds managed by the banking industry.

FIDC represents the NBFCs having almost 90% share of the assets financed by the industry as a whole. It emphatically suggests to RBI in respect of Draft Guidelines issued on 12th December the following:

Capital Adequacy Ratio: May be raised after introducing graded risk weight assigned to productive assets like commercial vehicles, equipment etc. which have been categorized as low risk by rating agencies like CRISIL. This is also in line with the graded risk weightage assigned to assets funded by housing finance.

NPA norms: Since NBFCs cater to unbanked customer segment who have no collaterals and irregular cash flows, NPA provisioning should be kept as it is without any change.

Public Deposit Norms: Since NBFCs are maintaining prescribed CAR, prescribing sub-limits for deposits further restrict the fund raising ability and will impact NBFCs adversely, when there is credit squeeze from banks to this sector. Moreover, NBFCs are creating assets as well as maintain SLR against this borrowing providing safety to the depositors.

Entry Norms: The existing norm of minimum NOF of Rs.2 crore to be maintained and not to introduce any new eligibility criteria like minimum assets for registration.

Making funds available to the sector for future growth:

- Almost 50% to 60% of equity in many of the large listed NBFCs of this sector comes from FIIs and if NBFCs are allowed to raise debt overseas through , ECB, will really help in the growth of this sector. ECB window needs to be opened for Asset Financing NBFCs also.
- Removing priority sector status for lending by banks to NBFC has put lot of hardship in raising funds from the banks at competitive rates resulting in higher cost to the end borrowers. The same should be restored as reaching to the end customer is very important agenda. The change in securitization guideline has also affected adversely the flow of funds to this sector through this source.
- There is a strong case for refinance institution for this sector in line with National Housing Bank (NHB) to ensure smooth and continuous flow of resources to NBFCs, playing very vital role in last mile credit delivery in vast county like India where many agencies are required along with bank to fulfil this objective.

R Sridhar, Chairman, FIDC

REGULATORY PERIMETER

RBI NOTIFICATIONS & CIRCULARS :

External Commercial Borrowings Policy – Non-Banking Financial Company – Infrastructure Finance Companies- RBI/2012-13/367-A.P. (DIR Series) Circular No. 69; Jan. 7, 2013

Guidelines on Fair Practices Code for NBFCs – Grievance Redressal Mechanism - Nodal Officer- RBI / 2012-13/416; DNBS.CC.PD.No. 320/03.10.01/2012-13 February 18, 2013

KYC norms /AML Standards / CFT / Obligation of banks under PMLA, 2002 : RBI/2012-13/422 DNBS (PD).CC. No 321 /03.10.42 /2012-13; Feb. 27, 2013

RBI liberalises ECB policy for NBFC-IFCs

RBI on Jan. 7 decided to enhance the ECB limit for NBFC-IFCs under the automatic route from 50 % of their owned funds to 75 % of their owned funds, including the outstanding ECBs. NBFC-IFCs desirous of availing ECBs beyond 75 % of their owned funds would require the approval of the Reserve Bank and will, therefore, be considered under the approval route. RBI also decided to reduce the hedging requirement for currency risk from 100 per

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cent of their exposure to 75 per cent of their exposure. The permitted end-use should be for on-lending to the infrastructure sector, as defined under the extant ECB policy.

NBFCs to have Grievance Redressal Mechanism - Nodal Officer

RBI revised guidelines on Fair Practices Code (FPC) for all NBFCs vide circular dated 18 Feb.2013 in view of the creation of a new category of NBFCs viz; NBFC-MFIs and also rapid growth in NBFCs' lending against gold jewellery. NBFCs are asked to lay down the appropriate grievance redressal mechanism within the organization to resolve disputes between the company and its customers and the mechanism should ensure that all disputes arising out of the decisions of lending institutions' functionaries are heard and disposed of at least at the next higher level. More over all NBFCs are directed to display prominently, for the benefit of their customers, at their branches / places where business is transacted, the details of the grievance redressal officer belonging to their company as also that of the local office of RBI as detailed at paragraph (A) (vi) of annexe of FPC.

