

NPTEL ONLINE CERTIFICATION COURSES

Financial Institutions and Markets

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Provident Fund and Pension Fund

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Types of Provident Funds in India

- Savings in PF: Contractual Obligation for Financial Security without any motive of Capital Growth
- Popular operational provident fund accounts available in India are
  - General Provident Fund (GPF)
  - Contributory Pension Fund (CPF)
  - Employees' Provident Fund Scheme (EPF)
  - Public Provident Fund (PPF)

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Factors Promoting Growth of Provident Funds (PF)

- Adoption of Statutory Measures
- Increase in commercial Establishments
- Expansion of Industrial and Service Sector
- Introduction of Attractive Schemes
- Provision of Tax Benefit
- Increase in the minimum rates of contribution
- Changes in the Pay Structure
- Increase in the Income Level

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Interest Rates of GPF, EPF and PPF

Year	GPF	PPF	EPF
2000–2001	11	11	11
2001–2002	9.5	9.5	9.5
2002–2003	9.0	9.0	9.5
2003–2004	8.0	8.0	9.5
2010–2011	8.0	8.0	9.5
2011–2012	8.6	8.6	8.25
2012–2013	8.8	8.8	8.5
2013–2014	8.7	8.7	8.75
2014–2015	8.7	8.7	8.75
2015–2016	8.7	8.7	8.8

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Investment Patters of Provident Funds since 1st April 2015

Sl. No.	Instruments	Limit
1	Government Securities	45– 55%
2	Debt Securities and Term Deposits of Banks	35– 45%
3	Money Market Instrument	Up to 5%
4	Equity and Equity Related Instruments	5– 15%
5	Exchange Traded Funds/Index Funds	5– 15%
6	Asset Backed Securities, Units of Real Estate, Infrastructure Investment Trusts	Up to 5%

Source: http://pib.nic.in/newsite/PrintRelease.aspx?relid=116214

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Classifications of Pension Plans

- Defined Benefits Pension Plan (DBPP)
- Defined Contribution Pension Plan (DCPP)
- Pay-as-you-go Pension Plan (PAYGPP)

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Features of NPS

- The new pension system (NPS) would be based on defined contributions and represents a market linked retirement investment product
- Individuals who are aged between 18 – 60 years as on the date of submission of his/her application can join NPS either as individuals or as an employee-employer group(s) (corporates) subject to submission of all required information and Know your customer (KYC) documentation.
- After attaining 60 years of age, you will not be permitted to make further contributions to the NPS accounts. A NRI can open an NPS account. Contributions made by NRI are subject to regulatory requirements as prescribed by RBI and FEMA from time to time
- It will use the existing network of bank branches and post offices etc. to collect contributions.
- The new pension system will be voluntary. The system would, however, be mandatory for new recruits to the Central Government service (except the armed forces).

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Features of NPS Cont…

- The State Government can choose to join this new pension scheme.
- Investment in NPS is independent of your contribution to any Provident Fund.
- NPS account can be operated from anywhere in the country irrespective of individual employment and location/geography.
- NPS account can be opened through the Point of Presence (POP) and who will assist the subscriber in opening the account including the filling up of necessary forms, providing the information about NPS and any other relevant information in this regard.

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Features of NPS Cont…

- NPS offers two types of accounts to its subscribers, namely Tier I and Tier II. While Tier I account is mandatory for opening of an NPS account, opening of Tier II account is optional and to be decided by the subscriber basing on his or her requirements. However, an active Tier I account is a pre-requisite for opening a Tier II account.
- After opening the account Every individual subscriber is issued a Permanent Retirement Account Number (PRAN) card and has a 12 digit unique number. In case of the card being lost or stolen, the same can be reprinted with additional charges.
- A subscriber has to contribute a minimum annual contribution of Rs.6000/- for his Tier I account in a financial year and if not contributed the account will be frozen.

