Chapter VI

Non-Banking Financial Companies

6.1 It is well recognised that the role of Non-Banking Financial Companies (NBFCs) as financial intermediaries is distinct from that of the banks. Most of the NBFCs have a well-defined business profile serving a *niche clientele* in a cost effective manner. However, a few of them have highly diversified portfolios. The liability side of their balance sheets also reflects a mixed composition driven mainly by their unique innovative schemes, interest rate premia and large-scale mobilisation efforts. The proliferation of NBFCs in the decade of 1990s left a regulatory gap, which was bridged with the amendment of the Reserve Bank of India Act, 1934 in January 1997. This has been followed by issuance of several regulations aimed at alignment of the regulatory environment of the NBFCs with that of the banks and ensuring protection to depositors. Subsequent regulatory initiatives covered areas of compulsory registration, prudential regulations, investment norms, disclosure standards, strengthening of supervisory oversight, *etc*. The tightening of regulatory and supervisory framework for NBFCs has also been coterminous with the rapid product development and diversification, sweeping changes in technology along with trends indicating consolidation in the financial sector.

6.2 The improvements are visible in terms of the soundness indicators, like capitalisation, asset quality, business performance and sustainability. While concentration of deposit holding in terms of types of NBFCs has not exhibited major changes, indicators of size-wise distribution and regional spread of public deposits improved considerably. However, such improvements have been accompanied by a reduction in the size of the balance sheet of the NBFC sector corresponding with the consolidation of the sector on account of mergers, closures and cancellation of certificates of registration and conversion into non-public deposit accepting activities. However, profitability and efficiency indicators of the NBFC sector improved marking a turnaround after the losses recorded for the two successive years of 2000-01 and 2001-02.

2. Non-Banking Financial Companies Regulated by the Reserve Bank

6.3 The NBFCs as defined in the Reserve Bank of India Act, 1934 are broadly classified into different categories on the basis of their principal activities. The Reserve Bank regulates and supervises the NBFCs in terms of Chapter III B of the Reserve Bank of India Act, 1934. The Reserve Bank has put in place a set of directions to regulate the activities of NBFCs under its jurisdiction. The directions are aimed at controlling the deposit acceptance activity of NBFCs in the four categories of Equipment Leasing (EL), Hire Purchase (HP), Loan and Investment Companies and deposits and business activities of Residuary Non-Banking Companies (RNBCs). Besides, the Reserve Bank has prescribed prudential norms for all the NBFCs. RNBCs are classified as a separate category as their business, which has evolved over the years, does not conform to any of the other defined classes of NBFC businesses. Certain other types of non-banking financial entities are either partially regulated by the Reserve Bank or are outside the purview of the Reserve Bank regulation.

6.4 The regulatory jurisdictions over the various types of NBFCs are clarified in Table VI.1.

3. Registration

6.5 The Reserve Bank of India (Amendment) Act, 1997 made it obligatory for NBFCs to apply to the Reserve Bank for a certificate of registration (CoR). The statutory requirement for minimum net owned funds[1] (NOFs) for

[1] Net owned funds (NOFs) of NBFCs is the aggregate of paid-up capital and free reserves, netted by (i) the amount of accumulated balance of loss, (ii) deferred revenue expenditure and other intangible assets, if any, and further reduced by investments in shares of (a) subsidiaries, (b) companies in the same group and (c) other NBFCs, and loans and advances to (a) subsidiaries and (b) companies in the same group in excess of 10 per cent of owned fund.

Table VI.1: Regulatory Authorities of NBFCs

	Type of NBFCs	Name of the Regulatory Authority
	1	2
1.	Equipment Leasing Companies (EL)	Reserve Bank of India
2.	Hire Purchase Finance Companies (HP)	Reserve Bank of India
3.	Loan Companies	Reserve Bank of India
4.	Investment Companies	Reserve Bank of India
5.	Residuary Non-Banking Companies (RNBCs)	Reserve Bank of India
6.	Miscellaneous Non-Banking Companies (Chit Funds)	Reserve Bank of India* and Registrars of Chits of the concerned States
7.	Mutual Benefit Finance Companies (Nidhis and Potential Nidhis)	Department of Company Affairs of GoI#
8.	Micro Finance Companies	Department of Company Affairs of GoI#
9.	Housing Finance Companies	National Housing Bank
10.	Insurance Companies	Insurance Regulatory and Development Authority
11.	Stock Broking Companies	Securities and Exchange Board of India
12.	Merchant Banking Companies	Securities and Exchange Board of India

* deposit taking activity only # Government of India

registration, was stipulated at Rs.25 lakh for the then existing NBFCs and Rs.2 crore for new NBFCs seeking grant of CoR on or after April 21, 1999. The three-year period provided in the Reserve Bank of India (Amendment) Act, 1997 for the NBFCs to attain the minimum NOFs necessary for registration expired on January 9, 2000. The further three-year period granted by the Reserve Bank, at its discretion, as per the Act, also came to a close on January 9, 2003.

6.6 As at the end of June 2004, a total of 38,050 applications were received for grant of CoR. Of these, the Bank has approved 13,671 applications, including 584 applications of companies authorised to accept/hold public deposits (Table VI.2).

Table VI.2: Certificates of Registration Issued to NBFCs

End-June	All NBFCs	NBFCs accepting Public Deposits
1	2	3
1999	7,855	624
2000	8,451	679
2001	13,815	776
2002	14,077	784
2003	13,849	710
2004	13,671	584

Note : The reduction in number is due to cancellation of CoRs/conversion of deposit taking companies to non-deposit taking companies and other reasons.

6.7 All NBFCs holding public deposits whose CoRs have been either rejected or cancelled cannot accept fresh deposits or renew maturing deposits and have to continue repaying the deposits on due dates and dispose off their financial assets within three years from the date of application/cancellation of the CoR. Thus, there has been a fall in the number of operating NBFCs reflecting mergers, closures and cancellation of licenses. Besides, the number of public deposit accepting companies also came down because of conversion to non-public deposit-accepting activities.

4. Supervision

6.8 Supervisory oversight by the Reserve Bank over NBFCs encompassed a four-pronged strategy including a) on-site inspection, based on the CAMELS methodology, b) off-site monitoring supported by state-of-the-art technology, c) market intelligence, and d) exception reports of statutory auditors.

6.9 For closer monitoring of the linkages of NBFCs including RNBCs with capital market, a system of quarterly reporting which was subsequently changed to monthly reporting for companies having public deposits of Rs.50 crore and above, was put in place. In case of large exposures to the capital market, the companies were also required to submit funds flow statements.

6.10 With a view to addressing issues relating to systemic risk and monitoring the affairs of financial conglomerates, the Reserve Bank put in place a reporting framework for such entities. Entities having significant presence in more than one financial segments under the jurisdiction of specified regulators (RBI, SEBI, IRDA, *etc.*) have been covered under this framework. NBFCs subject to this reporting discipline are required to submit returns at periodic intervals on their intra-group relationships.

6.11 Recently, a quarterly reporting arrangement has been introduced for NBFCs not accepting/holding public deposits and having assets size of Rs.500 crore and above as on March 31, 2004.

6.12 During the period July 2003 to June 2004, 705 registered NBFCs (368 deposit taking and 337 non-deposit taking companies) were inspected. In addition to the inspections, the Reserve Bank also conducted 372 snap scrutinies during the same period.

5. Policy Developments

6.13 The consolidation of policy initiatives with respect to the NBFCs continued during 2003-04. A few important measures undertaken included, i) streamlining of returns related to Asset-Liability Management (ALM) and exposure to capital market, ii) alignment of interest rates, iii) simplification of the procedures for collection of interest on the Government securities, iv) alignment of regulatory norms with the banking sector with respect to exposure to infrastructure projects, v) procedural change in nomination facilities, vi) issuance of 'Know Your Customer' (KYC) policy, vii) allowing NBFCs to take up insurance agency business, viii) legislative initiatives in the form of follow up of Financial Companies Regulation Bill (FCRB) and ix) issuance of guidelines for Securitisation Companies and Reconstruction Companies.

