6. NON-BANKING FINANCIAL COMPANIES

The activities of non-banking financial companies (NBFCs) in India have undergone qualitative changes over the years through functional specialisation. The role of NBFCs as effective financial intermediaries has been well recognised as they have inherent ability to take quicker decisions, assume greater risks, and customise their services and charges more according to the needs of the clients. While these features, as compared to the banks, have contributed to the proliferation of NBFCs, their flexible structures allow them to unbundle services provided by banks and market the components on a competitive basis. The distinction between banks and non-banks has been gradually getting blurred since both the segments of the financial system engage themselves in many similar types of activities. At present, NBFCs in India have become prominent in a wide range of activities like hire-purchase finance, equipment lease finance, loans, investments, etc. By employing innovative marketing strategies and devising tailor-made products, NBFCs have also been able to build up a clientele base among the depositors, mop up public savings and command large resources as reflected in the growth of their deposits from public, shareholders, directors and other companies, and borrowings by issue of non-convertible debentures, etc. Consequently, the share of non-bank deposits in household sector savings in financial assets, increased from 3.1 per cent in 1980-81 to 10.6 per cent in 1995-96. In 1998, the definition of public deposits was for the first time contemplated as distinct from regulated deposits and as such, the figures thereafter are not comparable with those before. The importance of NBFCs in delivering credit to the unorganised sector and to small borrowers at the local level in response to local requirements is well recognised. The rising importance of this segment calls for increased regulatory attention and focused supervisory scrutiny in the interests of financial stability and depositor protection (Box 6.1).

In response lo the perceived need for better regulation of the NBFC sector, the Reserve Bank of India (RBI) Act, 1934 was amended in 1997, providing for a comprehensive regulatory framework for NBFCs. The RBI (Amendment) Act, 1997 conferred powers on the RBI to issue directions to companies and its auditors, prohibit deposit acceptance and alienation of assets by companies and initiate action for winding up of companies. The Amendment Act provides for compulsory registration with the RBI of all NBFCs, irrespective of their holding of public deposits, for commencing and carrying on business of a non-banking financial institution; minimum entry point norms; maintenance of a portion of deposits in liquid assets; and creation of reserve fund and transfer of 20 per cent of profit after tax but before dividend annually to the fund. Accordingly, to monitor the financial health and prudential functioning of NBFCs, the RBI issued directions to companies on: acceptance of public deposits; prudential norms like capital adequacy, income recognition, asset classification, provisioning for bad and doubtful assets, exposure norms and other measures. Directions were also issued to the statutory auditors to report non-compliance with the RBI Act and regulations to the RBI, and Board of Directors and shareholders of the NBFCs.

Box 6.1: An Overview of Regulation of NBFCs

(1) Mission	(3) Basic Structure of Regulatory and Supervisory Framework
To ensure that • the financial companies function on healthy lines, • these companies function in consonance	Prescription of prudential norms akin to those applicable to banks, Submission of periodical returns for the purpose of off-site surveillance,

Box 6.1: An Overview of Regulation of NBFCs *(Concld.)*	
with the monetary policy framework, so that their functioning does not lead to systemic aberrations, • the quality of surveillance and supervision exercised by the RBI over the NBFCs keeps pace with the developments in this sector. • comprehensive regulation and supervision of Asset liability and risk management system for NBFCs,	Supervisory framework comprising (a) on-site inspection (CAMELS pattern) (b) off-site monitoring through returns (c) market intelligence, and (d) exception reports by statutory auditors, Punitive action like cancellation of Certificate of Registration (CoR), prohibition from acceptance of deposits and alienation of assets, filing criminal complaints and winding up petitions in extreme cases, appointment of the RBI observers in certain cases, etc. Co-ordination with State Governments to curb unauthorised and fraudulent activities, training programmes for personnel of NBFCs, State Governments and Police officials.
(2) Amendments to the Reserve Bank of India (RBI) Act, 1934	(4) Other steps for protection of depositors' interest
RBI Act was amended in January 1997 providing for, *inter alia.* • Entry norms for NBFCs and prohibition of deposit acceptance (save to the extent permitted under the Act) by unincorporated bodies engaged in financial business, • Compulsory registration, maintenance of liquid assets and creation of reserve fund, • Power of the RBI to issue directions to an NBFC or to the NBFCs in general or to a class of NBFCs. • Comprehensive regulation and Supervision of deposit taking NBFCs and limited supervision over those not accepting public deposits.	Publicity for depositors' education and awareness, workshops / seminars for trade and industry organisations, depositors' associations, chartered accountants, etc.

