

## **RBI Regulations for NBFCs - Circular**

Ref.DNBS(PD).CC.No.18/02.01/2001-02

January 1, 2002

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

Dear Sirs,

### **RBI Regulations for NBFCs**

RBI has received requests from the NBFCs and their associations for a review of some of the provisions of the regulations in order to obviate the operational difficulties, without in any manner compromising the principles of protection of interests of the depositors of the NBFCs. The requests have been examined in consultation with the Informal Advisory Group on NBFCs, wherever feasible and considered necessary. It has been decided to effect the following changes in the regulations:

### **Statutory Changes**

**(1) Rejected NBFCs – Requirement of conversion to Non-financial activities and disposal of financial assets**

(i) The extant RBI Regulations require all the rejected NBFCs holding public deposits to submit a monthly return in Form NBS-4 furnishing therein the information on repayment of public deposits and other aspects of their activities. The experience of receipt of returns from these companies has not been satisfactory. Resultantly, the position of rejected NBFCs with reference to the disposal of their financial assets or converting to non-banking non-financial companies is not known.

(ii) In this connection, a reference is made to paragraph 90 of the Mid Term Review of Monetary and Credit Policy for the year 2001-2002 announced by our Governor on October 22, 2001 in terms of which it has been decided that companies whose application for Certificate for Registration (CoR) have been rejected or companies whose CoR have been cancelled should continue to repay their deposits on due dates and dispose of their financial assets within three years from date of rejection / cancellation or convert into non-banking non-financial companies within the same period. The Regional Offices of the Department will advise the rejected NBFCs separately.

**(2) Companies Amendment Act, 2000 -  
Applicability of requirement of reporting to CLB  
about non-repayment of matured public deposits  
by defaulting NBFCs within 60 days of default**

(i) In terms of section 58AA of the Companies Act, 1956, a provision has been inserted requiring all the companies to report within 60 days to Company Law Board (CLB) the default to small depositors, if any, in repayment of the matured deposits or payment of interest thereon as per their conditions of acceptance.

(ii) RBI has examined the applicability of the above requirement to the NBFCs. The requirement under section 58AA of the Companies Act is also applicable to the NBFCs. Accordingly, the NBFCs are advised, for the sake of good compliance with the legal provisions, to report to CLB as required, whenever they have defaulted in repayment of deposits to small depositors.

**(3) Companies Amendment Act, 2000 -  
Acceptance of public deposits by private limited NBFCs**

(i) The provisions of section 3 (1) the Companies Act, 1956 have been amended in terms of which the definition of 'private company' has been modified. The additional requirement imposed by the amendment for a private company is that any invitation or acceptance of deposits from persons other than its members (shareholders), directors or their relatives is prohibited.

(ii) It is advised that the NBFCs which were hitherto private limited companies and were intending to take or holding public deposits are now public limited companies under the Companies Act, 1956. It is presumed that they have done the needful as required of them under the Companies Act. They may approach RBI for change in the certificate of registration to reflect the new name as a public limited company.

**Regulatory amendments**

**Amendments to Non-Banking Financial Companies  
Prudential Norms (Reserve Bank) Directions, 1998**

**(4) New Financial Leases – Accounting Standard 19 of ICAI  
Applicability of Prudential Provisioning Norms**

(i) The Institute of Chartered Accountants of India (ICAI) has issued Accounting Standard (AS) 19 "Accounting for Leases". The accounting standard is mandatory in respect of lease agreement (financial leases) executed on or after April 1, 2001. The accounting standard, inter alia, provides for the capitalization of Finance lease assets in the books of lessee instead of lessor. The lessor is now required to show the assets given on lease only as receivables in its balance sheet instead of as fixed assets.

(ii) The implications of the above AS for the NBFCs in the matter of applicability of prudential norms prescribed by RBI would be that all the fresh leases (financial leases) written on or after April 1, 2001 would now be accounted like hire purchase transactions. Accordingly, it is clarified that the prudential norms applicable to hire purchase assets would, mutatis mutandis, be applicable to the leases written on or after April 1, 2001. However, the leases written upto March 31, 2001 would continue to be governed by the prudential norms related to leased assets, as hitherto.

**(5) Paragraph 9A of the NBFC Directions on Prudential Norms  
Section 292A of the Companies Act, 1956 –  
Constitution of Audit Committee for NBFCs**

(i) We have stipulated in relation to the audit committee as under:

**"9A Constitution of Audit Committee by NBFCs**

An NBFC having the assets of Rs. 50 crore and above as per its last audited balance sheet shall constitute an Audit Committee, consisting of not less than three members of its Board of Directors."

(ii) A new section has been inserted in the Companies Act, 1956 in relation to constitution of Audit Committee which provides as under :

292A (1) Every public company having paid-up capital of not less than five crores of rupees shall constitute a committee of the Board known as "Audit Committee" which shall consist of not less than three directors and such number of other directors as the Board may determine of which two-thirds of the total number of members shall be directors, other than managing or whole-time directors.