6.14 Major changes effected during July 2003-June 2004 in the policies applicable to NBFCs are outlined below.

Interest Rates

6.15 Interest rate policies for the NBFC sector has been guided with the objective of alignment of interest rates for the NBFC sector with that of the banking sector. Important components of interest rate policy include (a) The maximum rate of interest that NBFCs (including *Nidhi* companies and Chit Fund companies) can pay remained unchanged at 11.0 per cent per annum (effective March 4, 2003); (b) the minimum rate of interest payable by the RNBCs also remained unchanged at five per cent per annum (to be compounded annually) on the amount of deposits made in lump sum or at monthly or longer intervals and three and one-half per cent per annum (to be compounded annually) on the amount deposited under daily deposit schemes (effective April 1, 2003); (c) keeping in view the prevailing interest rates on fresh repatriable deposits accepted from non resident Indians in the entire financial system, the rate of interest which the NBFCs and Miscellaneous Non-Banking Companies (MNBCs) could pay on such deposits was aligned with that payable by the scheduled commercial banks (SCBs) on these deposits effective from September 17, 2003. As and when the interest rate for NRE deposits is revised by the Reserve Bank for scheduled commercial banks, that rate would *ipso-facto* be applicable to NRI deposits on repatriation basis accepted by NBFCs and MNBCs also. With effect from April 24, 2004, NBFCs are not allowed to accept fresh NRI deposits except renewing the deposits already accepted.

Asset Liability Management

6.16 The ALM guidelines issued in June 2001 were made fully operational as on March 31, 2002. The first ALM Return as on September 2002 was submitted by NBFCs to the Reserve Bank by October 31, 2002. Thereafter returns are being submitted regularly on a half-yearly basis.

Transactions in Government Securities: Collection of Interest on Government Securities

6.17 NBFCs and RNBCs have already been directed to dematerialise Government securities. A few Government securities and Government guaranteed bonds that have not yet been dematerialised by the issuers and are held in physical form for the time being are withdrawn by NBFCs for the purpose of collection of interest from the safe custody of their designated bankers and re-deposited with the banks after the needful has been done. To avoid the process of withdrawal and re-depositing these securities, NBFCs/RNBCs were advised to authorise their designated banks as agents by exercising a

Power of Attorney in favour of them for collection of interest on due dates on these securities held in the physical form and lodged for safe custody.

Amendments to NBFC Regulations: Exposure to Infrastructure Projects

6.18 Prudential norms applicable to NBFCs were amended and aligned with those applicable to banks and FIs, in particular those exposures pertaining to infrastructure projects.

Nomination Rules Under Section 45QB of the Reserve Bank of India Act, 1934 for NBFC Deposits

6.19 The Reserve Bank in consultation with the Government of India, decided that NBFCs may adopt the Banking Companies (Nomination) Rules, 1985 made under Section 45ZA of the Banking Regulation Act, 1949. Accordingly, depositor/s of NBFCs are permitted to nominate one person, to whom, the NBFCs can return the deposit in the event of death of the depositor/s. NBFCs were advised in July 2003 to accept nominations made by the depositors in the forms similar to the one specified under the said rules, *viz*., Form DA1 for the purpose of nomination, and Form DA2 and DA3 for cancellation of nomination and variation of nomination, respectively.

'Know Your Customer' Guidelines

6.20 Know Your Customer (KYC) guidelines for NBFCs were issued on January 6, 2004. The guidelines are akin to those issued to commercial banks covering, *inter alia*, (i) customer identification; (ii) KYC procedure for existing customers; (iii) ceiling for and monitoring of cash transactions; (iv) internal control system; (v) internal audit/inspection; (vi) record keeping; and (vii) training of staff and management. The Board of Directors of the NBFCs have been advised to formulate policies and procedures to operationalise and ensure observance of these guidelines in respect of all new customers. The NBFCs have also been advised to complete the identification process in respect of the existing customers by June 30, 2004. These guidelines are applicable to all NBFCs including MNBCs (Chit Fund Companies) and RNBCs.

Insurance Agency Business by NBFCs

6.21 NBFCs may take up, without approval of the Reserve Bank, insurance agency business on fee basis and without risk participation subject to certain conditions. It was clarified that the prohibition from collection of premium from the insured by the NBFCs relates only to its insurance agency business. It does not relate to insurance of the assets in which the NBFCs have insurable interest for the purpose of lease or hire purchase or hypothecation of loans to the lessees, hirers and the loanees. However, NBFCs intending to set up insurance joint ventures with equity contribution on risk participation basis or making investments in the insurance companies, would continue to obtain the prior approval of the Reserve Bank as envisaged in earlier guidelines dated June 9, 2000.

Financial Companies Regulation Bill (FCRB), 2000

6.22 The Standing Committee on Finance of the Parliament has submitted its recommendations to the Government of India, on the FCRB. The Government has, in turn, called for the comments of the Reserve Bank on the recommendations of the Standing Committee. In view of the recent developments in the financial sector, the provisions of FCRB are being revisited.

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act)

6.23 The Government enacted the SARFAESI Act to enable banks and FIs to realise long-term assets, manage problem of liquidity, asset liability mismatches and improve recovery by exercising powers to take possession of securities, sell them and reduce non-performing assets by adopting measures for recovery or construction. In the light of the Supreme Court judgement in the Mardia Chemicals Ltd., certain amendments to the SARFAESI Act were necessitated. Certain other incidental changes have also been proposed taking suggestions received in this regard from several quarters. The Reserve Bank has so far granted CoR to three Asset Reconstruction Companies (ARCs) *viz*., Asset Reconstruction Company of India Limited (ARCIL), Assets Care Enterprise Limited (ACEL) and ASREC (India) Limited (ASREC). ARCIL has begun its operations and has acquired assets of book value of Rs.9,631 crore at a price of Rs.2,089 crore and has issued security receipts worth Rs.2,102 crore. ACEL is yet to commence its operations. The proposed merger of IFCI, one of its main sponsors, could be the probable cause for the delay. The third company, ASREC (India) has been granted CoR on October 11, 2004[2]. In order to ensure that the ARCs have a sound capital base and a stake in the management of the NPAs so acquired by them, the Reserve Bank has increased the requirement of minimum owned fund for commencement of business by these companies to an amount not less than 15 per cent of the assets acquired or to be acquired or Rs.100 crore whichever is less, on an aggregate basis.

Liberalisation of Bank Finance to NBFCs

6.24 In view of the expertise gained by NBFCs in financing second hand assets and to encourage credit dispensation, bank financing to NBFCs was liberalised. Henceforth, banks were allowed to extend finance to NBFCs against second hand assets financed by them, provided suitable loan policies duly approved by the banks' Boards are put in place.

Phasing out of Public Deposits

6.25 At present, NBFCs accepting public deposits are regulated and supervised by the Reserve Bank. Over a period, the dependence of the NBFCs (other than RNBCs) on public deposits as part of their overall resources has declined. The deposits of NBFCs declined from Rs.6,500 crore in 2000-01 (17.2 per cent of their total liabilities) to Rs.3,400 crore in 2003-04 (12.7 per cent of the total liabilities). The number of deposit taking NBFCs has also declined from 996 in 1997 to 577 by September 2004. Internationally, acceptance of public deposits is restricted to banks, and non-banks including NBFCs raise resources from institutional sources or by accessing the capital market. NBFCs are encouraged to move in this direction in line with international practices. The Reserve Bank will be holding discussions with NBFCs in regard to their plan of action for voluntarily phasing out of their acceptance of public deposits and regulations on banks' lending to NBFCs will be reviewed by the Reserve Bank as appropriate.

Primary Dealers (PDs)

6.26 The Primary Dealers (PDs) system has been in vogue in India for the last nine years. PDs serve as important intermediaries to promote activity in the Government securities market, especially in the development of the secondary market. The main objective of promoting PDs is to make the Government securities market vibrant, liquid and broad based and to ensure development of underwriting and market making capabilities for Government securities outside the Reserve Bank. PDs obligations include an annual bidding commitment, underwriting the primary issuance and offering two-way quotes. In return, PDs have access to Subsidiary General Ledger (SGL), current accounts, collateralised liquidity support and liquidity support through LAF scheme from the Reserve Bank. PDs also have access to the call money market as borrowers and lenders.

6.27 With the merger of SBI Gilts Ltd. and DFHI Ltd. recently, the number of PDs in the system came down from 18 to 17. PDs largely deal in Government securities and other interest rate products and support the borrowing programme of the Government of India and State Governments. For financing their securities holdings, they depend on short term funding thereby incurring an inherent mismatch. PDs are a systemically important segment of the financial system in view of their number, their market share in Government securities market and their participation in money market. Since PDs are highly leveraged in general, regulatory oversight thereon is desirable. Central banks across the world, typically, review the performance of the PDs and make continuation of their operations performance based.

6.28 The off-site supervisory returns required to be submitted by the PDs were rationalised during the year. Six returns were discontinued and three returns were revised. A new quarterly return on major financial indicators and various ratios was introduced from the quarter ended December 31, 2003.

6.29 With a view to enabling PDs to manage their exposure to interest rate risk, they were allowed to deal in exchange traded interest rate derivatives in a phased manner. In the first phase, they were permitted to transact only in interest rate futures on notional bonds and Treasury bills for the purpose of hedging the risk in their underlying investment portfolio. Subsequently, based on the feedback received, they were permitted to trade in these products subject to prudential guidelines and appropriate disclosures.

