Chapter V

Non-Banking Finance Companies

Introduction

The role of Non-Banking Finance Companies (NBFCs) in transferring the funds from lenders to borrowers has been well-recognized. The main advantages of these companies lie in the lower transactions costs of their operations, their quick decision-making ability, customer orientation and prompt provision of services. Partly on account of these advantages, NBFCs have in recent years grown sizeably both in terms of their numbers as well as the volume of business transactions[1]. The number of such financial companies grew more than seven-fold from 7,063 in 1981 to 51,929 in 1996[2]. Of these, only 10,161 or merely 20 per cent of these companies used to submit returns to the Reserve Bank. The regulated deposits of the reporting companies amounted to Rs.38,676.5 crore in 1996. As a percentage of household sector saving in gross financial assets, the share of non-bank deposits increased from a low of 3.1 per cent during 1980-81 to 10.6 per cent during 1995-96.

5.2 The rapid growth of the NBFCs sector can also be attributed to other factors. NBFCs were historically subjected to a relatively lower degree of regulation *vis-à-vis* banks. Secondly, the higher rates of return on deposits offered by NBFCs have enabled them to attract a large base of small savers. Added to these was the fact that the operations of NBFCs were characterized by several distinctive features *viz*., no entry barriers, limited fixed assets and no holding of inventories-all of which led to a proliferation of NBFCs. The growing role of NBFCs was recognized by the second Narasimham Committee (1998) as well as by the Reserve Bank of India in its Discussion Paper on Harmonisation of the Role and Operations of DFIs and Banks, as also in the Report of the Working Group on Money Supply (Chairman: Dr. Y.V. Reddy)[3].

5.3 This Chapter discusses mainly three aspects of NBFCs functioning, namely the regulatory, supervisory and developmental aspects, in order that the growth of NBFCs is consistent with the objective of providing the development as well as stability of the financial sector. First, a brief look at the actual numbers of NBFCs and their categorisation.

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1. This is the first attempt at providing a separate Chapter on NBFCs. The figures on deposits and the number of companies are as on March 1996, the latest year for which such figures are available. Subsequent upon the process of registration for NBFCs initiated in January 1997, the figures on their assets, deposits, etc. are yet to be firmed up, hence reference to figures is avoided.

2. Since 1997, a process of registration has been initiated for NBFCs. To make the figures comparable, the discussion in the overview is upto 1996.

3. Minimum Net Owned Fund for all NBFCs has been mandated in the RBI Act only in January 1997.

2. NBFCs-Numbers and Categorisation

5.4 The Reserve Bank accorded registration to 624 NBFCs as deposit taking entities up to August 31, 1999, which are covered under the Reserve Bank's comprehensive regulatory/ supervisory process, while another 7,231 NBFCs were registered as non-deposit accepting/holding entities subject to, *inter alia*, their having the minimum required NOF. The

aggregate public deposits of NBFCs in terms of survey data as reported by 1,724 NBFCs stood at Rs.20,237 crore as on March 31, 1998 and was equivalent to 3.4 per cent of the aggregate deposits of commercial banks. Consequent upon the amendments to the Reserve Bank of India Act, 1934, during 1997, the Reserve Bank has narrowed down its focus by confining its regulatory attention only in relation to public deposits. Public deposits was a component of the regulated deposits. Hence, the quantum of public deposits mobilised by NBFCs as on March 31, 1998, does not lend itself to be compared with the regulated deposits reported for the earlier periods.

5.5 NBFCs are not a homogeneous set: they consist of 8 categories, with differing implications for supervision and financial intermediation. Table V.1 provides a brief picture of the principal business conducted by each of the categories.

Table V.1: Categorisation of NBFCs

Non-Banking Finance Company	Principal Business
Equipment Leasing Company (EL)	Equipment leasing or the financing of such activity.
Hire Purchase Finance Company (HP)	Hire purchase transaction or the financing of such transactions.
Loan Company (LC)	Providing finance by making loans or advances, or otherwise for any activity other than its own; excludes EL/HP/HFCs.
Investment Company (IC)	Acquisition of securities and trading in such securities to earn a profit.
Mutual Benefit Financial Company (MBFC) i.e. *Nidhi Companies*	Notified by the Central Government under Section 620 A of the Companies Act, 1956.
Miscellaneous non-banking company i.e. *Chit Fund Companies*	Managing, conducting or supervising as a promoter, foreman or agent of any transaction or arrangement by which the company enters into an agreement with a specified number of subscribers that every one of them shall subscribe a certain sum in instalments over a definite period and that every one of such subscribers shall in his turn, as determined by lot or by auction or by tender or in such manner as may be provided for in the arrangement be entitled to the prize amount.
Housing Finance Companies (HFC)	The financing of the acquisition or construction of houses including the acquisition or development of plots of land. These companies are supervised by the National Housing Bank.
Residuary non-banking Companies (RNBC)	Company which receives deposits under any scheme or arrangement, by whatever name called, in one lump sum or in instalments by way of contributions or subscriptions or by sale of units or certificates or other instruments, or in any manner. These companies do not belong to any of the categories as stated above.

3. Regulatory Backdrop

5.6 The regulatory framework for NBFCs had been in existence since 1963 under the provisions of Chapter III B of the Reserve Bank of India Act and the Directions issued thereunder. However, the powers vested with the Reserve Bank were very limited in that it could regulate only the (a) limits upto which, (b) manner in which, and (c) conditions subject to which the deposits could be accepted by NBFCs depending upon the classification based on their principal business[4]. As these powers were not adequate from the point of view of regulation of NBFCs, it was necessary to strengthen the legislative framework relating to regulatory powers of the Reserve Bank of India. This view was also supported by various Working Groups which examined the function and working of the NBFC sector (Box V.1).

5.7 As detailed in Box V.1, several measures were initiated by the Reserve Bank in the light of the recommendations of the various Working Groups. In July 1996, the Reserve Bank introduced liberalisation/ rationalisation measures for NBFCs which were registered, rated and were complying with the prudential norms. Under these measures, the eligible companies were given freedom to determine their own rate of interest on deposits, accept unrestricted/increased amount of deposits and maintain lower level of liquid assets. At the same time, having regard to the recommendations of the Shah Working Group and the observations made by the Joint Parliamentary Committee in 1992, the Reserve Bank prepared and forwarded to the Government a comprehensive draft legislation in 1994, which was promulgated as an Ordinance by the Government in January 1997 and subsequently replaced by an Act in March 1997.

Box V.1: Development of Regulatory Framework for NBFCs

The regulation of the deposit acceptance activities of the Non-Banking Finance Companies (NBFCs) was initiated in the 'sixties with a view to safeguarding depositors' interests and to ensure that the NBFCs function on healthy lines. Accordingly, in 1963, a new Chapter III-B was inserted in the Reserve Bank of India Act, 1934 to effectively supervise, control and regulate the deposit acceptance activities of these institutions. The Bhabatosh Datta Study Group (1971) set up to examine the role and operations of NBFCs, recommended that NBFCs should be classified into 'approved' and 'non-approved' categories and the regulation should be centred primarily on the 'approved' (i.e., those which satisfy certain additional requirements such as adequate amount of capital, reserves, liquid assets, etc) NBFCs. Subsequently, the regulatory framework suggested by the James Raj Study Group (1974) aimed at keeping the magnitude of deposits accepted by NBFCs within reasonable limits and ensuring that they were in conformity with the objectives of monetary and credit policy.