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Features of NPS Cont…

- The monthly contribution would be 10 percent of the salary and DA to be paid by the employee and matched by the Central Government or the employer.
- The contributions and returns thereon would be deposited in a non-withdrawable pension account.
- At present, Subscriber has option to select any one of the following 8 pension funds: (i) ICICI Prudential Pension Fund, (ii) LIC Pension Fund, (iii) Kotak Mahindra Pension Fund, (iv) Reliance Capital Pension Fund, (v) SBI Pension Fund, (vi) UTI Retirement Solutions Pension Fund, (vii) HDFC Pension Management Company (viii) DSP Blackrock Pension Fund Managers. Since registration of PFMs is an ongoing process, this list will be updated from time to time.

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Features of NPS Cont…

- There is a default PFM provision under NPS and SBI Pension Funds Private Limited acts as the default Pension Fund Manager.
- You may select different PFMs and Investment Options for your NPS Tier I and Tier II accounts.
- The NPS offers two approaches to invest subscriber's money: (i) Active choice – Here the individual would decide on the asset classes in which the contributed funds are to be invested and their percentages (Asset class E(maximum of 50%), Asset Class C, and Asset Class G) (ii) Auto choice - Lifecycle Fund- This is the default option under NPS and wherein the management of investment of funds is done automatically based on the age profile of the subscriber.

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Features of NPS Cont…

- You can appoint up to 3 nominees for your NPS Tier I and NPS Tier II account. In such a case you are required to specify the percentage of your saving that you wish to allocate to each nominee. The share percentage across all nominees should collectively aggregate to 100%.
- Individuals who are employed and contributing to NPS would enjoy tax benefits on their own contributions as well as their employer's contribution as under: - (a) Employee's own contribution - Eligible for tax deduction up to 10% of Salary (Basic + DA) under Section 80 CCD(1) within the overall ceiling of Rs. 1 lac under Sec 80 CCE. (b) Employer's contribution – The employee is eligible for tax deduction up to 10% of Salary (Basic + DA) contributed by employer under Sec 80 CCC(2) over and above the limit of Rs. 1 lac provided under Sec 80 CCE.

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Features of NPS Cont…

- The self-employed people are Eligible for tax deduction up to 10 % of gross income under Sec 80 CCD (1) with in the overall ceiling of Rs. 1 lac under Sec 80 CCE.
- Individuals can exit from the scheme at the age of 60 years but they would have to invest mandatorily 40 per cent of the pension wealth to purchase an annuity from the IRDA regulated life insurer.
- Indian Life Insurance companies which are licensed by Insurance Regulatory and Development Authority (IRDA) are empanelled by PFRDA to act as Annuity Service Provider's to provide annuity services to the subscribers of NPS
- If somebody decides to retire or does not want to continue in the NPS before age 60 then at least 80% of the accumulated pension wealth of the subscriber needs to be utilized for purchase of an annuity providing for the monthly pension of the subscriber and the balance is paid as a lump sum payment to the subscriber.
- In the unfortunate event of death of the subscriber, the entire accumulated pension wealth (100%) would be paid to the nominee / legal heir of the subscriber and there would not be any purchase of annuity/monthly pension.

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Investment Guidelines for NPS

S. No.	Category	Investment guidelines
(i)	Government securities (upto 55 percent)	(a) Government securities. (b) Other securities guaranteed by the central government or any state government except those covered under (ii) (a) below. (c) units of mutual funds set up as dedicated funds for investment in government securities, not be more than 5 percent of the total portfolio of G Secs in the concerned NPS Scheme at any point of time.
(ii)	Debt securities (upto 40 percent)	(a) Debt securities having a minimum residual maturity period of three years. (b) Term deposit receipts of not less than one year duration issued by scheduled commercial banks. (c) Rupee bonds having an outstanding maturity of at least 3 years issued by institutions of the International Bank for Reconstruction and Development, International Finance Corporation and the Asian Development Bank, Rated IDFs, Rated ABS (Asset Backed Securities). (d) Debt Mutual Funds as regulated by SEBI.
(iii)	Money market instrument (upto 5 percent)	Money market instruments including units of money market mutual funds
(iv)	Equity (upto 15 percent)	Shares of companies on which derivatives are available in BSE or NSE or equity linked schemes of mutual funds or ETFs regulated by the SEBI.

Source: PFRDA, Annual Report 2013–2014.

