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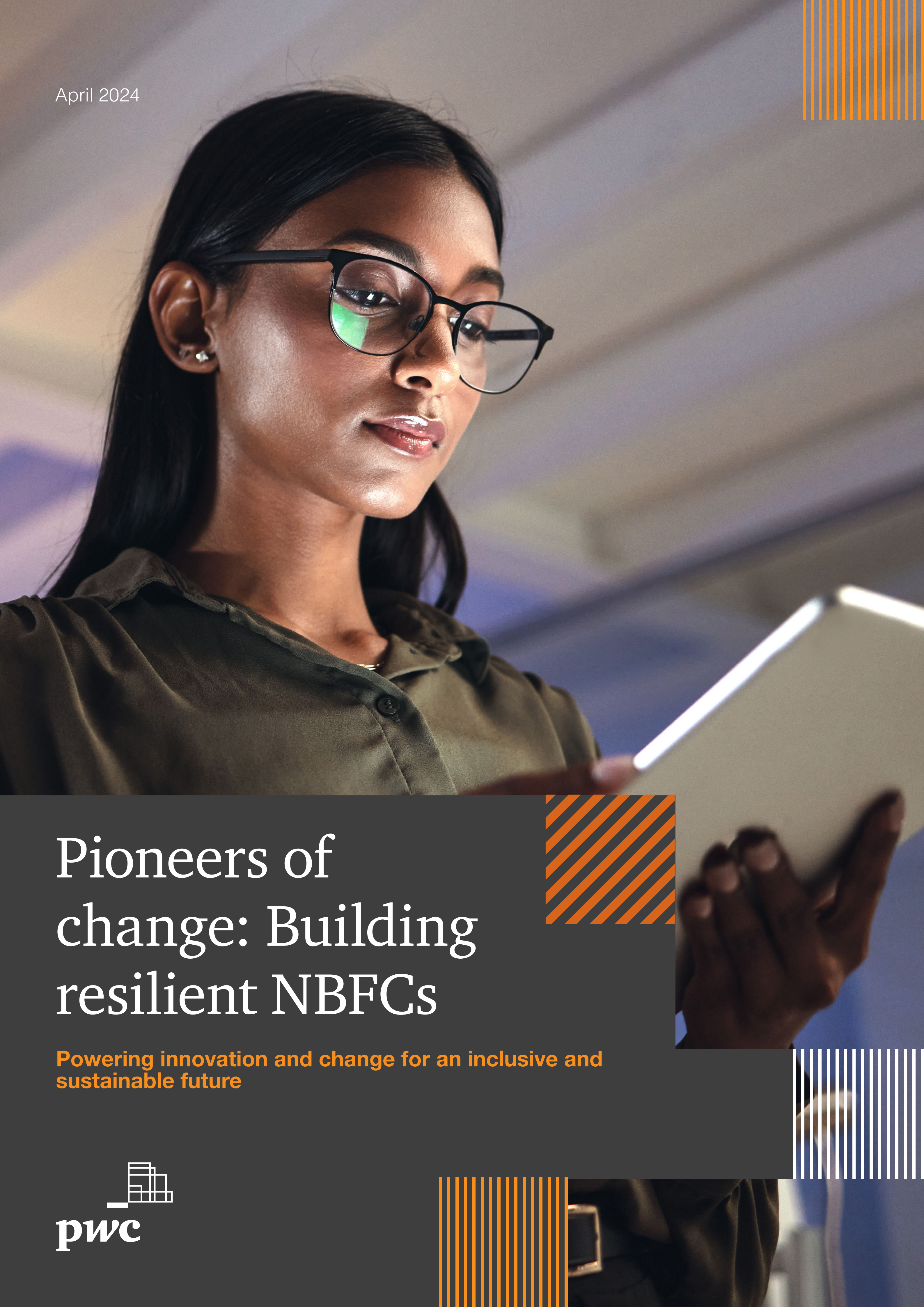

Pioneers of change: Building resilient NBFCs

Powering innovation and change for an inclusive and sustainable future

pwc

Foreword

India's non-banking financial company (NBFC) sector continues to remain instrumental in driving credit growth for the country's underserved segments. In 2023, the contribution of NBFCs to India's gross domestic product (GDP) stood at 12.60%, thus becoming an essential part of the country's economic engine.

Various market forces have been shaping the NBFC landscape over the last few years. Some of the key trends observed revolve around 1) innovation in business and operating models led by digital adoption, 2) evolution of the digital public infrastructure and 3) the evolving regulatory landscape for the NBFC sector. Furthermore, stiff competition from incumbents and FinTechs, rising technology advancements, and rapid shifts in customers' expectations require NBFCs to constantly revisit their business outlook.

I am excited to present this report which outlines the building blocks for robust, scalable, resilient and future-ready NBFCs that can seamlessly navigate the constantly evolving financial landscape in future and contribute significantly to India's economic aspirations.

This report illustrates the following key areas in detail that NBFCs must focus on in order to grow and operate in a sustainable manner in the future:

- Business model innovation
- Technology and digital acceleration
- Strengthening risk and governance

I trust you will find this to be an interesting read and gain relevant actionable insights for your respective organisations.

Gayatri Parthasarathy
Global Financial Services Technology Leader
India Financial Services Sector Leader
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1. Introduction

1.1. The evolution of NBFCs in the digital era

NBFCs have emerged as a crucial source of finance for a large segment of the population, including micro, small and medium enterprises (MSMEs), and economically unserved and underserved population. They have managed to cater to the diverse needs of the borrowers in the fastest and most efficient manner, by considering their vast geographical scope and understanding various financial requirements of the people. Furthermore, non-bank moneylenders have played an important role in the financial inclusion process by supporting the growth of millions of MSMEs and independently employing people.

In 2023, the contribution of NBFCs to India's gross domestic product (GDP) stood at 12.60%, and accounted for almost 30% market share of the total non-food credit in the country.[1] For the last five years, the market share of NBFCs has been growing with every passing year and spilling over into the banks' market share. NBFCs have undertaken product innovations to cater to the specific needs of different customer segments, thereby providing niche product offerings. Credit facilitation frameworks – like account aggregator (AA), Open Credit Enablement Network (OCEN) and Open Network for Digital Commerce (ONDC) – are further propagating new ways of lending. Furthermore, digitisation has enabled straight-through processing and frictionless journeys. Data democratisation and emerging technologies like artificial intelligence (AI), analytics and early warning system (EWS) are further enhancing operations across the lending value chain – sourcing, onboarding, credit underwriting, monitoring and collections. FinTech companies and digital platforms have proliferated access to credit by partnering with various NBFCs. Additionally, FinTech firms are now aspiring to transition from customer engagement platforms to NBFCs themselves. To this effect, various FinTech companies in the recent past have applied to the regulator for obtaining NBFC licences.

The Government and Reserve Bank of India (RBI) have taken various initiatives – like Mudra Loans, Trade Receivables electronic Discounting System (TreDS), account aggregators and ONDC – to push and support growth of small businesses. Other regulatory frameworks like co-lending and First Loss Default Guarantee (FLDG) have also enabled NBFCs and FinTech organisations to partner with banks and extend greater credit offerings to customer segments. In order to adapt its regulatory architecture to the evolving risk profiles of NBFCs, the RBI rolled out a regulation in October 2021, which factors in the scale of NBFCs. This move was meant to refine the categorisation of these financial entities in line with their shifting risk profile – by considering the growing size, escalating complexity and growing interconnectedness of NBFCs within the financial sector.

Recently, the RBI has also been monitoring NBFCs through both on-site as well as offsite oversight. This has resulted in the RBI taking penal actions (penalties, stopping of certain products etc.) against some of the NBFCs on account of non-compliance with regulatory guidelines. Moreover, it has been undertaking thematic reviews for certain regulations such as outsourcing guidelines, fair practice code, KYC Master Directions etc.

Despite potential transient setbacks, we anticipate that retail NBFCs will experience substantial growth, backed by technological advancements. This will be fuelled by a strong demand in urban areas and rise in credit penetration which will sustain expansion in consumer finance. However, growth might be subdued in the rural sector for a while. **Lending market share of NBFCs in consumer durables stood at nearly 61% in 2023.**[2] We are optimistic about further growth in consumer finance, owing to the increase in disposable incomes. In terms of **MSMEs, the NBFC advances market share stood at a meagre 1%.**[3] However, looking at the current trends, we believe that business and supply chain finance offerings will see an upward trend this year. Advances in other products like gold and vehicle loans will continue to grow (NBFCs had almost 60.0% and 43.5% market share of gold and vehicle loans respectively in 2023). Housing loans market share – which was at only 1.65% in 2023 – will rise this year owing to increased focus of NBFCs on affordable housing. However, mortgage-backed loans, specifically loans against property, seem to have a muted growth pattern.[4]

1 https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/08NONBANKINGFINANCIAL2712236AAF95EA1D004A298BCC9924C78098AD.PDF
2 https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/APPTBVI_4C9FC6D27259D40F387BA108C3CE918D7.PDF
3 Ibid.
4 Ibid.

1.2. Key trends in the NBFC sector

The Indian NBFC sector is rapidly transforming across four key areas. Firstly, digital adoption is increasing, leveraging AI and blockchain for operational efficiency and innovative product offerings via mobile and online platforms. Secondly, NBFCs are diversifying, expanding portfolios, forming partnerships and prioritising customer needs. Thirdly, digital infrastructure is helping reach underserved customers, fostering financial inclusion. Lastly, regulations are tightening to ensure compliance, digital processes and consumer protection, reflecting the sector's adaptation to digitalisation and evolving regulations for sustained growth.

1.2.1. NBFCs unleashing potential through digital adoption

With digital transformation taking place across NBFCs, they are increasingly focusing on paperless customer acquisition/onboarding, digital underwriting, disbursements and collections and technology-led product innovations.

- **Customer acquisition and onboarding:** Many NBFCs are now adopting digital journeys for their customer acquisition and onboarding processes. A large upper-layer NBFC has developed **an end-to-end paperless journey** in rural group loans, two-wheeler finance, farm equip finance and personal loans.
- **Super apps and segment-specific digital assets:** NBFCs are building super apps to list all their financial services offerings under one roof.

  NBFCs are also developing separate segment-specific digital assets to run lending programmes. One of India's biggest NBFCs has launched a cashflow-backed digital MSME lending platform that uses traditional and alternate data sources along with value-added services for the MSME ecosystem to manage and grow their business.
- **Mobile apps and online platforms:** NBFCs are gradually prioritising the development of user-friendly mobile apps and online platforms to provide convenient access to financial services. A large NBFC has acquired substantial number of users and runs multiple in-app programmes for its customers.
- **Automation, AI and chatbots in operations:** NBFCs are automating various aspects of their operations, including loan underwriting, risk assessment and customer service. Furthermore, they are now building multilingual chatbots to enhance customer experience and service.
- **Data analytics for insights:** Leveraging data analytics tools, NBFCs are gaining valuable insights into customer behaviour, market trends and credit risk profiles. Doing so enables them to develop targeted marketing strategies, assess creditworthiness more accurately and optimise business processes for better efficiency.
- **Cloud and cybersecurity:** Cloud adoption in NBFCs is on the rise, enabling scalable infrastructure and enhanced operational efficiency. However, there is also a heightened focus on cybersecurity measures to mitigate risks associated with data breaches and ensure robust protection of customer and sensitive financial information.