[2] Also refer to Box V.4 of the Report.

6.30 Operational guidelines were issued to PDs for Portfolio Management Services (PMS). PDs would require prior approval of the Reserve Bank and registration with Securities and Exchange Board of India (SEBI) before undertaking PMS activity. They are permitted to offer PMS services only to entities not regulated by the Reserve Bank. Prudential guidelines were also issued to PDs on their investment in non-Government securities. PDs are prohibited from investing in unrated debt securities and investments in unlisted instruments is limited to 10 per cent of the non-Government securities portfolio.

6.31 The revised 'capital adequacy standards and risk management guidelines' for PDs were issued in January 2004. Minimum holding period under Value-at-Risk (VaR) measure was reduced from 30 days to 15 days. This reduced market capital charge enabled PDs to hold higher portfolio. The reporting for capital adequacy was standardised. Some off-balance sheet items (such as, underwriting commitments), not included earlier, were included for reckoning of the risk weighted assets and capital adequacy. Guidelines relating to issue of Subordinated Debt Instruments under Tier II and Tier III capital have also been issued.

6.32 A cap of 200 per cent of their NOFs (as at the period ending March of the preceding financial year) was fixed on PDs borrowings in the call market in February 2004.

6.33 PDs need to have a sound capital base so as to absorb the adverse shocks in the event of upward movement of yields. Therefore, in June 2004, prudential guidelines were issued on dividend distribution policy with focus on payout ratio and capital adequacy. Dividend payout ratio for the PDs, having Capital to Risk Weighted Assets Ratio (CRAR) at 20 per cent or above in all the four quarters of the previous year, was capped at 50 per cent while for others, the dividend payout rate was capped at 33.33 per cent. A PD is not permitted to declare dividend if the CRAR in any of the four quarters has been below the minimum prescribed CRAR of 15 per cent.

6.34 In order to evaluate the role of PDs in the Government securities market and to undertake a comprehensive examination of the entire range of issues relating to the PDs with particular emphasis on their role and obligation, ability to cope with emerging risk and possible diversification of their balance sheet in general and the structure of their balance sheet in the context of changing financial environment, a sub-group of the Technical Advisory Committee (TAC) on Money, Foreign Exchange and Government Securities Markets was formed (Chairman: Dr. R.H. Patil). The Report of the sub-group is being placed before the TAC for advice to enable further action.

6.35 The Fiscal Responsibility and Budget Management Act stipulates that, with effect from April 1, 2006, the Reserve Banks participation in primary issues of Government securities will stand withdrawn. Consequently, open market operations (OMO) will become a more active instrument, warranting a review of processes and technological infrastructure consistent with market advancements. The Reserve Bank's intervention directly in the market or through PDs on a real time basis may become necessary. A Study Group would be constituted for strengthening the OMO framework to address these emerging needs and equip the Reserve Bank as well as the market participants appropriately.

6. Business Profile of the NBFC Sector

6.36 A broad business profile of the NBFC sector as at the end-March 2002 and end-March 2003, based on the periodic returns submitted by deposit accepting/holding companies is presented in Table VI.3 and Chart VI.1[3]. As at end-March 2002, the total outstanding public deposits of the 910

Table VI.3: Business Profile of the NBFC Sector

(As at end-March)

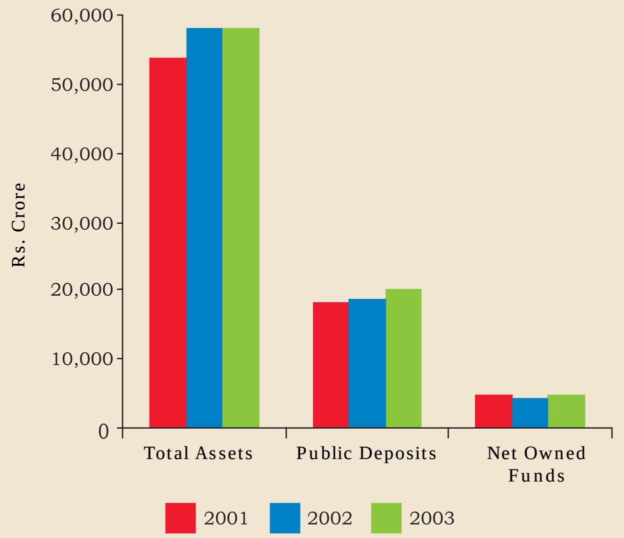
(Amount in Rs. crore)

Item	2002		2003	
	NBFCs	*of which* RNBCs	NBFCs	*of which* RNBCs
1	2	3	4	5
Number of reporting companies	910	5	875	5
Total Assets	58,290	18,458 (31.7)	58,071	20,362 (35.1)
Public Deposits	18,822	12,889 (68.5)	20,100	15,065 (75.0)
Net Owned Funds	4,383	111	4,950	809

Note: Figures in brackets indicate percentages to total.

[3] The data, however, are not strictly comparable across the years in view of differences in the total number of reporting companies.

Chart VI.1: Broad Profile of the NBFC Sector (end-March)



deposit holding companies (both registered and unregistered) aggregated Rs.18,822 crore, equivalent to 1.6 per cent of the outstanding deposits (Rs.12,05,930 crore) of scheduled commercial banks (excluding Regional Rural Banks). As at end-March 2003, the quantum of outstanding public deposits reported by 875 companies stood at Rs.20,100 crore, equivalent to 1.5 per cent of the aggregate deposits (Rs.13,55,880 crore) of scheduled commercial banks.

6.37 The aggregate assets of the NBFC sector declined marginally due to the reduction of Rs.3,815 crore in the assets of Loan Companies. However, this was partially offset by increase for other categories of NBFCs, *viz.*, (i) Equipment Leasing and Hire Purchase Companies (Rs.1,754 crore), (ii) RNBCs (Rs.1,904 crore), (iii) Investment Companies (Rs.132 crore) and (iv) MNBCs (Rs.14 crore), respectively.

Profile of public deposits of different categories of NBFCs

6.38 The profile of public deposits of different categories of NBFCs is provided in Table VI.4. At the disaggregated level, public deposits with the RNBCs and other NBFCs increased by 16.9 per cent and 24.2 per cent, respectively, during 2002-03 as compared with 2001-02. It may also be observed that the size of public deposits of Equipment Leasing Companies, Investment and Loan Companies has significantly declined by 23.5 per cent and 68.0 per cent, respectively, during the same period. However, since their shares in total deposits held by the NBFCs are small, their impact on the volume of public deposits of NBFCs was negligible (Chart VI.2). RNBCs hold a large share of public deposits. The total volume of public deposits of NBFCs in fact rose by 6.8 per cent during 2002-03.

Table VI.4: Profile of Public Deposits of Different Categories of NBFCs
(As at end-March)

(Amount in Rs. crore)

Nature of Business	Number of NBFCs		Public Deposits		Percentage Variation (Col. (5) over Col. (4))
	2002	2003	2002	2003	
1	2	3	4	5	6
1. Equipment Leasing (EL)	56	58	668 (3.5)	511 (2.5)	-23.5
2. Hire Purchase (HP)	463	439	3,709 (19.7)	3,539 (17.6)	-4.6
3. Investment and Loan (IL)	231	173	1,029 (5.5)	329 (1.6)	-68.0
4. RNBCs	5	5	12,889 (68.5)	15,065 (75.0)	16.9
5. Other NBFCs*	155	200	528 (2.8)	656 (3.3)	24.2
Total	**910**	**875**	**18,822** **(100.0)**	**20,100** **(100.0)**	**6.8**

* Includes Miscellaneous Non-Banking Companies, unregistered and un-notified *Nidhis*, *etc.*
Note: Figures in brackets indicate percentages to total.

