Credit Information Review

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NBFC DIRECTIONS

Amendments to NBFC Guidelines

The Reserve Bank of India has amended and clarified certain directions relating to non-banking finance companies (NBFCs) regulations issued by it earlier. The major modifications/clarifications are:

- *Micro finance* : NBFCs which are (i) engaged in micro financing activities, (ii) licensed under Section 25 of the Companies Act, 1956 and (iii) which are not accepting public deposits would be exempted from the purview of registration, maintenance of liquid assets and transfer of profits to reserve fund;
- *MBCs*: The mutual benefit companies (MBCs) in existence as on January 9, 1997 and having net owned fund (NOF) of Rs.10 lakh would be exempted from the requirements of registration, maintenance of liquid assets, creation of reserve fund and also from certain provisions of NBFC Directions on acceptance of public deposits and prudential norms which do not apply to notified nidhi companies;
- *Government NBFCs*: The Government NBFCs would be exempted from applicability of the provisions of RBI Act relating to maintenance of liquid assets and creation of reserve funds, and the directions relating to acceptance of public

deposits and prudential norms. The requirement of statutory registration of these companies would, however, continue;

- *Permissible limit*: The NBFCs have been permitted to maintain up to five per cent of the public deposits in the form of term deposits with scheduled commercial banks out of the present requirement of 15 per cent of public deposits to be invested in liquid assets. These instructions are effective retrospectively from the first day of the quarter beginning January 1, 2000.
- *Change of name*: An NBFC intending to change its present name would need to obtain prior permission of the Reserve Bank before approaching the Registrar of Companies for change of name;
- *PAN* : All NBFCs should furnish the details of Permanent Account Number (PAN) issued by Income Tax Authorities to each of their directors to the respective Regional Office of the Reserve Bank within two months, failing which the grant or continuance of the certificate of registration would be reconsidered;
- *Management change*: Any NBFC seeking change in management or merger or amalgamation with any other company has to give an option to every depositor to decide whether to continue the deposits with the company under the new management or the transferee company or not. The company would also be obliged to make the payment to the depositors who seek the repayment of their deposits.
- *Introduction*: The NBFCs should obtain proper introduction of the new depositors before opening their deposit accounts and accepting the deposits. They should also obtain written confirmation from their introducers. In the absence of such introduction, any other document of identity of the prospective deposit holders may be obtained and kept on their record, the evidence on which they have relied upon for the purpose of such introduction;
- *Subordinated debt*: The subordinated debt instruments with a minimum maturity period of 60 months or above at the time of their initial offer which (a) are unsecured and subordinated to the claims of other creditors, (b) are free from restrictive clauses, (c) are not redeemable at the instance of the holder or without the consent of the supervisory authority of the NBFC, would only be exempted from the definition of public deposits;
- *Shareholder deposits*: The deposits accepted by a private limited NBFC from the first named shareholders would only be exempted from the purview of public deposit. The deposits accepted from the rest of the joint shareholders would be treated as public deposit;
- *Opening of branch*: An NBFC having a certificate of registration and otherwise entitled to accept public deposits is allowed to open its branch/office or allow its agents to operate for mobilisation of public deposits within the State where its registered office is situated if its NOF is up to Rs.50 crore and any where in India if its NOF is more than Rs.50 crore and its fixed deposits programme has been rated by one of the approved credit rating agencies at 'AA' or above; An RNBC registered with the Reserve Bank and otherwise complying with all the statutory requirements is allowed to open additional branches/offices and/or allow its agents to operate for mobilisation of deposits within the State of the location of its

registered office if its NOF is up to Rs.50 crore and any where in India if its NOF is above Rs.50 crore;