1.2.2. Innovative business models fuelling NBFC expansion

Traditional operating models at NBFCs pose a variety of challenges like high-cost operating models with people and branches, longer lead generation and processing time, legacy systems and limited data governance. This has significantly limited the overall business growth for NBFCs.

Keeping up with the recent times, NBFCs are gradually introducing multiple innovative initiatives across the value chain in order to drive business growth. Some of these have been discussed below:

- **Marketplace model:** NBFCs are now moving beyond offering their own traditional financial services products to building marketplaces of financial services products which provide payments, insurance, cards, investments and deposits – in addition to loan products – all under one platform. They are partnering with other banks and financial institutions to offer multiple options to customers – for e.g. a large upper layer NBFC has created a marketplace, which is a one-stop digital platform offering financial products across all categories like loans, cards, insurance, investments, payments, pocket insurance and value added services (VAS).

- **Co-lending:** NBFCs are now embracing the co-lending set-up wherein banks and NBFC collaborate to facilitate the joint contribution of credit for priority sector lending. Co-lending is meant to enable risk sharing and facilitate seamlessness between current account–savings account (CASA) funded balance sheets to NBFCs (banks bring the cost of fund advantage and NBFCs bring efficient last-mile reach with asset class specialisation).
- **Embedded finance:** Embedded finance is a way to provide customers with access to credit via non-financial entities by embedding lending capabilities in the non-financial entity. In these cases, the entity providing credit will be a bank or an NBFC, although the channel to get credit will be a non-financial entity. New modes and channels of lending like OCEN, ONDC will help boost embedded finance.
- **Diversification of product portfolio:** NBFCs are now focusing on creating hyper-personalised financial products to cater to the evolving need of their customers. Many are launching products in affordable housing finance in their retail portfolio. Moreover, for MSMEs, they have introduced supply chain finance (SCF), which is a key offering to address working capital needs of MSMEs. With the introduction of TreDS, participation of NBFCs has become significantly easier. However, running one's own SCF programme in collaboration with SCF platforms will enable NBFCs to get access to a larger pool of MSMEs. This technology system will help with risk assessment as well. In the absence of credit history, AI-enabled risk assessment solutions will help NBFCs to evaluate borrowers' creditworthiness and expected business growth.
- **Partnerships and collaboration:** NBFCs are having strategic alliances with FinTech start-ups to leverage their technological expertise and customer reach. These partnerships often involve joint product development, sharing of data analytics capabilities and accessing new distribution channels. Some NBFCs are forming joint ventures with banks and/or other financial institutions to combine strengths and offer a range of financial services offerings. These partnerships can enhance credibility, expand market presence and mitigate risks.

1.2.3. Growth of digital public infrastructure

NBFCs are harnessing the potential of the country's robust digital public infrastructure, through platforms like AA, OCEN and ONDC. These innovative frameworks empower NBFCs to access and exchange financial data securely, enabling smoother processes for credit assessment, risk management and access to a greater pool of underserved customers across both retail and MSME segments.

With AAs, NBFCs can seamlessly retrieve consented customer data from various financial institutions, therefore enabling better underwriting and streamlining the lending process.

OCEN is finding a way to democratise access to credit by making it accessible to the level that a street vendor has access to it for small sums. It provides a standardised framework for credit products, facilitating interoperability and scalability while reducing operational complexities for NBFCs.

ONDC leverages its architecture for the provision of financial services in four domains – namely credit, insurance, investments and gift cards. Currently, gift cards that are exclusively redeemable on ONDC are live. Many NBFCs are eager to leverage this new platform for their business growth and are in various advanced stages of integration.

1.2.4. Evolving regulatory standards in the NBFC sector

Regulatory and compliance trends in the NBFC sector reflect a dynamic landscape shaped by evolving standards and increased scrutiny. The RBI is imposing stricter compliance requirements, emphasising enhanced risk management practices and strengthening consumer protection measures to safeguard financial stability and integrity. This includes stringent licencing criteria, robust capital adequacy norms and transparent disclosure requirements. These trends highlight a concerted effort to instil trust, mitigate risks and foster sustainable growth in the financial ecosystem.

2. Business model innovation, technology and digital acceleration and governance

In the evolving financial landscape, NBFCs are facing unprecedented challenges and opportunities. To successfully navigate this challenging environment, NBFCs must embrace a multifaceted approach centred around the three pillars of business:

- business innovation
- technology enablement
- compliance and governance.

These factors not only serve as the foundation for sustainable growth but also as key drivers for fostering resilience in the face of uncertainty.

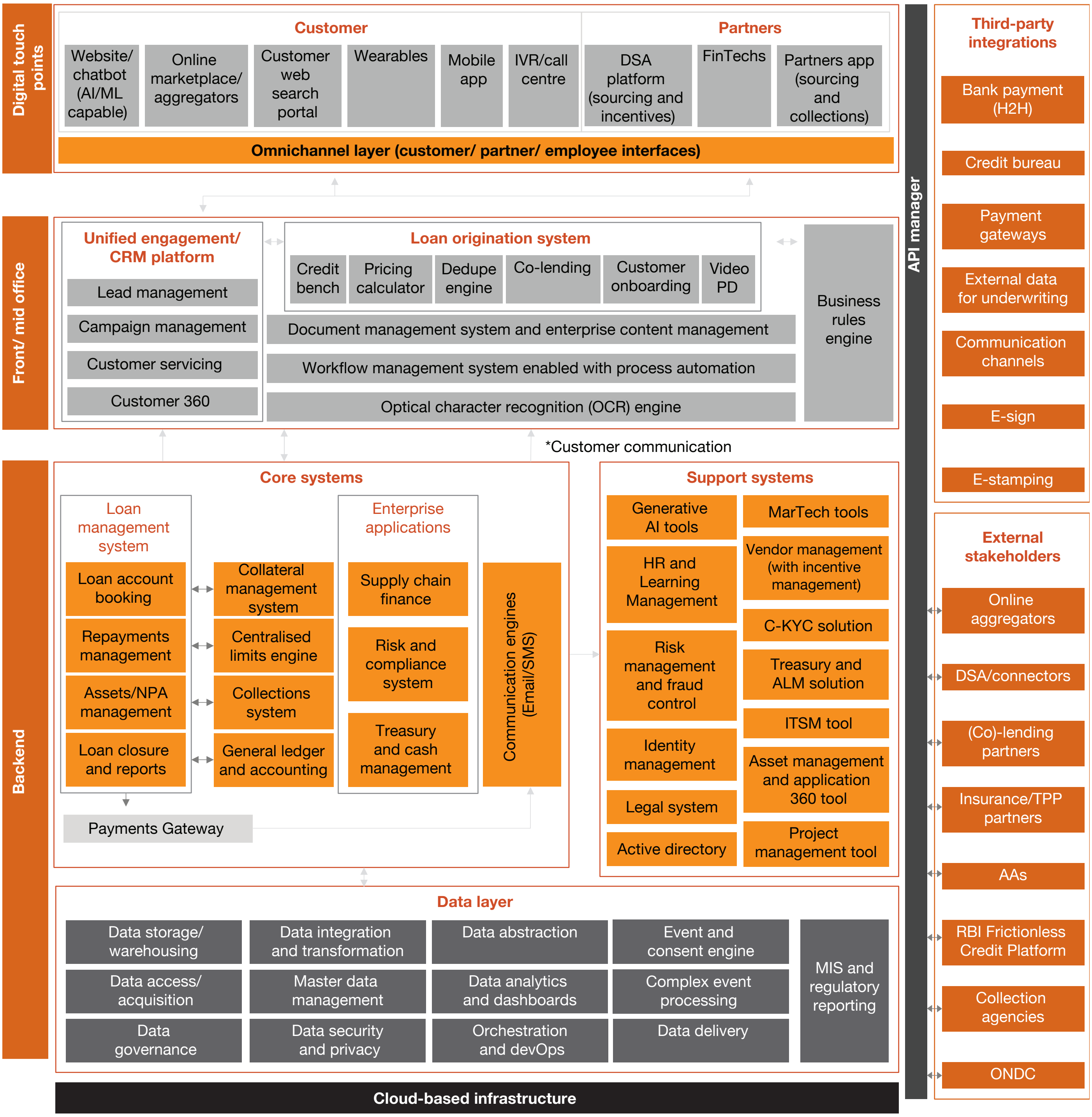
The RBI, in its master circular to NBFCs, mandated implementation of Core Financial Services Solutions (CFSS) for NBFCs belonging to the middle and upper-middle layers with ten or more fixed service offering units by 30 September 2025.[5] CFSS is envisioned to empower NBFCs with integrated operations, seamless customer interfaces and centralised databases, thus enabling customers to receive better services anytime, anywhere.

- **Anywhere, anytime services:** Provide seamless customer interface in digital offerings and transactions relating to products and services with anytime, anywhere facility.
- **Management information system (MIS) requirements:** Enable integration of NBFCs' functions across systems to provide a centralised database and accounting records, and generation of suitable MIS – both for internal purposes and regulatory reporting.

CFSS is a step towards digitalisation that will help NBFCs to improve customer experience and drive growth. Moreover, it is expected to strengthen the overall financial system of NBFCs.

5 https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=12247&Mode=0

Reference business architecture for a future-ready NBFC



In this section, we touch upon how NBFCs can harness the power of innovation, leverage advanced technologies, uphold regulatory compliance and strengthen governance frameworks to thrive in a competitive market while ensuring long-term stability and growth.

2.1. New operating models and trends in the ecosystem

Introduction

NBFCs are increasingly diversifying their service offerings and embracing digital transformation. This shift involves leveraging technology to enhance operational efficiency, streamline processes and offer innovative financial products by exploring strategic partnerships and collaborations and adopting more flexible and customer-centric operating models to stay competitive in a rapidly changing financial landscape.

1. Digital transformation

NBFCs have become more customer-centric by offering personalised products and services in a seamless manner through the customers' preferred channels according to their requirements.