Chart VI.2: Activity-wise Profile of NBFCs (end-March)

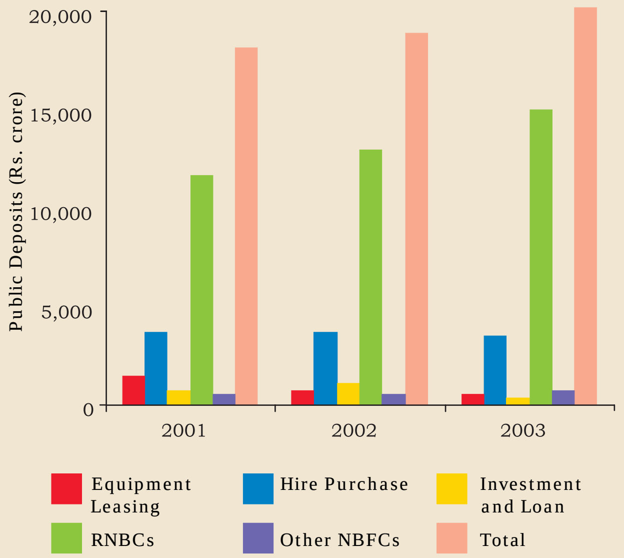
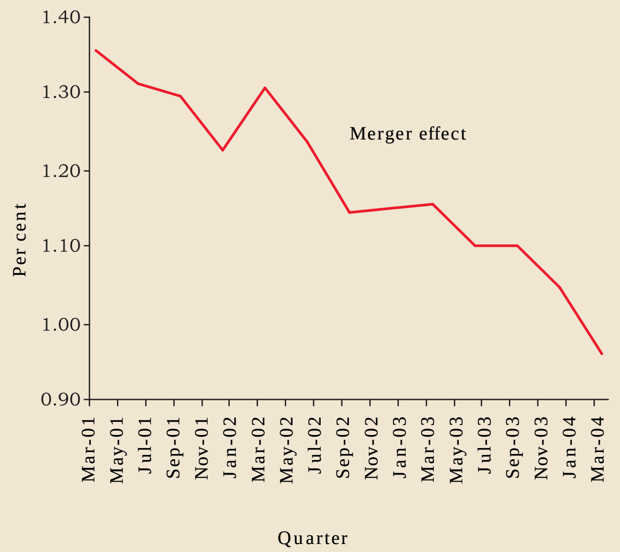


Chart VI.3: Share of NBFC Public Deposits in Broad Liquidity (L_3)



Size-wise classification of NBFC holdings

6.39 The size of public deposits held by NBFCs shows wide variation. Range-wise analysis of public deposits held by them is given in Table VI.5. It may be observed that number of NBFCs holding public deposits in the range of Rs.20 crore and above came down to 35 as at end-March 2003 from 42 NBFCs at end-March 2002. However, these NBFCs accounted for more than 80 per cent of total public deposits held by all the NBFCs in both the years.

6.40 The Reserve Bank publishes quarterly data on broad liquidity (L_3) encompassing monetary liabilities of the banking sector, postal deposits, term liabilities of financial institutions and public deposits of NBFCs on the recommendations of the Working Group on "Money Supply: Analytics and Methodology of Compilation" (Chairman: Dr. Y. V. Reddy, 1998). In view of the data lags, the Working Group recommended that estimates of NBFC public deposits could be generated on the basis of returns received from all NBFCs with public deposits of Rs.20 crore and above. The share of public deposits of all NBFCs continued to stagnate at around 1.0 per cent of L_3. Based on such lead data, NBFC public deposits recorded a marginal decline of 0.9 per cent during 2003-04 (Chart VI.3).

Table VI.5: Range of Deposit held by NBFCs (Excluding RNBCs)
(As at end-March)

(Amount in Rs. crore)

Deposit range	No. of NBFCs		Amount of deposit		Per cent	
	2002	2003	2002	2003	2002	2003
1	2	3	4	5	6	7
1. Less than 0.5	518	491	83	65	1.4	1.3
2. 0.5 - 2	237	233	234	225	3.9	4.5
3. 2 - 10	97	90	416	360	7.0	7.1
4. 10 - 20	11	21	160	284	2.7	5.6
5. 20 - 50	14	12	396	364	6.7	7.2
6. 50 and above	28	23	4,644	3,737	78.3	74.3
Total	**905**	**870**	**5,933**	**5,035**	**100.0**	**100.0**

7. Region-wise Composition of Deposits held by NBFCs[4]

6.41 The regional spread of the deposits held by NBFCs showed significant improvement (Table VI.6). The share of Eastern Region in the total deposits of the NBFCs declined significantly from 42.8 per cent in March 2002 to 38.0 per cent in March 2003. On the other hand, the Central Region accounting for 27.7 per cent of the aggregate public deposits as at end-March 2002 has shown a sharp increase in its share to 38.6 per cent as at end-March, 2003. The public deposits held by NBFCs in four metropolitan centres of Mumbai, New Delhi, Kolkata and Chennai has declined sharply to 59.2 per cent as at end-March 2003 from 69.8 per cent as at end-March 2002

8. Interest Rate and Maturity Pattern of Public Deposits with NBFCs

6.42 The interest rates offered by the NBFCs declined sharply in line with the easy interest rate environment. There was a significant rise in the quantum and percentage of public deposits in the interest rate range of upto 10 per cent and 10 to 12 per cent during the year 2002-03 (Chart VI.4). Deposits in the interest rate range of 10 to 12 per cent now constitute the largest component in the portfolio. On the other hand, public deposits in

Chart VI.4: Distribution of Interest Rate on Deposits by NBFCs (end-March)

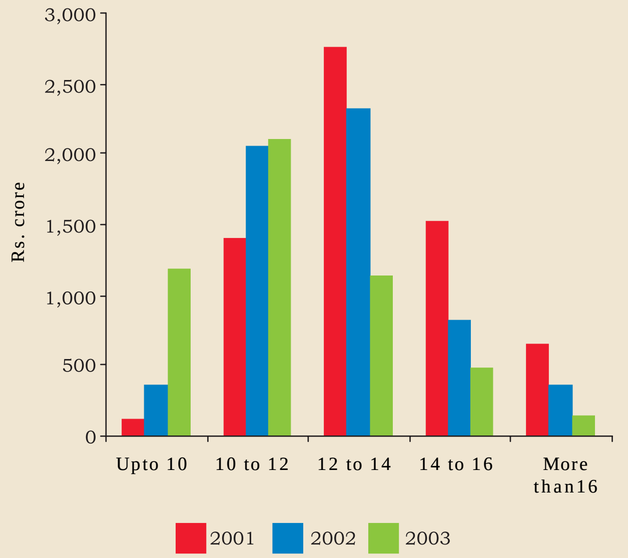


Table VI.6: Region-wise break-up of Public Deposits held by Registered and Unregistered NBFCs

(As at end-March)

(Amount in Rs. crore)

Region	2002						2003					
	NBFCs			*of which* RNBCs			NBFCs			*of which* RNBCs		
	No.	Amount	Per cent	No.	Amount	Per cent	No.	Amount	Per cent	No.	Amount	Per cent
1	2	3	4	5	6	7	8	9	10	11	12	13
Northern	271	554	2.9	–	–	–	271	543	2.7	–	–	–
North-Eastern	3	4	–	–	–	–	1	2	–	–	–	–
Eastern	21	8,051	42.8	3	7,812	60.6	21	7,634	38.0	3	7,422	49.3
Central	94	5,207	27.7	2	5,077	39.4	83	7,752	38.6	1	7,640	50.7
Western	70	1,467	7.8	–	–	–	63	687	3.4	–	–	–
Southern	451	3,538	18.8	–	–	–	436	3,482	17.3	1	3	–
Total	**910**	**18,821**	**100.0**	**5**	**12,889**	**100.0**	**875**	**20,100**	**100.0**	**5**	**15,065**	**100.0**
Metropolitan cities												
Mumbai	52	1,445	7.7	–	–	–	45	672	3.3	–	–	–
Chennai	317	3,183	16.9	–	–	–	318	3,162	15.7	–	–	–
Kolkata	21	8,051	42.8	3	7,812	60.6	18	7,625	37.9	3	7,422	49.3
New Delhi	111	460	2.4	–	–	–	108	443	2.2	–	–	–
Total	**501**	**13,139**	**69.8**	**3**	**7,812**	**60.6**	**489**	**11,902**	**59.2**	**3**	**7,422**	**49.3**

– Nil/Negligible.

[4] The region-wise analysis is based on the number of deposit-holding/accepting NBFCs (including RNBCs) that reported data to the Reserve Bank for the years ending March 31, 2002 and March 31, 2003.

Table VI.7: Distribution of Public Deposits of NBFCs (Excluding RNBCs) according to Rate of Interest
(As at end-March)

(Amount in Rs. crore)

Interest Range (Per cent)	Amount of deposits		Percentage to total deposits	
	2002	2003	2002	2003
1	2	3	4	5
Upto 10	358	1,174	6.0	23.3
10-12	2,055	2,101	34.6	41.7
12-14	2,326	1,137	39.2	22.6
14-16	833	475	14.1	9.4
More than 16	361	148	6.1	3.0
Total	**5,933**	**5,035**	**100.0**	**100.0**

interest rates range of 12 to 14 per cent, 14 to 16 per cent and more than 16 per cent declined. The public deposits in interest rate range of 12 to 14 per cent declined significantly from 39.2 per cent as at end-March 2002 to 22.6 per cent as at end-March 2003 (Table VI.7).