The provisions of Chapter III-B of the RBI Act, 1934, however, conferred very limited powers on the Reserve Bank. The legislative intent was aimed at moderating the deposit mobilization of NBFCs and thereby to providing indirect protection to depositors by linking the quantum of deposit acceptance to Net Owned Fund[1]. Thus, the directions were restricted to the liability-side of the balance sheet, and that too, solely to deposit acceptance activities. It did not extend to the asset-side of the balance sheets of NBFCs. Subsequently, several experts/working groups which examined the functioning of NBFCs were unanimous about the inadequacy of the legislative framework and reiterated the need for enhancing the extant framework. The Chakravarty Committee, in its Report submitted in 1985, recommended for the introduction of a system of licensing (based on the level of business) for NBFCs in order to protect the interests of depositors. Thereafter, the Narasimham Committee (1991) outlined a framework for streamlining the functioning of the NBFCs. The Narasimham Committee was of the view that, keeping in mind the growing importance of NBFCs in the financial intermediation process and their recourse to borrowing, regulatory framework to govern these institutions should be specified. Such framework should include, in addition to the existing requirements of gearing and liquidity ratios, norms relating to capital adequacy, debt-equity ratio, credit-concentration ratio, adherence to sound accounting practices, uniform disclosure requirements and assets valuation. Further, the Committee argued that the supervision of these institutions should come within the purview of the proposed agency to be set up for this purpose under the aegis of the Reserve Bank of India. The introduction of suitable legislation was deemed as essential not only for ensuring sound and healthy functioning of NBFCs, but also for safeguarding the interests of depositors.

In the light of these developments, the Reserve Bank appointed a Working Group on Financial Companies

(Chairman: Dr. A.C. Shah) in 1992 to make an in-depth study of the role of NBFCs and to suggest regulatory and control measures to ensure healthy growth of these companies. The Working Group, in its report submitted in September 1992, made wide-ranging recommendations for ensuring the functioning of NBFCs on sound lines. The Reserve Bank thereafter initiated a series of measures, including (i) the widening of the definition of regulated deposits to include inter-corporate deposits, deposits from shareholders and directors and the borrowings by issue of debentures secured by immovable property, (ii) the introduction of a scheme of registration of NBFCs having Net Owned Fund of Rs.50 lakh and above, (iii) the issuance of guidelines on prudential norms so as to regulate the asset side of the balance sheet of NBFCs. These measures relating to the registration and prudential norms could not be given statutory backing at that time since the provisions of the Reserve Bank of India Act, 1934, did not confer it with adequate powers to make them mandatory.

In January 1997, an Ordinance was issued by the Government effecting comprehensive changes in the provisions of the RBI Act, 1934. This was subsequently replaced by the Reserve Bank of India (Amendment) Act in March 1997. The salient features of the amended provisions, based on the recommendations of the Shah Committee, pertain to the entry point norm of Rs.25 lakh as minimum Net Owned Fund (NOF), (which can be subsequently raised to Rs.2 crore by the Reserve Bank), compulsory registration with the Bank, maintenance of certain percentage of liquid assets in the form of unencumbered approved securities, creation of reserve fund and transfer thereto every year an amount not less than 20 per cent of net profit, determination of policy and issuing of directions by the Bank on prudential norms, prohibition of NBFCs from accepting deposits and filing of winding-up petitions for violation of directions. The Company Law Board was empowered to direct a defaulting NBFC to repay any deposits. Stringent penal provisions were also included empowering the Reserve Bank to impose, *inter alia,* pecuniary penalty for violation of the provisions of RBI Act[2].

Exercising the powers derived under the amended Act and in the light of the experience in monitoring of the activities of NBFCs, a new set of regulatory measures was announced by the Reserve Bank in January 1998. As a result, the entire gamut of regulation and supervision over the activities of NBFCs was redefined, both in terms of the thrust as well as the forces. Consequently, NBFCs were classified into 3 categories for purposes of regulation, *viz*, (i) those accepting public deposits; (ii) those which do not accept public deposits but are engaged in the financial business, and (iii) core investment companies which hold at least 90 per cent of their assets as investments in the securities of their group/holding/subsidiary companies. While NBFCs accepting public deposits will be subject to the entire gamut of regulations, those not accepting public deposits would be regulated in a limited manner. Therefore, the regulatory attention was focussed primarily on NBFCs accepting public deposits. In respect of new NBFCs (which are incorporated on or after April 20, 1999 and which seek registration with the Reserve Bank), the minimum NOF has been raised to Rs.2 crore.

Consequent on the amendment to RBI Act, the liquidity requirement for the NBFCs was enhanced. Accordingly, loan and investment companies, which were earlier maintaining liquid assets at 5.0 per cent were directed to maintain 7.5 per cent and 10.0 per cent of their deposits in Government and other approved securities, effective January 1 and April 1, 1998, respectively. For other NBFCs, the percentage of assets to be maintained by them as statutory reserves was increased to 12.5 per cent and 15.0 per cent of their deposits respectively, to be effective from the above mentioned dates. Besides, with a view to ensuring that NBFCs can have recourse to such liquid assets in times of emergency, the custody of these assets with designated commercial banks was also prescribed. Keeping in mind the risk profile of NBFCs, the capital adequacy ratio was also raised in a phased manner to 10.0 per cent and 12.0 per cent by end-March 1998 and 1999, respectively.

To ensure the adherence of the NBFCs to the regulatory guidelines, a three-tier supervisory framework was put in place by the Reserve Bank for monitoring of NBFCs. The nature and extent of supervision of NBFCs, prepared in the backdrop of the provisions of the RBI (Amendment) Act, 1997, and the recommendations of the Khanna Committee (1995), were based on three criteria *viz*, (i) the size of a NBFC, (ii) the type of activity performed, and, (iii) the acceptance or otherwise of public deposits. To this end, a comprehensive supervisory model based on CAMELS (Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Systems) has been designed. The CAMELS approach re-orients the on-site inspection process towards examining intensively the assets of NBFCs, besides their liabilities. The methodology for conducting on-site inspection under the revised model has been manualised. Further, a suitable off-site reporting system with emphasis on profitability and balance sheet related parameters has been introduced to exercise intensified surveillance over the NBFCs having assets of Rs.100 crore and above. Steps have been initiated to resort to extensive use of information technology for scrutiny of all

off-site returns to reduce the degree of dependence on on-site inspection process. Apart from these, external auditors will be used as special vehicles: they will be asked to certify important returns of NBFCs. To impart greater efficacy to this supervisory setup, representatives of the Reserve Bank and the Institute of Chartered Accountants of India (ICAI) have formed a panel to devise a new format of balance sheet to reflect the true position relating to the financial health of NBFCs. The process of regulatory strengthening has been reinforced with the creation of an independent department, *viz*., Department of Non-Banking Supervision (DNBS), for focused attention to the supervision of NBFCs. To facilitate closer and continuous monitoring of NBFCs, the Department has opened 16 Regional Offices to supervise the NBFCs having their registered offices under their respective jurisdiction.