- *Prior notice*: The NBFCs/RNBCs would be required to give 30 days' notice to the Reserve Bank prior to the opening of any branch/office for mobilisation of public deposits within the specified area of operation and prior public notice of three months in leading newspapers before closing a branch. These directions are applicable prospectively;
- *Reporting*: The auditors of these companies would be entrusted with the responsibility of direct reporting to the Reserve Bank, along with other contraventions, if any, on the matters of non-compliance with the directions of the Reserve Bank on control over opening and closing of branches and engaging agents for mobilisation of public deposits by the NBFCs.
- *Internal audit*: All NBFCs having asset size of Rs.50 crore or above should have compulsory internal audit system accountable to the chief executive officer of the company. All these companies should also mandatorily constitute an audit committee from among the members of their board of directors;
- *Suitfiled/decreed debts*: In order to monitor the level of loan delinquencies in the NBFC sector, NBFCs have been advised to furnish, in their prudential norms return, information on suit filed/decreed debts by and against them.
- *Disclosure on exposure*: The disclosures relating to exposure to each NBFC's group companies and associations should be included in the application form for soliciting deposits without any further delay;
- *Extension of time*: The Reserve Bank of India may not, in the normal course, grant extension of time to those NBFCs which have not attained the prescribed minimum NOF of Rs. 25 lakh by January 9,2000 and accordingly their application may not be considered for registration;
- *Furnishing details*: The NBFCs not holding public deposits need not furnish the return to the Reserve Bank on and from the quarter ended December 1999.

Financial Institutions

ALM Guidelines for FIs

The Reserve Bank of India has issued comprehensive guidelines on asset liability management (ALM) system for the ten all-India term lending and refinancing institutions (FIs). The guidelines to these institutions were issued for instituting a structured asset liability management (ALM) system by them. The guidelines will be effective from April 1, 2000. The Reserve Bank has also advised to constitute an Asset Liability Committee (ALCO) headed by CEO/CMD/DMD/ED on which the senior management of the FI from the concerned department would need to be represented.

The purpose of the ALM guidelines is mainly to strengthen the management information system (MIS) within the FIs so as to sensitise them to the market risk assumed by them. Under the ALM guidelines, the FIs should prepare periodical statements on liquidity gap and interest rate sensitivity and put up to their top management. To begin with, these statements should be compiled at quarterly intervals beginning from April 1, 2000 but after the initial phase-in period of one year, the liquidity gap report should be required to be prepared at fortnightly intervals and the interest rate sensitivity statement at monthly intervals, with effective from April 1, 2001.

In the ALM systems prescribed for FIs, not only the items of assets and liabilities appearing on the balance sheets of FIs are captured but also the cash flows emanating from these items over the entire life of the asset, liability or contingent commitments. While the Reserve Bank has prescribed prudential limits on negative liquidity gaps at 10 per cent and 15 per cent of the cash outflows in the first two time buckets (viz.,1 to 14 days and 15 to 28 days), the FIs themselves have to evolve internal prudential limits for cumulative negative liquidity gaps across all time buckets as also for the interest rate gaps in various time buckets with the approval of their Board/ALCO. The ALM system also aims at capturing the foreign currency portfolio of the FIs and therefore, the FIs should compile currency-wise liquidity and interest rate sensitivity (IRS) reports in respect of their foreign currency exposures - for which separate formats have been prescribed. For the time being, the FIs should furnish the data to the Reserve Bank about their liquidity gaps and interest rate gaps for which necessary prescriptions will be made by the Reserve Bank separately in due course, after the system stabilises.

Prudential Norms for Takeout Finance

The Reserve Bank of India has prescribed certain prudential norms to be followed by both, the lending and taking-over financial institutions, in the case of takeout finance. In a circular issued to all financial institutions, the Reserve Bank has stated that it has examined the issue pertaining to the criteria for assigning risk weights and applying other prudential norms in respect of takeout finance by banks and financial institutions. It has advised the financial institutions to assign risk weights and apply income recognition and provision norms in the case of take out finance as under:

Risk Weight

Unconditional Takeover	Credit conversion factor	Risk Weight
(i) Lending institution (a) Where the full credit risk is assumed by the taking over institution	Not applicable since it is not an off balance sheet item	20 per cent
(b) Where only partial credit risk is assumed by taking over institution	-do-	20 per cent on the amount to be taken over 100 per cent on the amount not to be taken over
(ii) Taking over	100 per cent	100 per cent on the amount to be taken over
Conditional takeover		
(i) Lending institution	Not applicable since it will not be off balance sheet item	100 per cent
(ii) Taking over institution	50 per cent	100 per cent

Note : In the above cases where the counter party risk is guaranteed by Government the risk weight will be zero.