6.43 The maturity-wise analysis of public deposits held by NBFCs is presented in Table VI.8.

6.44 The broad trends indicate that outstanding public deposits with NBFCs (other than RNBCs) declined from Rs.5,933 crore as at end-March 2002 to Rs.5,035 crore at end-March 2003. The overall decline of Rs.898 crore (15.1 per cent) was evenly distributed in all the maturity buckets ranging from 'Less than one year' to 'five years and above'.

6.45 In the declining interest rate scenario, the interest rate differential between banks and NBFCs has narrowed over the years (Table VI.9).

Table VI.8: Maturity Pattern of Public Deposits held by NBFCs (Excluding RNBCs)
(As at end-March)

(Amount in Rs. crore)

Maturity Period	Amount of Deposits		Percentage to total Deposits	
	2002	2003	2002	2003
1	2	3	4	5
Less than 1 year	1,483	1,203	25.0	23.9
1 - 2 years	1,419	1,241	23.9	24.6
2 - 3 years	2,198	1,927	37.0	38.3
3 - 5 years	779	619	13.1	12.3
5 years and above	54	45	0.9	0.9
Total	**5,933**	**5,035**	**100.0**	**100.0**

Table VI.9: Maximum/Ceiling Interest Rates on Banks and NBFC Deposits
(as at end-March)

(Per cent)

Interest Rate	2000	2001	2002	2003	2004
1	2	3	4	5	6
1. Maximum interest rate on public sector bank deposits of 1-3 year maturity	10.5	9.5	8.5	6.75	6.75
2. Ceiling interest rate for NBFCs	16.0	14.0	12.5	11.0	11.0
3. Spread (2-1)	5.5	4.5	4.0	4.25	4.25

9. Asset Profile of NBFCs

6.46 The asset profile of NBFCs during 2001-02 and 2002-03 indicates that out of the 905 reporting companies, 62 NBFCs, with an asset size of Rs.50 crore and above, accounted for 92.2 per cent of the total assets in 2002 (Table VI.10). The share of assets of the companies in this range has remained unchanged though their number has changed marginally. Out of 870 reporting companies (excluding RNBCs), 64 companies having an asset size of Rs.50 crore and above accounted for same percentage, *i.e.*, 92.2 per cent of the total assets of NBFC sector as at end-March 2003. The number of companies in all the categories has decreased excepting the companies in the asset range of Rs.50-Rs.100 crore. The overall asset size of these companies has decreased from Rs.39,833 crore as on March 31, 2002 to Rs.37,709 crore as on March 31, 2003. The asset size of majority of the companies in each category has shown a decreasing trend during 2003, with the exception of those in the

Table VI.10: Asset Profile of NBFCs (Excluding RNBCs)
(As at end-March)

(Amount in Rs. crore)

Range of Assets	No. of Reporting Companies		Assets		Percentage to Total Assets	
	2002	2003	2002	2003	2002	2003
1	2	3	4	5	6	7
Less than 0.25	51	62	5	6	0.0	0.0
0.25 - 0.50	88	77	33	28	0.1	0.1
0.50 - 2	383	354	416	388	1.0	1.0
2 - 10	247	245	1,076	1,131	2.7	3.0
10 - 50	74	68	1,594	1,399	4.0	3.7
50 - 100	19	19	1,341	1,315	3.4	3.5
100 - 500	23	28	5,962	6,492	15.0	17.2
Above 500	20	17	29,406	26,950	73.8	71.5
Total	**905**	**870**	**39,833**	**37,709**	**100.0**	**100.0**

range of Rs.100-Rs.500 crore. The reason for the reduction in the asset size of many of the companies may be attributed to conversion of a few large sized deposit taking companies to non-deposit taking companies and also for the possible reason of utilisation of their assets to liquidate their high cost deposit liabilities.

10. Distribution of Assets of NBFCs According to Activity

6.47 The major portion of the assets of NBFCs (excluding RNBCs) are in the form of equipment leasing and hire purchase assets. The two together constituted 39.9 per cent of the total assets of NBFCs as at end-March 2003 whereas the loans and Inter-Corporate Deposit (ICD) portfolio accounted for 35.3 per cent of their total assets (Table VI.11).

Table VI.11: Activity-wise Distribution of Assets of NBFCs (Excluding RNBCs)
(As at end-March)

(Amount in Rs. crore)

Activity	Amount		Percentage to total	
	2002	2003	2002	2003
1	2	3	4	5
Loans & Inter-corporate deposits	13,710	13,296	34.4	35.3
Investments	4,334	4,338	10.9	11.5
Hire Purchase	13,202	13,031	33.1	34.6
Equipment Leasing	3,112	2,011	7.8	5.3
Bills	673	450	1.7	1.2
Other assets	4,802	4,583	12.1	12.2
Total	**39,833**	**37,709**	**100.0**	**100.0**

11. Borrowings by NBFCs

6.48 The borrowings by NBFCs (excluding RNBCs) at end-March 2002 and end-March 2003 indicate that the total borrowings have registered a marginal increase of Rs.480 crore during 2002-03 (Table VI.12). Funds raised through issue of debentures which constituted 17.4 per cent of the total borrowings at end-March 2002, increased to 21.9 per cent as at end-March 2003. The resources raised through 'Other Sources' also increased from 14.8 per cent as at end-March 2002 to 21.0 per cent as at end-March 2003. The Central/State Governments ceased to be a major source of funding for the sector with the reliance on this source declining by almost 50 per cent during the period under review.

12. Liabilities and Assets of Major NBFCs

6.49 Lead data on the performance of the major NBFCs (other than RNBCs) holding public deposits of Rs.20 crore and above accounting for three-fourth of sectoral assets based on returns introduced on the basis of the Working Group on "Money Supply: Analytics and Methodology of Compilation" (Chairman: Dr. Y.V. Reddy, 1998) is given in the Table VI.13. The

Table VI.12: Classification of Borrowings by NBFCs (excluding RNBCs)
(As at end-March)

(Amount in Rs. crore)

Source	Outstanding		Percentage to total	
	2002	2003	2002	2003
1	2	3	4	5
Money borrowed from Central/State Governments @	3,353	1,570	14.0	6.4
Money borrowed from foreign sources*	670	694	2.8	2.8
Inter-corporate borrowings	1,996	2,074	8.3	8.5
Money raised by issue of convertible or secured debentures including those subscribed by banks	4,180	5,352	17.4	21.9
Borrowings from banks	7,918	8,074	33.0	33.0
Borrowings from Financial Institutions	1,546	885	6.4	3.6
Commercial Paper	781	678	3.3	2.8
Others #	3,555	5,153	14.8	21.0
Total	**24,000**	**24,480**	**100.0**	**100.0**

@ Mainly by State-Government owned companies.
* The amount received from foreign collaborators as well as from institutional investors (Asian Development Bank, International Finance Corporation, *etc.*). The major amount is in infrastructure and leasing companies.
# Includes security deposits from employees and caution money, allotment money, borrowings from mutual funds, Directors, *etc.*

Table VI.13: Assets and Liabilities of Companies holding Public Deposits of Rs.20 crore and above
(As at end-March)

(Amount in Rs. crore)

Item	2003		2004	
	Amount	Share to total (per cent)	Amount	Share to total (per cent)
1	2	3	4	5
Liabilities				
Paid-up capital	1,693	6.4	1,100	5.2
Free Reserve (adj. for loss)	1,325	5.0	1,324	6.3
Public Deposits (i+ii)	3,686	14.0	3,233	15.3
(i) Public Deposits less than 1-year maturity	1,542	5.9	1,452	6.9
(ii) Public Deposits more than 1-year maturity	2,144	8.1	1,781	8.4
Convertible debentures	3,755	14.2	3,140	14.9
Other Borrowings (i+ii+iii)	8,675	32.9	7,601	36.1
(i) From Banks	6,785	25.7	6,130	29.1
(ii) Inter-Corporate Deposits	1,428	5.4	1,449	6.9
(iii) Foreign Government	462	1.8	22	0.1
Other Liabilities	7,222	27.4	4,685	22.2
Total Liabilities	**26,355**	**100.0**	**21,083**	**100.0**
Assets				
Investment (i+ii+iii)	2,696	10.2	1,113	5.3
(i) Government Securities	492	1.9	358	1.7
(ii) Corporate sector-shares, bonds, debentures	2,025	7.7	626	3.0
(iii) Others	179	0.7	130	0.6
Loans and Advances	8,576	32.5	8,588	40.7
Other Financial Assets (i+ii+iii)	10,255	38.9	8,619	40.9
(i) Hire Purchase	8,571	32.5	7,648	36.3
(ii) Equipment Leasing	1,546	5.9	916	4.3
(iii) Bills Discounting	139	0.5	55	0.3
Other Assets	4,828	18.3	2,763	13.1
Total Assets	**26,355**	**100.0**	**21,083**	**100.0**

Note: The sharp decline in the component of Other Borrowings from Foreign Government in the Liabilities and in the component of Corporate sector - shares, bonds, debentures in the Investment is due to conversion of some major NBFCs into non-deposit taking activities as well as portfolio shift in case of some other NBFCs.

structure of assets and liabilities of major NBFCs reveals a marginal increase in share of public deposits during 2003-04 accompanied by larger recourse to bank loans, partly driven by the softening of the lending rates. In terms of deployment of funds, only loans and advances recorded a marginal increase in contrast to decline in the other areas of business.

