

## **Amendments to NBFC Regulations**

**Ref.DNBS.(PD).CC.No. 13 /02.01/99-2000**

June 30, 2000.

**To All Non-Banking Financial Companies  
including Residuary Non-Banking Companies**

Dear Sirs,

### **Amendments to NBFC Regulations**

The Bank regulates the activities of NBFCs through five sets of Directions viz.

- (i) NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 1998
- (ii) NBFC Prudential Norms (Reserve Bank) Directions, 1998
- (iii) NBFC Auditors Report (Reserve Bank) Directions, 1998
- (iv) RNBC (Reserve Bank) Directions 1987
- (v) Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1977

2. The Bank last amended the NBFC regulations on January 13, 2000 to address the supervisory concerns arising out of certain undesirable practices of some NBFCs so that the NBFCs grow on sound and healthy lines and to enhance the protection available to the NBFC depositors. However, we have received further suggestions from the NBFCs and members of Informal Advisory Group on NBFCs. It has been decided to amend the above-mentioned directions, as per details given below :

#### **(1) Definition of public deposits for NBFCs other than RNBCs**

- (i) The Bank has received a number of representations from the trade and commerce that it is common for the members of family and other relatives of the directors of the companies to render financial help in the days of crisis of any business enterprise. This tradition holds good even for the entities engaged in the financial business. However, the present provisions of NBFC Directions on Acceptance of Public Deposits restrict borrowings from these sources owing to such receipt of money also falling within the purview of public deposits. As a result, the small and medium NBFCs which are family run but do not fulfill the conditions relating to the minimum investment grade credit rating are not able to access funds from their relatives thus affecting adversely their business operations.
- (ii) We have reviewed the position and it has been decided

- (a) to exempt the deposits from relative of a Director of the NBFC from the purview of public deposits;
- (b) that the onus of the proof that deposits have been accepted from the relative of a director of the company rests with the NBFC itself;
- (c) that the NBFCs shall obtain a separate application form from such depositors with suitable notice to their attention that such deposits would be treated as deposits from relatives;
- (d) that the relationship between the depositor and the specific director/s of the company would be material on the date of acceptance of such deposits. On any director ceasing to be the director of the company, such deposits would remain outside the definition of public deposits till the date of maturity. If the deposits are required to be renewed, the depositor-relative should have the relationship with one of the directors of the company on the date of renewal of such deposits by the NBFC. If the depositor does not have a relative among the directors on the date of renewal, the deposits, if renewed, would be treated as public deposits; and
- (e) that such deposits in the hand of both private limited NBFCs and public limited NBFCs as also the NBFCs accepting public deposits and those not accepting public deposits would be exempted from RBI Regulations.

**(2) Mandatory compliance by RNBCs with Prudential Norms for primary eligibility to accept deposits**

- (i) The provisions of prudential norms were extended to the residuary non-banking companies under the provisions of Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998 as contained in the notification No. DFC.119/DG(SPT)-98 dated January 31, 1998. However, the stipulations that RNBC should mandatorily comply with prudential norms, as applicable, were so far, inadvertently not included in the RNBC Directions as a precondition for its eligibility for accepting deposits like in the case of other NBFCs.
- (ii) It has now been decided to amend these Directions providing therein that the compliance by every RNBC with prudential norms is mandatory and a pre-

requisite for acceptance of deposits by these companies in the interests of depositors' protection.

- (iii) Accordingly, the RNBCs which do not comply with the Prudential Norms are directed to stop accepting deposits forthwith.

**(3) Interest rates payable on RNBC deposits**

- (i) Residuary Non-Banking Companies (RNBCs) are the only finance companies which are presently enjoined upon to pay a minimum rate of interest on their deposits whereas other NBFCs can pay any rate of interest subject to the maximum ceiling on the interest rate prescribed by RBI. These companies are obliged to keep at least 80 per cent of the aggregate deposit liabilities in the securities specified by the Bank on which the return is correlated to the yield on sovereign papers. In the wake of certain fundamental changes in the money market like the bank rate has been reduced to 7 per cent, the overall yield on their investments has declined.
- (ii) Some of the RNBCs have represented to the Bank that they are unable to reduce the interest rate payable on their deposits because of the floor ceiling prescribed by the Bank. It has, therefore, been decided keeping in view the factors stated in (i) above that RNBCs should pay interest rates on their deposits which shall not be less than,
  - (a) at the rate of 6 per cent per annum (to be compounded annually) on the amount deposited in lump sum or at monthly or longer intervals; and
  - (b) at the rate of 4 per cent per annum (to be compounded annually) on the amount deposited under daily deposit schemes.