6.1. Non-Banking Financial Entities Regulated by the RBI

The developments in the NBFC sector in terms of policies and performance during 2001-02 and for the subsequent periods (to the extent information is available) are discussed in the subsequent paragraphs.

Non-banking financial entities partially or wholly regulated by the RBI include: (a) NBFCs comprising equipment leasing (EL), hire purchase finance (HP), loan (LC), investment (1C) (including primary dealers[3] (PDs)) and residuary non-banking (RNBC) companies; (b) mutual benefit financial company (MBFC), *i.e. nidhi* company; (c) mutual benefit company (MBC), *i.e.* potential *nidhi* company; (d) miscellaneous non-banking company (MNBC), *i.e. chit fund* company (Table 6.1).

Table 6.1: Types of Non-Banking Financial Entities (Regulated by RBI)

Non-Banking Financial Entity	Principal Business
1. Non-Banking Financial Company	In terms of the Section 45-l(f) read with Section 45-i(c) of the RBI Act, 1934, as amended in 1997, their principal business is that of receiving deposits or that of a financial institution, such as lending, investment in securities, hire purchase finance or equipment leasing.
(a) Equipment leasing company (EL)	Equipment leasing or financing of such activity.
(b) Hire purchase finance company (HP)	Hire purchase transactions or financing of such transactions.
(c) Investment company (1C)	Acquisition of securities. These include Primary Dealers (PDs) who deal in underwriting and market making for government securities.
(d) Loan company (LC)	Providing finance by making loans or advances, or otherwise for any activity other than its own; excludes EL/HP/Housing Finance Companies (HFCs).
(e) Residuary non-banking company (RNBC)	Company which receives deposits under any scheme or arrangement by whatever name called, in one lump-sum or in instalments by way of contributions or subscriptions or by sale of units or certificates or other instruments, or in any manner. These companies do not belong to any of the categories as stated above.
II. Mutual Benefit Financial Company (MBFC) i.e., Nidhi Company	Any company which is notified by the Central Government as a Nidhi Company under section 620A of the Companies Act, 1956 (1 of 1956)
III. Mutual Benefit Company (MBC), i.e., potential *Nidhi* company	A company which is working on the lines of a Nidhi company but has not yet been so declared by the Central Government, has minimum net owned fund(NOF) of Rs.10 lakh, has applied to the RB1 for CoR and also to Department of Company Affairs (DCA) for being notified as Nidhi company and has not contravened directions/ regulations of RBI/DCA.
IV. Miscellaneous non-banking company (MNBC), Managing, Conducting or supervising as a promoter, foreman ori.e., *Chit Fund Company*	Managing, conducting or supervising as a promoter, foreman or agent of any transaction or arrangement by which the company enters into an agreement with a specified number of subscribers that every one of them shall subscribe a certain sum in instalments over a definite period and that every one of such subscribers shall in turn, as determined by tender or in such manner as may be provided for in the arrangement, be entitled to the prize amount.