However, this entails significantly upgrading technologies and establishing innovation and testing centres. While a digitally enabled NBFC looks at enhancing many of its customer-facing, front-end operations with digital solutions, the reality is that many bank processes still rely heavily on people and paper to process customer requests. Such manual processes are deemed to be costly and slow. Moreover, they can provide inconsistent results and are prone to errors. These inefficiencies, in turn, have a significant impact on customer experience. Although many NBFCs are working towards transforming customer experiences with the help of technology and by creating multiple channels, most of them are missing out on a potentially bigger opportunity – i.e. digitising their operations. With that in mind, a digitally enabled NBFC is also one that looks at digitising its middle and back-office operations in order to reduce overheads and, more importantly, improve end-to-end customer experiences.

2. Embedded finance

Embedded finance is any use case where financial services are integrated onto a non-financial platform within the customer journey to offer seamless access financial products through alliances and partnerships.

In the Indian financial landscape, we've seen four key focus areas for NBFCs. These are listed below:

- **B2B e-commerce marketplaces:** E-commerce platforms are providing buy now, pay later (BNPL) options to retailers at checkout. Trade and supply chain financing are also common value-adds embedded in these marketplaces.
- **Business aggregator companies:** Food delivery and services companies use embedded finance to provide small ticket size loans to their partners to help improve their service levels – for example, working capital loans for their restaurants, term loans for expansion, vehicle purchase/maintenance loans for delivery partners.
- **Accounting/khata apps:** As these apps have access to the financial information of their MSME and SME customers, they are in a good position to analyse their creditworthiness and provide working capital and term loans.
- **Logistics platforms:** These platforms enable NBFCs in the evaluation of loans through the supply of their revenue data. This makes it easier for their partners to acquire funds during periods of demand fluctuation without having to go to third parties. Consequently, due to the perception of logistics platforms being more reliable, their customer acquisition and retention rates are higher.

3. Co-lending

In last few years, multiple banks and NBFCs have undertaken lending through co-lending while keeping the focus on distribution and the customer segment by leveraging digital sourcing capabilities of small NBFCs and FinTechs. Banks are largely focused to meet their priority sector lending (PSL) target and mid- and large-sized NBFCs are focused towards earning higher risk-adjusted yields. Although the adoption of this model is currently low, it is expected to pick up in the near future.

A few success factors for co-lending are:

- seamless integrations between NBFCs and banks
- mutually agreed upon credit assessment framework
- real-time reporting and analytics
- reconciliation.

4. Hyper-personalisation

Customers are growing accustomed to FS players anticipating their needs and offering what they're looking for — sometimes pre-emptively. E-commerce and FinTechs are using predictive tools and algorithms to exceed expectations with highly personalised experiences. Digital teams at NBFCs are focusing on re-engineering their channels to enable highly personalised digital experiences.

- Provide personalised, relevant, pre-approved financial product offers.
- Use contextual data to deliver customised offers.
- Deliver personalised financial coaching to your customers.
- Empower branch and contact centre employees to better serve customers.
- Create a more engaging messaging experience for customers with enhanced communication, transparency and convenience during both initial acquisition and across the duration of their relationship.

5. Credit assessment

Financial assessments in both retail and corporate segments have been a time-consuming and manually intensive task in the past. However, trends in underwriting/credit appraisal process over the last decade indicate significant improvement in the process. Multiple analytical tools and credit rule engines have become a part of straight-through processing (STP) journeys. This has increased the efficiency and accuracy of underwriting and risk assessment processes, thereby reducing the turnaround time. Digital processes include C/V-KYC, OCR implementation, rule engine-based underwriting outputs, automated approval triggers and escalations/sanctions.

For rural segments, multiple technology firms have developed satellite-based imaging, IoT data-based credit underwriting models which enable financial institutions to get insights over past trends on cropping patterns, state of crop, water levels, infections, land size, location data, hours of usage, earning models and billing details, which is used for risk assessment by underwriters.

6. Focus on compliance

Tie-ups of lending service providers (LSPs), FinTechs and embedded finance with NBFCs have resulted in increased accessibility to a wider base of prospective customers, offering new revenue streams. NBFCs are moving towards behavioural-based lending approaches based on data-driven insights, which provides liberty to hyper-personalise existing product lines. Furthermore, NBFCs are keen on increasing scalability and reach while optimising the operational costs.

AAs are increasingly gaining traction in the Indian financial services sector. The AA signup penetration is increasing day by day, which will soon develop into systematic and standardised financial analytics and underwriting tool.

Widespread rollout of ONDC and OCEN will also play a significant role in partnership-based collaborations, enabling NBFCs to focus on multiple customer segments.

2.2. Embracing new technologies to thrive in a competitive market

Post the pandemic, NBFCs witnessed an accelerated shift in adopting innovative technologies to improve the products being offered by them. Due to the growing needs of new-age customers, NBFCs are gradually moving towards digitalising their processes and understanding their potential in the BFSI industry using various technology solutions.

Keeping up with current trends in the BFSI sector, NBFCs are increasingly adopting and incorporating various emerging technologies into their existing systems to reach the unserved and underserved population to make financial services more accessible for them. While traditional models often fall short of catering to a large population in a seamless manner, models incorporated with emerging technologies can help NBFCs to bridge the gap in the rapidly growing financial sector.

Furthermore, changing customer profiles – with a preference for mobile-first solutions – influence of digital personalities, and demand for seamless and instant services will also contribute significantly to the expansion story of NBFCs. The technology-driven business model of NBFCs, which aims to reduce dependency on manual tasks and is built on the capabilities of robotic process automation, will lead to better inclusion, cost-effectiveness, enhanced credit quality and a quicker turnaround time than traditional lending models of banks.

Key technologies for digitising different phases of the journey

1 Customer acquisition and onboarding

- CRM software
- Marketing tools
- KYC verification like eKYC, CKYC, etc.
- Electronic signature solutions

2 Loan origination

- Loan origination system (LOS)
- Integration with credit bureaus
- Document management systems (DMS)

3 Underwriting and disbursement

- Business rule engine (BRE)
- Automated underwriting system
- Loan management system (LMS)
- Electronic fund transfer (EFT) services

4 Repayment, collections and recovery

- Early warning systems
- Collections management software
- Predictive analytics for identifying delinquency

To stay competitive and resilient in a dynamic market, NBFCs should embrace new technologies while adhering to regulatory requirements. Additionally, NBFCs can leverage RegTech solutions across all phases of the customer journey to enhance efficiency, improve compliance and mitigate risks to gain an edge over competitors.

2.2.1. Customer acquiring and onboarding

NBFCs can streamline the customer acquisition and onboarding process by adopting and leveraging various key technologies. By developing an online application portal which facilitates a seamless and frictionless onboarding experience, NBFCs can significantly enhance customer experiences. Advanced digital marketing platforms, along with customer relationship management (CRM) software integrated with data analytics capabilities, can help NBFCs in precise audience segmentation, potential customer identification and personalised communication sharing, thereby increasing the conversion rate of leads into customers.

By adopting digital identity verification systems like electronic know your customer (eKYC), central KYC (CKYC) or video KYC (VKYC) solutions in the customer onboarding process, NBFCs will find it easier to adhere to regulatory requirements and accordingly develop a compliant customer onboarding process.

2.2.2. Loan origination

Loan origination systems (LOS) form the base for digital loan application journeys. By adopting an LOS, NBFCs can facilitate a streamlined digital loan application process for their customers and enhance overall experience. An LOS also enables integration with document management systems (DMS) which facilitate efficient processing and storage of application documents, reducing manual errors and turnaround time.

An LOS also enables integration with credit bureaus which allow the creation of advanced credit scoring models and improve an NBFC's risk assessment capabilities. This enables the NBFC to make informed lending decisions that are compliant with the regulatory requirements.

2.2.3. Underwriting and disbursement

By leveraging risk assessment tools and automated decisioning systems, NBFCs can evaluate borrower profiles efficiently and take real-time credit decisions in order to be more compliant towards regulatory norms while making valuable credit-related decisions. Additionally, through implementation of a loan management system (LMS), NBFCs can streamline the disbursement process to enhance customer experience and satisfaction and minimise their operational costs and turnaround time.

2.2.4. Repayment, collection and recovery

NBFCs should look forward to implementing an EWS to identify critical or stressed assets prior to them becoming delinquent. By using advanced collections management software and predictive analytics, NBFCs can identify potential delinquencies in advance and take prompt recovery actions. Moreover, NBFCs can apply RegTech solutions to minimise compliance risks and uphold regulatory standards in the repayment, collection and recovery phases.

Embracing technology and RegTech solutions while navigating regulatory requirements enables NBFCs to gain a competitive advantage, enhance operational efficiency and build resilience in the face of evolving market dynamics.

Furthermore, NBFCs can utilise various emerging technologies to embrace a highly digitised and streamlined approach for servicing customer requirements, resulting in greater customer satisfaction.

Emerging technology trends: Benefits and disruptive models

Emerging technology disrupting current models	Artificial intelligence	Robotic process automation	Advanced analytics	API	Blockchain	Chatbots and natural language processing
Key benefits of emerging technology	Automated end-to-end credit management	Paperless processing	24x7 customer support	Integrated accounting engine	Dynamic workflow management	Powerful rule engine
	Seamless integration with external data	Real-time reconciliation	Agility and scalability	Unified solutions and operational efficiency	Robust risk mitigation	Better compliance and fraud management
Disruptive models across the value chain	Faceless and paperless eKYC and onboarding	Faster loan processing from origin to disbursement	Addressing new markets – underserved and unserved	Based on multiple data sources – social media, government data	Automated and personalised underwriting and risk management process	Automated reconciliation, monitoring and update

2.3. Governance and compliance

In the past few years, the regulatory landscape governing NBFCs in India has experienced significant transformation under the purview of the RBI. This evolution reflects the dynamic nature of the financial sector, necessitating frequent updates and revisions to regulatory frameworks, in order to address emerging risks, strengthen resilience and enhance consumer protection.

The RBI has periodically revised and increased its supervisory focus. This constant evolution of regulations has prompted NBFCs to adopt a compliance-plus approach at all the times, and increase focus on automation for internal monitoring of compliance, using real-time dashboards. The following illustration highlights the evolving regulatory landscape of NBFCs.

The evolving regulatory landscape in India

NBFCs fill important gaps in financial inclusion by catering to geographies and sectors where the banking sector is unable to make an impact. Regulatory oversight and supervisory policies are constantly updated to keep pace with the evolving financial landscape in the country.

