Financial RegTech Newsletter

August 2019

Click to launch

Using technology to strengthen the NBFC sector

The NBFC sector has been playing an important role in ensuring credit flow and boosting consumption. The sector, which was once hailed for delivering high margins by tapping lending markets neglected by banks, is currently facing strong headwinds. The crisis that began with the IL&FS fiasco has now spread across the NBFC sector, leading to debt defaults and asset liability management (ALM) mismatch issues.

According to the RBI Financial Stability Report published in June 2019, loan growth in the NBFC sector declined to 18.6% in 2018–19, mainly due to higher borrowing costs for smaller NBFCs because of their asset quality and ALM mismatch issues.[1] Additionally, the gross non-performing assets (GNPA) of the NBFC sector as a percentage of total advances increased to 6.6% in 2018–19. Therefore, the RBI would not only be more stringent in the upcoming regulations with respect to liquidity but would also be extra thorough in monitoring and surveying the current regulatory submissions. There would also be a greater focus on asset quality and market exposure during the annual RBI inspection.

Types of Traditional NBFC	Credit/Loan	Investment Company	Asset Finance Company	Micro Finance Company	Infrastructure Finance	Others

Traditional Operating Model & Challenges					
	Longer lead generation and processing time	Lending based on income, credit score etc.	Manual work and human judgement	High cost model with people and branches	Legacy systems & limited data governance
	High operating expenses	Limited risk profiling and credit appraisal	Long term loan with short term financing	NPAs and high cost of fund	Growth Threshold

Key challenges faced by NBFCs

We believe that NBFCs need to gear up for a transformation journey to overcome the internal systemic issues and ensure complete regulatory remediation. Both traditional and emerging technology can be great enablers to alleviate the pain points that the NBFC sector is facing.

1. https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/FSRJUNE2019E5ECDDAD7E514756AFEF1E71CB2ADA2B.PDF

Using technology to strengthen the NBFC sector

Leveraging traditional technology for addressing systemic data quality and governance issues

The RBI currently mandates submission of regulatory returns covering ALM, capital risk adequacy ratios (CRAR), special mention account (SMA) and non-performing assets (NPA), and exposures to large corporates. While this information can aid the RBI in correctly accessing and monitoring the health of NBFCs, the quality of underlying data has been a point of contention. Due to system limitations and a non-existent data governance policy, most NBFCs have a limited view of their end-to-end data cycle, leading to poor data auditability and traceability. This leaves the organisation's management and the regulator with reduced visibility to monitor as well as foresee any risks.

Analytics-driven data management and governance

To improve data auditability and traceability, NBFCs need to create a reconciled centralised data layer with record-to-report data lineage for their regulatory and financial reporting. This means end-to-end data lineage, i.e. lineage for each loan account from source system to final reporting element. Furthermore, NBFCs need to create a compliance register comprising data definition, which would act as the foundation of this layer. They should also enforce strong governance around data flow life cycle by putting in strong risk controls.

This robust data foundation can lead the way for an analytics-driven digital governance, risk and compliance (GRC) solution. The GRC solution would be able to apply business rules (based on empirical evidence) to flag potential anomalies with credit appraisals and underwriting, and should also be able to track remediation. Benefits would include a reduced cost and time to compliance, increase in accuracy of audit reports and easy monitoring through dashboards. Additionally, an early warning system should be

Using technology to strengthen the NBFC sector

commissioned by leveraging internal data and external available corporate/sectoral data from sources such as CIBIL, the Central Fraud Registry (CFR) and SEBI to identify potential red flags in customer behaviour. Analytics-driven dashboards need to be created for continuous monitoring of trends, financials, ALM, expected credit loss (ECL), disbursement, repayment and collections.

Leverage emerging technologies to transform NBFCs

In addition to addressing systemic issues, investing in new technologies will enable NBFCs to increase their customer base, lower customer acquisition cost, deliver better services to customers and de-risk the portfolio.

