

RBI Press Release

Escrow Account Facility for NBFCs to exit from Public Deposits (April 12, 1999)

The Reserve Bank of India today announced that Non-banking, Financial Companies (NBFCs) presently holding public deposits will be allowed to park an amount equivalent to the amount of outstanding public deposits together with the present value of future interest differentials (between the yield on investments and the obligation of the company to pay the rate of interest) in an escrow account subject to certain conditions.

The escrow account facility to NBFCs will be subject to the following conditions:

- (i) The companies shall keep an amount equivalent to the amount of outstanding public deposits together with the present value of future interest differential (to be calculated on the basis of the return promised to the depositors and the expected yield on the government securities/ bank FDRs) in an escrow account in FDRs of one of the scheduled commercial banks or alternatively invest the amount in government securities.
- (ii) Deposit, the bank FDRs or government securities as the case may be with one of the scheduled commercial banks appointed for the purpose as a designated banker as per the provisions of NBFC Directions on acceptance of public deposits.
- (iii) Such securities can be withdrawn only at the beginning of each month only for repayment of public deposits on production of a certificate from its auditor about the amount of maturing deposits within the current month.
- (iv) The company should tender an undertaking that it would not accept any further public deposits or renew such maturing deposits in any manner.
- (v) The company may also be asked to submit a resolution from its Board of Directors to this effect.

This facility will benefit the NBFCs which are intending to exit from public deposits and desire to become non-public deposit holding companies. In terms of the present regulatory framework, companies not holding/not accepting public deposits are regulated by the Reserve Bank in a limited manner. They are not subject to stricter prudential norms.

Background

The Reserve Bank has shifted its regulatory and supervisory focus to NBFCs holding/

accepting public deposits and many such companies have indicated to the Reserve Bank their intention to exit from the public deposits. While NBFCs can prepay the public deposits without reducing the payable rate of interest by one percentage point for premature payments, subject to certain conditions, NBFCs have represented that their efforts have proved unsuccessful either because the depositors are untraceable and the deposits remained unpaid/unclaimed or the depositors have not given their consent for taking premature payment. Since the companies have opted to repay public deposits and they have chosen to raise resources through other means so as to exit from the regulatory attention of the Reserve Bank to the companies accepting/holding public deposits, the Reserve Bank has extended the escrow account facility to such companies with a view to protecting the interest of depositors.

RBI prescribes Regulations for Mutual Benefit Companies which are yet to be notified as Nidhis By Department of Company Affairs (April 13, 1999)

Nidhi companies which are already notified under Section 620A of the Companies Act, 1956 are classified as Mutual Benefit Financial Companies by the RBI and are exempted from several core provisions of the RBI Act and the Directions issued thereunder. These exemptions have been granted having regard to the fact that the companies notified as Nidhis are being regulated by the Department of Company Affairs (DCA) of Government of India and that their dealings are confined to their Members. However, there are a number of companies incorporated on or before January 9, 1997 functioning on the lines of Nidhi companies which were not yet notified by DCA. The functioning of such companies was adversely affected since they could not get the special dispensation available to the notified Nidhi companies.

Government desired RBI to prescribe regulatory norms for such companies similar to those applicable to notified Nidhi companies. Reserve bank of India today announced that such companies will now be classified as Mutual Benefit Companies (MBCs i.e. un-notified Nidhi companies) and they will be treated at par with the notified Nidhi companies subject to the following conditions :

- (i) the company must have been incorporated on or before January 9, 1997 and it must have applied for issue of Certificate of Registration to Reserve Bank of India within the stipulated period of six months.
- (ii) the company must be strictly complying with the Directions issued to MBFCs by the Bank under provisions of the RBI Act.
- (iii) the company must be strictly complying with the Directions of Department of Company Affairs issued from time to time.
- (iv) the total of Net Owned Fund (NOF) and preferential share capital should be Rs.10 lakh or more as on the date of last audited balance sheet. The NOF shall have the same meaning as assigned to it in the RBI Act, 1934. (The NOF would be assessed after taking into account the effect of income recognition norms and provisioning norms against bad and doubtful debts. The company will be reclassified after carefully examining their eligibility by actual inspection by the Bank as per the provision of RBI Act).

- (v) the company submits to the concerned R.O. of RBI having jurisdiction over the company an under- taking duly certified by the company's auditors that the company is fulfilling the eligibility norms enumerated above, accompanied by a Board Resolution to that effect and a Prudential Norms Return duly filled in complete in all respects including the Auditor's Certificate.

The regulatory norms and special dispensation as applicable to MBFCs will also be extended to the companies satisfying the above criteria. Further the companies will be given time up to December 31, 2002 to reach the amount of Rs.25 lakh as notified by DCA.

The MBCs whose functioning does not conform to the above requirements have been advised to stop accepting further deposits failing which they will invite penal action under the RBI Act.