Timeline

Prudential norms were prescribed based on the recommendations of the Shah Working Group

Classification of systemically important NBFCs – based on asset size

Revised guidelines on corporate governance for SI NBFC-ND and NBFC-D

Post IL&FS crisis

Appointment of Chief Risk Officer (CRO) for NBFCs

Implementation of Indian Accounting Standards (IND-AS)

Review of regulatory framework for Housing Finance Companies (HFCs)

Integrated Ombudsman Scheme 2021 and appointment of IO

Risk Based Internal Audit

Extension of Prompt Corrective Action (PCA) framework to NBFCs Digital Lending Guidelines

IT outsourcing/ IT governance

1994 1998 2006 2014 2015 2017 2018 2019 2020 2021 2022 2023

Regulatory framework for NBFCs issued

Revised regulatory framaework in terms of size and nature of operations

Master Directions on IT Governance

Harmonisation in NBFC categories

Scale-based regulations framework for NBFCs

Access for non-banks to centralised payment systems

Guidelines for appointment of SCA / SA

Compliance functions and role of CCOs in NBFCs

A review of regulatory and supervisory measures introduced by the RBI:

Prudential measures	Revised asset classification norms and enhancement of provision in line with banks; harmonisation of credit concentration norms between NBFC categories	**Corporate governance**	Constitution of audit, risk and nomination committees; fit and proper criteria for directors; additional disclosure requirements	**Other key changes applicable for all NBFCs**	Activity-based regulation; regulations for core investment companies; liberalisation of foreign investments in NBFCs

With the evolving landscape, the scope of the compliance function has become more extensive.

Core components

Governance and operating model

- Independence of compliance
- NBFC-wise compliance strategy
- Integrated risk management
- Roles and responsibilities
- Policy management
- Quarterly and annual review by board / ACB
- Compliance risk assessment
- Oversight, monitoring and reporting
- Training and communication
- Investigations

Processes and controls

New processes, product and technology	KYC/AML	Compliance advisory	Regulatory reporting
Regulatory communications	Regulatory supervision	Board/ACB/ CEO reporting	Compliance testing
Circular dissemination and implementation	Training and awareness	Compliance risk assessment	Culture and conduct

Enablers

- Workforce and talent
- Data and technology
- Culture and awareness

Role of the compliance function

Ensuring compliance with relevant statutes, regulations/guidelines from all regulators, standards and codes, internal policies and fair practices code

Ensuring timely and accurate regulatory reporting and submission of compliances to supervisory observations

Reporting to the board and senior management on regulations, rules and standards, any other developments and compliance issues

Conducting compliance risk assessment, testing, continuous controls monitoring and initiating investigations

Providing guidance on compliance-related issues, acting as a strategic advisor to the business and approving new processes and products

Liaising with regulators and acting as a nodal point of contact for regulators

Promoting compliance culture across the organisation

We've also outlined some notable measures taken by the RBI to enhance business prudence, operations and governance in the overall banking sector, which has specific implications on NBFCs.

Description of circular	What NBFCs need to do	Published/effective date	How we can help
• CFSS implementation • NBFCs must implement CFSS with 10 or more fixed service offering units.	• Mandatorily implement CFSS • CFSS enables integration of NBFCs' functions, provides a centralised database and accounting records. • CFSS must be enabled to generate suitable MIS, both for internal purposes and regulatory reporting.	23 February 2022/30 September 2025	• Implementation of CFSS system • Implementation of a reporting tool to support MIS requirements
• Scale-based regulation framework • The RBI has divided NBFCs into four categories based on size, activity and perceived risk. 1. Base (asset size < 1,000 crore) 2. Middle (asset size ≥ 1,000 crore) 3. Upper (top 10 NBFCS based on asset size) 4. Top layers (ideally empty)	• NBFCs need to classify asset/loan account as NPA where overdue days are more than 90 days. • NBFCs and banks must establish risk assessment policies. • Disclosure of below details in annual statement: 1. corporate governance report 2. disclosure on modified opinion 3. exceptional income or expenses 4. breaches in terms of covenants or defaults 5. divergence in asset classification and provisioning	21 March 2024	• Implementation of an NPA monitoring system and a reporting system
• Streamlining of internal compliance monitoring function – leveraging use of technology • The RBI issued important guidelines on 31 January 2024, to ensure implementation of automated compliance monitoring by 30 June 2024.	• NBFCs to ensure implementation of automated compliance monitoring system • Tool/system must have processes for identifying, assessing, monitoring, and managing compliance requirements; escalate issues of non-compliance.	31 January 2024/ 30 June 2024	• Set up automated compliance system and reporting tool.
• Master Direction on IT governance, risk, controls and assurance practices • Establish a strong IT management system to support information systems and infrastructures to ensure efficient functioning of the entire IT environment. • Areas covered in these directions are disaster recovery action plan, performance, resources, policy management and risk.	• Banks must develop a new IT plan to replace outdated infrastructure and software before end of support (EOS).	7 November 2023/ 1 April 2024	• Develop IT strategy and plan to replace outdated software and infrastructure. • Assist in vendor selection and implementation.

<table>
<tr><th>Description of circular</th><th>What NBFC needs to do</th><th>Published/effective date</th><th>How we can help</th></tr>
<tr><td>Master Direction on Outsourcing of Information Technology Services</td><td>Risk management framework for outsourcing of IT services
Roles and responsibilities of the board, board committees and senior management
Comprehensive assessment of need for outsourcing and associated risks
Robust grievance redressal mechanism
Recognising and interacting with the service providers
Implementing outsourcing agreements into practice
Keeping an eye on and managing the risk-reduction and outsourcing frameworks
Disclosure of cyberattacks
Compliances across borders</td><td>10 April 2023/
1 October 2023</td><td>Assessment of the risks and implementing best practices</td></tr>
<tr><td>FLDG
RBI has limited the cap to 5% of the outstanding loan portfolio on FLDG arrangements between NBFCs and FinTech entities (LSP).</td><td>Implement system to perform due diligence of the customer and BRE-based underwriting.</td><td>10 August 2022/
8 June 2023</td><td>Set up AI/ML-based robust BRE system to sanction loan.</td></tr>
<tr><td>Co-lending model:
The RBI issued its latest guidelines for co-lending models (CLM2). Banks and NBFCs shall formulate Board approved master agreement for entering CLM, where the NBFC will take the lead in the origination and disbursement, and the bank will reimburse up to 80% of the loan amount.</td><td>Responsibility of all due diligence measures will be with NBFC
Third party responsible for due diligence to provide information to bank within two days to NBFC or from the cKYC records registry
Norms for risk management, sanctioning and underwriting practices, write-off and provisioning in NBFC/HFC to be in place
Implementing system in compliance with the policies, using technology to track loans and repayment, recoveries, asset values etc.</td><td>5 November 2020</td><td>Leveraging technology to set up a system which is configurable based on the master agreement to support end-to-end CLM business model
Robust risk, compliance and BRE system to sanction and monitor disbursed loan
LOS, LMS and collection system</td></tr>
</table>

3. Way forward for a resilient future

The path to a resilient future for NBFCs hinges on innovative business models, accelerated technology adoption and robust governance practices. Embracing agile strategies and collaborative partnerships fosters innovation, while leveraging cutting-edge technologies enhance competitiveness. Coupled with transparent governance frameworks, these approaches empower NBFCs to navigate challenges effectively and thrive in an ever-evolving financial landscape.

3.1. Beyond boundaries: Powering growth through new business models

3.1.1. Product and channel strategy

The path to purchase products has evolved into a complex, non-linear and interconnected path, NBFCs want to offer superior, standard experience and depth of products seamlessly across channels. This has made way for a modular, streamlined product and channel strategy.

Pillars

- Modular
- Hyper efficient
- Employee- and client-centric
- Listens and evolves
- Product innovation
- Manages risks continuously
- Predictive and proactive

Key considerations		Capability and consideration areas
Engagement venues	Being present across channels and engagement influences purchase decisions.	Channel efficiency
Digital/physical integration	Complex product purchases will continue to pivot around physical channels; therefore, integrated omni-channel capabilities are key.	Omni-channel engagement
Purchase behaviour	Digital footprints provide a new opportunity for segmentation, customer 360 view and product innovation.	Innovative product strategy and embedded finance
Changing engagement across all channels	Importance of measuring interactions and engagement and referrals will increase in the future.	Channel, social listening/monitoring
Personalised / targeted marketing	Marketing function is moving from focusing on the customer experience to being held accountable for a tangible return on marketing investment (ROMI).	Data-driven marketing

Key use cases

Product and channel level innovations introduced by NBFCs

EMI card

Implemented by several NBFCs as a card-based or physical form of embedded finance and marketplace-based lending. NBFCs tie up with several consumer retail businesses to offer POS loans against purchases.

01

Doorstep gold loan

This innovation was introduced by NBFCs to bring gold loans, a traditionally physical and branch-based product to a customer's doorstep, thereby increasing reach while creating a new channel for customers.

02

BNPL

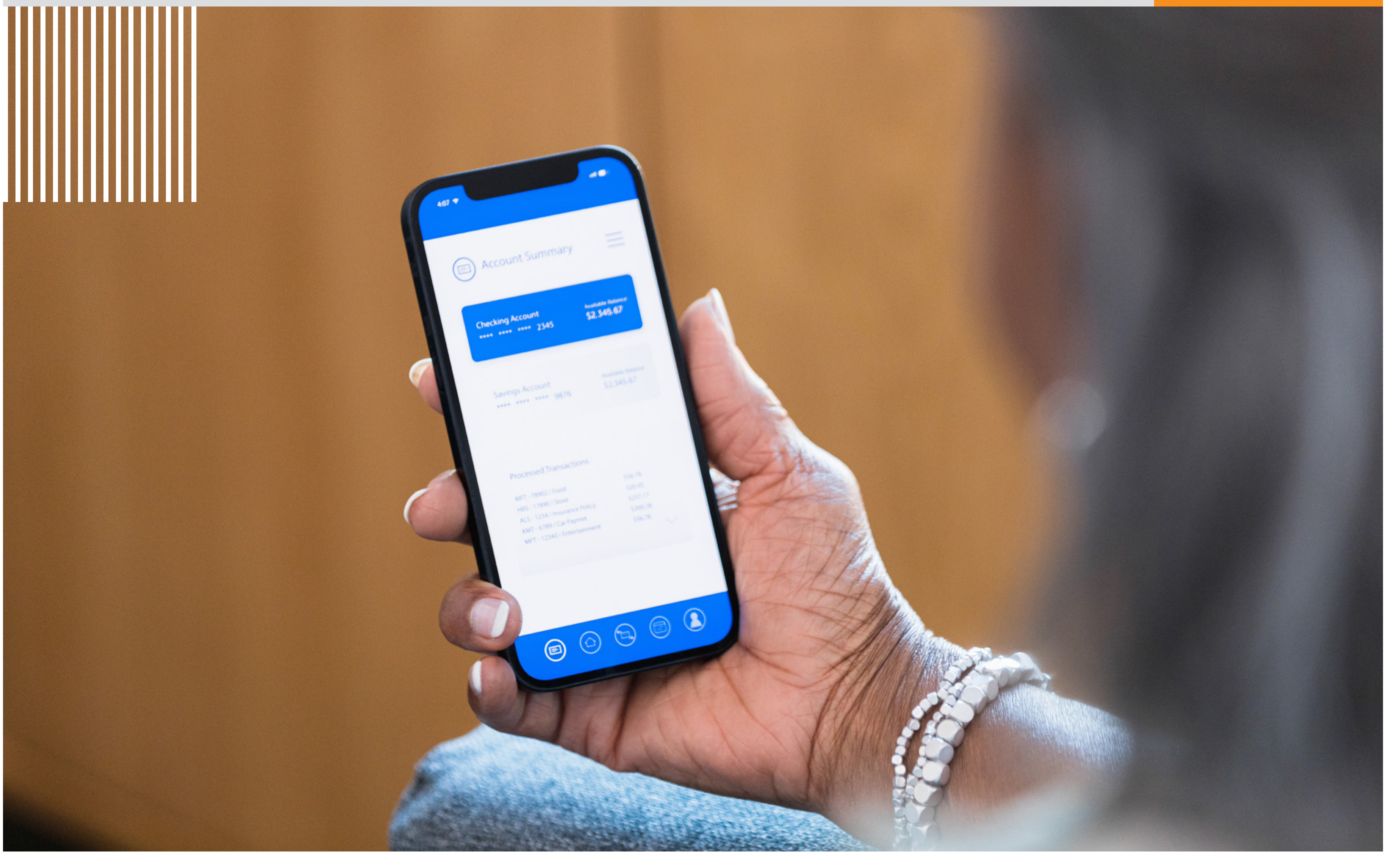
NBFCs have established strategic alliances with e-commerce and consumer durable vendors to offer a BNPL product to customers. Based on purchase behaviour, NBFCs are now able to create tailor-made products that are marketed to potential customers.