Emerging Tech Disrupting Current Models	Artificial Intelligence	Robotic Process Automation	Advanced Analytics	API	Blockchain	Chatbots and NLP
Key Benefits of Emerging Tech	Automated end-to-end credit management	Paperless processing	24*7 customer support	Integrated accounting engine	Dynamic workflow management	Powerful Rule Engine
	Seamless integration with external data	Real-time reconciliation	Agility & Scalability	Unified solutions & operational efficiency	Robust risk mitigation	Better compliance and fraud management
Disruptive models across value chain	Faceless & Paperless eKYC and onboarding	Faster Loan Processing. From Origination to Disbursement	Addressing new markets – underserved & unserved	Credit Models based on multiple data sources – Social Media, Govt. data, e-commerce etc.	Automated & personalized underwriting & risk process management	Automated reconciliation, monitoring and updation

Using technology to strengthen the NBFC sector

Artificial intelligence (AI)/machine learning (ML) and robotic process automation (RPA)

Traditionally, NBFCs have adopted a one-size-fits-all approach. With advent of AI combined with ML, NBFCs can adopt a personalised approach to underwriting and origination. The approach will help broaden the customer funnel, allowing sales teams to target a large pool of prospective customers and offer relevant products. Digital-focused NBFCs can transform the manual, time-consuming, human judgement-based underwriting process using technology advances to provide instant, real-time approvals. With next level of growth coming from accounts with little or no credit history, NBFCs will need to leverage wider data sets from social media channels and online platforms in order to explore derivation of delinquent account strategy.

Blockchain

NBFCs should leverage the opportunity to reduce transaction costs and the amount of paperwork that they process and work in tandem with technology vendors, financial institutions and FinTechs to implementing blockchain to make their onboarding process increasingly efficient, secure, and profitable.

Using technology to strengthen the NBFC sector

Open application programming interface (API)

The ability of NBFCs to directly retrieve transactional data from the borrowers' bank account will go a long way in eliminating fraud and improving access to credit. Since most of this data is already available, it would be easier for NBFCs to get this data through APIs directly from banks as against using intermediaries. This will enable NBFCs to provide a seamless experience and reduce operational costs, which can be passed on to consumers. The success of such a credit risk system will depend on the number of institutions involved and how much data is shared among them. There is an opportunity to develop common industry standards around APIs to increase ease of interoperability.

Road ahead

The future of NBFCs lies in digitising the customer lifecycle with seamless integration between the front end, middleware and back end to make the entire product and service stack technology-driven. This doesn't simply end at automating the end-to-end process but also entails the adoption of agile and robust technology platforms and solutions that would enable companies to quickly react to external events, market and customer demands, and simultaneously address NBFCs core issues.

Regulatory news

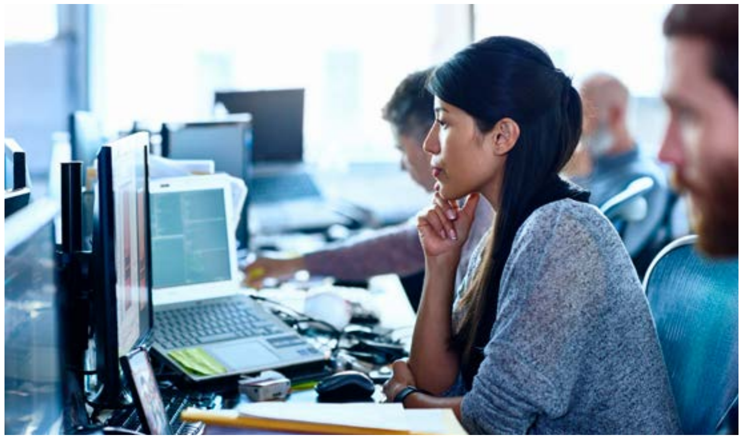
Priority sector lending – NBFC on-lending

With a view to boost credit to the priority segment, the RBI has decided to consider the loans given to registered NBFCs for on-lending to needy segments as priority sector loans. The RBI has also issued new per borrower limits for priority sectors as below:

- Agriculture - INR 10 lakh
- Micro and small enterprises - INR 20 lakh
- Housing - INR 20 lakh.

This is in line with priority sector norms, in which the banks need to lend a substantial portion of loans to the priority sector. The above guidelines are valid for the current financial year and will be subject to review after 31 March 2019.

The detailed notification can be accessed here.



NBFCs – levy of foreclosure charges

The RBI has issued guidelines to deposit-taking and non- deposit-taking NBFCs not to charge foreclosure charges or pre-payment penalties on any floating rate loans to individual borrowers. These guidelines are applicable on loans given to individual borrowers with mortgages and do not apply to loans sanctioned for business purposes.

The detailed notification can be accessed here.

Change in bank rate

The RBI has announced a revision in bank rate as envisaged in the Third Bi-Monthly Monetary Policy Statement 2019-20. The new bank rate has been reduced by 35 basis points to 5.65% from the existing rate of 6%.