RBI extends deadline for issuance of new cheques

The RBI asked banks to issue new cheque books only under the new format [the new standard CTS-2010] and gave them time till July-end to withdraw the old format cheques. All cheques at present with customers in the old format (non-cheque truncation system) will continue to be valid for another four months (the earlier deadline was March 31), the apex bank said. The central bank also said the system of post dated cheques and payment via equated monthly installment (EMI), in either the old or new format, will be banned from now wherever electronic debit facilities are available. All residual non-CTS-2010 cheques with customers will continue to be valid and accepted in all clearing houses (including the cheque truncation system (CTS) centers) for another four months up to July 31, subject to a review in June 2013, RBI said in a circular to bank heads. [Financial Chronicle/PTI, Mar 18]

Scrap post-dated cheque system: RBI panel

The RBI wants to do away with post-dated cheques (PDC) in all fresh loans. It is also debating putting a charge on cash deposits and withdrawals from banks in current accounts above certain limits. The suggestions have been made in a discussion paper on disincentivising issuance and usage of cheque issued by the Bank. "Existing PDCs should be converted to electronic payment mandates within a prescribed timeline," the RBI paper said. Preference of the lenders for post-dated EMI cheques rather than other electronic modes of collection under the strong belief that the lender gets protection under Negotiable Instruments Act only if the payments are made through cheques. Corporates have to also be discouraged from issuing physical interest warrants and dividend warrants. "Where such physical instruments are issued, a processing charge (for instance Rs 25 per instrument) may be levied by the paying bank when the instrument is presented for payment," the paper said. Similarly, cash deposits in current accounts need to be discouraged actively, the RBI paper said. [Financial Express, Feb. 1]

Present propositions are patently loaded against NBFCs: Mahesh Thakkar

At a seminar organized by Indian Merchants Chambers and FIDC jointly at Mumbai on January 7 Mr. Mahesh Thakkar, director general, FIDC said while outlining the draft guidelines issued by RBI on 12th December 2012 that 'given the ground realities, over two-thirds of registered NBFCs face closure if the recommendation on minimum asset size of Rs. 25 crore of financial assets and mandatory credit rating is brought in'. He further added that 'The present propositions are patently loaded against NBFCs', and appealed that they must be adequately reconsidered.

Panel to plug regulatory gaps in shadow banking

Raising concern on regulatory and data availability gaps on the shadow banking system, the Reserve Bank of India (RBI) on Dec. 28 said plugging these was necessary for a full assessment of the size of the non-banking financial segment, and of the systemic risks posed by the latter. To address these, a working group with representation from all financial sector regulators is attempting to "macro map" the shadow banking sector, it said. RBI also raised concern about regulatory gaps in the case of entities operating collective investment schemes, such as chit funds or multi-level-marketing schemes.

In its Financial Stability Report issued on Dec. 28, RBI cited a few examples from the current financial system which were out of its regulatory purview. "Government-sponsored NBFCs remain outside the regulatory and supervisory framework," it said. It has recently proposed that all government companies qualifying as NBFCs under the revised principal business criteria will be required to comply with the regulatory framework applicable to NBFCs at the earliest. [Business Standard, Dec.29]

Issues related to gold loans NBFCs

Institutional Issues and Domestic Financial Stability Concerns

Indian gold loan market expanded considerably in recent years. The recent developments in the gold loan market have both positive and negative implications. In a country, where illiterate and semi-literate people have to raise a loan for meeting some sudden medical exigency or an educational loan or a business loan by a small and medium enterprise owner, the gold loans extended by the NBFCs are very handy and flexible, though costlier than such loans disbursed by banks. At a time, when financial inclusion is a major policy goal, the services rendered by the gold loans NBFCs, which are a part of the organised loan market are contributing in a reasonable measure to cater to the borrowing requirements of a needy section of the society. Secondly, gold is an idle asset in the hands of individuals and there is a huge unlocked economic value in the Indian economy, which is said to have anywhere between 18000 to 20000 tonnes of gold. Just a small fraction of about three per cent of this idle gold stock is being used for raising gold loans, at present. The process through which gold loans are raised is monetising the gold in the country. If we cannot bring down the demand for gold significantly, at least, we need to ensure that the gold is put to an economic use through gold loans. The Working Group sees huge potential for the gold loans business in India in the medium and long run, as the gold stock increases ceaselessly in the country for varied reasons. Banks and gold loan NBFCs extending gold loans are playing a role in this financialisation process. But, there are developments, which are of concern like very rapid rate of growth of the gold loan business of NBFCs, the speed with which they opened branches, the rate at which they started raising resources both from banks and non-bank sources, their high profitability, complaints made by borrowers against the NBFCs and the steady decline in their capital funds. These developments warranted regulation and careful monitoring of their operations and activities. The regulatory actions initiated by the Reserve Bank in the recent months will have to be viewed against this setting. Customer protection has become an issue in the light of multiple complaints against the gold loans NBFCs.