Other provisions in this regard remain unchanged.

**(4) Permission to RNBCs to invest in the schemes of Mutual Funds besides UTI**

- (i) We have received requests from certain RNBCs that they may be permitted to invest in the schemes of mutual funds, besides those of UTI. The Directions to these companies regarding investments of the aggregate amount of deposit liabilities are driven by the objectives to safeguarding the depositors' interest

while ensuring that these companies remain economically viable and have sufficient avenues for investment of their deployable funds.

- (ii) It has, therefore, been decided to allow these companies to
  - (a) invest upto 2 percent of the amount of aggregate deposit liabilities to the depositors in any scheme/s of any mutual fund governed by SEBI regulations subject to the condition that aggregate of such investments including the investments in the schemes of UTI should not exceed 10 percent of such amount.
  - (b) It may be clarified that the ceiling of 2 percent is not applicable to the schemes of UTI and the company may invest upto 10 percent of such amount in the schemes of UTI. It is also clarified that the norms for income recognition and the valuation of investments in mutual fund units as prescribed under the NBFC Directions on Prudential Norms would be applicable, ipso facto.

**(5) Amendments to Prudential Norms Directions**

- (i) The NBFCs and their Associations have brought to the notice of the Bank that
  - (a) in the case of credit against second hand assets becoming NPA because the value of such assets after five years is treated as nil on account of administered rate of depreciation at 20 percent per annum on straight line method, the company has to make entire provision for such credit in the first year itself and thus financing of second hand assets has been badly hit;
  - (b) there have also been instances that the NBFCs have granted finance for periods upto 5 years whereas the NBFC Directions on Prudential Norms envisage full provisions against NPAs within a period of 4 years; and
  - (c) the concept of net realisable value is a matter of interpretation because of the different bench-marks used by different NBFCs.
- (ii) It is recognised that the equipment leasing and hire purchase finance companies have been playing an important role in financing of new as well as second hand commercial assets. It is also our endeavour that the RBI regulations should be self-

contained and should lead to uniform practices among the NBFCs. It has accordingly been decided to rationalise the prudential norms in respect of the equipment leasing and hire purchase finance assets as under :

- (a) The NBFCs should make provisions against NPAs with correlation to the net book value of the assets in four stages at 10, 40, 70 and 100 per cent (as against the present three stages of 10, 50 and 100 per cent );
- (b) In the case of HP agreements, the amount of caution money or margin money or security deposit may be adjusted, if received as per the terms of agreement, against the provisions required to be made for unsecured portion, provided the same has not been taken into account while calculating the equated monthly instalment earlier. However, the value of any other security to which the NBFC has a valid recourse may be deducted only against the provisions stipulated under clause (ii) of paragraph 8(2);
- (c) In the case of leased asset, the amount of security deposit together with the value of any other asset to which the NBFC has a valid recourse may be deducted only against the provisions stipulated under clause (ii) of paragraph 8(2);
- (d) The value of second hand assets would be the cost of acquisition of the asset by the hirer and not the invoice cost of the vehicle on the date of its original acquisition. The provisions in case of the asset becoming NPA should then be made on the such cost of acquisition on the same lines as are applicable to financing of a new vehicle;
- (e) The concept of net book value has been done away with and the unsecured portion has to be computed as the difference between the total dues and the depreciated value of the hire purchase asset; and
- (f) Other provisions in the Prudential Provisioning Norms shall remain unchanged like the income recognition on accrual basis upto 12 months, stipulation that the outstanding balance in a non-performing account shall be fully provided for within 12 months of the date of expiry of the contract period; the rate of depreciation for hire purchase assets at 20 per cent on straight line method, etc.