With a view to reviewing the existing regulatory framework and addressing some of the shortcomings in dealing with the investors' complaints, a Task Force was constituted by the Government of India in August 1998 under the Chairmanship of Special Secretary (Banking), Ministry of Finance. The Task Force submitted its recommendations in October 1998. Some of the major recommendations of the Task Force were:

(a) Higher CRAR of 15 per cent for NBFCs seeking public deposits without credit rating; (b) ceilings for exposures to real estate sector and investment in capital market, especially unquoted shares; (c) upward revision of the minimum NOF for NBFCs seeking registration with the Reserve Bank; (d) tightening of the norms for exposures to connected companies; (e) review of particulars to be disclosed in the advertisements; and (f) access to loans from corporates by unincorporated bodies.

The regulatory system for NBFCs has already made significant progress in realigning itself to the emerging needs of this sector since the onset of regulatory developments in this segment in the 'sixties. The continuing efforts by the Reserve Bank in this direction have helped in sustaining the health of the NBFC sector and in the years ahead, the objective will be to ensure that NBFCs function on sound lines while safeguarding depositors' interests.

References

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5.8 An important objective of the recent measures has been to align better the NBFCs with the overall financial system, subject to their adherence to the prudential guidelines in place. In this context, it is important to examine the regulatory framework for NBFCs as prevalent in different countries, so as to understand what policy conclusions can be inferred from their functioning (Box V.2).

New Regulatory Framework

5.9 The RBI Act was amended in January 1997 by effecting comprehensive changes in

Chapter III-B, III-C and V of the Act, thereby vesting considerable powers with the Reserve Bank for effective regulation of NBFCs to ensure that they integrate their functioning within the Indian financial system. The amended Act provides for entry point norm of Rs.25 lakh as minimum capital funds. Under the Act, the Reserve Bank was vested with the powers of enhancing the minimum NOF of NBFCs to Rs.2 crore. In the Monetary and Credit Policy statement for the year 1999-2000, it was proposed that in respect of new NBFCs, which are incorporated on or after April 20, 1999 and which seek registration with the Reserve Bank, the requirement of minimum NOF will be Rs.2 crore. This stipulation will not apply to NBFCs which are already registered with the Reserve Bank or whose applications are presently under consideration. In terms of Section 45-1A of the RBI Act, registration of an NBFC with the Reserve Bank has been made mandatory. The companies existing on January 9, 1997 were given time upto July 8, 1997 to make an application for Certificate of Registration (COR) under the statute. Moreover, no new company can commence its business of NBFC without obtaining a COR from the Reserve Bank. The position of NBFCs for issue of COR is given in Table V.2.

Box V.2: Regulation of the Activities of NBFCs in Selected Countries

Diversification of the financial sector has been one of the central features of economic growth in several countries. A central feature of the evolution of the financial system has been the emergence of non-banking financial institutions, outside the traditional banking system, including finance companies, leasing companies, merchant banks and trust and investment companies. While the willingness of these companies to engage in varied forms of financial intermediation, hitherto unavailable to the banking system, has provided the countries with valuable flexibility in financing new areas of growth, their complex range of activities has opened up challenges for policymakers and regulators to integrate their functioning within the overall framework of the financial system. The regulatory framework for NBFCs in different economies is discussed as follows:

Australia: Until June 1992, the registered NBFCs in Australia were regulated by the Reserve Bank of Australia (RBA) under the Financial Services Act, 1974. However, since 1992, the work of regulating and supervising building societies and credit unions, which constitute the major segment of the non-banking financial institution, had been delegated to the Australian Financial Institutions Commission (AFIC), with the RBA retaining the power to focus exclusively on bank supervision. In 1992, these building societies and credit unions were brought under the jurisdiction of a principal statutory law, i.e., Financial Institutions Legislation and a scheme of prudential supervision known as Financial Institution Scheme was introduced for them. For the purpose of day-to-day supervision of these entities, State Supervisory Authorities (SSA) are given the responsibility and the AFIC as a nodal agency is functioning under the overall supervision of ministerial council (MINCIN).

France: The French banking system consists of a large number of credit institutions which may be authorized as banks, mutual or co-operative banks, savings and prudential institutions, municipal credit banks, specialised financial institutions and financial companies-all of whom are governed by the French Banking Act of 1984. Under the Act, credit institutions need an authorization from the French banking system before beginning their operations. Financial companies, in particular, are classified into different categories depending on their area of specialization such as consumer credit, investment credit, real estate financing, equipment leasing, real estate leasing factoring etc., and they may carry out only such banking operations as are covered by the decision authorizing them to operate or by the laws and regulations applying to them. Unless authorized by the Banking Regulating Committee, financial companies and specialized financial institutions may not receive funds from the public at sight or at less than two years term.

Hong Kong: Hong-Kong maintains a three-tier system of deposit-accepting institutions, *viz*., licensed banks, restricted licensed banks (RLBs) and deposit-taking companies (DTCs). They are collectively known as authorized institutions (AIs) and are subject to the supervision of the Hong Kong Monetary Authority (HKMA). The Banking Ordinance of 1986 constitutes the legal basis for the HKMA's powers to regulate and supervise AIs. Licensed banks alone are permitted to conduct the full range of retail and wholesale banking business. RLBs, on the other hand, may take call, notice or time deposits from the public in amounts of US$ 5,00,000 or above without any restriction on maturity. DTCs are however restricted to taking deposits of US $ 1,00,000 or above with an original term to maturity or call or notice period of at least three months. They are mostly owned or otherwise associated with banks and are engaged primarily in consumer finance, trade finance and securities business.

Indonesia: Insurance companies comprise the largest non-bank intermediary in Indonesia. The relative importance of insurance companies grew substantially in the decade of the eighties. However, almost half of the assets of the insurance industry are held by five government-owned social insurance companies which primarily provide pensions, health insurance, and workers' compensation for the employees of government agencies. As part of the deregulation measures announced in the late 1980s, insurance premiums have been de-regulated and since 1988, these have been left to market forces. Prudential regulatory requirements for life insurance, casualty insurance and re-insurance and restrictions on their investment portfolios were established in the 1990s. Besides insurance companies, there exist finance companies specially established to conduct activities that cover leasing, factoring, credit card business, consumer financing, securities trading, etc. The finance company has to be a limited liability company. All financing institutions are obliged to have a license from the Government. Promoters' ability to bring in the required capital, their sincerity and capability in conducting the operations are verified before issuing a license. They are not allowed to draw funds from the public in certain forms of deposits. There are restrictions on the amount of loan that can be raised by a finance company. Capital participation by a finance company is restricted to

only in another finance company. A finance company engaged in the securities trading business is precluded from engaging in other types of operations. The supervision is carried out by the Ministry of Finance (MOF) in co-operation with the Bank Indonesia.