(2) Every Audit Committee constituted under sub-section(1) shall act in accordance with terms of reference to be specified in writing by the Board.

(3) The members of the Audit Committee shall elect a chairman from amongst themselves.

(4) The annual report of the company shall disclose the composition of the Audit Committee.

- (5) The auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote.
- (6) The Audit Committee should have discussions with the auditors periodically about internal control systems, the scope of audit including the observations of the auditors and review the half-yearly and annual financial statements before submission to the Board and also ensure compliance of internal control systems.
- (7) The Audit Committee shall have authority to investigate into any matter in relation to the items specified in this section or referred to it by the Board and for this purpose, shall have full access to information contained in the records of the company and external professional advice, if necessary.
- (8) The recommendations of the Audit Committee on any matter relating to financial management, including the audit report, shall be binding on the Board.
- (9) The chairman of the Audit Committee shall attend the annual general meetings of the company to provide any clarification on matters relating to audit.
- (10) If a default is made in complying with the provisions of this section, the company, and every officer who is in default, shall be punishable with imprisonment for a term which may extend to one year, or with fine which may extend to fifty thousand rupees, or with both.'

(iii) In order to ensure that RBI regulations should be in alignment with the provisions of Companies Act, 1956 it has been decided to prescribe requirement of constitution of Audit Committee by each NBFC having either paid up capital of not less than Rs. 5 crore or assets of Rs. 50 crore and above as per its last audited balance sheet. The Audit Committee constituted by an NBFC as required under Section 292-A of the Companies Act, 1956 shall also be the Audit Committee for the purposes of RBI Regulations and shall have the same powers, functions, duties as laid in Companies Act, 1956.

(6) Investments by NBFCs in joint venture for insurance –  
Paragraph 11B and 12 of the Prudential Norms Directions –  
Exemption from exposure norms to the extent of RBI approval

(i) In terms of extant guidelines for entry into insurance business,

*"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...."*

(ii) The investment in insurance ventures does not attract the provisions of paragraph 11B, if the investee company is a subsidiary or a company in the same group. However, there may be cases, when the investee company does not become the subsidiary or a

company in the same group and such investment could result in contravention of the Prudential Norms relating to the investment in unquoted shares or investment norms restricting concentration in single party to 15 per cent of the owned fund of the NBFC .

(iii) Accordingly, it has been decided to amend the Directions so as to exclude the "investment in insurance business to the extent specifically permitted by RBI under the Final Guidelines for Entry of NBFCs into Insurance" from provisions of paragraphs 11B and 12 of the Prudential Norms Directions.

**Amendments to Non-Banking Financial Companies  
Acceptance of Public Deposits (Reserve Bank) Directions, 1998**

**(7) Safe Custody of liquid asset securities**

(i) NBFCs and RNBCs are required to entrust the securities required to be maintained under the provisions of RBI Act and Directions issued thereunder to the designated banker for the security of depositors. These securities can be withdrawn only for repayment of deposits. Further, NBFCs are also permitted to keep the securities with Stock Holding Corporation of India Ltd (SHCIL) or Constituent's Subsidiary General Ledger account with designated banker with prior approval of RBI.

(ii) Keeping in view the recent strides in dematerialisation of securities, it has been decided to permit NBFCs and RNBCs to keep these securities with any depository participant having registration from Securities and Exchange Board of India, subject to prior written approval of RBI.

**Changes in guidelines**

**(8) Accounting of investments –  
Paragraph 6 of Prudential Norms Directions -  
AS 13 of ICAI - Mandatory sub-classification  
into long term and current investments**

As per the provisions of NBFC Prudential Norms Directions, all accounting standards issued by ICAI are mandatory for all NBFCs. They are permitted to value their long term investments as per AS-13 of ICAI. However, in view of the queries from the chartered accountant fraternity and also NBFCs about certain issues emanating from the implementation of the above accounting standard, it was considered necessary to have a

relook at the guidelines for valuation of investments. The proposals were discussed with the members of the Informal Advisory Group and it has been decided as follows:

- (i) The Board of Directors of the NBFC should frame and implement investment policy for the company;
- (ii) Each investment shall be classified into current and long term at the time of making investment. The criteria to classify the investments into current and long term should be spelt out in the investment policy of the company as approved by the Board;
- (iii) there would be no inter-class transfer on ad-hoc basis;
- (iv) the inter-class transfer can take place only at the beginning of half year as on April 1 or October 1 with the approval of the Board; and
- (v) the investments are to be transferred scrip-wise at lower of book value or market value from long-term to current or vice-versa. The depreciation, if any, in each scrip should be fully provided for and appreciation should be ignored. Further, the depreciation in one scrip cannot be set off against appreciation in another scrip at the time of such inter-class transfer even though it may be in the same category.