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Challenges to NPS

- The voluntary nature of the proposed NPS along-with poor financial literacy and the attitude of the households towards financial savings, risk and retirement planning, also pose a challenge to achieving optimum coverage of NPS
- Creating awareness about these reforms and gaining the confidence of the people to encourage them to be a part of this movement is the single most important challenge faced by policymakers today.
- At present, NPS is subject to the EET (exempt-exempt-taxed) tax regime. 'The EET method eliminates/reduces the bias inherent against savings under the income tax'. On the other hand, EPF, GPF and PPF have a more favourable tax treatment. EEE benefit is available to them.

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Features of Atal Pension Yojana

- APY is open to all citizens of India who have a savings bank account. The minimum age of joining APY is 18 years and maximum age is 40 years.
- The central government would co-contribute 50 percent of the total contribution or ₹1000 per annum, whichever is lower, to each eligible subscriber, for a period of 5 years, that is from financial year 2015–2016 to 2019–2020, who join the APY before 31-12-2015, and who are neither the members of any statutory social security scheme and nor the income tax payers.
- Under the APY, the subscribers would receive the fixed minimum pension of ₹1000, 2000, 3000, 4000, and 5000 per month, at the age of 60 years, depending on their contributions, which itself would be based on the age of joining the APY. Therefore, the benefit of minimum pension would be guaranteed by the government. However, if higher investment returns are received on the contributions of subscribers of APY, higher pension would be paid to the subscribers.
- A subscriber joining the scheme of ₹1000 monthly pension at the age of 18 years would be required to contribute ₹42 per month. However, if he joins at age 40, he has to contribute ₹291 per month. Similarly, a subscriber joining the scheme of ₹5000 monthly pension at the age of 18 years would be required to contribute ₹210 per month. However, if he joins at age 40, he has to contribute ₹1454 per month.
- APY applications may be submitted to any of the following enrolment agencies: (i) All banks, including all nationalised banks, private banks, banking companies, regional rural banks, co-operative banks and so on either directly or through the following enablers: (a) All points of presence (service providers) and aggregators, which are governed under the institutional architecture of NPS and are appointed as such by PFRDA, could work as facilitators with banks. (b) Those Business Correspondents (BCs)/existing non-banking aggregators, Micro Finance Institutions (MFIs) and so on are appointed as enablers by banks. (ii) Other enrolment agencies that may be specified as such by PFRDA or the central government, such asDepartment of Posts under CBS Platform.

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Insurance Companies

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Meaning and Concepts

- **Insurance** is a form of financial risk management tool in which the insured transfers the risk of a potential financial loss to the insurance company (insurer), which mitigates it in exchange for a monetary compensation popularly known as **insurance premium**.
- The **pure premium** is the present value of the expected cost of an insurance claim.
- Since there is a lag between payment of premiums and payment of claims, there is generation of investible funds known as **insurance reserves**.
- **Insurance policy** is the contract between the insured (policy holder) and the insurer (insurance company).

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Meaning and Concepts Cont…

- **Sum assured** is the amount that is promised by the insurance company in case of a claim either by maturity or by loss to the insured subject matter.
- **Surrender value** is the amount that the insurer pays if the insured discontinues the policy to the insurer.
- **Life of the policy** is the time period wherein the insurance policy is in vogue.
- **Moral hazard** refers to the mala fide intensions of either of the parties of the contract in fulfilling their obligations with respect to their performance of the contract.

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Principles of Insurance

- Principle of Utmost Good Faith
  - Both insurer and insured should enter into the contract in good faith. The insured should voluntarily disclose all the facts related to the subject matter of the contract. The insurer should also provide all the details regarding the insurance contract.
- Principle of Insurable Interest
  - Insured must have the insurable interest on the subject matter i.e. the policy holder should be able to establish a monetary relationship between him/her and the subject matter of the insurance.
- Principle of Indemnity
  - Indemnity refers to the assurance given by one to put the person who buys insurance, in the event of loss, in the same position that he/she occupied immediately before the happening of the event for which indemnity is sought for.
- Principle of Subrogation
  - This principle refers to the right of the insurer to stand in the place of insured after the settlement of a claim and it gives the insurer right to recover from an alternative source, which is involved in this case.