Income Recognition and Provisioning
Where the credit facility becomes a non-performing asset before take over by the taking over institution:

Lending institution	Taking over institution
(i) Should be classified as NPA	(i) No obligations would arise till the asset is actually taken over.
(ii) Income not to be recognised on accrual basis (iii) Provision to be made appropriate to the asset classification. (iv) As and when the asset is taken over by the taking over institution, the corres-ponding provision could be reversed.	(ii) On taking over such assets should make provisions treating the account as NPA from the actual date of it becoming NPA even though the account was not in its books on that date.

In its circular, the Reserve Bank has stated that prescribing of prudential norms for financial institutions entering into takeout finance arrangements had become necessary as in order to meet the financing requirements of infrastructure projects, financial institutions/banks have been increasingly taking recourse to the new product of takeout finance.
Under a takeout finance arrangement, the financial institution/bank financing an infrastructure project (lending institution) transfers the outstanding of such financing to the books of another financial institution (taking over institution) on a pre-determined basis. Takeout finance helps the banks in asset-liabilities management since they finance infrastructure which requires long term funds out of their resources which are short-term. There are several variants of takeout finance but basically they are either in the nature of unconditional takeout finance or conditional takeout finance, though it may involve taking over institutions assuming full credit risk or a part of it. Takeout finance involves three parties, viz., project company, lending bank/financial institution and the taking over institution. The company recognises the takeout finance arrangement by way of an inter-creditor agreement.

Utilisation of Special Reserves

The Reserve Bank of India has issued revised guidelines on the utilisation of special reserves created under Section 36(1)(viii) of the Income Tax Act, 1961 to all India term lending institutions for the purpose of making provisions for non-performing assets (NPAs) or general provision for standard assets both for current year and for any shortfall in provisions of the earlier years. The Reserve Bank of India has advised all-India term lending institutions that such provisions should not be directly debited to special reserves but should be provided for in the profit and loss account of the year 'above the line' and the current profit, i.e., profit for the year be determined. The transfer, if any, from the special reserves should be shown 'below the line'.

Banking Policy

Savings Accounts in the Name of Collector/DM/DC

The Reserve Bank of India has now decided to allow public sector banks to open savings bank accounts in the name of Collector/District Magistrate/District Commissioner in respect of funds released for implementation of Member of Parliament Local Area Development Scheme (MPLADS) where the works under the scheme are executed through Planning Department of the State Government. Public sector banks may also open savings bank accounts under MPLADS scheme in the name of District Rural Development Agency (DRDA). The banks were earlier prohibited by the Reserve Bank of India from opening savings bank accounts, inter alia, in the name of Government departments/bodies depending upon budgetary allocations for performance of their functions except certain organisations/agencies which were exempted from this prohibition.

Interest on Minimum Credit Balance of Farmers' Accounts

Scheduled commercial banks had earlier been advised to (i) introduce annual composite cash credit limits to all agricultural borrowing families and (ii) consider designing a fully liquid savings module with an appropriate return and in-build the same in the loan product which will take care of the farmers' interests in the event of adverse price fluctuations or natural calamities. It has, therefore, been decided to allow scheduled commercial banks to pay interest at their discretion, at a rate based on their perception and other relevant factors on the minimum credit balance in the composite cash credit accounts of farmers during the period from the 10th to the last day of each calendar month.

Priority Sector Lending - Housing Finance

The Reserve Bank of India has advised all primary (urban) co-operative banks that :

i) The direct housing loans by banks up to Rs 10 lakh for construction of houses by individuals in urban and metropolitan areas would be eligible for inclusion under priority sector ;

ii) All investments in bonds issued by National Housing Bank (NHB)/Housing and Urban Development Corporation (HUDCO) exclusively for financing of housing, irrespective of the loan size, per dwelling unit, would be reckoned for inclusion under priority sector advances ;

iii) The overall target of 60 per cent of total advances for priority sector, of which 25 per cent advances for weaker section remains unchanged.

