Syllabus subtopic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Prelims and Mains focus: About the liquidity crisis in the NBFC sectors and efforts of RBI to improve the liquidity situation

News: The Reserve Bank of India (RBI) has extended by six months existing relaxations for securitization of assets by non-banking financial companies (NBFCs).

Aim of the move

The move is aimed at providing NBFCs with some more breathing space to repair their balance sheets by selling assets and improving liquidity.

Background

- In November 2018, the RBI had first eased the minimum holding period (MHP) requirement for originating NBFCs, for loans of maturity above five years to six months from 12.
- The relaxation was originally given for six months till May 2019. RBI then extended it to 31 December 2019.
- These relaxations were allowed after the liquidity crisis in the non-bank space following defaults by Infrastructure Leasing and Financial Services (IL&FS) in 2018. So much so that NBFCs and their mortgage lending peers relied largely on securitization deals to raise funds.
- A report by rating agency ICRA in October 2019 found that these two classes of non-bank lenders raised Rs. 2.36 trillion through the securitization route between October 2018 and September 2019.

What is MHP?

The minimum holding period is the duration for which an NBFC is required to hold the loans on its book before selling them.
Efforts made by the RBI to improve liquidity in NBFCs

- The RBI has maintained that it is regularly monitoring the top 50 NBFCs which roughly represent about 75% of the sector.
- NBFCs are also being monitored by the RBI to see whether they have adequate coverage for their liquidity requirements for at least three months.
- Credit flow is slowly reviving to the NBFC sector and the better-performing ones are able to access funds from the market at pre-IL&FS rates.

About NBFCs

The Non-Banking Financial Companies (NBFCs) are the financial institutions that offer the banking services, but do not comply with the legal definition of a bank, i.e. it does not hold a bank license.

Both banks and NBFCs are financial intermediaries. NBFCs can lend and make investments. Hence, their activities are akin to that of banks.

However, there are a few differences between NBFCs and banks:

1. NBFC cannot accept demand deposits;
2. Banks can maintain demand deposits (savings/current accounts) but NBFCs accept only term deposits;
3. Banks form a part of Payment and Settlement Mechanism but NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself;
4. Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

Significance of NBFCs

Non-banking finance companies (NBFCs) are a fundamental part of the Indian financial system playing a significant role in nation building and financial inclusion. It plays a complementary role to the banking system in promoting financial inclusion. There are multiple varieties of NBFCs and so the sector demands a well-coordinated response from all stakeholders keeping in mind the differential contextual requirements of different categories of NBFCs.