Malaysia: The banking system in Malaysia comprises three different types of institutions, *viz.*, commercial banks, finance companies and merchant banks. They are licensed and governed under the Banking and Financial Institutions Act, 1989 (BAFIA). Only a public company holding a valid license granted by the Minister of Finance on the recommendations of Bank Negara Malaysia (BNM) is allowed to carry on banking, finance company or merchant banking business. Finance companies typically specialize in consumption credit comprising hire purchase finance, leasing finance, housing loans and personal loans. They are differentiated from commercial banks not only by the name and type of business they conduct, but also by the differences in a number of regulatory requirements they have to comply with. There is a two-tier regulatory system (TTRS) for financial institutions. The institutions with large capital base and which satisfy the minimum criteria set by BNM are accorded tier-I status. Companies accorded such a status are allowed to operate in a more liberal regulatory environment and can carry on activities such as factoring services and venture capital activities, provide remittance services within Malaysia, grant unsecured business loans upto a maximum of RM 5,00,000 and personal loans upto RM 10,000. TTRS was extended to finance companies in 1996. Large sized companies are obliged to furnish monthly statement of assets and liabilities, break up of loans and advances, weekly return of interest rate on deposits and eligible liabilities and are subject to reserve and statutory liquidity ratio requirements.

Singapore: Finance companies in Singapore are governed by the Finance Companies Act, which is administered by the Monetary Authority of Singapore (MAS). In accordance with the Act, only those finance companies which have been granted licenses are permitted to transact financing business. Except as provided in the Act, a finance company is not permitted to carry on any kind of business other than financing activities. They are also not permitted to accept any deposit which is repayable on demand, by cheque, draft or order drawn by a depositor on the finance company. The Finance Companies Act was revised in 1994. The amended Act, *inter alia*, stipulated minimum capital requirements of US $ 50 million, capital ratio not less than 12 per cent, maintenance of a reserve fund and transfer a prescribed amount to that fund out of the net profits of each year. These apart, finance companies are also required to maintain adequate provisions for bad and doubtful debts. The MAS also has powers to appoint auditors, other than the auditors appointed by the company and inspect the books of accounts of the company. Irregularities, breach or non-compliance with the provisions of the Act, if any, noticed during the course of audit, need to be immediately reported to the MAS. If a financial company is unable to meet its obligation or is conducting its business to the detriment of the depositors or creditors, the MAS has powers to assume control of the company and can even petition to court to wind up a company. Currently, non-bank financial institutions under MAS supervision comprise merchant banks, finance companies, securities and financial futures firms, money changers and remitters and insurance companies.

Thailand: Non-bank savings institutions consist of various units, which include, among others, finance companies, credit foncier companies and life insurance companies. The finance companies in Thailand are regulated under the Act on the Undertaking of Finance Business, Securities Business and Credit Foncier Business, 1979, which was subsequently amended in 1985. Newly developed prudential control measures relating to capital adequacy ratio, liquidity ratio, single lending limits, portfolio investment limits, and disclosure requirements are covered under the Act and are designed to follow international best practices. The Bank of Thailand has been vested with adequate powers to regulate and supervise the finance companies. The laws authorize the Bank to remove the institution's management if found unfit or improper; to order financially troubled institutions to make corrections and improvements or to assume control or revoke the licenses when deemed as necessary. The Bank of Thailand employs consolidated supervision approach whereby financial institutions have to submit reports on activities of their subsidiaries. In 1994, the Bank of Thailand stipulated that finance companies must have written internal control procedures encompassing the following topics, (a) Receiving or paying of money; (b) Lending and undertaking contingent liabilities; and (c) Selling the company's securities/properties. Life insurance companies, on the other hand, operate under the Life Insurance Act of 1967 and are regulated and supervised by the Ministry of Commerce. The Act empowers the Ministry to specify various forms of investment in which such companies can engage in.

The aforesaid discussion suggests that the regulation of NBFCs in different economies has evolved over a period of time, depending on the country's political-economy and socio-economic considerations. As the consolidation of the

NBFC segment in India gathers momentum, the regulatory framework will need to be tailored to meet the needs of the evolving situation as evidenced in these countries.

References

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5.10 The cases which have remained pending pertain to those companies which are yet to furnish the clarifications sought from them or against whom the Reserve Bank has initiated some adverse action and a final decision on their applications can not be immediately taken. The companies which do not satisfy the minimum NOF have been granted three year period to attain the minimum required capital funds of Rs.25 lakh and their applications for issue of COR will be considered only after they fulfill the above requirement.

Table V.2: Position of NBFCs for issue of Certificate of Registration

	Criteria	Number
1.	Total Number of Applications Received	37,390
2.	Number of NBFCs having NOF of Rs.25 lakh and above (i.e., fulfilling primary eligibility criteria)	10,486
3.	Number of approved applications	7,855
	Of which:	
	Number of NBFCs permitted to hold/accept public deposits	624
4.	Number of Rejections	1,167
5.	Number of NBFCs whose applications are under process	1,464
6.	Number of NBFCs having NOF below Rs.25 lakh	26,904

Note: Position as on August 31, 1999.

5.11 The services of chartered accountants have been enlisted as a one time measure for special audit of the companies having asset base of Rs.5 crore and above to expedite the process of registration of NBFCs. Approximately 1,400 companies were subjected to special audit to ascertain their eligibility criteria.

5.12 In the aftermath of amendments to the RBI Act 1997 and certain disconcerting developments in the NBFC sector, the Reserve Bank initiated several steps to consolidate the functioning of the NBFCs. In this regard, the Reserve Bank instituted a regulatory framework initially in January 1998 and this was subsequently amended in December 1998. In the new regulatory framework, the entire gamut of regulation and supervision over the activities of NBFCs was redefined, both in terms of the thrust as well as the forces. Consequently, NBFCs were classified into 3 categories for purposes of regulation, *viz*, (i) those accepting public deposits; (ii) those which do not accept public deposits but are engaged in the financial business, and (iii) core investment companies which hold at least 90 per cent of their assets as investments in the securities of their group/ holding/subsidiary companies. While NBFCs accepting public deposits will be subject to the entire gamut of regulations, those not accepting public deposits would be regulated in a limited manner. Therefore, the regulatory attention was focussed primarily on NBFCs accepting public deposits.

Regulations over NBFCs accepting Public Deposits

5.13 The regulatory attention has been utilised to enable intensified surveillance of NBFCs accepting public

deposits[5]. The Reserve Bank issued directions relating to acceptance of public deposits prescribing, *inter-alia*, (a) the quantum of public deposits (Table V.3), (b) the period of deposits which should not be less than 12 months and should not exceed 60 months, (c) the rate of interest payable on such deposits subject to a ceiling of 16 per cent, (d) the brokerage fees and other expenses amounting to a maximum of 2 per cent and 0.5 per cent of the deposits, respectively, and, (e) the contents of the application forms as well as the advertisement for soliciting deposits.

5.14 The companies which accept public deposits are required to comply with all the prudential norms on income recognition, asset classification, accounting standards, provisioning for bad and doubtful debts, capital adequacy, credit/investment concentration norms, etc. While the provisioning norms are on par with those for commercial banks (except that no provision is required to be made on standard assets), the capital adequacy ratio has been fixed at 12 per cent and above, in accordance with the eligibility criteria for accepting public deposits. The credit and investment concentration norms have been fixed at 15 per cent and 25 per cent of the owned funds, depending on whether the exposure is to a single borrower or to a borrower group, while the totality of loans and investment has been subject to a ceiling of 25 per cent and 40 per cent of the owned fund, respectively, depending on whether the exposure is to a single party or to an industry group.