No immediate systemic implications in terms of domestic financial stability from the gold loans NBFCs.

The financial performance of the gold loans NBFCs and the current level of their borrowings from the banking system are not of a significant concern. There appears to be no immediate systemic implications in terms of domestic financial stability due to the interconnectedness of gold loans NBFCs and banking system. It was empirically tested that increase in gold loans extended by NBFCs and banks does not impact significantly the gold prices in India both in long run and short run. However, if the present rate of growth in their bank borrowings is unchecked, gold loans may become significant portion in the portfolio of banks in the medium term. There were also instances of regulatory violations in the manner in which resources are raised through debentures by the gold loan NBFCs.

The impact of recent regulatory measures on gold loans NBFCs is clearly visible

The recent regulatory measures initiated by the Reserve Bank are in the right direction and is expected to make the gold loans NBFCs robust and reduce the regulatory gaps between banks and gold loans NBFCs. As gold loans NBFCs aspire for a level playing field with banks over medium term, they should be prepared for equal regulatory and supervisory treatment and strengthening of their capital buffers. The Working Group recognises the fact that there is a tradeoff between the goal to monetise as much idle gold in the economy as possible and the need to have a restrictive 'loan to value ratio' imposed on gold loan NBFCs. Therefore, once the business levels of these gold loans NBFCs comes to a level as considered 'appropriate' by the Reserve Bank, there appears to be a case for revisiting the prescribed 'loan to value ratio' of 60 per cent. The Group suggested an alternative uniform method to calculate the LTV ratio and also to have working definition of gold 'value'.

Going forward, customer protection should be the focus of the gold loans NBFCs

Going by the nature of complaints against gold loans NBFCs, like excessive interest rate related disputes, charges of improper documentation and auction related issues, there is a need to monitor the operational practices of the gold loans NBFCs carefully and continuously. There is also a continued need for strengthening the regulations and supervision to make them robust over medium and long haul and also make them highly customer-oriented. The major gold loan companies need to follow appropriate documentation, modify auction procedures and also go for a self-imposed interest rate rationalisation. In sum, the operational practices followed by the NBFCs need an overhaul. The Gold Loan industry can play a proactive role in ensuring the scrupulous implementation of the prescribed fair practices code in all aspects of the functioning of gold loans NBFCs.

[Extract from executive summary of the Final Report of the RBI Working Group to Study the Issues Related to Gold Imports and Gold Loans NBFCs in India]

NBFC sector in India- Evolution of regulation

Mr. Anand Sinha, Deputy Governor, Reserve Bank of India

"The NBFC sector has been the fastest growing segment in the Indian financial sector today with year on year growth higher than that of banking sector."

"we have always been cognizant of the fact that NBFCs play a significant role in the financial system and in the economic growth."

Non-Banking Financial Companies (NBFCs) in India are defined as companies carrying out a range of financial activities such as making loans and advances; investing in shares /bonds/debentures/and other securities; asset financing including leasing, and hire-purchase finance. The recent additions to this sector have been (i) Infrastructure Finance Companies (IFC), (ii) Infrastructure Debt Funds (IDF), (iii) Micro Finance Institutions (NBFC- MFI) and (iv) Factors. In India, NBFCs quintessentially epitomize the shadow banking system as they perform bank like credit intermediation outside the purview of banking regulation. Apart from this, where the entire OFI assets account for approximately 24 percent of bank assets as on March 31, 2012, assets of the NBFC sector alone account for 12 percent, denoting the significance of NBFCs in the Indian shadow banking system.*