13. Income Expenditure Statement of NBFCs

6.50 The profitability analysis of the NBFCs indicates that both income and expenditure of these companies registered decline during 2002-03 (Table VI.14). Income witnessed a decline of 5.1 per cent, largely due to a drop in fund-based income. Total expenditure of NBFCs declined by Rs.830 crore (15.6 per cent) mainly due to a sharp contraction in financial expenditure by Rs.540 crore. The decline in financial expenditure, in turn, was on account of a significant decline in interest expenses. While the other components of expenditure also declined, the decline in ‘other expenditure’ was larger than the decline in ‘operating expenditure’. This resulted in a turnaround with the NBFCs recording net profit of Rs.339 crore in 2002-03 as against a net loss of Rs.212 crore in 2001-02 (Chart VI.5).

Table VI.14: Financial Performance of NBFCs (Excluding RNBCs)

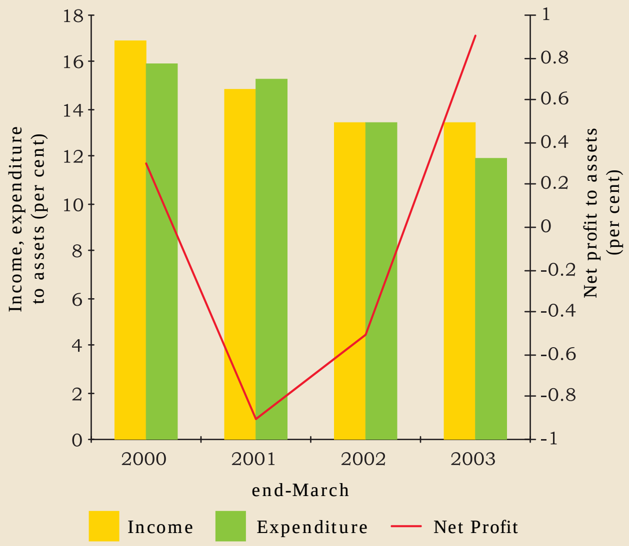
(Amount in Rs. crore)

Item	2001-02	2002-03	Percentage Variation Col (3) over Col (2)
1	2	3	4
A. Income (i+ii)	**5,357**	**5,084**	-5.1
(i) Fund based	5,005	4,709	-5.9
(ii) Fee based	352	375	6.5
B. Expenditure (i+ii+iii)	**5,321**	**4,491**	-15.6
(i) Financial	3,297	2,757	-16.4
(ii) Operating	1,225	1,100	-10.2
(iii) Other	799	634	-20.7
C. Tax Provisions	**248**	**254**	2.4
D. Net Profit	**-212**	**339**	
E. Total Assets	**39,833**	**37,709**	**5.3**
F. Financial Ratios			
(as per cent of total assets)			
(i) Income	13.4	13.5	
(ii) Fund Income	12.6	12.5	
(iii) Fee Income	0.9	1.0	
(iv) Expenditure	13.4	11.9	
(v) Financial Expenditure	8.3	7.3	
(vi) Operating Expenditure	3.1	2.9	
(vii) Other Expenditure	2.0	1.7	
(viii)Tax Provisions	0.6	0.7	
(ix) Net Profit	-0.5	0.9	

14. Interest Cost to Total Income

6.51 Interest expended by NBFCs declined from 25.6 per cent of the total income as at end-March 2002 to 19.2 per cent of the total income as at end-March 2003 reflecting the soft interest conditions prevailing in the economy. The non-interest expenses incurred also decreased from 73.7 per cent of the total income to 69.2 per cent of the total income for the period under review (Table VI.15 and Chart VI.6). This reflected a decline in the operating expenses including wages and establishment cost.

Chart VI.5: Performance of NBFCs (excluding RNBCs)



15. Net Owned Funds (NOFs) of NBFCs

6.52 The NOFs of reporting NBFCs (Table VI.16) indicate that the number of companies in most of the NOFs ranges has decreased. However, the ratio of public deposits to the NOFs maintained by these companies has remained stable in 2002 and 2003 with the exception of companies in the range of NOFs between Rs.0.25 crore to Rs.2.0 crore, Rs.2.0 crore to Rs.10 crore and Rs.50 crore to Rs.100 crore.

16. Capital Adequacy Ratio

6.53 The capital adequacy norms were made applicable to NBFCs in 1998. The norms relating to Capital to Risk-weighted Assets Ratio (CRAR) stipulate that every NBFC shall maintain a minimum capital ratio consisting of Tier I and Tier II capital that shall not be less than (a) 10 per cent on or before March 31, 1998; and (b) 12 per cent on or before March 31, 1999, of its aggregate risk-weighted

Table VI.15: Interest cost to Total Income

(Amount in Rs. crore)

	Total Income	Total Cost	Per cent total cost to Total Income	Interest Cost	Per cent to Total Income	Non-Interest Cost to total Income	Per cent to Total Income
1	2	3	4	5	6	7	8
2001-02	5,357	5,321	99.3	1,371	25.6	3,950	73.7
2002-03	5,084	4,491	88.3	974	19.2	3,517	69.2

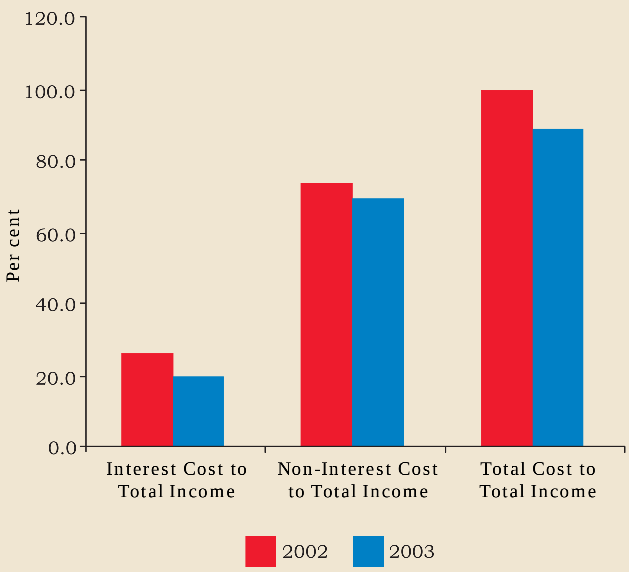
Table VI.16: Net Owned Funds *vis-à-vis* Public Deposits of NBFCs (Excluding RNBCs)

(As at end-March)

(Amount in Rs. crore)

Range of Net owned funds	2002				2003			
	No. of Reporting Companies	Net Owned Fund	Public Deposits	Public Deposits as multiple of NOFs	No. of Reporting Companies	Net Owned Fund	Public Deposits	Public Deposits as Multiple of NOFs
1	2	3	4	5	6	7	8	9
Upto 0.25	214	-1,351	1,120	-	208	-1,356	843	-
0.25 - 2	515	314	267	0.9	497	309	369	1.2
2 - 10	113	470	302	0.6	110	461	467	1.0
10 - 50	38	798	718	0.9	30	677	447	0.7
50 -100	11	798	846	1.1	10	639	255	0.4
100-500	14	3,243	2,680	0.8	15	3,411	2,654	0.8
Total	**905**	**4,272**	**5,933**	**1.4**	**870**	**4,141**	**5,035**	**1.2**

Chart VI.6: Ratio of Interest Expended to Total Income



assets and of risk-adjusted value of off-balance sheet items. The total of Tier II capital, at any point of time, shall not exceed 100 per cent of Tier I capital. Capital adequacy improved marginally with 93.7 per cent (out of 605) NBFCs (excluding nidhis, potential nidhis and MNBCs) achieving more than 12 per cent capital adequacy ratio as on March 2003, in contrast to 93.5 per cent (out of 663) NBFCs achieving the same level as on March 2002 (Table VI.17).

17. Non-Performing Assets of NBFCs

6.54 The gross and net non-performing assets of the reporting NBFCs has experienced a steady decline in recent years (Table VI.18). Lower provisioning for the half-year ended at September 2003 led to a marginal increase in net NPAs of the NBFCs.