Table V.3: Deposit Acceptance Norms of Companies accepting Public Deposits

Net Owned Fund	Type of Company	
	EL/HP	LC/IC
Below Rs.25 lakh with or without credit rating.	Nil	Nil
Rs.25 lakh and above without credit rating.	Public deposits not exceeding 1.5 times of NOF or public deposit of Rs.10 crore, whichever is less, provided the company has CRAR of 15 per cent or above with immediate effect.	Nil
Rs.25 lakh and above with minimum investment grade credit rating.	4 times of NOF provided the company has CRAR of (a) 10 per cent or more as on March 31, 1999. (b) 12 per cent or more as on March 31, 1999.	Public deposits not exceeding 1.5 times of NOF, provided the company has CRAR of 15 per cent or above with immediate effect.

Disclosure about Unrated Status of the EL / HP Companies accepting Public Deposits

5.15 As a move towards greater levels of disclosure and transparency in their operations, NBFCs accepting public deposits have been directed to furnish certain essential information on their financial activities in their publicity material for soliciting deposits. They have been specifically advised to indicate their rating in their advertisements for deposits.

5.16 In order to ensure that depositors place their savings with the NBFCs in full cognizance of its true financial health, certain stipulations on EL/HP companies have been enforced. It has been prescribed that EL and HP finance companies (without minimum investment grade credit rating) mobilising public deposits upto 1.5 times of its NOF or Rs.10 crore, whichever is lower, should disclose in their advertisement and the application form, the fact that it is an un-rated EL and HP finance company (a) having capital adequacy ratio of not less than 15 per cent and (b) it is accepting public deposits within the aforesaid regulations of the Reserve Bank.

Caution to Depositors

5.17 The Reserve Bank has been vigorously disseminating through the news media during July and October 1998 information about the NBFCs seeking deposits. Prospective depositors are being cautioned, through advertisements

and otherwise, that they should be careful in understanding the actual financial position of the company concerned and the statements or representations made by the management in their advertisement while placing their deposits with the NBFCs. Instant publicity is also provided for companies whose certificate of registration have been rejected or against whom prohibitory orders have been issued.

Disclosure of Dues from Group/Connected Companies

5.18 Information relating to the exposure of the NBFCs in the subsidiaries/ companies in the group, other entities and the business ventures in which the directors and the NBFC itself are holding substantial interest which is not found in their application forms and the advertisement soliciting deposits is a vital input for assessing the health of the company. The disclosure norms for the NBFCs accepting public deposits have, therefore, been widened and also was made compulsory since December 1998 so as to enable depositors to make an informed decision.

Restrictions on Investment in Land and Building and Unquoted Shares of other than Subsidiaries/Group Companies

5.19 In order to restrict indiscriminate investment by NBFCs in real estate and in unquoted shares, the NBFCs have been directed to restrict their investment in real estate, except for their own use, upto 10 per cent of their owned funds. Further, a ceiling has also been prescribed for investment in unquoted shares of other than group/subsidiary companies. The prescribed investments in this regard should not exceed (a) 10 per cent of the owned fund for EL and HP finance companies; and (b) 20 per cent of the owned fund for LC/IC.

5.20 A time frame of three years has been allowed to the companies for bringing down the excess assets held and also for disposing off of such assets acquired by the company in satisfaction of its debts in case the company surpasses the ceiling. As a move to facilitate NBFCs that intend to exit from the public deposits, the Reserve Bank announced in April 1999 the provision of an escrow account facility for NBFCs subject to certain conditions.

Restrictions on Creation of Assets by Defaulter Companies

5.21 The Reserve Bank has directed NBFCs which fail to repay the matured deposits as per the terms of their acceptance that they cannot create assets in any manner, including by granting of loan or making of investment, until the default is rectified.

At the same time, depositors can also lodge their claims against the NBFCs with the Company Law Board (CLB). Such a move is expected to deter NBFCs with ulterior intentions in diverting the funds at the cost of their creditors and enhance the protection available to the depositors.

Maintenance of Liquid Assets

5.22 The companies have been directed to maintain liquid assets of not less than 12.5 per cent and 15 per cent of the public deposits effective April 1, 1998 and April 1, 1999, respectively. The Reserve Bank has imposed a penalty on NBFCs in case of any default in the maintenance of the requisite value of approved securities.

5.23 The liquid assets are required to be entrusted to one of the scheduled commercial banks appointed as a designated banker in this behalf, so as to obviate the chances of stripping off of these securities, except for repayment to depositors. Apart from the scheduled commercial banks, NBFCs have been permitted to keep their liquid securities with the Stock Holding Corporation of India Ltd. with a view to enable them to meet their compliance with the requirement of NBFC directions.

Regulations over NBFCs not Accepting Public Deposits

5.24 The NBFCs not accepting public deposits would be regulated in a limited manner. Such companies have been exempted from the regulations on interest rates, period as well as the ceiling on quantum of borrowings. The ceiling on the aforesaid factors for NBFCs accepting public deposits is expected to act as a benchmark for NBFCs not accepting public deposits. However, prudential norms having a bearing on the disclosure of true and fair picture of their financial health have been made applicable to ensure transparency in the financial statements to these

companies, excepting those relating to capital adequacy and credit concentration norms.

Regulations over Core Investment Companies

5.25 The core investment companies, not accepting public deposits and are holding investments to the extent of 90 per cent or more of their assets as securities issued by their group/subsidiary companies and are not trading in these securities have been exempted from all the provisions of directions except the statutory provisions of (a) registration and (b) creation of reserve fund.

Residuary Non-Banking Companies

5.26 The deposit taking activities of the Residuary Non-Banking Companies (RNBCs) are governed by the provisions of Residuary Non-Banking Companies (Reserve Bank) Directions, 1987 issued by the Bank under the provisions of Chapter III B of the RBI Act. In view of low or negligible NOF, the quantum of deposits which can be accepted by these companies is not linked to their NOF and for the purpose of safeguarding depositors' interest, they are enjoined upon to invest at least 80 per cent of their deposit liabilities in the securities as per a prescribed investment pattern. These securities are required to be entrusted to a public sector bank and can be withdrawn only for the purpose of repayment to the depositors. The details of the investment pattern for these companies are presented in Table V.4.

5.27 With effect from November 1997, these companies are required to pay interest on their deposits which shall not be less than 6 per cent per annum on daily deposit schemes (5 percent for daily deposits upto 2 years) and 8 per cent on other deposit schemes of higher duration or term deposits. Other provisions of the Directions relating to (a) minimum and maximum period of deposits, (b) prohibition from forfeiture of any part of the deposit or interest payable thereon, (c) disclosure requirements in the application form and advertisement soliciting deposits, (d) furnishing of periodical returns and information to the Reserve Bank, which are in force since May 1987, have been kept unaltered.

Table V.4: Investment Pattern for RNBCs

	Nature of Securities	Percentage of Deposit Liabilities
1.	Government Securities.	Not less than 10 per cent
2.	Fixed deposits/CDs of SCBs and specified Financial Institutions.	Not less than 10 per cent
3.	Bonds, debentures, CPs of public sector and private sector companies and units of UTI(with a sub-ceiling of 10 per cent each on debentures of private corporates and schemes of UTI).	Not less than 60 per cent
4.	Other Investments (not specified above).	Not more than 20 per cent or 10 times the NOF of the company, whichever is less.