6.2. Registration

In terms of the RB1 Act, 1934, registration of NBFCs with the RBI is mandatory, irrespective of whether they hold public deposits or not. The amended Act (1997) provides an entry point norm of Rs. 25 lakh as the minimum net owned fund (NOF), which has been revised upwards to Rs.2 crore for new NBFCs seeking grant of CoR on or after April 21, 1999. Certain types of financial companies, *viz.*, insurance companies, housing finance companies, stock broking companies, *chit fund* companies, companies notified as '*nidhis*' under Section 620A of the Companies Act, 1956 and companies engaged in merchant banking activities (subject to certain conditions), however, have been exempted from the requirement of registration under the RBI Act, as they are regulated by other agencies. Accordingly, as at the end of March 2006, RBI received 38214 applications of which 13873 were approved and 24134 were rejected. The rest of the applications are pending at different stages of processing. Of the total approvals, only 434 companies have been permitted to accept/ hold public deposits. Moreover, all NBFCs holding public deposits, whose applications for Certificate of Registration (CoR) have been rejected or CoRs have been cancelled, have to continue repaying the deposits on due dates and dispose of their financial assets within three years from the date of rejection of application/ cancellation of certificate or convert themselves into non-banking non-financial companies within the same period.

6.3. Supervision

The RBI has instituted a strong and comprehensive supervisory mechanism for NBFCs. The focus of the RBI is on prudential supervision so as to ensure that NBFCs function on sound and healthy lines and avoid excessive risk taking. The RBI has put in place a four pronged supervisory framework based on:

i. On-site inspection;

ii. Off-site monitoring supported by state-of-the art technology;

iii. Market intelligence; and

iv. Exception reports of statutory auditors of NBFCs.

The thrust of supervision is based on the asset size of the NBFC and whether it accepts/ holds deposits from the public. The system of on-site examination put in place during 1997 is structured on the basis of assessment and evaluation of CAMELS (Capital, Assets, Management, Earnings, Liquidity, and Systems and Procedures) approach and the same is akin to the supervisory model adopted by the RBI for the banking system. Market intelligence system is also being strengthened as one of the important tools of supervision. This process of continuous and on-going supervision is expected to facilitate RBI to pick up warning signals, which can result in triggering supervisory action promptly. The returns being submitted by the NBFCs arc reviewed and re-looked at intervals to widen the scope of information so as to address the requirements either for supervisory objectives or for furnishing the same to various interest groups on the important aspect of the working of these companies. The companies not holding public deposits arc supervised in a limited manner with companies with asset size of Rs.100 crore and above being subjected to annual inspection and other non-public deposit companies by rotation once in every 5 years. The exception reports, if any, from the auditors of such companies coupled with adverse market information and the sample check at periodical intervals are the main tools for monitoring the activities of such companies *vis-à-vis* the RBI regulations.

6.4. Policy Developments

The RBI introduced a number of measures to enhance the regulatory and supervisory standards of this sector, to bring them on par with commercial banks over a period of time. The regulatory norms, applicable to NBFCs are presented in Box 6.2. Regulatory measures adopted during the year aim at aligning the interest rates in this sector with the rates prevalent in the rest of the economy, tightening prudential norms, standardising operating procedures and aligning the RBI's regulations with the requirements of the amended Companies Act.

Directions applicable to NBFCs

The RBI has issued comprehensive deposit acceptance and asset side regulations as under for the NBFCs.

While all the prudential norms are applicable to public deposit accepting/holding NBFCs only, some of the regulations are applicable to non-deposit accepting companies.

Box 6.2: Regulatory Norms and Directions for NBFCs A. Important Statutory Provisions of Chapter III B of the RBI Act as applicable to NBFCs