Table VI.17: CRAR of Reporting NBFCs*

(As at end-March)

CRAR Range (per cent)	2002					2003				
	EL	HP	LC/IC	RNBC	**Total**	EL	HP	LC/IC	RNBC	**Total**
1	2	3	4	5	6	7	8	9	10	11
Less than 12	10	17	15	1	**43**	11	13	13	1	**38**
12-15	1	8	1	-	**10**	-	2	1	1	**4**
15-20	4	32	9	1	**46**	3	27	3	-	**33**
20-30	9	54	11	1	**75**	9	52	13	1	**75**
Above 30	32	334	121	2	**489**	37	321	96	1	**455**
Total	**56**	**445**	**157**	**5**	**663**	**60**	**415**	**126**	**4**	**605**

* Excluding MBFCs, MBCs and MNBs.

Table VI.18: Non-Performing Assets of NBFCs*

(per cent of credit exposure)

Period	Gross NPAs	Net NPAs
1	2	3
March 1999	10.2	7.0
September 1999	7.7	4.4
March 2000	9.9	9.5
September 2000	10.0	6.3
March 2001	11.5	5.6
September 2001	12.0	5.8
March 2002	10.6	3.9
September 2002	9.7	4.3
March 2003	8.8	2.7
September 2003	8.2	2.9

* Excluding MBFCs, MBCs and MNBCs.

18. Profile of RNBCs

6.55 Residuary non-banking companies (RNBCs) are a class of NBFCs which accept deposits from public and are required to invest 80 per cent of their deposits in the prescribed categories stipulated by the Reserve Bank from time to time and the remaining 20 per cent at their discretion. Over a period, their deposits have grown substantially, with just two companies accounting for more than 80 per cent of total public deposits held by all NBFCs. The RNBCs usually raise deposits through various schemes either as fixed tenure deposits or as recurring deposits/daily deposits. The deposits raised by RNBCs are required to be invested in the approved pattern as prescribed by the Reserve Bank (Box VI.1). The aggregate liabilities to the depositors of the RNBCs as at end-March 2003 increased by 16.9 per cent to Rs.15,065 crore from Rs.12,889 crore as at end-March 2002. A broad profile of RNBCs indicates that their total assets increased by 10.3 per cent during 2002-03. The aggregate NOFs of the RNBCs significantly increased from Rs.111 crore to Rs.809 crore during 2002-03 due to internal accruals and infusion of capital. Such large increase in NOFs consequently led to a decrease of the ratio of aggregate deposits to NOFs. The net profit of these companies decreased by 37.0 per cent mainly on account of increase in financial cost during 2002-03 by 11.1 per cent, in the absence of any discernible improvements in their income (Table VI.19).

Investment Pattern of RNBCs

6.56 The investment pattern maintained by RNBCs points to a compositional shift with a

Box VI.1: Maintenance of Directed Investments by RNBCs

In order to rationalise the pattern of the directed investments and address the systemic risk, and with a view to protecting depositors' interest, the level of investments of RNBCs in Government securities was increased, and rating and listing requirements in respect of other approved investments were introduced in June 2004.

The Reserve Bank has recently reviewed the current regulations on investments by RNBCs and modified them to reduce the overall systemic risk and impart greater liquidity and safety to the investments of RNBCs and thus enhance protection available to the depositors.

The salient features of the modified directions are given below:

- RNBCs may invest only in (i) the FDs and CDs of SCBs; and (ii) CDs of specified FIs provided such CDs are rated not less than AA+ or its equivalent by an approved credit rating agency, with exposure to one SCB/specified FIs not exceeding one per cent of the Aggregate Liabilities to the Depositor (ALD) of the bank as on March 31 of the previous account year.
- RNBCs should invest in Central and State Government securities issued by the Governments in the course of their market borrowing programme an amount which shall not be less than 15 per cent of the outstanding ALD.
- Investment in debt securities should be confined to those having minimum AA+ or equivalent grade rating and listed on one of the stock exchanges.
- The investment in units of mutual funds should be in those fund schemes only which are debt oriented, subject to the aggregate investment in the mutual funds not exceeding 10 per cent and in a single mutual fund not exceeding two per cent of ALD.
- From April 1, 2005 RNBCs will be permitted to make investments as per their discretion upto 10 per cent of the ALD as at the second preceding quarter or one time their NOFs, whichever is lower and from April 1, 2006 this limit would stand abolished.

However, RNBCs represented that the restriction on discretionary investments would affect their viability and also requested for some modifications in other prudential stipulations. With a view to smoothening the process of transition of RNBCs to compliance with the Reserve Bank's directions, the following approach has now been proposed:

Investments of RNBCs in certificates of deposit of financial institutions which have a minimum rating of AA+ at the time of investment will be reckoned as eligible securities as long as they have minimum investment grade rating.

Current account balances of RNBCs with commercial banks would be considered as eligible investments.

The investments of RNBCs in bonds and debentures of companies which meet stipulated listing and rating requirements at the time of investment will be considered as ineligible investments if they migrate to below the investment grade rating.

Table VI.19: Profile of RNBCs
(As at end-March)

(Amount in Rs. crore)

Item	2002	2003	
	Amount	Amount	Variation of Col. (3) over Col. (2) (per cent)
1	2	3	4
A. No. of RNBCs	5	5	–
B. Net Owned Funds	111	809	628.8
C. Aggregate Liability to Depositors (ALD)	12,889	15,065	16.9
D. Assets (i to v)	18,458	20,362	10.3
(i) Unencumbered approved securities	4,080	6,129	50.2
(ii) Fixed deposits with banks	1,830	1,470	-19.7
(iii) Bonds or debentures or commercial papers of a Govt. company/ public sector bank/public financial institution/ corporation	6,265	6,553	4.6
(iv) Other investments	529	912	72.4
(v) Other Assets	6,169	6,040	-2.1
E. Income*	1,785	1,801	0.9
F. Total Expenses (i+ii+iii)	1,376	1,435	4.3
(i) Financial Cost	1,091	1,212	11.1
(ii) Operating Cost	93	105	12.9
(iii) Other cost	193	118	-38.9
G. Tax	41	134	226.8
H. Net profit	368	232	-37.0

* Comprises of only fund based income.

marked increase in investments in unencumbered approved securities while the investments in banks' fixed deposits and subscription to bonds and debentures declined. There was thus, an improvement in the risk profile of the investment portfolio of the RNBCs (Table VI.20).

19. Primary Dealers

6.57 During 2003-04, PDs continued to be significant players in the Government securities market. All the PDs recorded a profit during 2003-04 and the overall profit of the PDs increased by 7.8 per cent over 2002-03 (Appendix Table VI.1). The share of Government securities in total assets of PD system continued to be around 80 per cent.

Table VI.20: Investment Pattern of RNBCs
(As at end-March)

(Amount in Rs. crore)

Item	2002	2003
1	2	3
Aggregate Liabilities to the Depositors (ALD)	12,889 (100.0)	15,065 (100.0)
Unencumbered approved securities	4,080 (31.6)	6,129 (40.7)
Fixed Deposits with banks	1,830 (14.2)	1,470 (9.8)
Bonds or debentures or commercial papers of a Govt. company/public sector bank/ public financial institution/corporation	6,265 (48.6)	6,553 (43.5)
Other investments	714 (5.6)	913 (6.0)

Note : Figures in bracket are percentage to ALD.

6.58 The overall financial strength of PDs (Table VI.21) has improved as is evident from the increase in NOFs from Rs.5,055 crore as at end-March 2003 to Rs.6,015 crore as at end-March 2004, due to the capitalisation of profits and induction of fresh capital. Despite higher net profits during the year, the return on net worth was lower on account of a substantial increase in the net worth of the PD system. PDs performance, in terms of return on assets, was lower when compared with the performance in 2002-03 mainly due to lower earnings of interest income and trading profit.

6.59 PDs continued to maintain capital to risk weighted assets ratios far in excess of the minimum capital requirement of 15 per cent of aggregate risk weighted assets, including credit risk and market risk (Appendix Table VI.2). The CRAR as at end-March 2004, increased from 29.7 per cent to 42.7 per cent on account of reduction in the holding period under Value at Risk measure from 30 to 15 days, of largely static assets and higher capital funds.