(6) **Formats of returns to be submitted by NBFCs and RNBCs**

With the introduction of a comprehensive regulatory and supervisory framework in the year 1998 and installation of state of the art wide area network for off-site surveillance, the need for rationalising and modifying the existing returns being submitted was felt essential. The earlier system of returns on one hand called for some information which has lost relevance at the same time some important information was not available in the existing system. Therefore, the returns being submitted by the NBFCs have been modified and rationalised. Further, the annual return submitted by NBFCs having total assets of Rs.100 crore and above giving the comparative position of operational data for the last three years and the quarterly return submitted by NBFCs holding public deposits of Rs.50 crore and above have been discontinued.

**(7) Introduction for NBFC Depositors**

It has been brought to the notice of the Bank by a number of NBFCs and their Associations that the NBFCs raise public deposits from the depositors located in far-flung areas and deal with the general masses who may not be fully conversant with the banking needs. It is advised for abundant clarification that introduction for NBFC depositors mean the identification of the prospective depositor. The NBFCs may ensure that the new depositor is not a fictitious person by verifying physically some form of identification, i. e. PAN number, Election ID card, passport, ration card or introduction by one of the existing depositors, etc. A copy of such an evidence may be kept on record by the company.

**Other Measures for protection of interests of depositors**

3. The following additional measures are being advised as a part of the various steps taken for the protection of interests of depositors:

**(1) Registered NBFCs to brand their Certificates of Registration**

- (i) The Bank has stratified the NBFCs into two categories viz. those taking public deposits and those not accessing public deposits. The companies specifically permitted to accept public deposits are so advised and the other companies are also advised that they should not accept public deposits without prior permission of the Bank.
- (ii) The companies taking public deposits are comprehensively regulated for protection of depositors' interests. However, the format of Certificate of

registration does not make any distinction between the companies permitted to accept and not allowed to accept such deposits.

**(iii)** There are chances that a few unscrupulous NBFCs registered with the Bank but not allowed to accept public deposits may misrepresent to the gullible public to place their savings with them on the ground that they are registered with the Bank. While the Bank would take serious action against the erring companies, it is advised in the interests of the NBFCs and the depositors that all the NBFCs who have so far been issued a Certificate of Registration by the Bank should

- (a) **brand the Certificate as Deposit Taking Company or as Non-Deposit Taking Company in bold letters in red ink; and**
- (b) **send to the Regional Office of DNBS of the Bank a copy thereof duly certified by their auditors stating therein that the original certificate has been so branded.**

## **(2) Acceptance of public deposits by Registered NBFCs and RNBCs**

- (i) Three year period allowed to the NBFCs under the provisions of RBI Act for attaining minimum NOF of Rs.25 lakhs has since expired on January 10, 2000. Although such a period could be extended by the Bank at its discretion, it has been decided to allow extension of time only on a selective basis. Nevertheless, the extension of time is relevant only for attaining the minimum NOF and not for acceptance of public deposits. The Bank has also been aggressively advertising that the members of public should make deposits only with the registered NBFCs.
- (ii) Having completed the work of registration of all eligible NBFCs, it has been decided that registration of an NBFC with RBI under Section 45-IA of the RBI Act would be the primary eligibility criteria for accessing public deposits. Accordingly, only the registered NBFCs, if specifically permitted by the Bank should accept public deposits, subject to their eligibility as per the provisions of Directions as applicable. The unregistered NBFCs are not allowed to accept public deposits even though their applications may be pending with the Bank for any reason. Further the NBFCs which have been granted the Certificate of Registration but have been specifically advised to obtain prior permission of the Bank before they intend to accept public deposits, should scrupulously adhere to the above Directions and should not accept public deposits until they have been permitted to do so.

**Guidelines for entry of NBFCs into insurance business**

4. In the statement of Monetary and Credit Policy for the year 2000-2001 announced by our Governor on April 27, 2000 it was indicated, inter alia, that the guidelines for entry of NBFCs into insurance business would be announced shortly. Accordingly, the Bank has issued on June 9, 2000 the final guidelines after taking into account the views/suggestions/comments of the market participants. A copy of the guidelines is enclosed as Annexure I. The aspirant NBFCs are advised to make an application along with necessary particulars duly certified by their statutory auditors to the Regional Office of Department of Non-Banking Supervision under whose jurisdiction the registered office of the NBFCs is situated.

5. A copy each of the amending Notifications No. 141-145 dated June 30, 2000 is enclosed. You are requested to ensure meticulous compliance with the regulatory framework.