03

Hyper-local customised loans

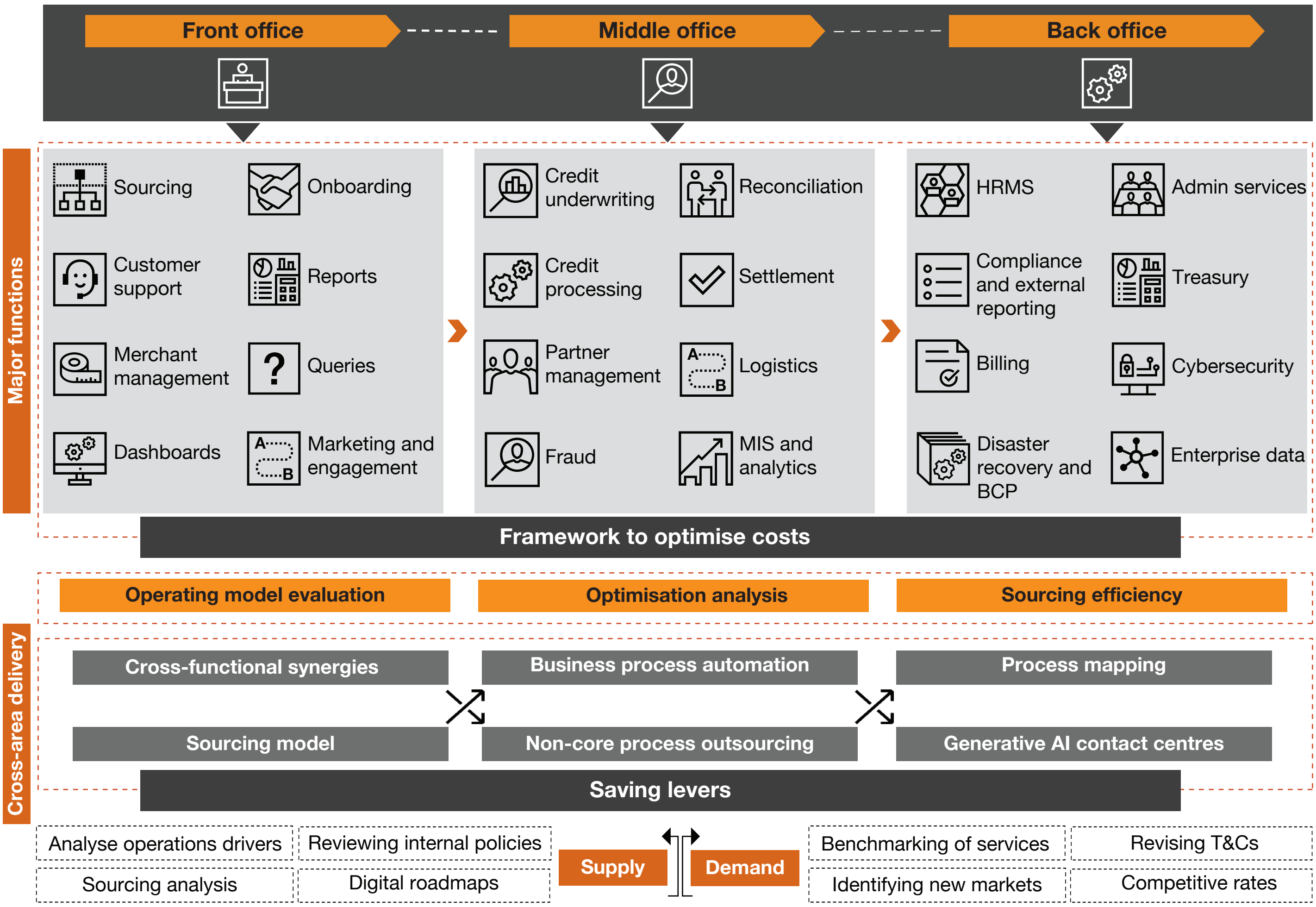
NBFCs with large branch networks are increasingly looking at customer demand and credit requirement at a branch level to create new loan propositions that are hyper local in nature and tailored to customer demand.

04



3.1.2. Operational and cost efficiency

The landscape of the financial services sector in India continues to evolve, demanding more innovative approaches to manage existing resources and optimise cost. Post the steep growth phase witnessed during the pandemic, NBFCs are now gearing up to maximise the bottom-line profitability. Through this change in focus, NBFCs will have to rethink how they fundamentally structure and take up innovative approaches to build cross-functional synergies by centralising and consolidating key capabilities across the middle- and back-office ecosystems, while decentralising the areas forming part of the front office to achieve operational and functional agility.



Key use cases

Major dimensions and levers ensuring operational and cost efficiency for NBFCs

1. **Operating model and organisation**
   Assess transactional and differentiated activities to identify potential savings through redundancy reduction, relocation of opportunities across the function and cross-leveraging opportunities across value streams.
2. **Process standardisation and optimisation**
   Leverage process mining to track and validate workflows, and identify viable automation/process improvement measures that bolster savings.
3. **Demand management**
   Identify eliminative, minimisable and optimisable activities to assess potential savings opportunities.
4. **Intelligent automation and digitisation**
   Use RPA and new-age technologies like generative AI to minimise manual interventions and create straight-through models.
5. **Centralisation, shared services and outsourcing**
   Analyse processes and tasks to identify centralisation or outsourcing opportunities for tasks non-specific to any business units or product value streams.

3.2. Charting the digital growth trajectory of NBFCs

The key strategies for enhancing digital resilience in NBFCs include focusing on areas such as digital factory implementation, resilient enterprise architecture, data and analytics utilisation, generative AI integration, cloud adoption, and cybersecurity measures. These initiatives help to fortify NBFCs against disruptions, thus enabling them to unleash new avenues of business growth and optimise operational efficiency in an increasingly digital landscape.

3.2.1. Digital factory: Reinventing the technology operating model

In a world of constant disruption, there is an increasing need for organisations to quickly respond to market conditions and deliver change in new and more agile ways. The digital factory model is intended to augment and accelerate traditional programme delivery methods to result in faster, more iterative delivery of customer and business outcomes.

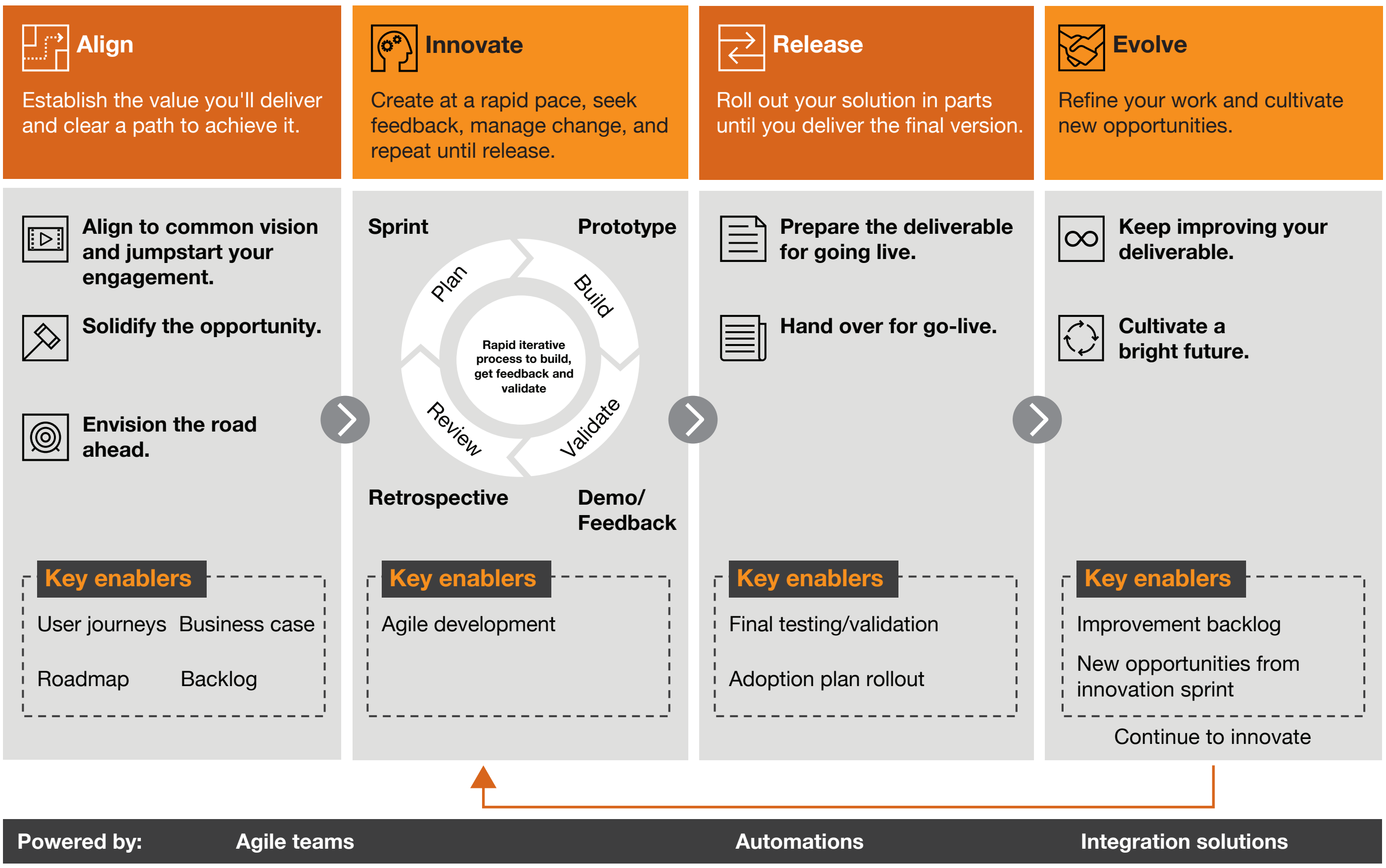
Changing the business, while running it, calls for a new approach to digital transformation. This is where a digital factory helps in ensuring successful yet efficient transformations. A digital factory serves as the hub for transformative endeavours in your organisation. It consists of specialised cross-functional teams that collaborate on initiatives aimed at changing bank programs. These teams operate akin to factory workers in that they utilise standardised tools and procedures to develop tailored outputs such as novel customer experiences, services or solutions. The key to a digital factory's effectiveness lies in its compact teams which, in close alignment with business stakeholders, operate as catalysts – like start-up accelerators.