PMRY - Affidavit on Income of the Applicant

The Government of India has now decided to allow applicants under the Prime Minister Rozgar Yojna (PMRY) to submit to the District Industrial Centre (DIC)/banks a declaration about their eligibility under the scheme on plain paper. Earlier, the applicants had to submit the details about their eligibility on a non-judicial stamp paper. The formal affidavit on the relevant non-judicial stamp paper should be submitted to the bank only when the loan amount is sanctioned.

Investment Exemption to RRBs extended

The Reserve Bank of India has decided to extend the exemption granted to Regional Rural Banks (RRBs) for investments made by them in approved securities from valuation

of investments, charging of depreciation etc., for a period of two years viz. for the financial year 1998-99 and 1999-2000.

The Reserve Bank of India had, in 1995, exempted the Regional Rural Banks from adhering to these guidelines for three years.

Relief to PMRY Beneficiaries of Orissa

The Government of India has decided to allow banks to reschedule the repayment of loans disbursed under Prime Minister's Rozgar Yojana (PMRY) in Orissa. It has also allowed extension of the cut-off date for closure of disbursements of sanctioned loans during the programme year 1998-99 under PMRY from December 31, 1999 to February 29, 2000 in Orissa State. The relaxations have been given in view of the widespread damage caused in the State by super cyclone on October 29-30, 1999.

Opening of Credit Card Centres

It has been decided that foreign banks may set up credit card centres and obtain a post-facto licence under Section 23 of the Banking Regulation Act, 1949 within one month from the setting up of the credit card centres from the concerned Regional Office of the Department of Banking Operations and Development (DBOD) of the Reserve Bank in whose jurisdiction the principal office of the foreign bank in India is located.

These credit card centres will undertake only credit card related activities such as :

(i) Attending to the request for and issue of credit cards.
(ii) Processing of credit cards.
(iii) Acceptance of credit card payment by cheques.
(iv) Marketing credit cards to prospective customers.
(v) Utilisation of services of agent at centres (where the bank has no presence) to carry out credit card related activities.
(vi) Maintenance of cash balances for meeting expenses of the centre and not for payment to credit card holders.

Banks are advised to submit to DBOD a list of credit card centres set up by them with detailed addresses as on March 31 every year.

Collection of Outstation Cheques

The Reserve Bank of India has advised all commercial banks to issue necessary instructions to their branches to ensure strict compliance of its instructions on automatic credit of interest in respect of delayed collection of outstation cheques. The advice has been reiterated so as to avoid any room for representations complaints from public.

The Reserve Bank had earlier advised all commercial banks to ensure that the account holders should be paid penal interest on the amount of cheques/instruments drawn on the collecting bank's own outstation branches or on those of other banks if the proceeds are not realised/credited to the customer's accounts or the unpaid instruments are not returned to the customers within a period of 14 days from the date of their lodgements. The penal interest should be paid for the period beyond 14 days till the proceeds are realised/credited to the customers' accounts or the instruments are returned in cases of such delays in collection of outstation cheques. In the case of instruments drawn on State Headquarters banks have to pay interest beyond 10 days if they are not collected within 10 days except that in respect of the state capital in North Eastern region and Sikkim, the norm of 14 days would remain unchanged.

The commercial banks were also advised to pay a penal interest for such delays as under :

i) Where the proceeds of an instrument are to be credited to the cash credit/overdraft/loan amount of a party at the prime lending rate fixed from time to time.

ii) In other cases at 2 per cent per annum above the rate of interest applicable to balances in savings bank accounts.

The Reserve Bank has reiterated its earlier advice as it was brought to the Bank's notice that banks do not give automatic credit of interest for delayed collection of outstation cheques, but they comply with the same only if the matter is brought to their notice.

