



भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA
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DRAFT FOR PUBLIC COMMENTS

DNBS (PD) CC.No. /03.05.02/2012-13

December 12, 2012

All NBFCs (except primary dealers)

Dear Sir,

'Review of NBFC Regulatory Framework – Recommendations of the Working Group on Issues and Concerns in the NBFC Sector – Entry Point Norms, Principal Business Criteria (PBC), Multiple and Captive NBFCs.

The Reserve Bank set up a Working Group (WG) under the chairmanship of Smt Usha Thorat, former Deputy Governor, RBI, to review the extant regulatory framework of NBFCs. The WG submitted the report on August, 2011 which was placed in public domain by the Reserve Bank for comments. The report along with the feedback was examined by the Reserve Bank and accordingly, it has been decided to amend the existing regulatory framework for NBFCs, wherever applicable.

2. The details of changes made to the existing regulatory framework on entry point norms, principal business definition and certain fresh prescriptions for multiple companies in a group as also captive companies are given in the Annex.

Yours sincerely,
(Uma Subramaniam)
Chief General Manager-in-Charge

Encl: as above.

**Revised Guidelines on Entry Point Norms, Principal Business Criteria
(PBC), Multiple and Captive NBFCs**

1. Approach to Regulation

1.1 In order to focus regulatory resources to where the risks lie, the approach to regulation and supervision has been reviewed and will be informed by the following broad guiding principles :

- i. NBFCs would henceforth be classified under two categories - exempted NBFCs and registered NBFCs.
- ii. All registered NBFCs would be under RBI regulation.
- iii. The Bank reserves the right to bring exempted NBFCs under regulation, should the need arise thereof at a later date.
- iv. All deposit taking companies, irrespective of size, would continue to be registered NBFCs with RBI and as such would fall under the purview of RBI regulations. In other words, no deposit taking company is exempt from registration and thereby RBI regulation.

2. Nomenclature for Various Categories of NBFCs :

2.1 Henceforth, in the interest of clarity and common understanding, the nomenclature used for various entities in NBFC sector would be as under :

- i. Registered NBFCs : Registered NBFCs are those which have been registered and issued a CoR by RBI and are under the purview of RBI regulation.
- ii. Exempted NBFCs : Exempted NBFCs are those which are exempted from registration by RBI.

3. Exempted NBFCs :

3.1 The following categories of NBFCs are exempted from registration with the Reserve Bank

- i. NBFCs with asset size below Rs. 25 crore whether accepting public funds or not.
- ii. NBFCs with asset size below Rs. 500 crore and not accepting public funds, directly or indirectly.

3.2 The provisions of Chapter IIIB of the RBI Act 1934, except Section 45N, will not apply in respect of the above exempted category of NBFCs. These NBFCs will have the option of surrendering the CoR on a voluntary basis.

3.3 The rationale for exemption is that as the above are essentially small non-deposit taking NBFCs and do not contribute to any major systemic risks or major disruptions in the market. Such a measure would not prevent small but potentially dynamic and innovative start-up companies from entering into the financial activity.

4. Position Relating to Existing NBFCs :

4.1 Existing NBFCs-ND with asset size below the threshold of Rs. 25 crore but which intend to continue to be registered are required to notify the Bank within three months from the date of these Directions, with a road map for increasing their asset size to Rs. 25 crore or above within a period not exceeding 2 years. Notwithstanding the fact that any such company has obtained a Certificate of Registration under Section 45IA of the RBI Act 1934, it shall be required to apply for a fresh COR within a period of 6 months from the date of achieving the asset size threshold.

4.2 Further, NBFCs-ND which de-register would need to approach the Bank afresh for CoR if

- a) individually the asset size exceeds Rs. 25 crore or
- b) the asset size exceeds Rs. 500 crore, even if such NBFC does not access public funds.

4.3 In addition, financial entities as defined at para 6.2.ii below will also need to register themselves with the Bank as NBFCs.

5. Entry Point Norms

5.1 In terms of Section 45IA of the RBI Act, 1934, no NBFC shall commence or carry on the business of NBFIs without having Net owned funds (NOF) of Rs. 25 lakh or such other amount not exceeding Rs. 2 crore as may be specified by RBI. With effect from April 1999 all new NBFCs were required to have a minimum NOF of Rs. 2 crore for the purpose of registration with the Bank. Since then, the NBFC sector has undergone a sea change from being small family run businesses, primarily using own funds, to large sized NBFCs, dependent largely on public funds. NBFCs have also entered into several newer areas of financial services.

5.2 New companies having NOF not less than Rs. 2 crore and minimum asset size of Rs. 25 crore, fulfilling the revised PBC as given in paragraph 6 below are required to obtain registration.

5.3 Foreign owned companies will however require the CoR from the Bank before commencing any non-banking financial activity. They will also continue to follow the minimum capitalization norm as under FEMA.