Typically, digital factories help financial institutions with the following:

1. Faster go-to-market of products – quicker than traditional methods (six months vs two years)
2. Doing more with existing resources (multiple product launches per year vs one or two annually)
3. Creating dramatically reimagined customer experiences (loan disbursal in five minutes vs multiple days)
4. Reducing technology development costs by a third (reduced change requests/reworks, no cost overruns)

NBFCs need to focus on having customers at the centre of what they do, and constantly iterate and improve products or services in a proactive manner. They also need to provide their workforce with the right environment and resources to help them become flexible, collaborative, data-driven/analytically enabled and most importantly, empowered to make decisions.

Digital factory: The new technology delivery framework



Why are so many financial institutions turning to agile methods to deliver their technology transformation programmes?

The key benefits of agile as a methodology over waterfall are faster time-to-market, incremental delivery of value and increased visibility and accountability which ultimately reduces associated risks.

NBFCs seeking to adopt a digital factory-centric operating model for technology transformation must execute the following interconnected actions:

1. Begin by selecting one or two primary objectives for implementation within at least one digital factory, aiming to achieve significantly enhanced outcomes within a 16-week timeframe. If the goals cannot be realised within this timeframe, reassess the approach.
2. Clearly define goals aligned with the overarching business strategy and establish metrics for monitoring progress.
3. Allocate ample time to collaborate with functional and business unit leaders to ensure alignment with the digital factory's operational approach. This entails garnering support from various functional departments crucial for seamless future operations – such as IT, compliance, marketing and legal.

The digital factory-centric model of delivery draws heavily from pure agile methodology (as the goal is to deliver the benefits outlined above), but it also includes insights from our collective global experience and other PwC methodologies and approaches.

3.2.2. Resilient enterprise architecture (EA): Building agility across the enterprise

At the centre of a financial institution's technological infrastructure lies its EA. Defining the EA of the financial institution is fundamental to its application, data and technological architecture, while ensuring alignment with the business model. Therefore, establishing the appropriate EA lays the foundation for technological success. Various frameworks, such as The Open Group Architecture Framework (TOGAF) and Zachman Framework, are available to serve as fundamental tools for assessing the businesses. The architecture is constructed according to a series of design principles or guidelines which will help the financial institution to create a future-proof EA that can accommodate future enhancements, decisions and any rationalisations.

Key layers of a financial institution's technology architecture

Customer/ UX layer

Omnichannel experience to meet customer's rising expectations in terms of user experience and personalisation (e.g. for the next-best action)

Applications and integration layer

Hybrid environments with best-of-breed SaaS providers and legacy components Integration layer with process automation through RPA/AI real-time integration

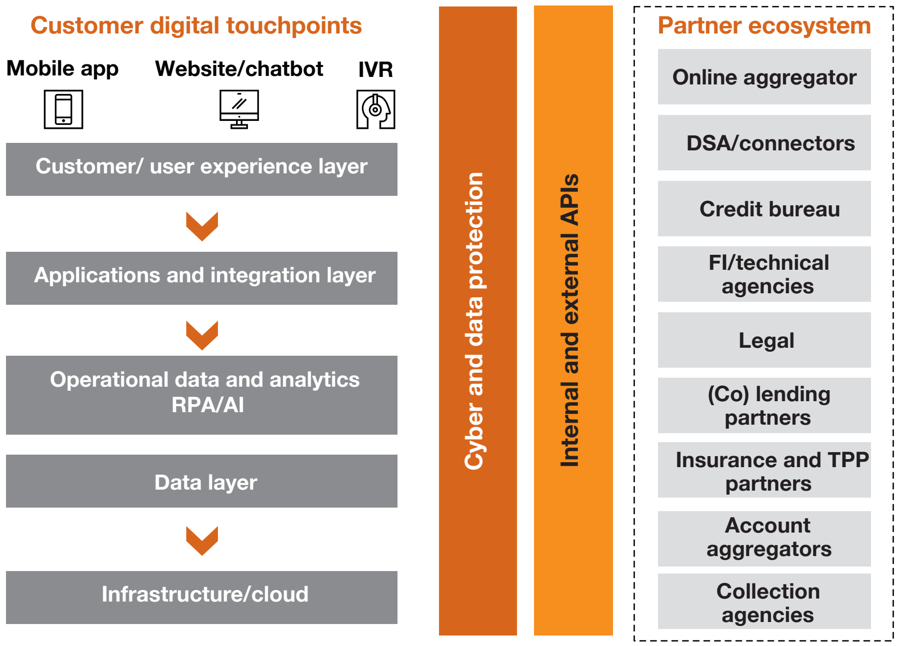
Data layer

One integral data layer, including all core components

Business analytics and prediction for data-driven decision making

Infrastructure layer

Use of public cloud providers for scale and cost effects, as well as internal/external private clouds with focus service level and automation



Cyber and data protection

Protect assets with a defence-in-depth approach.

Quickly recognise and react to internal and external attacks.

Internal and external APIs

Define APIs and API layers for internal data access and external data exchange.

It is imperative for NBFCs to have a resilient EA. Having an EA will always form a solid starting point for any transformation initiative, as the existing core banking architecture of an NBFC influences the strategy and extent of technological transformation needed to support various platform banking business models.

For NBFCs equipped with legacy core banking architectures characterised by monolithic applications, numerous point-to-point integrations and batch processing, transformation can occur incrementally with minimised risk. This phased approach involves setting near- and long-term objectives deliberately.

In contrast, NBFCs possessing modern cores, often featuring service-oriented/microservices-based architectures and mature application programming interface (API)-based systems, can pursue transformation on a broader scale akin to larger NBFCs. This is facilitated by their well-developed IT department.

Having an EA offers certain benefits in transformation projects. We've highlighted some of these below:

1. ability to identify potential benefits and then monitor their delivery over time
2. shortening the time of projects and thereby reducing impact of lengthy transformations on business as usual (BAU) processes
3. ensuring high quality of activities such as testing, understanding of peripheral integrations, etc.
4. supporting business and management buy-in for transformational activities
5. reducing operational risks by providing better control and decision-making material.

3.2.3. Data and analytics: Generating and leveraging better insights

The increase in digital adoption by NBFCs and ever-changing digital public infrastructure ecosystem has led to an explosion of data. NBFCs now must deal with a high volume of data, making it imperative to bolster their digital team's data science and analytics capabilities. NBFCs now can access both structured and unstructured customer data from various sources to offer personalised banking products and services, enhance credit decisioning and improve customer experience. However, winning in this data-abundant market requires NBFCs to implement key data strategies across the value chain. We've highlighted some of these below:

Embracing data analytics for credit decisioning

Historically, NBFCs relied on conventional credit scoring models to underwrite, which often excluded credit history or other digital transactions data for decisioning. However, now, NBFCs leverage advanced data analytics methods to make use of a wide variety of alternative data sources. This will help in the inclusion of a larger underserved population segment under the formal credit system.

Enhancing customer experience with digital channels

For NBFCs, the integration of digital channels has transformed customer interactions. Customers can now easily access a variety of financial services at their fingertips, including online loan applications and fund transfers. In addition to improving the customer experience, such digital transformation allows NBFCs to pass on the savings to their clients by drastically lowering their own operating expenses.

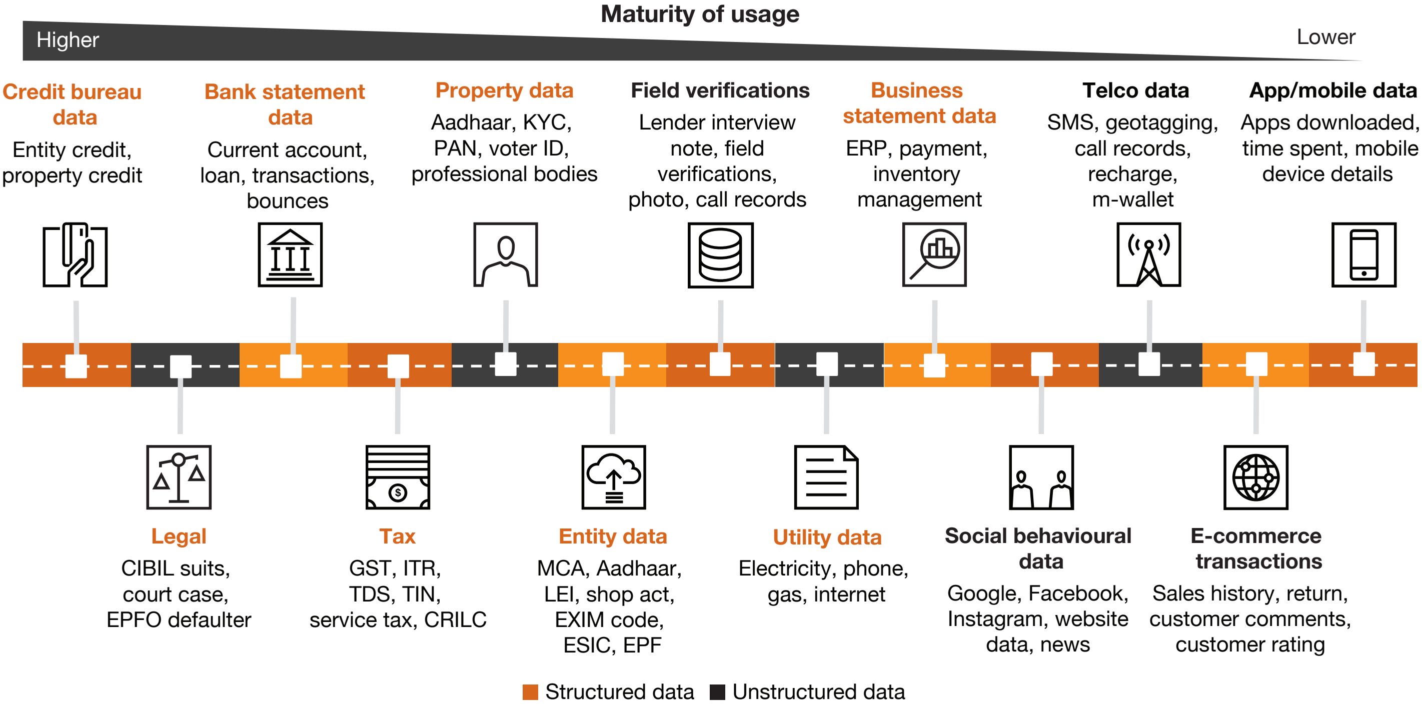
Improving organisational efficiency with data

NBFCs can now use data in customer segmentation, providing hyper-personalised products, fast-tracking underwriting and reducing turnaround time. Effective use of data improves efficiency by reducing the process time. Moreover, digitisation has improved operational efficiencies by reducing manual efforts in reviewing loan applications, and segregating customers into early- and mid-delinquency, and defaulters for collections teams.