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Principles of Insurance Cont…

- Principle of Warranties
  - Warranties are the conditions that are written by the insured in the insurance contract that state the truth by affirming or denying the existence of a particular state of facts.
- Principle of Cause Proxima
  - Proximate cause refers to the immediate cause that resulted in the loss.
- Principle of Contribution
  - Under this principle insured can’t make profit by making claim for some loss more than once.
- Principle of Loss Minimization
  - This principle states that the insured must take all the necessary steps to minimize the loss to insured properties.

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Types of Insurance

- Protection to Investors, means for accumulating savings, channelize savings for Investment
- Broadly, insurance is offered either as life insurance or general insurance.
- Life insurance covers insurance of life and covers risks related to the death of a person for whom insurance is bought.
- General insurance encompasses all those kind of insurance contracts that cover non-life subjects. These include motor insurance, marine insurance, property insurance, liability insurance, commercial or business insurance, housing loan insurance
- Health insurance is also a part of general insurance.

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Objectives of Life Insurance Companies

- To provide life insurance protection to the masses at reasonable cost.
- To mobilize people's savings through insurance-linked savings schemes.
- To invest the funds to serve the best interests of both the policy-holders and the nation.
- To act as trustees of the policy-holders and protect their individual and collective interests.
- To involve all the people working in the corporation to ensure efficient and courteous service to the insured public.

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Nature of Life Insurance Policies

- Life policy is a claim to a future payment of either a lump sum or a stream of income.
- There are only a few basic types of such policies, viz. term insurance, whole life insurance, endowment policies, annuity contracts, individual insurance, group insurance, pension plans, children's plans, and equity-linked plans.
- The life fund is built up out of the excess of premiums and investment income over claims and expenses on revenue and capital accounts. The life fund is valued from time to time, the valuation being based on the method of discounting future income and expenditure back to the present.

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Nature of Non-Life Insurance Policies

- The essence of general insurance is the collective pooling of risks arising from fortuitous occurrences.
- The general insurance companies do not collect savings, yet they do accumulate pools of funds from premium and investment income out of which they meet claims under their policies.
- Liabilities are normally short-term in nature
- Claims against them are unpredictable
- Assets are held in relatively liquid form

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Overview of Insurance Sector in India

- As an 31st March 2016 one public sector insurer (Life Insurance Corporation of India) and 23 private life insurance companies are operating in India.
- As on 31st March 2016 there are 30 non-life insurance companies in India including one reinsurer. Out of them five private sector insurers are registered to underwrite policies exclusively in health, personal accident and travel insurance segments.
- GIC is the national reinsurer, providing reinsurance to the direct general insurance companies in India.

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Insurance Penetration and Density

- Insurance penetration is measured as the percentage of insurance premium to GDP, insurance density is calculated as the ratio of premium to population (per capita premium)

Year	Life insurance		Non-life insurance		Total industry	
	Density (US dollar)	Penetration (percent)	Density (US Dollar)	Penetration (percent)	Density (US dollar)	Penetration (percent)
2001	9.1	2.15	2.4	0.56	11.5	2.71
2005	18.3	2.53	4.4	0.61	22.7	3.14
2010	55.7	4.40	8.7	0.71	64.4	5.10
2011	49.0	3.40	10.0	0.70	59.0	4.10
2012	42.7	3.17	10.5	0.78	53.2	3.96
2013	41.0	3.10	11.0	0.80	52.0	3.90
2014	44.0	2.60	11.0	0.70	55.0	3.30
2015	43.2	2.72	11.5	0.72	54.7	3.44

Source: IRDA, Annual Reports Various Issues.

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Mutual Funds

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What is Mutual Fund?

- A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested in capital market instruments such as shares, debentures and other securities.

- The income earned through these investments and the capital appreciation realized are shared by its unit holders in proportion to the number of units owned by them.

- Thus a Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.