6. Principal Business Criteria (PBC)

6.1 In terms of the Press Release 99/1269 dated April 8, 1999 issued by RBI, a company is treated as an NBFC if its financial assets are more than 50 per cent of its total assets (net of intangible assets) and income from these financial assets is more than 50 per cent of the gross income. Both these tests are required to be satisfied. This also entails that NBFCs under the current regulation can conduct non-financial activities along with financial activities, as NBFCs registered with the Bank, which could pose risk to its financial activities. There are also operational risks in monitoring such entities as their business

modules are not consistent with financial activities. It is felt that financial activity as defined under Section 45-I c of the RBI Act, 1934 must be a significant part of the business for a company to be considered as a financial institution. It has, therefore, been decided that NBFCs should gradually move towards undertaking financial activities, primarily. Further, there could be systemically important financial entities not fulfilling one of the twin criteria for principal business but holding large financial assets that could have implications for the financial sector.

6.2 Consequently, **the revised PBC** for the purpose of registration as NBFC is redefined as follows:

- i. A company not accepting deposits, will qualify for registration as NBFC if and when its financial assets¹ aggregate Rs 25 crore and constitute 75 per cent and above of its total assets (net of intangible assets) and financial income constitutes 75 per cent or above of its gross income subject to conditions at para 5 above.
- ii. Financial entities having asset size of Rs.1000 crore or above, holding financial assets which constitute 50% of the total assets **OR** generate financial income which as a proportion of the gross income is at least 50%, will need to be registered and regulated by the Bank.

7. Roadmap for existing NBFCs to comply with revised Principal Business Criteria

7.1 Existing NBFCs will be given a period of 2 years with the following milestones for achieving the minimum threshold of Rs. 25 crore of financial assets:

¹Financial Assets will include all assets that are financial in nature except cash, bank deposits, advance payment of taxes and deferred tax payments.

March 2014 – 65%

March 2015 – 75%

7.2 NBFCs-ND unable to comply with the threshold within the two year period, will be deregistered by the Reserve Bank through a public notification and shall no longer be eligible to carry out such activity and must exit the business within a given time frame.

7.3 Existing NBFC-D failing to achieve the 75 % threshold in financial assets and income by March 2015 will not be allowed to accept fresh deposits or renew deposits thereafter. They will be required to repay deposits within a given timeframe as decided by the Bank and be deregistered thereafter.

7.4 Principal business for AFCs has been redefined in alignment with that of the revised principal business criteria for NBFCs. Accordingly, a minimum of 75 per cent of the assets of AFCs (as against 60 per cent at present) should be in asset financing activities and at least 75 per cent of total income (as against 60 per cent at present), should be from these asset financing activities. Existing AFCs would be allowed to conform to the revised principal business criteria within a period of two years from the date of this Directions, in two stages as per the milestones given above.

8. Multiple NBFCs

8.1 There are groups in the sector which have floated multiple non-deposit taking NBFCs for different reasons. However, such entities that are part of a corporate group or are floated by a common set of promoters will not be viewed on a standalone basis and instead their total assets will be aggregated to determine if such consolidation leads to the cut off limit prescribed for a systemically important NBFC i.e. Rs. 100 crore of assets. For this purpose, the definition of the word “group” will be the same as per Accounting Standards².

². “**Companies in the Group**”, shall mean an arrangement involving two or more entities related to each other through any of the following relationships : Subsidiary – parent

8.2 For the purpose of regulation, the total assets of all NBFCs in a group will be taken together to determine the cut off limit of Rs. 100 crore for application of prudential norms. All provisions of the NBFC Prudential Norms, 2007 will be applicable to each NBFC in the group. For this purpose, Statutory Auditors would be required to certify the asset size of all the NBFCs if the Group has more than one NBFC.

8.3 In case there is a deposit accepting NBFC within the group, it would be supervised on a solo basis and all regulations prescribed for registered NBFCs would apply.

9. Captive NBFCs

9.1 It has been observed that a number of manufacturing groups have been floating NBFCs which are captive to their requirements to facilitate the sale of their products or services. A captive NBFC is defined as one which holds receivables generated on account of its parents activities at least to the extent of 90% of its total assets, net of intangible assets. The business franchise of such captives is inextricably linked to the parent's fortunes. As a result, credit underwriting standards could be weaker in such entities and the recall, if any, of parental assets could further stress the captive NBFC. Consequently, risks in the captives are much higher and warrant a higher Tier I capital, if not a different start-up NOF requirement.

9.2 It has, therefore, been decided that captive NBFCs shall maintain Tier I capital at 12 per cent, as against 7.5 per cent at present. Existing captive NBFCs that do not fulfill the requirement would be given a period of three years from the date of this notification to comply, upon which they shall produce a statutory auditor's certificate of compliance.

(defined in terms of AS 21), Joint venture (defined in terms of AS 27), Associate (defined in terms of AS 23), Promoter-promotee (as provided in the SEBI (Acquisition of Shares and Takeover) Regulations, 1997) for listed companies, a related party (defined in terms of AS 18), Common brand name, and investment in equity shares of 20% and above.