**(9) Classification of NBFCs into EL/HP categories –  
Inclusion of certain hypothecation loans against specified assets**

- (i) In terms of extant instructions, NBFCs having not less than 60 per cent of the total assets in lease and hire purchase and deriving not less than 60 per cent of their total income from such activities can be classified as hire purchase/equipment leasing companies. The assets in both these activities could be combined to satisfy the ratio of 60 per cent.
- (ii) The Bank has received representations from NBFCs and their associations that they are finding it increasingly difficult to write further leases or enter into hire purchase agreements owing to market conditions. The industry suggested that loans against hypothecation of assets may also be considered along with the lease/hire purchase assets to satisfy the 60 per cent norm. The matter has been discussed in the meeting of the Informal Advisory Group on NBFCs and it has been decided that loans against hypothecation of
  - (a) all types of automobiles like trucks, buses, tractors, cars, three wheelers, two wheelers and dumpers which are registered with Road Transport Authority and the charge is recognised by Motor Vehicles Act;

- (b) aircrafts which are registered with Director General of Civil Aviation;
- (c) ships which are registered with Director General of Shipping

may be included along with other equipment leasing and hire purchase assets to comply with the norms of 60 per cent of total assets and income for the purpose of classification of an NBFC as equipment leasing or hire purchase finance company. Other instructions relating to the manner of classification of the NBFCs, review of the classification every year on the basis of audited balance sheet, etc. would remain unchanged. The NBFCs may review their status as on the date of last available audited balance sheet for the purpose of their classification on the basis of the above revised norms and bring the same to the notice of the concerned Regional Office of RBI under whose jurisdiction their registered office is located.

(iv) However, it is clarified that prudential norms relating to loans and advances only would be applicable to such loans against hypothecation of assets despite their clubbing with EL/HP assets for the classification of NBFCs. In other words, classification of NBFC and prudential norms are two different aspects.

**(11) Repossessed Hire Purchase and Lease assets –  
Accounting Guidelines**

RBI has prescribed vide circular DNBS(PD)CC No.16/2000-01 dated June 27, 2001, accounting procedure for repossessed assets for NBFCs after the deliberations in the meeting of the Informal Advisory Group on NBFCs. We have received representations from some NBFCs about the difficulties at operational level in observance of the above guidelines. Accordingly, the request has been examined in consultation with some of the NBFCs concerned and the existing as well as the revised guidelines for accounting of the repossessed assets are furnished hereinbelow:

Existing Guidelines	Revised Guidelines
<p>In case the asset is taken as part of <u>Fixed assets for own use</u></p> <p>(i) The repossession of leased or hire purchase assets should be treated as foreclosure of the contract of lease or hire</p>	<p>(a) The repossessed assets should be shown as distinct from `assets on lease' or `stock on hire' under the head `Fixed Assets' or `Current Assets' as the case may be.</p> <p>(b) Valuation of assets may be done as per accounting standards of ICAI.</p>

<p>purchase finance;</p> <p>(ii) The accounting adjustment should be done in these cases by taking the assets at its book value;</p> <p>(iii) In case of hire purchase assets, in arriving at the book value, the asset value should be depreciated by 20 per cent per annum of the cost on straight-line method;</p> <p>(iv) The releasable value has to be arrived at after deducting the expenditure likely to be incurred on resale of the asset;</p> <p>The provision in regard to deficit between book value and realisable value should be made in the current year itself.</p> <p>In case the asset is still treated as <u>part of Lease / hire purchase portfolio</u></p> <p>The asset should continue to be treated as non-performing and provisions should be made according to the provisioning norms on the lines of those applicable to rescheduled contracts.</p>	
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**(12) Auditor's Reports on contraventions of RBI Regulations by NBFCs**

- (i) A reference may please be made to our circular DNBS(PD)CC.7/1998-99 dated December 18, 1998 requiring NBFCs to include in their letter of appointment of the Statutory Auditors about their responsibility to report directly to RBI, the violations or irregularities, if any, noticed by them in the course of their audit of the NBFC. However, the experience in regard to receipt of such exception reports from the auditors has not been very satisfactory.
- (ii) NBFCs are once again advised to ensure that they include invariably in the letter appointing the auditors, a clause informing the auditors of their obligations under

the RBI Act, 1934 and Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 1998 to report the exceptions directly to RBI.

- (iii) The auditors of NBFCs are also being informed through the ICAI about their responsibility in this regard.

**(13) Applicability of CRAR on an ongoing basis**

It is reiterated that every NBFC which is required to maintain the prescribed minimum capital ratio, shall maintain the same not only as on reporting dates but on an ongoing basis. Failure to do so would be deemed to be violation of the Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998.

- 4. A copy each of the amending Notifications Nos. 154 to 156 of date is enclosed for your meticulous compliance.

Yours faithfully,

Sd/-

(L. M. Fonseca)

Chief General Manager – in – Charge