

FACULTY OF JURIDICAL SCIENCES

Lecture-19



NON BANKING FINANCIAL INSTITUTIONS

NBFI is a financial institution that does not have a full banking license and cannot accept deposits from the public. However, NBFIs do facilitate alternative financial services, such as investment (both collective and individual), risk pooling, financial consulting, brokering, money transmission, and check cashing. NBFIs are a source of consumer credit (along with licensed banks). Examples of nonbank financial institutions include insurance firms, venture capitalists, currency exchanges, some microloan organizations, and pawn shops. These non-bank financial institutions provide services that are not necessarily suited to banks, serve as competition to banks, and specialize in sectors or groups.

A non-bank financial institution is a company that offers financial services, but does not hold banking licenses and therefore cannot accept deposits. NBFIs are not supervised by a national or international banking regulatory agency. However, operations of non-bank financial institutions are often still covered under the country's banking regulations.

An NBFI will facilitate bank-related financial services, without holding the status of a 'bank'. These services often include risk pooling, contractual savings, and market brokering and general investments. NBFIs are generally praised within the financial sector for offering a greater range of choice to people with financial opportunities and concerns.

- Nonbank financial companies (NBFCs), also known as nonbank financial institutions (NBFIs) are entities that provide certain bank-like financial services but do not hold a banking license.
- NBFCs are not subject to the banking regulations and oversight by federal and state authorities adhered to by traditional banks.
- Investment banks, mortgage lenders, money market funds, insurance companies, hedge funds, private equity funds, and P2P lenders are all examples of NBFCs.
- Since the Great Recession, NBFCs have proliferated in number and type, playing a key role in meeting the credit demand unmet by traditional banks.

SIGNIFICANCES:-

- Alternate source of funding and credit
- Direct contact with clients, eliminating intermediaries
- High yields for investors

- Liquidity for the financial system

Role in financial system

NBFIs supplement banks in providing financial services to individuals and firms. They can provide competition for banks in the provision of these services. While banks may offer a set of financial services as a package deal, NBFIs unbundle these services, tailoring their services to particular groups. Additionally, individual NBFIs may specialize in a particular sector, gaining an informational advantage. By this unbundling, targeting, and specializing, NBFIs promote competition within the financial services industry.

Having a multi-faceted financial system, which includes non-bank financial institutions, can protect economies from financial shocks and recover from those shocks. NBFIs provide multiple alternatives to transform an economy's savings into capital investment, which act as backup facilities should the primary form of intermediation, fail.

However, in countries that lack effective regulations, non-bank financial institutions can exacerbate the fragility of the financial system. While not all NBFIs are lightly regulated, the NBFIs that comprise the shadow banking system are. In the run up to the recent global financial crisis, institutions such as hedge funds and structured investment vehicles, were largely overlooked by regulators, who focused NBFI supervision on pension funds and insurance companies. If a large share of the financial system is in NBFIs that operate largely unsupervised by government regulators and anybody else, it can put the stability of the entire system at risk. Weaknesses in NBFI regulation can fuel a credit bubble and asset overpricing, followed by asset price collapse and loan defaults.

For most people, the bank is the first port of call when seeking out financial aid or advice. However, many people also find that the services offered by the bank don't adequately meet their requirements, leaving them at a loss for what to do next.

While banks tend to offer a set of financial services as part of a clear packaged deal, NBFIs unbundle these offers and tailor their services to meet the needs of the specific client. Therefore, many people who can't find help at the bank can find it with an NBFI.

The role of NBFIs is generally to allocate surplus resources to individuals and companies with financial deficits, allowing them to supplement banks. By unbundling financial services, targeting them and specializing in the needs of the individual, NBFIs work to enhance competition in the financial sector.

NBFIs offer most kinds of banking services, often including:

- Loans
- Credit facilities
- Retirement planning
- Education funding
- Underwriting stocks and shares
- Money market trading
- TFCs (Term Finance Certificates)
- Wealth management
- Portfolio of stocks and shares management
- Discounting services

Distinction between banks and NBFC

| Basis of Comparison | NBFCs | Banks |
|-------------------------------|--|---|
| Meaning | They provide banking services to people without holding Bank License | It is government authorized financial intermediary which aim at providing banking services to the public. |
| Regulated under | Companies Act 2013 | Banking Regulation Act 1949 |
| Demand Deposit | Cannot be Accepted | Can be Accepted |
| Foreign Investment | Allowed up to 100% | Allowed up to 74% for Private Sector Bank |
| Payment and Settlement system | Not a part of the System | An Integral part of the System |
| Maintenance of Reserve Ratios | Not Required | Mandatory |
| Deposit | Not Available | Available |

| | | |
|----------------------|-----------------------------|--------------------|
| Insurance Facility | | |
| Credit Creation | NBFC does not create Credit | Bank create Credit |
| Transaction Services | Cannot be provided by NBFC | Provided by Bank |