Fostering financial inclusion

The digital and data-driven approach in NBFCs has been instrumental in expanding financial inclusion across the country. NBFCs can now reach the underbanked and unbanked populations in rural and remote areas by utilising technology and tools like digital wallets, mobile banking and other FinTech solutions, which have played a key role in closing the financial gap and bringing a larger percentage of the populace under the formal financial system.

Variety and depth of data available for financial institutions has increased exponentially.



3.2.4. Generative AI, cloud and security: Focusing on technological efficiency

NBFCs are rapidly shifting towards digitisation and adopting emerging technologies to redefine their product offerings for catering to the varied demands of their customers. Recently, the emergence of generative AI is enabling the digital transformation journey for NBFCs to help them reshape the financial landscape.

Generative AI can help NBFCs in driving innovation, efficiency and inclusivity. As the industry embraces digital transformation, generative AI will help in unlocking new opportunities and redefining the future of finance.

As per latest trends, the Indian financial services industry is steadily adopting generative AI with varied degrees of maturity. By utilising matured AI models such as chatbots and automated claim processing, various financial institutions in India have already managed to enhance the overall customer experience significantly. As more AI models like AI threat modelling, voice AI for lead nurturing, customer journey personalisation and others gain traction, the industry will increasingly adopt generative AI tools to stay relevant in a competitive market.

Generative AI can be to create new opportunities across key areas for NBFCs as highlighted below:

1. **Enhance customer experience:** NBFCs can utilise AI to offer personalised banking services and product recommendations.
2. **Boost financial inclusion:** NBFCs can provide financial services to the underbanked or unbanked population by enabling low-cost, digital financial services.
3. **Improve risk management:** NBFCs can utilise AI-driven predictive analytics to make data-driven lending decisions, identify and prevent fraudulent activities in real-time, and protect customer data.
4. **Augment operational efficiency:** Generative AI can help NBFCs to streamline repetitive tasks like account management and compliance.
5. **Improve cost savings:** Automation and AI can lead to cost reductions in customer service, back-office operations and compliance. It can also help in optimising resource allocation based on demand.

By harnessing generative AI, a large NBFC has implemented a conversational AI-based chatbot to provide customers with instant assistance for loan applications, queries about products and account management. On similar grounds, other financial institutions are using conversational AI in their chatbots to offer customers personalised assistance for various lending products and investment options.

Generative AI can have multiple use cases across the financial services ecosystem and make a positive impact on key business areas. We've outlined a few such instances in the table below:

Key business area	Activities
Customer servicing	• Personalised product and service recommendations • Virtual financial advisors • AI-powered chatbots (24x7 support) • Auto-categorisation of emails and auto reply
Audit/compliance	• Automated regulatory compliance • Anti-money laundering (AML) compliance programme • AI-driven risk analysis for regulatory compliance • Fraud detection, compliance and security
Marketing and sales	• Personalised marketing • Lead generation • Sales volume forecasting • Customer behaviour analysis
Risk	• Fraud detection • Credit risk analysis • Pre-delinquency and loss forecasting • Credit underwriting
Operations	• Loan recommendation engine • Debt collection strategy • Knowledge management maturity analytics • Process automation
IT	• Service request analytics • Anomaly detection • Downtime analytics/IT system monitoring • Code generation/review
Investment	• Automated portfolio adjustment and monitoring • AI-based investment research and analysis • Algorithmic trading • Predictive analytics for investment management

However, to ensure productive and responsible implementation of generative AI, NBFCs should develop relevant policies to help them streamline the adoption of generative AI as well as ensure best practices post its implementation.

Leveraging cloud-based solutions

NBFCs should utilise cloud-based solutions strategically to drive innovation, enhance agility and optimise costs in the ever-evolving competitive landscape. By leveraging cloud-based solutions across various functions, NBFCs can revolutionise their operations, accelerate digital transformation and strengthen their position as industry leaders.

1. **Scalability and flexibility:** Cloud solutions provide NBFCs with an adaptable infrastructure, enabling rapid adjustments to meet changing market needs, expand operations and launch new products.
2. **Operational efficiency:** NBFCs can adopt cloud-based solutions to streamline operations, reduce infrastructure costs and enhance resource utilisation, allowing them to focus on core activities.
3. **Data security and compliance:** Cloud platforms offer robust security features and compliance certifications, ensuring data protection and regulatory adherence for NBFCs.
4. **Innovation and digital transformation:** To deliver innovative solutions and personalised experiences to customers, NBFCs can adopt cloud-based solutions which also facilitate rapid experimentation and integration with emerging technologies.

To effectively manage the adoption of cloud-based solutions, NBFCs should create and adopt a cloud solutions policy. This will not only help NBFCs in effectively managing their cloud adoption but also help them to streamline the process.

Enhancing security protocols

Due to the high influx of emerging technologies in the market, organisations often put themselves at risk by adopting these without first establishing adequate security protocols. This makes them vulnerable to cybersecurity risks, which may result in financial and reputational damage. Accordingly, it is crucial that NBFCs adopt comprehensive security measures to fortify their digital infrastructure and protect sensitive data.

NBFCs must adopt secure practices like multi-factor authentication, security audits, employee training and awareness programmes, and data privacy compliance to ensure that customer data is collected, stored and processed in compliance with the applicable laws and regulations. Separately, NBFCs can utilise AI and machine learning to enhance threat-detection capabilities to avoid any cybersecurity-related threats.

By focusing more on enhanced security protocols, NBFCs can leverage key benefits like:

1. **Risk mitigation:** By implementing enhanced security protocols, NBFCs can prevent cyberattacks, fraud, data breaches, safeguard reputation and assets.
2. **Compliance adherence:** A robust security protocol can help NBFCs in meeting regulatory requirements, avoid penalties, legal consequences and ensure conformity.
3. **Operational efficiency:** Through enhanced security measures, NBFCs can minimise disruptions, streamline processes and focus on core activities effectively.
4. **Competitive advantage:** NBFCs can stand out, attract security-conscious customers and differentiate from competitors by implementing a robust security protocol.
5. **Cost savings:** An enhanced security protocol can enable NBFCs in preventing breaches, reducing damages and ensuring long-term financial benefits.
6. **Business continuity:** Robust security protocols can make NBFCs resilient by helping them protect critical systems, mitigate disruptions and ensure survival.

Establishing robust cybersecurity measures will help NBFCs in strengthening their overall digital infrastructure and safeguarding customer interests/data. Additionally, NBFCs should implement a security policy to ensure robust implementation and adoption of enhanced security protocols.

3.2.5. People readiness

The CIO role is evolving from just being a technology enabler to that of a business leader and strategic advisor. CIOs should enhance their leadership skills and ensure the readiness of their team to navigate the evolving technological landscape. Therefore, investments in people development across various dimensions must be prioritised by NBFCs to thrive in the digital age.

Upskilling:

NBFCs need to identify the skills necessary for utilising the full potential of emerging technologies and should accordingly train their employees. This includes increasing workforce competencies in areas such as data analytics, customer experience management and process automation.

Cultural shift:

It is essential for NBFCs to promote a culture of innovation, agility and continuous learning. They should also work towards empowering their employees to experiment with new ideas and approaches for building a conducive environment where employees can adopt and grow. The NBFC's leadership team should encourage a mindset of openness to foster changes and facilitate collaboration across departments.

Talent acquisition and retention:

Attracting the best talents having the requisite skills by offering them competitive compensation packages, opportunities for career development and supportive work environment are other areas to focus on. Additionally, NBFCs should establish mentorship programmes and cross-functional team initiatives to facilitate knowledge transfer and skill development among employees.

Change management:

NBFCs should work towards managing organisational change more effectively as it is crucial for successful technology adoption. They should work towards communicating transparently about the rationale behind technological initiatives, addressing employee concerns and providing adequate support throughout the transition process. Moreover, in order to help track progress and ensure alignment with overarching business objectives, it is important to establish clear goals, milestones and performance metrics.

NBFCs can position themselves for the proactive adoption of technology innovations, enhancing efficiency and delivering better value to the customers through investment in human resource development. The success of this technological information depends, ultimately, on the collective competence and commitment of the workforce within the organisation.

3.3. Effective governance and risk resilience: Making NBFCs future-ready

In order to swiftly navigate the ever-changing regulatory environment, NBFCs need to prioritise robust compliance and risk management functions. It is crucial to foster a culture of compliance and accountability within NBFCs, with compliance officers playing a pivotal role in ensuring alignment with regulatory standards. Collaborative efforts between compliance and risk management teams, along with the integration of technology, facilitate proactive identification and mitigation of risks.

3.3.1. Effective corporate governance

Corporate governance is paramount for NBFCs amidst new regulatory changes. The tone for governance is set at the board level. Strong governance structures ensure transparency, accountability and ethical conduct, bolstering investor confidence and mitigating risks. With regulatory oversight intensifying, the board and senior management assume utmost responsibility to ensure adherence to governance principles, which are essential for maintaining regulatory compliance and safeguarding stakeholders' interests. Effective corporate governance fosters long-term sustainability and resilience, positioning NBFCs to thrive in a dynamic regulatory environment. Key recommendations for corporate governance include:

- **Establishment of an audit committee:** NBFCs must establish an audit committee comprising a minimum of three members from its board of directors.
- **Formation of a nomination committee:** NBFCs should create a nomination committee to assess the suitability of proposed or existing directors.
- **Constitution of a risk management committee:** NBFCs should establish a risk management committee, in addition to the asset liability management committee, to oversee and mitigate operational risks.

- **Disclosure and transparency:** NBFCs are required to disclose their risk management policies, strategies for risk mitigation and adherence to corporate governance standards – including committee composition, roles, functions and details of review meetings – to the board of directors at regular intervals.

