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RBI goes fishing for NBFCs

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Unable to save lakhs of investors from losing thousands of crores, RBI has started fishing for NBFCs. It has recently shot thousands of notices to companies asking to send their annual reports, for the RBI to examine whether the company is an NBFC or not. It is the same RBI that slept over the years as Sahara collected in excess of Rs 20,000 crores.

All this, surprisingly, comes just in the backdrop of the Usha Thorat Panel Report which sought a major recast of NBFC regulation. RBI itself has published an advanced notice of rule making seeking to exempt companies, except those very large, from registration requirements. Currently RBI is sitting on some 12,385 companies which are registered with the RBI as NBFCs[1]. As if this was not enough, RBI has sent roving mailers to all those companies bearing registration with the ROC under a "financial code" asking the companies to send their annual reports and details of other companies in same group, so that the RBI could ensure that the company is not an NBFC.

In other words, by default, every company is an NBFC, unless the RBI concludes otherwise, or at least, every company with a financial code registration. A 'financial code' is a vast code and includes all financial intermediation, except insurance and pension funding (division 65 as per NIC code 2004) and all activities auxiliary to financial intermediation (division within its ambit. Financial intermediation activities include loan, hire purchase, investment, mutual fund, housing finance, chit funds, leasing and other related financial activities. However, it is pertinent to note that division 67 'Activities auxiliary to financial intermediation' includes financial and mortgage advisory, brokers, security dealing activities on behalf of others etc. Thus, the companies proposing to render financial advisory have no other option but to select the financial code at the time of incorporation.

As per the annual report of MCA for the year 2012-13, 31.57% of total companies which got registered during the year 2012-13 (till December 31, 2012) were registered under 'Finance, Insurance, Real estate and Renting, Business Services' head forming the largest chunk among all other categories. Last year also maximum companies got registered under the said head aggregating to 41.83% of the total. It is quite apparent that there will be some lakhs of companies registered under 'financial code'. Is RBI intending to send notices to all such companies!

The efficiency of any regulation lies in relevance of the regulation and not its expansiveness. The more expansive, it becomes shallower. Hence, Usha Thorat Panel recommended the RBI to focus on the big fish.

[1] Till March, 2012

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Apparently, the move of the RBI to send fishing letters is deplorable. If all the RBI needs to know, by looking at the balance sheets of the companies, as to whether the company is a financial company or not, the balance sheets of the companies are on the website of the ROC, and they are available for download.
In addition, the RBI instituted a system of auditor's report in terms of Non Banking Financial Companies Auditors' Report (Reserve Bank) Directions, 2008 where every auditor of a company is also supposed to report, both to the Board of Directors and the RBI, as to whether the company is carrying a financial activity and the company has registration with the RBI to do so. The auditor is required to make an exception report to the RBI if the company is carrying on a financial business, and is not registered with the RBI.

As if throwing the obligation of registration with the respective companies coupled with a secondary check by the auditing professionals, was not sufficient, the RBI now wants to get into action directly by instructing all companies to communicate to the RBI their financials. It is almost like the local police office calling all citizens to be examined by the police to ensure that they have not done any crime.

It is this expansive regulatory attitude that is largely responsible for the present plight of millions of depositors in the country. With attention of the RBI offices diluted into thousands of non-descript, companies, the big fish continue to have a field day right under the nose of the RBI.