As a background to the setting up of the Working Group on NBFCs chaired by Ms. Usha Thorat, let me briefly touch upon the evolution of regulation of NBFC sector in India. Steps for regulation of NBFCs were initiated as early as in the sixties. Regulation of NBFCs was found to be necessary for three reasons viz., ensuring efficacy of credit and monetary policy, safeguarding depositors' interest and ensuring healthy growth of Non-Banking Financial Intermediaries (NBFIs). Thus, the Banking Laws (Miscellaneous Provisions) Act, 1963 was introduced to incorporate a new chapter (i.e., Chapter III B) in the Reserve Bank of India Act, 1934 to regulate the NBFIs. Subsequently, to enable the regulatory authorities to frame suitable policy measures, several committees were appointed from time to time, to conduct in-depth study of these institutions and make suitable recommendations for their healthy growth. These include the Bhabatosh Datta Study Group (1971), the James Raj Study Group (1974), and the Chakravarty Committee, 1985. Thereafter, the Narasimham Committee (1991) outlined a framework for streamlining the functioning of the NBFCs, which would include, in addition to the existing requirements of gearing and liquidity ratios, norms relating to capital adequacy, debt-equity ratio, credit-concentration ratio, adherence to sound accounting practices, uniform disclosure requirements and assets valuation. The Joint Parliamentary Committee (JPC), appointed in connection with the irregularities in the Securities Transactions, had also recommended that legislative framework should be strengthened to vest in RBI more powers to effectively regulate NBFCs. The extant regulatory and supervisory framework as it stands today is based on the recommendations of the Shah and Khanna Committees (1992 and 1995).

The growing significance of NBFCs was also recognized by the second Narasimham Committee (1998) as well as by the RBI in its Discussion Paper on Harmonisation of the Role and Operations of DFIs and Banks. Recognizing the increasing significance of the sector, the Working Group on Money Supply (Chairman: Dr. Y.V. Reddy) in 1998 proposed a new measure of liquidity aggregate incorporating NBFCs with public deposits of Rs. 0.20 billion and above.

There was a significant increase in the nature of NBFC activities in the nineties. NBFCs grew sizably both in terms of their numbers as well as the volume of business transactions. The number of NBFCs grew more than seven-fold from 7,063 in 1981 to 51,929 in 1996. Accordingly, based on the recommendations of the Shah Committee, the RBI Act was amended in January 1997 to provide a comprehensive legislative framework for regulation of NBFCs by effecting changes in the provisions contained in Chapter III-B and Chapter V of the Act and vested more powers with the RBI. The regulatory framework was based on the three pillars viz., onsite supervision, offsite monitoring and exception reporting by auditors. Though the amended Act provided for registration of all NBFCs, the focus continued to be the protection of depositors' interest thus covering the deposit taking NBFCs, while keeping the non-deposit taking NBFCs subject to minimal regulation. These measures resulted in consolidation of the sector, reduction in the number of deposit taking NBFCs, reduction in the quantum of public deposits and increase in the number of non-deposit taking NBFCs. The number of deposit taking NBFCs, including Residuary Non-Banking Finance Companies (RNBCs), decreased from 1,429 in March 1998, to 273 in March 2012. The deposits held by these companies (including RNBCs) decreased from Rs. 238 billion to Rs.101 billion during the same period.

With the consolidation of the sector and stabilising of deposit taking NBFCs, the focus in 2006 widened to include non-deposit taking NBFCs which were growing in number as well as in size. Considering the issue of systemic importance of large NBFCs in view of their size, their enhanced risk taking capabilities, growing complexity of their activities, and the financial market interlinkages, a comprehensive regulatory framework was introduced for these NBFCs. To begin with, non deposit taking companies having asset size of Rs. 1 billion (100 crore) and above were classified as systemically important non deposit taking NBFCs (NBFCs-ND-SI) and subjected to capital adequacy and credit concentration norms. Subsequently, liquidity and disclosure norms were made applicable to them. Presently, as on March 31, 2012, there are 375 NBFCs-ND- SI with a total asset size of Rs. 9213 billion.