6. Please acknowledge the receipt of this letter to the General Manager/Deputy General Manager of the Regional Office of the Department of Non-Banking Supervision under whose jurisdiction the registered office of your company is located.

Yours faithfully,

Sd/-  
(V. S. N. Murty)  
Chief General Manager - in -Charge

Encls : As above

**Issued on June 9, 2000**

**Final Guidelines for Entry of NBFCs into Insurance**

1. Any non-banking financial company (NBFC) registered with RBI having net owned fund of Rs. 2 crore would be permitted to undertake insurance business as agent of insurance companies on fee basis, without any risk participation.

2. All NBFCs registered with RBI which satisfy the eligibility criteria given below will be permitted to set up a joint venture company for undertaking insurance business with risk participation, subject to safeguards. The maximum equity contribution such an NBFC can hold in the joint venture company will normally be 50 per cent of the paid-up capital of the insurance company. On a selective basis, the Reserve Bank of India may permit a higher equity contribution by a promoter NBFC initially, pending divestment of equity within the prescribed period [see Note (1) below]. The eligibility criteria for joint venture participant will be as under, as per the latest available audited balance sheet.

- (i) The owned fund of the NBFC should not be less than Rs. 500 crore,
- (ii) The CRAR of the NBFC engaged in loan and investment activities holding public deposits should be not less than 15% and for other NBFCs at 12% irrespective of their holding public deposits or not.
- (iii) The level of net non-performing assets should be not more than 5% of the total outstanding leased/hire purchase assets and advances taken together,
- (iv) The NBFC should have net profit for the last three continuous years,
- (v) The track record of the performance of the subsidiaries, if any, of the concerned NBFC should be satisfactory,
- (vi) Regulatory compliance and servicing public deposits, if held.

The provisions of RBI Act would be applicable for such investments while computing the net owned funds of the NBFC.

3. In case where a foreign partner contributes 26 per cent of the equity with the approval of insurance Regulatory and Development Authority/Foreign Investment Promotion Board, more than one NBFC may be allowed to participate in the equity of the insurance joint venture. As such participants will also assume insurance risk, only those NBFCs which satisfy the criteria given in paragraph 2 above, would be eligible.

4. No NBFC would be allowed to conduct such business departmentally. A subsidiary or company in the same group of an NBFC or of another NBFC engaged in the business of an

non-banking financial institution or banking business will not normally be allowed to join the insurance company on risk participation basis.

5. NBFCs registered with RBI which are not eligible as joint venture participant, as above can make investments up to 10 per cent of the owned fund of the NBFC or Rs.50 crore, whichever is lower, in the insurance company. Such participation shall be treated as an investment and should be without any contingent liability for the NBFC. The eligibility criteria for these NBFCs will be as under:

- (i) The CRAR of the NBFC (applicable only to those holding public deposits) should not be less than 12 per cent if engaged in equipment leasing/hire purchase finance activities and 15 per cent if it is a loan or investment company ;
- (ii) The level of net NPA should be not more than 5 per cent of total outstanding leased/hire purchase assets and advances;
- (iii) The NBFC should have net profit for the last three continuous years.

6. All NBFCs registered with RBI entering into insurance business as agents or investors or on risk participation basis will be required to obtain prior approval of the Reserve Bank. The Reserve Bank will give permission to NBFCs on case to case basis keeping in view all relevant factors. It should be ensured that risks involved in insurance business do not get transferred to the NBFC and that the NBFC business does not get contaminated by any risks which may arise from insurance business.

Notes :

(1) Holding of equity by a promoter NBFC in an insurance company or participation in any form in insurance business will be subject to compliance with any rules and regulations laid down by the IRDA/Central Government. This will include compliance with Section 6AA of the Insurance Act as amended by the IRDA Act, 1999, for divestment of equity in excess of 26 per cent of the paid up capital within a prescribed period of time.

(2) For applications received during the financial year 2000-2001, any fresh capital infused after the audited balance sheet date for 1999-2000 would also be taken into account. The unaudited and certified balance sheet as on a latest date may be reckoned for determining the eligibility criteria and the audited balance sheet for the above date would be submitted to RBI as soon as possible.

(3) For subsequent years, the eligibility criteria would be reckoned with reference to the latest available audited balance sheet for the previous year.