The companies incorporated after January 9, 1997 will be considered for classification as Mutual Benefit Companies only if they have minimum Net Owned Fund of Rs.25 lakhs and have obtained a certificate of registration from RBI under the provisions of the RBI Act.

Background

A Nidhi company notified under Section 620A of the Companies Act is classified at present as "Mutual Benefit Financial Company" by RBI and regulated by the Bank for its deposit taking activities and by DCA for its operational matters as also the deployment of funds. These Companies have been exempted from substantial provisions of the RBI Act viz. requirement of registration, maintenance of liquid assets and creation of reserve fund. They are also exempted from almost all the provisions of RBI Directions except those relating to interest rate on deposits, prohibition from paying brokerage on deposits, ban on advertisements and the requirements of submission of certain Returns. However, they are allowed to deal with their shareholders only both for the purpose of accepting deposits and making loans.

There are a number of companies incorporated on or before January 9, 1997 and

functioning on the lines of Nidhi companies but not yet notified by DCA. RBI Directions to classify such companies as loan companies adversely affected such companies since they could not get the special dispensation available to Notified Nidhi companies. The Bank as well as the Government received representations from a large number of such MBCs as also their associations. Government has decided to give a special dispensation to the companies working on the lines of Nidhi companies and created a separate class of these companies till they are notified as Nidhis. The Government of India has prescribed that for considering the applications for classification as Nidhi company, companies incorporated on or before 9.1.1997 should have minimum NOF and preference share capital of Rs.10 lakhs. All the Nidhi companies which have been declared as Nidhi so far have been required to attain the figure of Rs.25 lakh by 31.12.2002 and that the companies which will be declared as Nidhi hereafter shall also have to attain the total of NOF and preference share capital of Rs.25 lakh by the said date. The Notification gives existing Nidhi Companies time upto December 31, 2002 for raising their NOF. The applications of companies incorporated on or before January 9, 1997 shall be considered by the Government for Notification as Nidhi Company under Section 620A of the Companies Act, 1956 only if they have minimum NOF of Rs.10 lakh or more and that these shall be required to have NOF of Rs.25 lakh by December 31, 2002. All such eligible companies in the mean time shall be classified as Mutual Benefit Companies till they are notified. Government has also clarified that NOF shall have the same meaning as assigned to it in the RBI Act, 1934.

As desired by the Government, Reserve Bank has proposed to modify its Directions in terms of which the eligible Mutual Benefit Companies can accept deposits as per the dispensation available to the notified Nidhi companies subject to the fulfilment of the specified conditions. The amending notification is being separately issued.

Treatment of Preference Shares for Capital Adequacy Standards (April 24, 1999)

The Reserve Bank of India has decided that for the purpose of capital adequacy, the all India term lending and refinance institutions may treat the "grant equivalent" implicit in non-cumulative preference shares at par with perpetual non-cumulative preference shares subject to certain conditions.

"Grant element" is calculated to measure the amount of perpetual 'subsidy' or unrequited transfer implicit in any loans/shares transferred at below market value or interest rates.

In a circular issued to all-India term lending and refinance institutions on capital adequacy standards, the Reserve Bank has prescribed that to be able to treat the "grant equivalent" as Tier I capital, the term lending institution will have to create a corpus of such minimum amount, the investment of which on maturity becomes equal to or more than the amount of such preference shares. The Reserve Bank has also asked financial institutions to invest such corpus in Government of India securities having maturity coinciding with the maturity of such preference shares so as to eliminate the re-investment risk.

Further, it has asked the institutions to value the amount in the corpus every year in order to provide for changes in the tax rates. Shortfall in the corpus, if any, will have to be met through the transfer of equivalent amount from the reserves.

The Reserve bank has also stated that the financial institution should not use the amount of the corpus so created for its normal operations and must keep it separately. The FI should also disclose the amount and the purpose of the corpus separately in the balance sheet, prospectus for raising of resources, etc.

Although the capital adequacy standards prescribed by the Bank for International Settlements permit inclusion of non-cumulative perpetual preference shares in Tier-I capital, in India under the Companies Act, 1956, issuance of perpetual preference shares is not allowed. The Companies Act allows issuance of preference shares for a maximum period of only 20 years. The Reserve Bank has, therefore, allowed only the amount of preference shares less the amount of corpus created as above to be treated as Tier-I capital.

Assuming that the value of preference shares is Rs.100 and the yield on 20-year government securities is 12.45 per cent, the discounted value of Rs.100 works out to Rs.21.09. The balance Rs.78.91 (Rs.100 - Rs.21.09) will be the grant equivalent and can be assumed to be available to the recipient of preference shares as a grant in perpetuity. In other words, the amount that could be treated as Tier-I capital in this example will be Rs.78.91.