This will also impact all the penal interest rates on shortfalls linked to the bank rates. Depending on the duration of shortfalls in reserve requirements, the new revised rates would be the bank rate plus 3 percentage points or 5 percentage points.

The detailed notification can be accessed here.

Regulatory news

RTGS – extension in operating hours

The RBI has decided to extend the operating hours for customer transactions and inter-bank transactions in RTGS. With effect from 26 August 2019, the commencement time for RTGS transactions would be 7:00 am with the initial cut-off time for customers and inter-bank transactions being 18:00 hours and 19:45 hours respectively.

The detailed notification can be accessed here.

Liquidity adjustment facility (LAF) – Revision in rates

The Monetary Policy Committee (MPC) has decided to revise the policy repo rate and reverse repo rate under the LAF. The new repo rate and reverse Repo rate stand adjusted at 5.40% and 5.15% respectively.

The detailed notification can be accessed here.

Other regulatory news

Stock exchange – Product Advisory Committee

In consultation with the Commodity Derivatives Advisory Committee (CDAC), SEBI has issued guidelines to recognised stock exchanges to constitute a Product Advisory Committee for each commodities group having common stakeholders.

The committee, which will constitute representatives from trade associations, exchanges, stakeholders, financial institutions, brokers and individual experts, will be responsible for providing consultation on new contract design or review of existing contract design, review of delivery centres and contracts performance on multiple parameters.

The detailed notification can be accessed here.

Listed companies – disclosure of reasons for encumbrance

With a view to promote transparency related to encumbrance, SEBI has issued additional disclosure requirements for reasons of encumbrance by promoters and persons acting in concert (PACs).

As per the new guidelines, it is mandatory to disclose detailed reasons on encumbrance by the promoters of every listed company if the combined encumbrance equals or exceeds 50% of shareholding of company or 20% of the total share capital of the company. This shall be done in the prescribed format within two working days of creation of encumbrance.

The detailed notification can be accessed here.

Parking of funds by mutual funds in scheduled commercial banks

SEBI has issued a circular which restricts trustees/ asset management companies (AMCs) from parking scheme funds in the short-term deposits (STDs) of scheduled commercial banks that are investment parties in the scheme. It also directs the trustees/AMCs to ensure that banks with STDs do not invest in the same scheme until the tenure of the STD.

The detailed notification can be accessed here.

Global regulatory news

EU banks target market-based funding

In a recent update, the European Banking Authority (EBA) published its annual update on funding plans and asset encumbrance of European Union Banks. The assessment of the funding plans of 160 banks indicates an increase in client deposits and debt issuance over the next three years, particularly in unsecured debt instruments. The total assets are forecasted to grow by 6.1% by 2021, with the major drivers being household and non-financial corporate loans.

The detailed notification can be accessed here.

Identification of Global Systemically Important Institutions (G-SIIs) – data updates

The European Banking Authority, which acts as the central data hub, updated the yearly data from the 36 largest financial institutions in the European Union whose leverage ratio exposure exceeds EUR 200 billion. It has also published 12 indicators of performance. This data is used to identify G-SIIs based on assessments of the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB).

The detailed notification can be accessed here.

EBA – implementation of the Deposit Guarantee Schemes Directive (DGSD)

The EBA issued the first of its three opinions on DGSD implementation in the European Union, with two others scheduled later in 2019. The opinion envisages changes related to deposits, coverage scope and cooperation between DGSs. The purpose is to strengthen depositor protection and promote operational efficiency and financial stability.

The detailed notification can be accessed here.

Using technology to strengthen the NBFC sector

Regulatory news

Other regulatory news

Global regulatory news

Contact us

Contacts

Vivek Belgavi
Partner
vivek.belgavi@in.pwc.com
+91 9820280199

Vishal Motwani
Director
vishal.motwani@pwc.com
+91 7506800901

Hardik Gandhi
Associate Director
hardik.gandhi@pwc.com
+91 9819379703

Acknowledgements

This newsletter has been researched and authored by **Hardik Gandhi**, **Umang Agrawal**, **Avneesh Narang**, **Ajit Shukla** and **Raghav Aggarwal**

About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 157 countries with over 276,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

In India, PwC has offices in these cities: Ahmedabad, Bengaluru, Bhopal, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai, Pune and Raipur. For more information about PwC India's service offerings, visit www.pwc.in

PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.

pwc.in

Data Classification: DC0

SUB/September2019-M&C