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Structure of Mutual Funds in India

- According to the SEBI, mutual funds are established in the form of a trust to raise money through the sale of units to the public under various schemes for investing in different securities.
- A mutual has (i) a sponsor, (ii) trustees, (iii) an asset management company (AMC) and (iv) custodians.
- The sponsors set up the trust as promoters. The trustees hold the property in trust for the benefit of the unit holders.
- They monitor AMC's performance and compliance with the SEBI regulations.
- The AMC manages the funds. The custodian holds the securities of the fund in its custody.
- Example: SBI Mutual Fund; Sponsor: SBI, Trustee: SBI Mutual Fund Trustee Company Private Limited; Asset Management Company: SBI Funds Management Private Limited ('AMC') (A joint venture between SBI and AMUNDI); Custodians: Bank of Nova Scotia / HDFC Bank / SBI-SG Global Securities Services Private Limited

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Structure of Mutual Funds in India Cont…

- Two-thirds of the trustees of a mutual fund must be independent persons and not associated with the sponsors in any manner.
- The trustees should enter into an investment management agreement with the AMC for the purpose of making investments.
- The trustees would have the right to obtain from the AMC, all information concerning the operations of the various schemes of the mutual fund managed by it

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Structure of Mutual Funds in India Cont…

- The sponsor of the mutual funds/trustees would appoint the AMC, with the prior approval of the SEBI. Its appointment can be terminated by a majority of trustees or 75 per cent of the unit holders of the scheme.
- The eligibility criteria for the appointment of an AMC include sound track record, adequate professional experience, not guilty of moral turpitude, non-conviction of any economic offence/violation of any securities laws, inclusion of 50 per cent independent directors and net-worth of at least Rs. 10 crore.

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Structure of Mutual Funds in India Cont…

- AMC can undertake other business activities in the nature of portfolio management services, management and advisory services to pension funds, venture capital funds, management of insurance funds, financial consultancy etc. on a commercial basis, if any of these activities do not conflict with the activities of the mutual fund.
- It is obligatory for an AMC to take all reasonable steps and exercise due diligence to ensure that the investment of funds confirms to the provisions of the SEBI regulations.
- An AMC can launch a mutual fund scheme after its approval by the trustees and filing of the offer document with the SEBI.
- The offer document should contain adequate disclosures to enable the investors to make an informed investment decision.
- The mutual fund should appoint a custodian to carry out the custodial services for the scheme. A mutual fund cannot appoint a custodian in which 50 per cent or more of the voting rights/directorships is held by the sponsor/associate companies.

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Key Concepts Related to Mutual Fund

- **Entry Load:** It is a sales charge that the investors pay when they buy some units of a mutual fund scheme.
- **Exit Load:** It is the amount of money that the investor needs to pay to the mutual fund companies when intend to exit from a scheme. It is also called as 'Repurchase' or 'Back-end' Load.
- **Sale Price:** It is the price paid by investors at the time of investing in a scheme. Or in other words, it is the purchase price for investors and is also called as 'Offer Price'.
- **Systematic Investment Pan:** Like recurring deposits, it is an investment tool offered by mutual funds which helps investors to make a regular investment of small amount for a certain period of time.

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Key Concepts Related to Mutual Fund Cont…

- **Systematic Encashment Plan:** This plan facilitates the investors to withdraw a specified amount or units from the invested fund at a pre-determined interval.
- **Switch:** It is a mechanism by virtue of which investors can shift their investments from one scheme to others within that fund.
- **Monthly Income Plans:** This is special type of scheme where a part of fund is invested in equity and another remaining in debt. Investors who want a regular income stream invest in these schemes.

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Key Concepts Related to Mutual Fund Cont…

$$NAV = \frac{\text{Total market value of the assets or securities in the portfolio of the fund} - \text{liabilities}}{\text{Number of funds' units (shares) outstanding}}$$

$$\text{Sale Price} = \frac{\begin{array}{c}\text{(Market value of the assets} - \text{liabilities excluding contingent liabilities,}\\ \text{initial share capital, reserves and unit capital)} +\\ \text{(Brokerage charges, commissions, taxes, stamp duties, other}\\ \text{management and administrative expenses)}\end{array}}{\text{Number of units outstanding}}$$

$$\text{Repurchase Price} = \frac{\begin{array}{c}\text{(Market value of the assets} - \text{liabilities excluding contingent liabilities,}\\ \text{initial share capital, reserves and unit capital)} - \text{(Brokerage charges,}\\ \text{commissions and so on.)}\end{array}}{\text{Number of units issued or outstanding.}}$$

The expected rate of return on units can be calculated as:

$$RRU = \frac{(NAV_t - NAV_{t-1}) + \text{Dividends} + \text{Capital Gains}}{NAV_{t-1}}$$

where

RRU = expected rate of return on units;

NAV = net asset value;

t = current year;

$t - 1$ = previous year.