5.28 The operations of RNBCs were characterized by a host of features including (a) systematic understatement of their deposit liability, (b) payment of high rates of commission, (c) discontinuation of deposit certificates to the tune of 80 to 90 per cent in some of the schemes, (d) forfeiture of deposits, (e) low or negligible rate of return on deposits, (f) appropriation of capital receipt to revenue account and consequent non-disclosure of the entire deposit liability in their books of accounts/balance sheets, (g) negative or negligible NOF, (h) levy of service charges on the depositors, etc. The Reserve Bank adopted several measures to remove these unsatisfactory features.

5.29 The track record of regulatory compliance for RNBCs has been significantly lower *vis-à-vis* other NBFC groups. Monitoring and inspection of these companies, from time to time, revealed continuance of many unsatisfactory features including non-compliance with the core provisions of the Directions, diversion of the depositors' money to associate concerns and/or investment in illiquid assets, violations of investment requirements / pattern, etc. These features were impinging upon the interests of the depositors. The Reserve Bank could only prohibit the errant companies from accepting deposits any further. However, keeping in view both the depositors' interests as well as the interest of the employees of the companies, imposing prohibitory orders in all cases was not a

solution to the problem, particularly in the case of large RNBCs with substantial public deposits. Accordingly, persistent efforts were made by the Reserve Bank to spruce up their operations and ensure compliance with the Directions. In cases where adherence to Directions were found unavoidable, the Reserve Bank has had to resort to issue of prohibitory orders on a case-by-case basis. However, in many cases, the actions initiated by the Reserve Bank were constrained when some of these companies approached the courts of law and obtained stay orders and at the same time continued to mobilise deposits. Some of the ingenious promoters floated new companies and started accepting deposits through new entities or shifted their areas of operations to other states.

5.30 Equipped with the new regulatory framework of Chapter III-B of the RBI Act, 1997, the Reserve Bank has extended prudential norms to the RNBCs. The requirement for compulsory registration for RNBCs before commencing business coupled with other concerted action against such companies has curbed the unhealthy tendency of mushrooming growth of these companies. The inspections and monitoring of the activities of the RNBCs have been stepped up to ensure that the erring companies should rectify the irregularities and fall in line with the regulatory framework.

Mutual Benefit Financial Companies

5.31 A *Nidhi* company notified under Section 620 A of the Companies Act is classified as “Mutual Benefit Financial Company” (MBFC) by the Reserve Bank and is regulated by the Reserve Bank for its deposit taking activities and by the Department of Company Affairs (DCA) for its operational matters as also the deployment of funds. The companies incorporated after January 9, 1997 have been considered as Mutual Benefit Companies only if they have minimum NOF of Rs.25 lakh and have obtained a Certificate of Registration from the Reserve Bank under the provisions of the RBI Act. These companies have been exempted from substantial provisions of the RBI Act *viz*, requirement of registration, maintenance of liquid assets and creation of reserve fund. They have also been exempted from almost all the provisions of RBI Directions except those relating to (a) interest rate on deposits, (b) prohibition from paying brokerage on deposits, (c) ban on advertisement and (d) requirements of submission of certain returns. However, they are allowed to deal only with their shareholders both for the purpose of accepting deposits and making loans.

5.32 On the other hand, the companies which are purportedly working like *nidhis* without their names being notified under Section 620 A of the Companies Act, 1956, were adversely affected by the Reserve Bank's directions to classify such companies as loan companies, as they could not obtain the special dispensation available to notified *nidhi* companies. As a result, the Government decided to give a special dispensation to these companies working on the lines of *nidhi* companies. Accordingly, a separate class of such companies termed as mutual benefit companies (MBCs) or un-notified *nidhi* companies was created subject to certain norms, till they are notified as *nidhi* companies.

Chit Fund Companies

5.33 Operations of Chit Funds companies are governed under the Chit Funds Act, 1982, which is administered by State Governments. However, their deposit taking activities are regulated by the Reserve Bank and they are allowed to accept a miniscule amount of deposits, i.e., upto 25 per cent of their NOF from the public and upto 15 per cent from their shareholders. The concerns regarding the protection of depositors' interests are further minimized to a great extent as the Chit Fund companies usually accept deposits from their chit subscribers.

5.34 Merchant banking companies have been exempted from the provisions of the RBI Act, 1934, provided they are registered with SEBI. These relate to (a) compulsory registration (Section 45 1A), (b) maintenance of liquid assets (Section 45 1B), and (c) creation of reserve fund (Section 45 1C) as well as all provisions relating to deposit acceptance and prudential norms.

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1. Net Owned Fund is the aggregate of the paid-up capital and free reserves, reduced by the amount of accumulated balance of loss, deferred revenue expenditure and other intangible assets, if any, and further reduced by investments in shares and loans and advances to subsidiaries, companies in the same group and other NBFCs in excess of 10 per cent of owned fund.

2. Insurance companies, stock-broking companies and stock exchange companies have been granted exemptions from certain provisions of the amended Act. Nidhi companies and Chit Fund Companies have also been exempted from certain core stipulations including maintenance of percentage of assets and reserve fund.

4. In April 1999, the Reserve Bank announced that in order to identify a particular company as a NBFC, it will consider both the assets and the income pattern, as evidenced from the last audited balance sheet of the company to decide their principal business. The company will be treated as an NBFC if its financial assets are more than 50 per cent of total assets (netted off against intangible assets) and income from financial assets is more than 50 per cent of the gross income. Both these criteria are required to be fulfilled as the determinant factor for principal business of a company.

5. The entitlement of public deposits and requirement of credit rating is applicable to EL/HP and Loan/Investment Companies.

4. Supervisory Framework for NBFCs

5.35 Coupled with the process of regulatory tightening, the Reserve Bank of India has instituted a comprehensive supervisory mechanism over NBFCs. A discussion of the instituted supervisory framework is given in Box V.1.

On-site Inspection

5.36 The process of on-site inspection aims at ascertaining the level and quality of adherence by the inspected entities to the regulatory norms prescribed by the Reserve Bank in relation to their deposit taking, asset quality, capital adequacy, etc.

Extent and Periodicity of Inspections

5.37 The on-site inspection procedure is being tailored to be need-based. Accordingly, on-site inspection has been sought to be carried out on a random basis, taking into account the various factors such as the track record of compliance of the NBFCs with the Directions, adherence to the prescribed norms, incidence of complaints, etc. The primary focus of on-site inspection is directed towards large (with public deposits of Rs.50 crore and above) NBFCs; the remaining companies will be monitored mainly through off-site surveillance involving scrutiny of statutory returns, balance sheets, profit & loss account, auditors reports, etc. All NBFCs holding public deposits, irrespective of the size of their NOF, would be subjected to at least one round of on-site inspection on an annual basis to ensure that they function within the regulatory framework.

Off-site Surveillance System

5.38 The Reserve Bank has also devised comprehensive formats for conducting off-site surveillance of NBFCs with asset size of Rs.100 crore and above. The returns so prescribed are designed to provide the comparative position of their operational data for 3 years in regard to various items of their balance sheet, profit and loss account and certain key ratios. Further, in terms of the off-site system, it is mandatory on the part of all NBFCs to submit various returns at quarterly / half-yearly / annual intervals, irrespective of the size of their NOF or their acceptance or otherwise of public deposits. Errors/discrepancies in such analyses, if any, are expected to trigger on-site inspections to ensure supervisory comfort. Steps have also been initiated by the

Reserve Bank to computerize the off-site surveillance mechanism in its entirety.