3.3.2. Robust compliance and risk office

NBFCs' compliance and risk offices must adapt by enhancing agility in policy implementation, staying abreast of regulatory updates and investing in advanced technology for efficient monitoring. Collaboration between departments and continuous training are necessary for ensuring adherence to evolving regulations and maintaining regulatory compliance. NBFCs should ensure the following to establish a robust compliance and risk function:

- Foster a culture of compliance, emphasising ethical conduct, adherence to regulations and accountability.
- Compliance officers ensure alignment with regulatory requirements, monitoring developments and communicating implications to senior management.
- Collaborate with risk management to integrate regulatory compliance into the broader framework, identifying and mitigating risks proactively.
- Leverage technology and data analytics for efficient compliance and risk management, automating reporting and enhancing monitoring capabilities.
- Provide continuous training for professionals to stay updated on regulatory requirements, and invest in comprehensive programmes covering updates, frameworks and emerging technologies.
- Cross-functional training fosters collaboration, enhancing organisational resilience and agility in navigating regulatory complexities.

Collaboration with industry peers, regulatory bodies and industry associations is important for NBFCs to navigate regulatory complexities effectively. Participation in industry forums, working groups and regulatory consultations enables NBFCs to exchange insights, share best practices and influence regulatory reforms positively. Moreover, engaging in proactive dialogue with regulators fosters mutual understanding, promotes regulatory compliance and enhances regulatory predictability.

Enablers for technology-driven compliance function in NBFCs

Accountability

- Real-time screening of risk landscape and prioritisation of risks
- Centralised compliance reporting/analytics into CoEs
- Ownership culture

Training and awareness

- Strategic alignment and clear mandate
- Performance targeting
- Digital upskilling
- Real-time coaching and development

Standardisation

- Defining a well-defined data governance plan
- Data quality assessment
- Rationalisation of returns
- Unified taxonomy across all compliance risk area

Automation

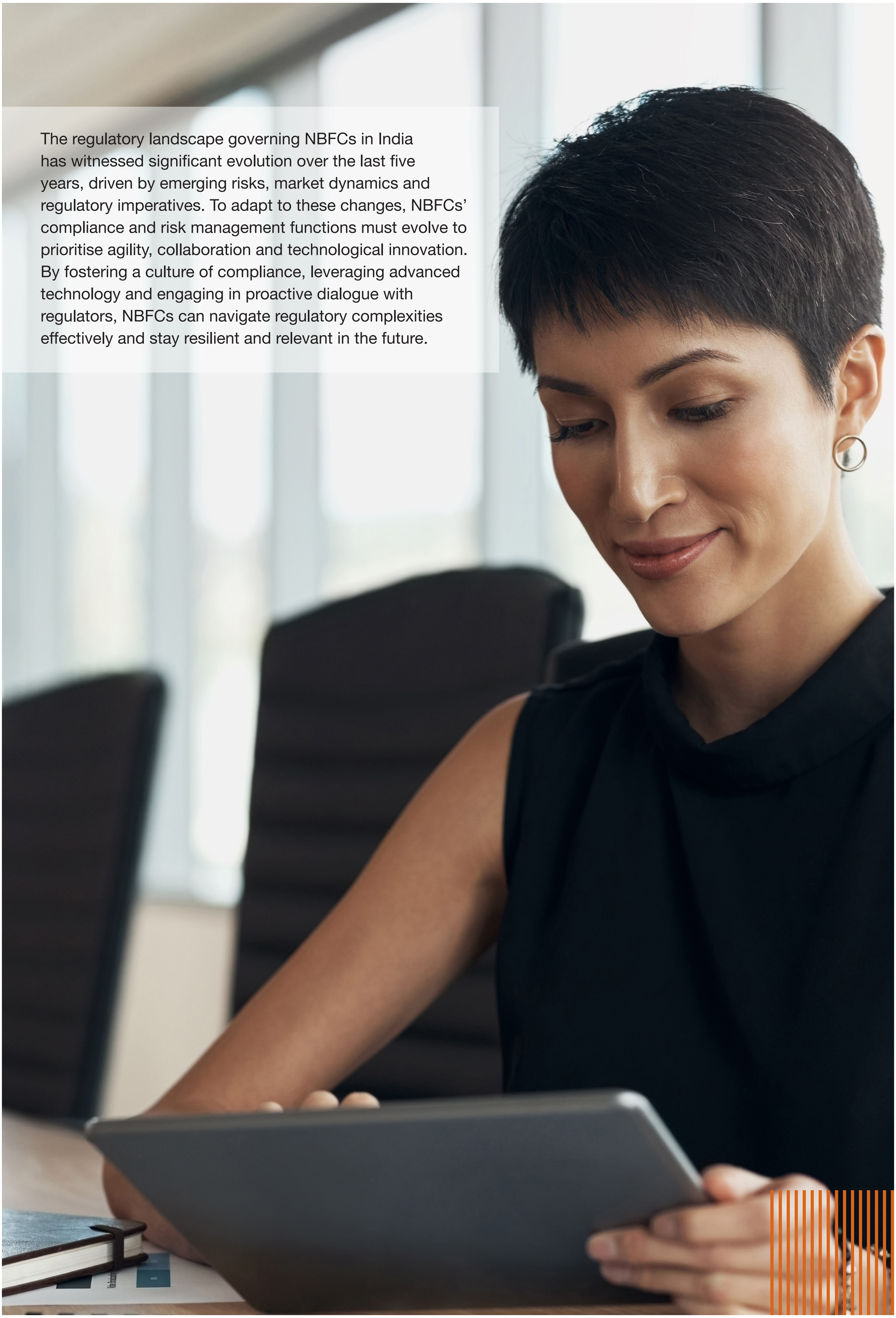
- Risk assessment and controls testing workflow automation
- Automatic identification of unusual intraday risk patterns
- Digital controls hardwired in technology-enabled business workflows

Communication

- Horizon scanning for regulatory updates
- Cross-department co-ordination
- Policy-driven change management process

Aggregation

- Consolidation of risk assessment and issues management system
- Risk data pooled in an integrated data lake
- Universal data system for enterprise risk intelligence



The regulatory landscape governing NBFCs in India has witnessed significant evolution over the last five years, driven by emerging risks, market dynamics and regulatory imperatives. To adapt to these changes, NBFCs' compliance and risk management functions must evolve to prioritise agility, collaboration and technological innovation. By fostering a culture of compliance, leveraging advanced technology and engaging in proactive dialogue with regulators, NBFCs can navigate regulatory complexities effectively and stay resilient and relevant in the future.

4. NBFCs in 2030

4.1 Navigating tomorrow: Outlook for NBFCs in 2030

As we move into the second half of the decade, NBFCs in India are poised for a remarkable transformation. By 2030, NBFCs are anticipated to undergo significant transformations across various fronts, including technology, business models, partnerships, governance, risk, compliance and talent resilience. This evolution is not only driven by the internal factors but also by the changing dynamics of the financial market in India.

As per the Ministry of Finance, India is aspiring to become a USD 7 trillion economy by 2030,[6] and in the next three years, the country is expected to become a USD 5 trillion economy.[7] Since the overall economy of India is on a positive growth trajectory, it is expected that the BFSI sector will also experience considerable growth. The lending market for NBFCs is projected to witness substantial growth across product segments, fuelled by factors such as increasing consumer demand, technological advancements and regulatory reforms.

Key growth drivers of NBFCs

- **Financial inclusion initiatives:** Programmes such as PMJDY, DAY-NRLM, direct benefit transfer and Atal Pension Yojana have worked towards bringing more citizens, who mostly belong from rural areas, under the ambit of digital financial services, thereby increasing financial inclusion in the country.
- **Favourable demographics:** It is projected that the demand for financial services will rise from the lower end of the income spectrum – i.e. 140 million middle-income and 21 million high-income households will be added in India by 2030, which will drive the demand and growth of financial services.[8]
- **Increasing internet and smartphone penetration:** With the second-highest number of smartphone users globally and second-largest internet user market, India is looking towards raising the number of internet users to nearly 1 billion by 2026. As of 2021, the number of households in India with internet connection stood at 160 million and this is expected to increase by 46%, reaching 233 million by 2026.[9]
- **India Stack and digital public infrastructure:** To encourage the use of digital financial services, the Government is working towards sponsoring API infrastructures to ease the consent-based sharing of financial data to enable unbanked individuals and small businesses to access credit. Digital public infrastructure like AA, OCEN and ONDC will gradually become mainstream. ONDC is aiming to utilise its architecture framework for four domains – namely credit, insurance, investments and gift cards.
- **Frictionless Credit Platform by RBI:** In order to enable frictionless credit, the RBI is developing a platform to facilitate digital information to financial sector players. This platform, known as Public Tech Platform for Frictionless Credit (PTPFC), is currently in its pilot phase, focusing on kisan credit card, dairy, unsecured MSME, personal and home loans through participating banks. The platform facilitates a smooth exchange of data between lenders. With its open architecture, APIs and standards, this end-to-end digital platform allows all players in the financial sector to connect to it easily using a plug-and-play approach.
- **Digital payments explosion:** It is expected that the transaction volume of the payment landscape in India will reach USD 100 trillion and the revenue volume will reach USD 50 billion by 2030.[10]
- **Innovative business models:** In the near future, we will see more NBFCs adopting business models such as co-lending and embedded finance. Also, the number of NBFCs that will have super apps is likely to grow significantly.

6 https://www.thehindubusinessline.com/economy/india-can-aim-to-be-7-trillion-economy-by-2030-growth-in-fy25-to-be-closer-to-7-economic-review/article67788463.ece#:~:text=The%20report%20said%20India%20can,rate%20for%20the%20coming%20fiscal

7 https://www.moneycontrol.com/news/business/markets/india-to-be-worlds-third-largest-economy-by-2027-with-gdp-at-5-trillion-jefferies-12325441.html

8 https://www.investindia.gov.in/sector/bfsi-FinTech-financial-services

9 Ibid.

10 Ibid.

- **Robust risk management frameworks:** By 2030, NBFCs will prioritise robust risk management frameworks and compliance measures to mitigate emerging risks and ensure regulatory adherence. Advanced analytics, real-time monitoring tools and investments in cybersecurity will safeguard the integrity operations, thus fostering trust and resilience in an increasingly complex and dynamic financial landscape.

In conclusion, the evolution of NBFCs in 2030 will be marked by technological innovation, increased Governmental push for financial inclusion, new business models, strategic partnerships, robust governance, risk and compliance frameworks, and a resilient and diverse workforce. By embracing these transformative trends and leveraging emerging opportunities, NBFCs will not only adapt to the evolving financial landscape but also emerge as key drivers of growth, inclusion and sustainability in the Indian economy.

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