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Advantages of Investing Mutual Funds

- Professional Management
- Diversification
- Economies of Scale
- Spread of Risk
- Liquidity & Flexibility
- Simplicity
- Low transaction Costs
- Taxes Benefit
- Wide Choice of Schemes

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Mutual Fund and Economic Growth

- Mutual Funds help Capital Market Stability by providing Structure, Clarity and Transparency

- Not just a vehicle to invest, but a vehicle to invest wisely
- It also helps and empower the people giving them the opportunities to (i) save for retirement, (ii) buy the house, (ii) finance the children education

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Mutual Funds-II

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Mutual Fund Schemes

- By Structure
  - Open-Ended
  - Close-Ended
- By Investment Objective
  - Growth
  - Income
  - Balanced/Hybrid
  - Specialized Fund

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Mutual Fund Schemes by Structure

- Open-Ended Fund
  - An open-ended fund is a collective investment which can issue and redeem shares at any time.
- Close-Ended Fund
  - It can issue shares of mutual fund only in the beginning and can't redeem or reissue till the end of their fixed investment duration.
  - Listed in the stock exchanges

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Mutual Fund Schemes by Investment

- **Growth Fund**
  - Not for regular Income
  - Equity (Growth) – only in Stocks – Long Term (3 years or more)
- **Income Fund**
  - Debt (Income) – only in Fixed Income Securities (3-10 months)
  - Regular and Steady Income to Investors
  - Capital Appreciation is Limited
  - Suitable for Retired People

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Mutual Fund Schemes by Investment

- **Balance Fund**
  - Both Income and Capital Appreciation
  - Combination of both debt and equity
- **Specialized Fund**
  - Sectoral
  - Money market
  - Gilt Fund
  - Real Estate
  - Offshore Fund