High Level Committee on Credit to SSI

The Reserve Bank of India has advised all scheduled commercial banks (including regional rural banks) to take appropriate action for immediate implementation of the recommendations made by the High Level Committee on credit to small scale industries (S.L. Kapur Committee). The recommendations include non-stipulation of cash margins from small scale industries borrowers on non-fund based facilities in cases where there is adequate security to cover the bank's exposure, undertaking research activities on credit related policies in relation to specific sectors of SSI extending special term loans for meeting pre-operative expenses etc., on liberal terms of margin and repayment period based on the merits of the case, increase in the exemption limit for obtention of collateral security/third party guarantee from Rs.25000 to Rs.1 lakh, development of a set of written loan policies by banks, drawing a line to separate bonafide credit decisions from malafide decisions while fixing accountability, evolving a system of maintaining a balanced score card in public sector banks for assessing of performance of each officer in taking credit decisions and development of computerised information and monitoring system for SSI units.

Lending institution	Taking over institution
(i) Should be classified as NPA	(i) No obligations would arise till the asset is actually taken over.
(ii) Income not to be recognised on accrual basis (iii) Provision to be made appropriate to the asset classification. (iv) As and when the asset is taken over by the taking over institution, the corresponding provision could be reversed.	(ii) On taking over such assets should make provisions treating the account as NPA from the actual date of it becoming NPA even though the account was not in its books on that date.

Dossier

Micro Finance

Micro Finance: The most acceptable definition of micro finance is the provision of thrift credit and other financial services and products of very small amount to the poor in rural, semi-urban or urban areas to enable them to raise their income levels and improve standard of living.

Micro credit: Micro credit is defined as supply of credit to the poor. It is one of the micro finance services. Unlike, direct bank loans to weaker sections and loans under SGSY, banks have a discretion to determine rate of interest on micro credit.

Self Help Group: Self Help Group (SHG) is a registered or unregistered group of the micro entrepreneurs having homogenous social and economic background, voluntarily coming together to save small amount regularly, to mutually agree to contribute to a common fund and to meet their emergency needs on mutual help basis. Besides, SHGs facilitate providing of collateral free loans at the doorstep of the borrower on the terms and conditions decided by the group. The group members use collective wisdom and peer pressure to ensure proper end use of the credit and its timely repayment. The peer pressure has been recognised as an effective substitute for collaterals. As a result of watch and vigil on the economic activities of each other, the recovery performance under micro credit movement is as high as 80 to 90 per cent. In order to supplement the income of the poor families, women are encouraged to form SHGs to undertake economic activities. In India, women SHGs are about 84 per cent. SHGs also ensure social economic development of its members by undertaking adult education programme, skill development programmes, etc.

Financing through SHGs conduits : Individually, poor are economically weak and fragile; but organised in a group, they gain empowerment. Besides, financing through SHG reduces transaction costs of both lenders and borrowers as a result of providing credit at the doorstep of borrowers without lengthy formalities. Lenders get benefit as a result of handling of a single account of SHG instead of a large number of small sized individual accounts. The borrowers organised in a SHG are able to minimise expenditure on travel (to and fro branch and other places) for completing paper work, loss of work days, in canvassing the loans, etc. Furthermore the peer pressure is used both for the proper utilization of credit and timely repayment of loans. There are 19 members per SHG in India.

Role of NGOs: Non-Governmental Organisation (NGO) is a voluntary organisation established to undertake social intermediation like organising the SHGs of micro-entrepreneurs, entrusting them to the interested banks, arranging adult education and skill development programmes, etc. While some of the NGOs borrow bank funds for on-lending to SHGs, others undertake only social intermediation.

SHG-Bank linkage: In order to strengthen the efforts of NGOs and augment the resources of SHGs, a scheme of linking of SHGs with banks was launched in 1992 under the aegis of the National Bank for Agriculture and Rural Development (NABARD). Under the scheme NABARD provides refinance assistance to the banks at an interest rate of 6.5 per cent. The NABARD also supports various micro finance institutions for capacity building through grants and revolving fund assistance. It also provides resources to NGOs and imparts training to bank officials engaged in micro-finance. At the end of March 1999 under the scheme there were about 33,000 SHGs with 5.6 lakh micro entrepreneurs with outstanding loans of Rs 570 million. The number of banks and NGOs involved were 202 and 550 respectively. NABARD has taken an ambitious programme of covering 75 lakh micro rural entrepreneurs under SHG movement in next five years with the support of banking system.

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