The NBFC sector has been the fastest growing segment in the Indian financial sector today with year on year growth higher than that of banking sector as seen from the figures below:

NBFC sector during the 2008 crisis

The NBFC sector came under pressure during the 2008 crisis due to the funding interlinkages among NBFCs, mutual funds and commercial banks. NBFCs-ND-SI relied significantly on short term funding sources such as debentures (largely non convertible short term debentures), and CPs, which constituted around 56.8 percent of the total borrowings of NBFCs-ND-SI as on September 30, 2008. These funds were used to finance assets which were reportedly largely a mix of long term assets, including hire purchase and lease assets, long term investments, investment in real estate by few companies, and loans and advances. These mismatches were created mainly as a business strategy for gaining from the higher spreads. However, there were no fall back alternatives in cases of potential liquidity constraints. The ripple effect of the turmoil in American and European markets led to liquidity issues and heavy redemption pressure on the mutual funds in India, as several investors, especially

*In India, NBFCs constitute a major segment of shadow banking system alongside other entities such as Insurance companies and Mutual Funds, both of which are regulated by other regulators. In the address, NBFCs are referred to be largely representing the shadow banking sector.

Mr. Niranjan Hiranandani, President, Indian Merchants' Chamber (IMC), Mr. Mahesh Thakkar, Co-Chairman, Finance and Banking Committee, IMC, Mr. TT Srinivasaraghavan, Managing Director, Sundaram Finance Ltd., Mr. K V Srinivasan, CEO, Reliance Commercial Finance, Ms. Usha Thorat, currently the Director, CAFRAL and the Chairperson of the Working Group on the issues and concerns in the Non Banking Financial Companies (NBFC) sector, and several other distinguished guests were present at the event.

Growth in Total Assets of Banks vis-à-vis NBFCs						
Item	As at end					
	2007	2008	2009	2010	2011	2012
Banks	3459961	4326486	5241330	6025141	7183522	8299400
Growth (Y-o-Y)		25	21.1	15	19.2	15.5
NBFCs	366452	478997	560035	657185	866713.7	1038189
Growth (Y-o-Y)		30.7	16.9	17.3	31.9	19.8
Source: Trend and Progress of Banking in India, various issues						
Note: NBFCs include all deposit taking NBFCs and NBFCs-ND-SI						

institutional investors, started pulling out their investments in liquid and money market funds. Mutual funds being the major subscribers to CPs and debentures issued by NBFCs, the redemption pressure on MFs translated into funding issues for NBFCs, as they found raising fresh liabilities or rolling over of the maturing liabilities very difficult. Drying up of these sources of funds along with the fact that banks were increasingly becoming risk averse, heightened their funding problems, exacerbating the liquidity tightness.

Measures taken by RBI to enhance availability of liquidity to NBFCs

RBI undertook many measures, both conventional as well as un conventional, to enhance availability of liquidity to NBFCs such as allowing augmentation of capital funds of NBFCs-ND-SI through issue of Perpetual Debt Instruments (PDIs), enabling, as a temporary measure, access to short term foreign currency borrowings under the approval route, providing liquidity support under Liquidity Adjustment Facility (LAF) to commercial banks to meet the funding requirements of NBFCs, Housing Finance Companies(HFCs) and Mutual Funds, and relaxing of restrictions on lending and buy-back in respect of the certificates of deposit (CDs) held by mutual funds.

In addition to these measures, a Stressed Asset Stabilisation Fund viz., IDBI SASF, was set up to provide liquidity to NBFCs through purchase of securities of NBFCs which would in turn be refinanced by RBI through purchase of Govt. guaranteed securities issued by the SASF.

Notwithstanding the market reports, the actual condition of NBFCs was not so alarming inasmuch as only one NBFC availed refinance from the SASF and no NBFCs went under. However, this dichotomy between perception and reality serves to show how susceptible the sector could be to reputational risk. Thus, the significance of the above measures lies also in their ability to create confidence in the sector.

The crisis did, however, highlight some regulatory issues concerning the non-banking financial sector, particularly risks arising from regulatory gaps, arbitrage and systemic inter-connectedness. A need was, therefore, felt to reflect on the broad principles that underpin the regulatory architecture for NBFCs keeping in view the economic role and heterogeneity of this sector and the recent international experience. It was felt necessary to examine in depth, the risks in the NBFC sector in the changed scenario and recommend appropriate regulatory and supervisory measures to address these risks with the aim of creating a strong and resilient financial sector which is vital for all round economic growth of the country. Accordingly a Working Group (Chair: Ms. Usha Thorat) was constituted to suggest reforms in various important areas relating to NBFC sector. The Working Group comprised representatives from the industry and co- regulators like SEBI.