Sr.No.	Subject	Particulars
1.	Certificate of Registration	No company, other than those exempted by the RBI, can commence or ea the business of non-banking financial institution without obtaining a CoR RBI. The pre-requisite for eligibility for such a CoR is that the NBFC f have a minimum NOF of Rs. 25 lakh (since raised to Rs. 2 crore on and April 21, 1999 for any new applicant NBFC). The RBI considers grant CoR after satisfying itself about the company's compliance with the c enumerated in Section 45-1A of the RBI Act
2.	Maintenance of Liquid Assets	NBFCs have to invest in unencumbered approved securities, valued at a not exceeding current market price, an amount which, at the close of business on any day, shall not be less than 5.0 per cent but not exceeding 25.0 per cent specified by RBI, of the deposits outstanding at the close of business on the working day of the second preceding quarter.
3.	Creation of Reserve Fund	Every non-banking financial company shall create a reserve fund and transfer thereto a sum not less than 20.0 per cent of its net profit every year as disi in the profit and loss account and before any dividend is declared. Such fund to be created by every NBFC irrespective of the fact whether it accepts] deposits or not. Further, no appropriation can be made from the fund ft purpose without prior written approval of RBI.
(1) Deposit Acceptance Related Regulations		
1	Ceiling on quantum of public deposits	Loan and investment companies - 1.5 times of NOF if the company has NOF of Rs. 25 lakh, minimum investment grade (MIG) credit rating, complies with all the prudential norms and has CRAR of 15 per cent.Equipment leasing and hire purchase finance companies - if company has NOF of Rs. 25 lakh and complies with all the prudential norms. i. with MIG credit rating and 12 per cent CRAR - 4 times of NOF ii. without MIG credit rating but CRAR 15 per cent or above - 1.5 times of NOF, or Rs. 10 crore, whichever is less.
2	Investment in liquid assets	NBFCs - 15 per cent of outstanding public deposit liabilities as at the close of business on the last working day of the second preceding quarter, of which
		i. not less than 10 per cent in approved securities and ii. not more than 5 per cent in term deposits with scheduled commercial banks. Directions for investments by RNBCs were rationalized in June 2004 with a view to reducing the overall systemic risk in the financial sector and safeguarding the interest of the depositors. In this regard the following roadmap was prescribed: a) From the quarter ended June 2005 and onwards, RNBCs were permitted to invest only to the extent of 10% of the Aggregated Liabilities to Depositors (ALDs) as at the second preceding quarter or one time of their Net Owned Funds, whichever is

		lower, in the manner which in their opinion of the company is safe as per approval of its Board of Directors. b) From the quarter ended June 2006 onwards, this limit would stand abolished and RNBCs would not be permitted to invest any amount out of ALDs as per their discretion. However, to avoid strain, in complying with 100% directed investments by companies, the same had been modified to 95% of ALD up to March 31, 2007 and 100% of ALD thereafter. These liquid asset securities are required to be lodged with one of the scheduled commercial banks or Stock Holding Corporation of India Ltd.. or a depository or its participant (registered with SEB1).Effective October 1, 2002, government securities are to be necessarily held by NBFCs either in Constituent's Subsidiary General Ledger Account with a scheduled commereial bank or in a demat account with a depository participant registered with SEBI.These securities cannot be withdrawn or otherwise dealt with for any purpose other than repayment of public deposits.
3	Period of Deposits	No demand deposits NBFCs – 12 to 60 months RNBCs – 12 to 84 months MNBCs (chit Funds) – 6 to 36 months
4	Ceiling of deposit rate	NBFCs, MNBCs and *Nidhis* - 11.0 per cent per annum (effective March 4,2003) RNBCs - Minimum interest of 4.0 per cent on daily deposits and 6.0 per cent on other than daily deposits.Interest may be paid or compounded at periods not shorter than monthly rests.
5	Advertisement methodology for acceptance of deposits/public deposits	Every company which accepts deposits by advertisement has to comply with the advertisement rules prescribed in this regard, the deposit acceptance form should contain certain prescribed information ,issue receipt for deposits and maintain a deposit register. etc.
6	Submission of returns	All NBFCs holding or accepting public deposits have to submit periodical returns to RBI at Quarterly, half yearly and annual intervals.
(2) Prudential Norms applicable to only those NBFCs which are accepting/holding public deposits		
1	Capital to Risk Assets Ratio (CRAR)	The NBFCs holding/accepting public deposits are required to maintain CRAR as under: i. Equipment leasing companies/hire purchase finance companies (with MIG credit rating) 12 percent ii. Equipment leasing companies/hire purchase finance companies (without MIG credit rating) 15 percent iii. Loan/investment companies 15 percent iv. RNBCs 12 per cent CRAR comprises – tier I and tier II capitalTo be maintained on a daily basis and not merely on the reporting dates.Tier I Capital – core capital or NOF but includes compulsorily convertible preference shares (CCPS) as a special case for CRAR purposes.Tier II Capital – all quasi-capital like preference shares (other than CCPS) subordinated debt, convertible debentures, etc.Tier III