Table VI.21: Select Indicators of the Primary Dealers
(As at end-March)

(Amount in Rs. crore)

Item	2002	2003	2004
1	2	3	4
Number of PDs	18	18	17
Total Capital Funds	4,371	5,055	6,015
CRAR (per cent)	38.4	29.7	42.7
Total Assets (net of current liabilities and provisions)	15,305	17,378	17,135
Of which: Government Securities	12,217	14,573	14,094
Government Securities as percentage of total Assets	80	84	82
Return on Average Assets	8.4	6.6	5.9
Return on Average Net Worth	38.7	24.2	20.4
Liquidity Support Limit	4,000 (normal)	3,000 (normal)	2,250 (normal)
	2,000 (back-stop)	1,500 (back-stop)	2,250 (back-stop)

Note: Figures for 2004 does not include SBI Gilts Ltd.

6.60 For 2003-04, the liquidity support limits for PDs was fixed at Rs.4,500 crore, the same as in 2002-03. As stated in the Monetary and Credit Policy 2003-04, the ratio of the normal and back-stop facilities for PDs was changed to 1:1 from 2:1 in 2002-03. With effect from March 29, 2004, the normal and back-stop liquidity support facilities were merged into a single facility to be made available at a single rate, *viz.*, the reverse repo rate[5]. The liquidity support for 2004-05 has been fixed at Rs.3,000 crore.

6.61 For 2003-04, bidding commitment in Treasury Bill auctions for all PDs taken together was fixed at 121.8 per cent of the issue amount indicated to be raised. The total bids received from them at Rs.99,279 crore accounted for 157.8 per cent of the total treasury bills issues of Rs.62,921 crore thereby outstripping the bidding commitment. For dated securities auctions, the bidding commitments for all PDs taken together, were originally fixed at Rs.1,31,000 crore. Subsequently, the bidding commitments were reduced to Rs.98,200 crore due to reduction in the market-borrowing programme of the Government. The actual bids tendered by them (Rs.1,10,953 crore) were at 110.9 per cent of the amounts notified. The success ratio at auctions, as against the prescribed 40 per cent was at 66.6 per cent for treasury bills and 45.1 per cent for dated securities as against 62.6 per cent and 45.3 per cent, respectively, in 2002-03. PDs offered Rs.1,00,000 crore for underwriting the primary issues during the year, out of which bids for Rs.49,150 crore were accepted by the Reserve Bank. The share of total primary purchases of treasury bills by the PDs was higher in 2003-04 at 67 per cent as against 65 per cent during 2002-03. For dated securities, the same was, however, lower during 2003-04 at 50.1 per cent as against 63.0 per cent in 2002-03, reflecting a more aggressive interest in the primary market for dated securities by other investors.

20. Other Developments

Developments Pertaining to Working Group on Development Financial Institutions

6.62 In order to address the regulatory and supervisory issues relating to the existing term lending and refinancing institutions and for improving the flow of resources to them, the Reserve Bank in mid term Review of monetary and credit policy 2003-04 set up a Working Group, for examining, within the broader framework of NBFCs, various regulatory and supervisory aspects including access to short term resources for the DFIs as a separate category. With regard to NBFCs, the Working Group had the specific mandate to advise whether NBFCs with large sized liabilities should automatically be brought under the separate category of NBFCs as applicable to DFIs; and to review the status of RNBCs and identify where they have characteristics of DFIs and suggest mechanisms by which the companies under this category could move into one of the definable categories of NBFCs including that of the DFIs (Box VI.2).

Road Map for RNBCs

6.63 The mid-term Review of annual policy Statement for the year 2004-05 has drawn a roadmap for the RNBCs with an intention to focus on improvements in the functioning of RNBCs. The measures envisaged are expected to ensure that the depositors are served appropriately and systemic risks are avoided. The measures include: (i) transparency of operations, especially in the connected lending relationships; (ii) corporate governance standards including professionalisation of the Boards and ensuring 'fit and proper' criteria in consonance with the

[5] Also refer to Footnote 1 of Chapter II of the Report.

Box VI.2: The Working Group on Development Financial Institutions – Recommendations relating to NBFCs[6]

The Working Group on Development Financial Institutions (Chairman: Shri N. Sadasivan) looked in to the aspects of regulations with respect to RNBCs and NBFCs and submitted its Report on May 10, 2004. Specifically, the group was to look into i) whether NBFCs with large sized liabilities should automatically be brought under the separate category of NBFCs, as applicable to DFIs; ii) to review the status of Residuary Non-Banking Companies (RNBCs) and identify areas of similarities with DFIs and accordingly, suggest mechanisms, by which the companies under this category could move into one of the definable categories of NBFCs.

The Working Group observed that while non-public deposit taking NBFCs are slated to be excluded from the purview of the Reserve Bank regulations, there is a need to focus on all large sized NBFCs from the angle of their systemic significance. The Group recommended that for this purpose the Reserve Bank should put in place as an initial measure, a system of periodical collection of all information relevant to the systemic concerns pertaining to large sized non-public deposit taking companies. The information system may include, besides submission of annual financials, quarterly reporting of specific details of the company's assets and liabilities which focus on their linkages to the market, inter-corporate/inter-company and capital market exposures and all other sensitive information. This system may also be specified for public deposit taking companies to the extent required. Taking cognisance of the recommendations made by the Working Group, the Reserve Bank has introduced a quarterly reporting arrangement for NBFCs not accepting/ holding public deposits and having assets size of Rs.500 crore and above as on March 31, 2004.

With respect to RNBCs, the Working Group held that while the regulation of RNBCs by the Reserve Bank needs to be viewed in the historical perspective of evolution of such companies and the concerns of the Reserve Bank to protect the interest of depositors, there was a need for revisiting the existing regulatory structure in the current context. With regard to conversion of RNBCs to the category of DFIs, the Working Group was of the view that there is no commonality of characteristics between the RNBCs and DFIs, and that the transformation of RNBCs into the DFI mould would be neither feasible nor desirable. As regards the prospect of RNBCs transforming into other categories of NBFCs, namely, equipment leasing (EL), hire purchase (HP), loan and investment company, the Working Group found that it may be possible for RNBCs to convert their asset profile to these categories. Any such conversion would involve the companies submitting themselves to the regulations relating to the liabilities, especially NOFs related restrictions on quantum of public deposits. However, the working group noted that in case the RNBCs move on to any NBFC category, immediate compliance by them with the applicable regulations on public deposits would not be possible and regulatory relaxations would be required.

The Working Group was of the view that continuation of RNBCs in their current mould is not desirable because the scope that exists now for unrestricted growth of deposits in RNBCs, poses serious concerns relating to the depositors' interest. A cap in terms of NOFs may be fixed for mobilisation of public deposits by RNBCs. The cap would be in terms of public deposits, as opposed to all deposits, which are covered by the extant regulations. The cap on RNBCs' access to public deposits may be stipulated, as an initial measure, at a level of 16 times the NOFs, along with a direction that the RNBCs will ultimately have to conform to the norms for raising of public deposits as applicable for NBFCs in general *i.e.*, a ceiling of 4 times or 1.5 times of NOFs, as applicable. The Group is of the view that the time for such transition should preferably be not more than 5 years, although extension of time may be warranted by, among other reasons, the future cash flows arising out of the deposit contracts already entered into by the respective RNBCs and the nature of the fixed costs built into their operations. The progressive reduction of the cap on deposits in terms of NOFs may be accompanied by a commensurate progressive increase in the discretion to be allowed to the RNBCs for deployment of funds so that on completion of transition period, the RNBCs would comply with the norms for raising public deposits, while enjoying the freedom to use the deposits and other funds in the manner applicable to other NBFCs.

As regards the recommendations on the asset side of the portfolio of RNBCs, the Working Group was of the view that unlisted and unrated bonds issued by any company/ institution, including PFIs, should not be part of the investments. Further, investments in unlisted but rated bonds and debentures should be only to an extent of five per cent of their total investments in debt securities. Suitable caps would be fixed by the Reserve Bank for exposures to capital market, real estate, unlisted but rated securities and units of equity oriented mutual funds.

Keeping in view the conscious policy of moving away from an administered interest rate regime, the Working Group suggested the removal of the floor rate on interest to be offered by the RNBCs. As the rate of return on assets of RNBCs are expected to increase substantially, the Working Group suggested that the benefits of higher yields should be passed on to the depositors in the form of lower interest to compensate for the service charges levied at the time of maturity. The Working Group was of the view that the commission structure and the agency agreements for the collection of instalments should be uniform. There should also be clauses built in the agency agreements to prevent the practice of discontinuity of the deposits.

standards in banks; (iii) avoiding untenable rates of commission to agents; (iv) adherence to 'know your customer' rules through systems consistent with their business but subject to regulator's close oversight; and (v) customer service in terms of clear indication of the identifiable contact with the field agents so that matters such as unclaimed deposits are appropriately addressed. Detailed guidelines in regard to action to be taken by RNBCs on the above would be issued subsequently.

[6] Also refer to Box V.1 of the Report.