Recommendations of the Working Group

The Working Group in its report submitted in August 2011 made various recommendations both to ensure the resilience of the NBFC sector and also to contain risks emanating from the sector in the context of overall financial stability. The recommendations of the Working Group can broadly be divided into four categories, comprising issues relating to (i) Entry Point norms, Principal Business Criteria, Multiple and Captive NBFCs; (ii) Corporate Governance including Disclosures, (iii) Liquidity management and (iv) Prudential regulation including capital adequacy, asset provisioning, risk weights for certain sensitive exposures, and restrictions on deposit acceptance.

Based on the recommendations of the Working Group and the subsequent extensive deliberations with all the stakeholders, viz, industry participants as well as the Government of India, draft guidelines have been formulated and put in the public domain for comments in December 2012.

As I have stated before, going by Press Reports as well as the responses observed today, some apprehension has been expressed regarding the proposed guidelines. However, let me emphasize that our intention is not to restrict the activities or constrain the innovativeness of the sector but rather ensure that possible risks to financial stability are addressed, thereby creating, or should I say, ensuring continuation of a resilient system of non-bank credit intermediation. To go back to my earlier remarks on shadow banking and global regulatory initiatives, I would stress that the setting up of the Working Group and implementation of its recommendations was undertaken in line with the international agenda for shadow banks.

Some apprehensions have been expressed that the regulation of shadow banking is becoming as rigorous as banking regulation, which is not warranted given the differences in the profiles of these two segments. I agree with the concerns. While one can argue that identical functions should be regulated in an identical manner irrespective of the nature of the legal entity in which these functions are housed, we have gone for differential regulations between banks and NBFCs due to differences in business models, their significance in the financial system and varying risk profiles. Regulations for banks are much more stringent than that for NBFCs and the proposed new regulatory framework for banks under Basel III proposes even more stringent requirements to address the risks of banks.

However, the distinction between banks and non-banks is more fuzzy now and as the global crisis has adequately evidenced, non-banks are increasingly taking up bank-like activities. In such a scenario, where both banks and non-banks undertake similar activities, if only bank regulation is tightened, there is a very distinct possibility of risks migrating from the more tightly regulated sector to a more lightly regulated sector, the way water flows from high pressure points to low pressure points. Therefore, to contain risks in the overall financial system, there is a case for reviewing the regulations of the non-banking sector along with that for banks, holistically. In India, we have been alive to these issues as I have already mentioned earlier. Setting up of the Working Group on the Issues and Concerns of the NBFC Sector in September 2010 is another instance of taking a pro-active stance in dealing with regulatory issues and concerns.

The overarching principles to the new regulatory framework revolve around some guiding principles:

- Appreciating the contribution of the NBFC sector to the financial system and the economy and rationalising regulations to preserve the innovativeness of the sector
- Recognising the need to address systemic risk arising out of concentration and exposure of NBFCs to sensitive sectors
- Recognising that the NBFCs have the ability to leverage on the RBI registration and therefore, rationalising the scope of regulation to address risks appropriately
- Conserving regulatory resources and directing them where required
- Dealing with regulatory arbitrage while not recommending completely bank-like policies and regulation for NBFCs and
- Giving adequate transition period to the industry so as to cause minimum dislocation to the sector.

Let me briefly touch upon some of the significant features of the draft guidelines.

Principal Business Criteria

Under the present dispensation, a company is treated as an NBFC if its financial assets are more than 50 percent of its total assets (netted off by intangible assets) and income from these financial assets is more than 50 percent of its gross income. Both these tests are required to be satisfied. There is a problem with this definition. As a financial regulator, Reserve Bank primarily regulates the financial activities of NBFCs, while they can also engage in non financial activities of comparable magnitude. It is, therefore, important to insulate the sector from the spillover of possible risks from non-financial activities. The most preferred solution, therefore, from a regulatory perspective, would be the one in which the NBFCs do not undertake any activity other than financial activities on the same lines as banks are permitted to undertake only those activities which are enumerated in Section 6(1) of the Banking Regulation Act, 1949. However, that is not possible for the NBFC sector given the structure of the sector. As ensuring 100 percent financial activity is not feasible, the next best alternative would be to raise the threshold for principal business. Accordingly, the threshold has been raised from 50 percent to 75 percent of total assets/income, to ensure that the regulation focuses on predominantly financial entities. However,