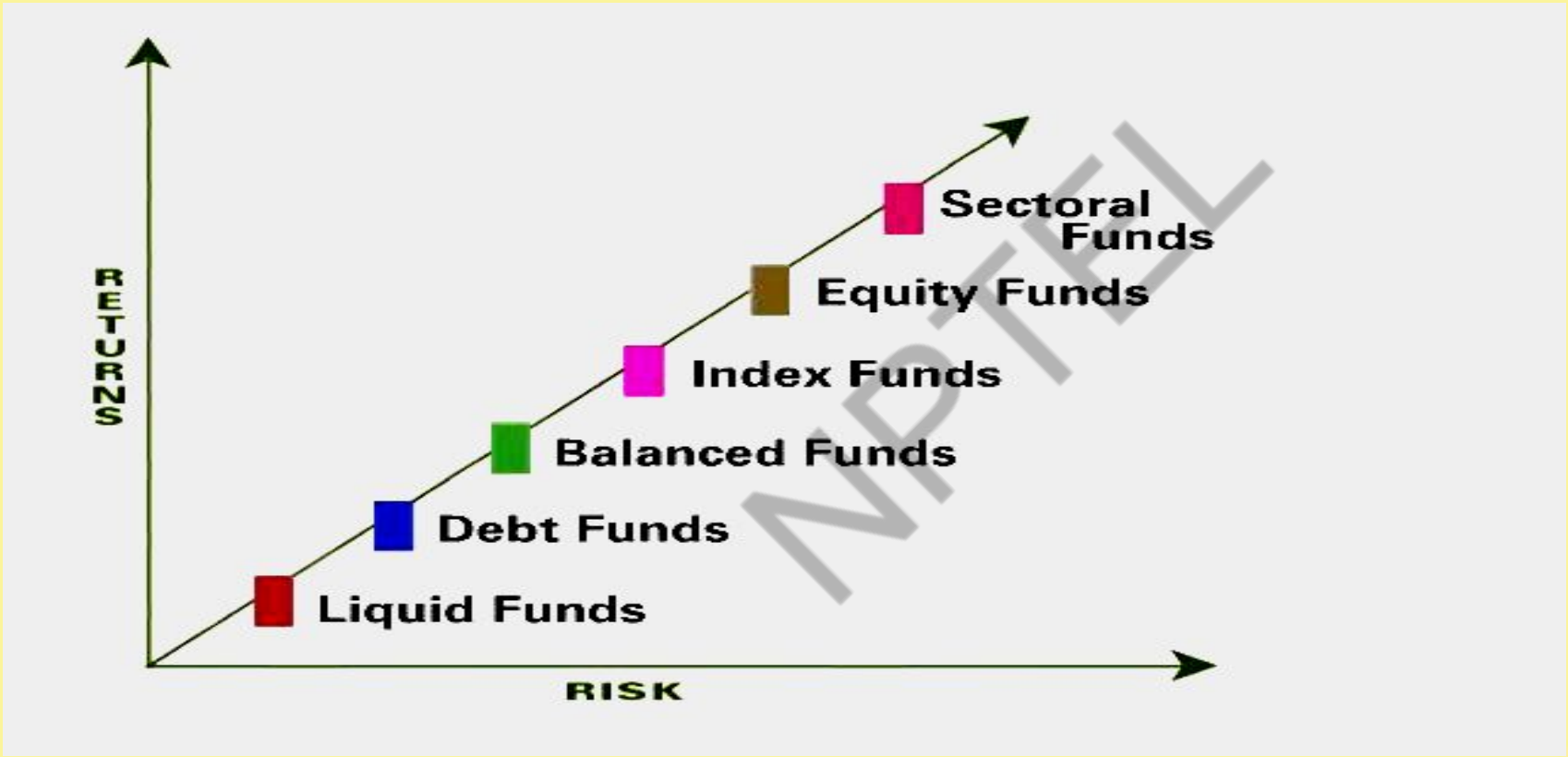
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Index Fund

- It attempts to design a portfolio to replicate the performance of a specific index i.e. benchmark index.
- The difference arises between benchmark index and portfolio because of cash flow, company mergers and bankruptcies.

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Return and Risk of Different Types of Funds



$$\text{Sharpe Ratio} = \frac{E(R_{mf}) - R_f}{\sigma_{mf}}$$

Here, $E(R_{mf})$ is the expected rate of return from a mutual fund, R_f is the risk-free rate of interest, σ_{mf} is the standard deviation of mutual fund returns.

$$\text{Treynor Ratio} = \frac{E(R_{mf}) - R_f}{\beta_m}$$

Here, $E(R_{mf})$ is the expected rate of return from a mutual fund, R_f is the risk-free rate of interest, β_m is the systematic risk.

$$\text{Jensen Ratio} = \frac{\alpha}{\beta_m}$$

The alpha (α) can be determined using the capital asset pricing model (CAPM). Assume that

R_i = the realised return of the portfolio or mutual fund

R_m = the realised return of the market index

R_f = the risk-free rate of return for the time period

β_m = the beta of the portfolio of investment with respect to the chosen market index

$$\text{Alpha } (\alpha) = (R_i - R_f) + \beta_m(R_m - R_f)$$

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Hedge Fund

- Hedge funds are a special type of investment vehicles, as an alternative to mutual funds, which pools funds from investors and invest in various investment avenues to earn high return.
- Characteristics of Hedge Fund

  - Only accredited investors can invest in hedge fund. The minimum ticket size for an investor to be a part is ₹1 crore.
  - Hedge fund investment universe contains all categories of investments such as land, real estate, stocks, derivatives and currencies.
  - Hedge funds employ leverage to generate a higher amount of profit.
  - They charge fees for asset management as well as performance of the funds. Generally, they charge 2 percent as the asset management fee and 20 percent of the generated return as the performance fee.

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Difference Between Hedge Fund and Mutual Fund

- Regulatory Requirements
- Fees
- Pricing and Liquidity
- Investor Characteristics
- Risk and Diversification

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Non-Banking Financial Companies (NBFCs)-I

What is NBFC?