		Capital not to exceed tier I capitalGeneral provisions and loss reserves not to exceed 1.25 per cent of the risk – weighted assets.Subordinated debt issued with original tenor of 60 months or more.
2	Restrictive norms	Acceptance of public deposits not allowed if the prudential norms are not complied with fully. Any NBFC defaulting in repayment of the matured deposits prohibited from creating any further assets until the defaults are rectified Investments in real estate, except for own use, restricted to 10 per cent of the owned fund.Investments in unquoted shares restricted as under:EL/HP Companies 10 percent of owned fund Loan/investment companies 20 per cent of owned fund No further investments in real estate or unquoted shares in case of excess position held till its regularisation. Sufficient adjustment period allowed - further extension on merits of each case.
3	Credit/investment concentration norms	Single borrower exposure limits credit - 15 percent of owned fund Investments - 15 percent of owned fund Single group of borrower exposure limits credit - 25 percent of owned fund Composite (credit and investments) exposure limits Single borrower 25 percent of owned fund Single group of borrowers 40 percent of owned fund
		• Exposure norms also applicable to own group companies and subsidiaries. • Includes all forms of credit and credit related and certain other receivables as also off balance sheet exposures. • Debentures/bonds to be treated as credit for the purpose of prudential norms but as investments for the purpose of balance sheet and compliance with investment obligations.
4	Reporting System: Half yearly return	Half-yearly returns to be submitted as at the end of March and September every year, • Time allowed for submission - 3 months from the due date, • The return to be certified by the statutory auditors of the company. However, it need not wait for audit and the figures furnished therein could be the unaudited figures but must be certified by auditors
(3) Prudential Norms applicable to all NBFCs irrespective of whether they accept/hold public deposits or not		
1	Income Recognition Norms	The recognition of income on the NPA is allowed on cash basis only.The unrealised income recognised earlier is required to be reversed.

2	NPA norms	Recognition of income on accrual basis before the asset becomes NPA as under:Loans and Advances: Upto 6 months and 30 days past due period (past due period done away with effect from March 31, 2003) Lease and Hire Purchase Finance: 12 months
3	Restrictive Norms	Loans against own shares not allowed
4	Policy on demand/call loans	Companies to frame a policy for demand and call loans relating to cut-off date for recalling the loans, the rate of interest, periodicity of such interest, periodical reviews of such performance, etc.
5	Accounting Standards	All the Accounting Standards and Guidance Notes issued by Institute of Chartered Accountants of India (ICAl) are applicable to all NBFCs in so far as They are not inconsistent with the guidelines of RBI.
6	Accounting for investments	All NBFCs to have a well defined investment policy. Investments classified into two categories - (1) long term and (ii) current investments. Long term investments to be valued as per Accounting Standard, issued by ICAI. Current investments to be classified into - (a) quoted and (b) unquoted. Current quoted investments to be valued at lower of cost or market value. Block valuation permitted - Notional gains or losses within the block permitted to be netted - but not inter-block, net notional gains to be ignored but notional losses to be provided for. Valuation norms for current unquoted investments are as under: i. Equity shares (at lower of cost or break up value or fair value) ii. Re I/- for the entire block of holding if the balance sheet of the investee company is not available for the last two years iii. Preference shares at lower of cost or face value iv. Government securities at carrying cost v. Mutual Fund units at net asset value (NAV) for each scheme and vi. Commercial paper (CP) at its carrying cost
7	Asset Classification	All forms of credit (including receivables) to be classified into four categories - ● Standard asset ● Sub-standard asset ● Doubtful asset ● Loss asset
8	Provisioning for Non-Performing Assets – Loans and Advances	Standard assets - No provisionSub-standard assets- 10 per cent of outstanding balance Doubtful assets - on unsecured portion 100 per cent and on secured portion 20, 30 and 50 per cent depending on the age of the doubtful assets Loss asset - 100 per cent of the outstanding