5.39 Besides, the market intelligence system is also being strengthened in major regional offices, under the overall guidance of a Market Intelligence Officer. Steps have also been initiated for closer co-ordination with other regulatory bodies like SEBI and credit rating agencies.

External Auditing

5.40 The responsibilities of ensuring compliance of the Directions issued by the Reserve Bank as well as adherence to the provisions of the RBI Act has been entrusted with the statutory auditors of the NBFCs. The statutory auditors of the NBFCs are required to report to the Reserve Bank any irregularity or violation of the Reserve Bank's regulations concerning acceptance of public deposits, credit rating, prudential norms and exposure limits, capital adequacy, maintenance of liquid assets and regularisation of excess deposits held by the companies.

5. Task Force on NBFCs

5.41 It was being increasingly recognized that the existing legislative and regulatory framework needed further improvement because of the twin concerns of the rising number of defaulting NBFCs as well as the absence of an efficient and expeditious system for redressal of grievances of individual depositors. In particular, the procedure for taking over the assets and the subsequent liquidation procedures of defaulting and insolvent NBFCs were cumbersome and was neither able to effectively prevent asset stripping nor was it able to quickly dispose of the assets for the benefit of all creditors, whether secured or unsecured.

5.42 With a view to reviewing the existing framework and addressing some of the shortcomings in dealing with the investors' complaints, the Finance Minister announced the setting up of a Task Force under the Chairmanship of Shri C.M.Vasudev, then Special Secretary (Banking), Ministry of Finance where the Reserve Bank was also represented. The Task Force submitted its Report on October 28, 1998. The recommendations are given in Box V.3.

The Tamil Nadu Protection of Interests of Depositors' Act

5.43 The Tamil Nadu Protection of Interest of Depositors (in Financial Establishments) Act, 1997 received the consent of the President of India on August 7, 1997 and it came into force with immediate effect. It was notified in the Gazette of the Tamil Nadu Government on August 8, 1997. To administer the above Act, rules were framed on November 10, 1997.

Box V.3: Report of the Task Force on Non-Banking Finance Companies (1998)

The Finance Minister had announced in July 1998 the setting up of a Task Force for reviewing the regulatory framework for non banking finance companies. The recommendations of the Task Force, submitted in October 1998, have been guided by the twin considerations of creating an environment for healthy growth of sound NBFCs, while, at the same time, providing an enhanced degree of comfort to the depositors in NBFCs.

The recommendations of the Task Force can be categorised under four broad heads:

1. The recommendations which can be implemented with immediate effect through changes in the RBI Directions for NBFCs and issue of notification under RBI Act for unincorporated bodies;

2. The recommendations, the implementation of which requires suitable statutory amendments. For this, the necessary action by the Reserve Bank will be initiated in consultation with the Banking Division, Ministry of Finance, Government of India;

3. The recommendations which are to be implemented over a period of time by amending the directions within the existing powers already available under the RBI Act; and

4. The recommendations which need no amendments to the Directions or the Statute, but are to be implemented over a period of time through administrative action.

The Table below delineates the action taken on the recommendations of the Task Force.

Table: Action taken on the Recommendations of the Task Force

	Recommendation		Action Taken
1.	**Credit Rating and enhanced Capital to Risk Assets Ratio.**		
	It is appropriate for the Reserve Bank of India to stipulate a higher ceiling for public deposit for those companies which have obtained credit rating for their instruments. However, it may not be necessary to link the quantum of deposit to the rating per-se provided the rating is above the minimum. In summary, the proposed ceiling could be as under :		Implemented in December 1998.
	Type of Company	**Limit of public deposits.**	
	NBFC with NOF less than Rs.25 lakhs.	No access to public deposits.	
	Equipment Leasing/Hire Purchase (EL/HP) company (higher without credit rating with CRAR of 15 per cent).	1.5 times or Rs.10 crore which is lower.	
	EL/HP company with investment Grade credit rating or above.	4 times the NOF	
	Loan/Investment companies(higher CRAR of 15 percent) with investment grade credit rating or above.	1.5 times the NOF	
2.	**Ceilings on Exposure to Real Estate and Unquoted Investment**		
	The RBI should prescribe ceilings for exposure to the real estate sector and also investment in capital markets specially unquoted shares.		Implemented in December 1998.
3.	**Disclosure in Application Form and Advertisements for Public Deposits**		
	RBI should also stipulate that the NBFCs seeking deposits should disclose their credit rating or that the quantum of public deposits is less		Implemented in December 1998.

than 1.5 times NOF or Rs.10 crore and as such they are exempted from obtaining a credit rating. This information should be prominently disclosed in all application forms for public deposits and in all advertisements.

4. Norms for Exposures to Connected Companies to be tightened

The norms for exposures to connected companies need to be tightened. These measures are essential to prevent deployment of public deposits in high risk and speculative avenues.

Implemented in December 1998.

5. Review of Particulars which should be Disclosed in the Advertisements

There is a need for reviewing the particulars given in the advertisement. In addition to the information, which the NBFCs have been directed to disclose, information on dues from group companies, connected entities and business ventures in which the directors are interested and the amount of exposure including the non-fund based facilities provided to such entities should also be disclosed in the advertisement.

Implemented in December 1998.

6. Unincorporated Bodies may have access to loans from Corporates

The amendment to the RBI Act in 1997 is a step in the right direction and allowing access to deposits from individuals to unincorporated bodies for allowing them to have access to loans other than public deposits. They could be permitted to access loans from bodies with a corporate identity, including NBFCs.

Implemented in December 1998.

7. Enhancement of Minimum Capital Requirement from present level of Rs.25 lakh

The present minimum capital requirement of Rs.25 lakhs itself may have to be reviewed upward keeping in view the need to impart greater financial soundness and achieve economies of scale in terms of efficiency of operations and higher managerial skills.

The minimum NOF for new NBFCs (i.e., incorporated on or after April 20, 1999) has been raised to Rs.2 crore.

8. Extension of Time for attaining Minimum NOF of Rs.25 lakh beyond January 2000 to be made conditional

The three year period for attaining minimum NOF of Rs.25 lakh would expire in January, 2000. Any extension granted by the RBI should be made conditional upon the concerned NBFC having taken adequate steps to increase NOF in the initial three year period and satisfactory arrangements to attain the minimum capital requirement as may be applicable at that point of time within the extended period.

The Reserve has already Bank announced this requirement. The Reserve Bank has also written to all NBFCs drawing their attention to the requirement of seeking specific time period for increase in NOF.

9. Time-Bound Programme for Completion of Work Relating to Registration of NBFCs

It would be necessary for the RBI to draw up a time bound programme for disposal of applications received for registration as NBFC.

As on September 30, 1999, 82 per cent of the eligible applications has been disposed off.

10. State Governments to be kept informed of Companies Registered /Rejected

Given the fact that the operations of NBFCs are often concentrated in far flung areas, the RBI may apprise the State Governments of the particulars of companies which have been granted registration as well as of the companies whose applications have been rejected.

State Governments have been provided with the lists of all the approved and rejected lists of NBFCs.