- A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.
- A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

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Differences between NBFC and bank

- NBFC cannot accept demand deposits
- NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself
- Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks
- Some of the NBFCs are registered with the RBI and some of them are registered and regulated by the other regulatory bodies like SEBI and IRDA

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Importance of NBFCs

- Mobilization of Resources
- Capital Formation
- Provision of Long-term Credit and specialised Credit
- Aid in Employment Generation
- Help in development of Financial Markets
- Helps in Attracting Foreign Grants
- Helps in Breaking Vicious Circle of Poverty by serving as government's instrument
- Financial Inclusion

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Types of NBFCs Registered with RBI

- Financial activity as principal business is when a company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria will be registered as NBFC by RBI.
- Deposit and Non-Deposit accepting NBFCs
- Non-deposit taking NBFCs are two types such as systemically important and other non-deposit holding companies (NBFC-NDSI and NBFC-ND)
- NBFCs whose asset size is of Rs. 500 cr or more as per last audited balance sheet are considered as systemically important NBFCs.
- In terms of activities undertaken, NBFCs are classified into eight categories, viz., Asset Finance Companies (AFCs), Investment Companies (ICs), Loan Companies (LCs), Infrastructure Finance Companies (IFCs), Core Investment Companies (CICs), Infrastructure Debt Fund - Non-Banking Financial Companies (IDF-NBFCs), Non-Banking Financial Company - Micro Finance Institutions (NBFC-MFIs) and NBFC-Factors.

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Asset Finance Company (AFC)

- An AFC is a company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/economic activity, such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipment, moving on own power and general purpose industrial machines. (60 % income should come from principal business)
- Example: Power Finance Corporations, Bajaj Capital, Tata Capital Financial Services Ltd.

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Hire Purchase Credit

- It is defined as a system under which term loans for purchases of goods and services are advanced to be fractionally liquidated through a contractual obligation.
- The Hire-Purchase means buying the goods on an installment plan. This means the hirer can buy commodities in exchange for the regular installment payments (principal amount+ interest) over a period of time.
- The main sources of funds of the hire purchase company are retailers and wholesalers, hire-purchase finance companies and banks and financial institutions.

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Lease Finance

- It is a form of financing employed to acquire the use of assets. Every lease involves two parties—the user of the asset known as the lessee, and the owner of the asset known as the lessor.
- The periodical payment made by the lessee to the lessor is known as lease rental.
- Under lease financing, lessee is given the right to use the asset but the ownership lies with the lessor and at the end of the lease contract, the asset is returned to the lessor or an option is given to the lessee either to purchase the asset or to renew the lease agreement.

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Investment Company (IC)

- IC means any company which is a financial institution carrying on as its principal business the acquisition of securities. Most of them give loans for consumption, commerce and trading purposes.
- The interest rates charged by these institutions for financial assistance are higher than those charged by commercial banks and other organised financial institutions.
- Loans are often unsecured and the procedures are simpler while bank finance is difficult to obtain

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Systemically Important Core Investment Company (CIC-ND-SI)

- CIC-ND-SI is an NBFC carrying on the business of acquisition of shares and securities which satisfies the some specific conditions
  - It holds not less than 90% of its total assets in the form of investment in equity shares, preference shares, debt or loans in group companies
  - Its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not less than 60% of its Total Assets;
  - It does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;
  - It does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the RBI act, 1934 except investment in bank deposits, money market instruments, government securities, loans to and investments in debt issuances of group companies or guarantees issued on behalf of group companies.
  - Its asset size is ₹ 100 crore or above and it accepts public funds

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Loan Company (LC)

- LC means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company
  - These institutions give loans to wholesale and retail traders, small-scale industries, and self-employed persons
  - These loans are mainly short-term loans although they are quite often and quite easily renewed. The loans are generally unsecured, which is made possible by the institution's knowledge of local conditions and the personal credit standing of the borrowers.
  - These institutions also provide certain other services, such as (a) discounting post-dated cheques, (b) collecting dividends for their customers, and (c) purchasing and discounting of hundis .

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