9	Provisioning for Non-Performing Assets – Equipment Lease and Hire Purchase accounts	● Unsecured portion to be fully provided for ● Further provisions on net book value (NBV) of EL/HP assets ● Accelerated additional provisions against NPAsNPA for 12 months or more but less than 24 months 10 per cent of NBVNPA for 24 months or more but less than 36 months 40 per cent of NBVNPA for 36 months or more but less than 48 months 70 per cent of NBVNPA for 48 months or more 100 per cent of NBVValue of any other security considered only against additional provisions.Rescheduling in any manner will not upgrade the asset upto 12 months of satisfactory performance under the new terms.Repossessed assets to be treated in the same category of NPA or own assets - option lies with the company.
10	Risk – Weights and Credit Conversion factors	● Risk - weights to be applied to all assets except intangible assets. ● Risk - weights to be applied after netting off the provisions held against relative assets. ● Risk - weights are 0, 20 and 100. ● Assets deducted from owned fund like exposure to subsidiaries or companies in the same group or intangibles to be assigned 0 per cent risk - weight. ● Exposures to all-India financial institutions (AIFIs) at 20 per cent risk -weight and all other assets to attract 100 per cent risk - weights. ● Off-balance sheet items to be factored at 50 or 100 and then converted for risk - weight.
11	Disclosure requirements	1. Every NBFC is required to separately disclose in its balance sheet the provisions made as outlined above without netting them from the income or against the value of assets. 2. The provisions shall be distinctly indicated under separate heads of accounts as under: i. provisions for bad and doubtful assets; and ii. provisions for depreciation in investments. 3. Such provisions shall not be appropriated from the general provisions and loss reserves held, if any, by the NBFC. 4. Such provisions for each year shall be debited to the profit and loss account. The excess of provisions, if any, held under the heads general provisions and loss reserves may be written back without making adjustment against them. 5. *Nidhis* and *Chit Fund* companies exempted.

6.5 Interest Rates

Keeping in view interest rates prevalent in the financial sector, the ceiling on interest rates on deposits payable by NBFCs, including *chit fund* companies and *nidhi* companies, was reduced from 16 per cent per annum to 14 per cent per annum effective April 1, 2001 and further to 12.5 per cent per annum effective November 1, 2001 and further to 11% effective from March 2003.

6.6. Classification of NBFCs as Equipment Leasing and Hire Purchase Finance Companies

In response to representations from NBFCs, it was decided to include loans and advances against hypothecation of automobiles, aircrafts and ships registered with the specified authorities in the aggregate of equipment leasing and hire purchase assets for the purpose of classification of an NBFC into equipment leasing and hire purchase finance company.

6.7. Alignment of the RBI's Regulations with Companies (Amendment) Act, 2000

Changes were effected in the RBI directions to NBFCs to align with those contained in the Companies Act, 1956, as amended by the Companies (Amendment) Act, 2000. Accordingly, all NBFCs were advised to report to the Company Law Board the defaults, if any, in repayment of matured deposits or payment of interest to small depositors within 60 days of such default. In addition to NBFCs with asset size of Rs.50 crore and more, those with paid up capital of not less than Rs.5 crore have to constitute Audit Committees. Such committees would have the same powers, functions and duties as laid down in Companies Act, 1956. Moreover, some NBFCs, which were hitherto private limited companies holding public deposits, have now become public limited companies under the Companies Act. Such NBFCs have to approach the RBI after obtaining a fresh certificate of incorporation from the Registrar of Companies, for change of name in the CoR to reflect their status as public limited companies.