11. Easing Flow of Credit from Banks to NBFCs

The RBI should consider measures for easing the flow of credit from banks to NBFCs and then consider prescribing a suitable ratio as between secured and unsecured deposits for NBFCs.

The ceiling on bank lending to NBFCs (except RNBCs) registered with the Reserve Bank has been removed in May1999.

12. Co-ordination between Regional Offices of Company Law Board (CLB) and the Reserve Bank

Till such time as the amendments for setting up depositors' grievances redressal authorities are carried out, it is essential that the Company Law Board (CLB) tightens its procedures for dealing with complaints of depositors and puts in place a mechanism for speedy disposal of these complaints. The regional offices of the RBI and the regional offices of the CLB should set up a coordination mechanism to ensure that defaulting companies are speedily dealt with for violation of any regulatory/statutory requirements.

Regional level Co-ordination Committee has been set up at the four metro centres to review the orders of CLB against the defaulting NBFCs.

13. State Governments to set up District Level Cells for Dissemination of Information on Depositors' Grievance Redressal Procedures

State Governments may set up cells at the state and district level to help disseminate information relating to procedure for redressal of depositors' grievances.

The attention of the State Governments has been specifically invited to this recommendation.

14. Reserve Bank to conduct Publicity Campaign for Depositors'Awareness

There is a need for the RBI to continue to take more intensive measures for a sustained depositors' awareness campaign. These publicity campaigns should be through print and electronic media, seminars, conferences, etc. Associations of NBFCs and various investors' forums such as Consumers' Education Research Centre, Investors' Grievances Forum, Depositors' Associations, etc. should also be actively involved in these campaigns.

The Reserve Bank started the publicity campaign on January 29, 1999. Further, the detailed campaign for depositors' education has also been launched.

15. Separate Instrumentalities under aegis of RBI for Regulation and Supervision of NBFCs

A separate instrumentality for regulation and supervision of NBFCs under the aegis of the RBI should be set up. It should have representation of experts and other professionals and should help the overall supervisory policies of the RBI. Rules and regulations for the new instrumentality should provide enough flexibility for induction of specialists and experts with requisite supervisory skills. The RBI should have a separate Executiv Director for this purpose, supervised by a Deputy Governor, so that there is greater focus in regulation and supervision of the NBFC sector.

A separate Executive Director has been appointed with effect from September 01, 1999.

16. Services of Chartered Accountants (CAs) to be used for Inspection

	Recommendation	Action taken
	of smaller NBFCs	
	RBI could use the services of chartered accountants with suitable experience and capabilities to carry out inspections of the smaller NBFCs. Inspection reports could be forwarded to RBI on periodic basis.	The services of CAs are being utilised by the Reserve Bank, as and when warranted for inspections, special audit or other verifications of NBFCs.
17.	**Annual Inspection of NBFCs**	
	There should be an annual inspection of the NBFCs at least in the transitional period.	All the NBFCs holding public deposits are proposed to be inspected during the year 1999 for one round of inspection.
18.	**Off-site Surveillance Mechanism**	
	The offsite surveillance mechanism should pick up any significant spurt in NPAs and any bunching of repayment of deposits.	The system is being stabilised.
19.	**Expeditious Computer Processing of Returns**	
	Computer processing of returns should be expedited so as to capture warning signals at the earliest. The time period allowed for filing the returns from the present three to six months should also be reduced in order to obtain latest data without delay. The macro level preparation of statistics should be so arranged that the data for a particular quarter / half year / year should be available within the next three months. This would enable the authorities in initiating corrective and penal action against a particular erring NBFC or a class of NBFCs for any undesirable findings.	State-of the-art technology system has been installed by the Reserve Bank for computer processing of the returns. The staff are being trained for the purpose.
20.	**Sensitive Market Intelligence System**	
	It is important to have a very sensitive market intelligence system which could trigger on-site inspections followed by appropriate regulatory responses.	A senior officer has been made the in-charge of the Market Intelligence Cell at Central Office and the Regional Offices have also set up such cells at their end.

5.44 The Reserve Bank advised the Chief Secretaries of all the States to consider enacting legislation on the lines of Tamil Nadu Act and keep a watch on the activities of unincorporated bodies accepting deposits. The Government of Maharashtra has taken steps for enactment of legislation on the aforesaid lines and has recently passed the Maharashtra Protection of Interests of Depositors (in Financial Establishments) Ordinance, 1999. The Governments of Andhra Pradesh, Gujarat, Himachal Pradesh, Assam and Haryana have also taken effective steps to put in place the legislation on the above lines.

6. Other Developments

5.45 A number of NBFCs facing liquidity or solvency problems have been kept under close scrutiny. The Reserve Bank is in constant dialogue with the promoters of these NBFCs so as to

not only monitor their activities but also to evaluate the steps taken by them to overcome the difficulties. The Reserve Bank has published a book in March 1998 containing consolidated regulatory framework for NBFCs in order to make the regulations over NBFCs available at one place to the entire gamut of users. A booklet on the questions and answers providing clarifications and explanations of the provisions of regulations has also been published.

5.46 In order to encourage a vibrant and healthy NBFC sector and also to ensure that the regulatory framework is attuned to the needs of the emerging environment whilst protecting depositors' interests, the Reserve Bank has held meetings with NBFCs and their associations for consultation and discussion on the various issues impinging on the regulatory framework for NBFCs. Besides, the Reserve Bank has been conducting seminars on NBFCs and has been deputing officers to various workshops arranged by the Associations of NBFCs, trade bodies and Investors Forum in the context of and on the need for the extant regulations. The Reserve Bank has also introduced a special training programme for the benefit of the personnel working in NBFCs.

5.47 The Reserve Bank has been entrusted with the implementation of the provisions of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 and the Chit Funds Act, 1982 in coordination with the respective State Governments. Besides, the implementation of the provisions of Chapter IIIC of the RBI Act where concurrent powers have been vested with the State Governments, is also overseen by the Reserve Bank. Moreover, the Reserve Bank also maintains close interface with State Governments, Department of Company Affairs, Securities and Exchange Board of India and other regulatory authorities for implementation of the provisions of RBI Act over various entities whose activities fall within the purview of multiple regulators. The regional offices are in constant touch with the state authorities for initiating action against some of the unincorporated bodies engaged in financial business and mobilising public deposits in violation of the statute.

Working Group on Asset Securitisation in the Indian Financial System

5.48 A Committee was set up to explore the possibilities of developing the asset securitisation in the country. The Committee is expected to submit its report shortly.

Informal Advisory Group on NBFCs

5.49 An Informal Advisory Group for NBFCs was set up by the Reserve Bank in January 1998 to monitor the implementation of the regulations issued, and to suggest remedial measures for mitigating the hardships of the NBFCs during the period of transition. The meetings of the Group have provided important inputs for effecting changes in the directions of the Reserve Bank so as to impart greater policy focus and market-orientation.

Committee for Designing the Financial Statements for NBFCs

5.50 A Committee with representatives from the Reserve Bank and ICAI has been established to design and suggest a separate balance sheet, profit and loss account and disclosure norms for NBFCs. The Committee submitted its report in September 1999. It is expected that the format of

the proposed balance sheet and profit and loss account will seek to enhance transparency of operations of NBFCs and address some of the major concerns of the supervisory authorities.