6.8. Liquid Asset Securities of NBFCs

Effective from October 1, 2002, all NBFCs should necessarily hold their investments in government securities either in Constituent's Subsidiary General Ledger Account (CSGL) with a scheduled commercial bank or Stock Holding Corporation of India Ltd. (SHCIL) or in a dematerialised account with depositories [National Securities Depository Ltd. (NSDL)/ Central Depository Services (India) Ltd. (CDSL)] through a depository participant registered with SEBI. The facility of holding government securities in physical form, therefore, stands withdrawn. Government guaranteed bonds, which have not been dematerialised may be kept in physical form till such time these are dematerialised. Only one CSGL or a dematerialised account can be opened by any NBFC. In case the CSGL account is opened with a scheduled commercial bank, the account holder has to open a designated funds account (for all CSGL related transactions) with the same bank. In case the CSGL account is opened with any of the non-banking institutions indicated above, the particulars of the designated funds account (with a bank) should be intimated to that institution. The NBFCs maintaining the CSGL/designated funds accounts will be required to ensure availability of clear funds in the designated funds accounts for purchases and of sufficient securities in the CSGL account for sales before putting through the transaction. No further transactions in government securities should be undertaken by NBFCs with any broker in physical form with immediate effect. All further transactions of purchase and sale of government securities have to be compulsorily through CSGL/demat account. Government securities held in physical form were to be dematerialised by October 31, 2002.

6.9. Accounting Standards

In terms of Accounting Standard (AS) 19 (Accounting for Leases) issued by the Institute of Chartered Accountants of India (ICAI), it was clarified that (i) the prudential norms applicable to hire purchase assets would, *mutatis mutandis*, be applicable to the financial leases written on or after April 1, 2001 and (ii) the leases written up to March 31, 2001 would continue to be governed by the prudential norms relating to leased assets, as hitherto.

6.10. Statutory Auditors

NBFCs have to reiterate in their letter of appointment to statutory auditors their statutory responsibility to report directly to the RBI the violations, if any, of the provisions of the RBI Act or Directions issued thereunder, noticed by them in the course of their audit.

6.11. Prudential Regulation

Some NBFCs were granting demand/call loans with an open period or without any stipulation regarding the rate of interest and servicing, resulting in problems of compliance with prudential norms relating to income recognition, asset classification and provisioning in respect of such loans. Accordingly, guidelines were issued to obviate such difficulties and to ensure that all such loans are appropriately classified and the position of NPAs are truly reflected in the financial statements of NBFCs. The concept of 'past due' would be done away with in respect of the definition of NPA for NBFCs effective from March 31, 2003, which would be reflected in the half-yearly return on prudential norms and the balance sheet as on March 31, 2003. In terms of NBFCs Directions on Prudential Norms, the NBFCs accepting/holding public deposits have to ensure maintenance of minimum prescribed capital to risk-weighted assets ratio (CRAR) at all times. The format for the report of the auditors has accordingly been amended. In order to obviate the probability of applying divergent yardsticks for identification of potential threat of non-recoverability of loans, RBI has prescribed objective criteria for classification of assets as loss assets.

6.12. Submission of Returns by NBFCs

Several NBFCs have been lax in timely submission of the returns to the RBI. Action has been contemplated against such NBFCs - initially those with public deposits of Rs.50 crore and above - for non-submission of returns. The action may include imposing penalties as provided in the RBI Act, 1934 as also launching court proceedings against the errant companies, besides considering rejection/ cancellation of the CoR. A list of returns submitted by NBFCs is presented in *Annex 6.1*.

6.13. Protection of Depositors' Interest

With a view to protecting the interest of depositors, it was decided to issue press advertisements in cases where winding up petitions filed by the RBI have been admitted in Court and provisional liquidators have been appointed or where criminal complaints have been filed by the RBI and summons have been issued by the Court.

6.14. Asset Liability Management

Based on the guidelines issued in July 2001, effective March 31, 2002 asset liability management system in all NBFCs with public deposits of Rs. 20 crore and above as also NBFCs with asset size of Rs. 100 crore and above has been made operational. Instructions were also issued to the effect that the first return as on September 30, 2002, should be submitted by the NBFCs to the RBI latest by October 31, 2002.