Master Circular - Lending to Non-Banking Financial Companies (NBFCs)

RBI /2004-05/14

DBOD / IECS.No. 7 /08.12.01/2004-2005

July 1, 2004

Chairman and Managing Director/
Chief Executives of all Commercial Banks

Dear Sir,

Master Circular - Lending to Non-Banking Financial Companies (NBFCs)

Please refer to our Master circular No. 9 /08.12.01/2003-04 dated March 11, 2004 on the captioned subject. The enclosed Master Circular consolidates and updates all the instructions issued by the Department on the subject till date.

Yours faithfully,

(A.Sreekumaran)
Deputy General Manager

Encl. As above

Master Circular on Lending to NBFCs

1. GENERAL

1.1 Reserve Bank of India has been regulating the financial activities of the Non-Banking Financial Companies under the provisions of Chapter III B of the Reserve Bank of India Act, 1934.

1.2 With the amendment of the Reserve Bank of India Act, 1934 in January 1997, in terms of Section 45 IA of the said Act, all Non-Banking Financial Companies have to be mandatorily registered with the Reserve Bank of India.

2. BANK FINANCE TO REGISTERED NBFCs

In the context of mandatory registration of NBFCs with the Reserve Bank, as also consistent with the policy of bestowing greater operational freedom to banks in the matter of credit dispensation, the ceiling on bank credit linked to Net Owned Fund (NOF) of such companies has been withdrawn in respect of all NBFCs which are statutorily registered with RBI and are engaged in principal business of equipment leasing (EL), hire-purchase (HP), loan and investment activities.

3. BANK FINANCE TO NBFCs NOT REQUIRING REGISTRATION

In respect of NBFCs which do not require to be registered with RBI, [viz. i) Insurance Companies registered under Section 3 of the Insurance Act, 1938; ii) Nidhi Companies notified under Section 620A of the Companies Act, 1956; iii) Chit Fund Companies carrying on Chit Fund business as their principal business as per Explanation to Clause (vii) of Section 45-I(bb) of the Reserve Bank of India Act, 1934; iv) Stock Broking Companies/Merchant Banking Companies registered under Section 12 of the Securities & Exchange Board of India Act; and v) Housing Finance Companies being regulated by the National Housing Bank (NHB) which have been exempted from the requirement of registration by RBI], banks may take their credit decisions on the basis of usual factors like the purpose of credit, nature and quality of underlying assets, repayment capacity of borrowers as also risk perception, etc.

4. BANK FINANCE TO RESIDUARY NON-BANKING COMPANIES (RNBCs)

4.1 Residuary Non-Banking Companies (RNBCs) are also required to be mandatorily registered with Reserve Bank of India. In respect of such companies registered with RBI, bank finance would be restricted to the extent of their **Net Owned Fund (NOF)**.

4.2 **Net Owned Fund (NOF)**

4.2.1 Banks should follow the definition of NOF as given in the explanation to Section 45-IA of the Reserve Bank of India Act, 1934, i.e.,

I. Net Owned Fund means

(a) the aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance sheet of the company after deducting therefrom

(i) accumulated balance of loss;

(ii) deferred revenue expenditure; and

(iii) other intangible assets; and

(b) further reduced by the amounts representing

(1) investment of such company in shares of

(i) its subsidiaries;

(ii) companies in the same group;

(iii) all other Non-Banking Financial Companies; and

(2) the book value of debentures, bonds, outstanding loans and advances (including hire purchase and lease finance) made to, and deposits with

(i) subsidiaries of such company; and

(ii) companies in the same group,

to the extent such amount exceeds ten percent of (a) above

II. "subsidiaries" and "companies in the same group" shall have the same meanings assigned to them in the Companies Act, 1956 (1of 1956).

5. ASSESSMENT OF WORKING CAPITAL

5.1 Banks may assess and provide need-based finance to NBFCs referred to above, within the prudential guidelines and exposure norms prescribed by the Reserve Bank subject to the condition that the activities indicated in paragraph 6 are not financed by them. Banks should lay down transparent policy and guidelines for credit dispensation in respect of NBFCs with the approval of their Boards.

5.2 Banks should ensure that lending to Non-Banking Financial Companies (including bill discounting / rediscounting) is part of the overall working capital credit limit sanctioned to such companies after proper appraisal of their genuine working capital needs.

5.3 In the light of the above, the instructions/guidelines issued in the past by RBI regarding assessment of working capital credit needs of equipment leasing and hire purchase finance companies, based on the concept of Maximum Permissible Bank Finance (MPBF), have ceased to be **mandatory**.

6. Activities Not Eligible for Bank Credit

6.1 The following activities undertaken by NBFCs, are not eligible for bank credit:

(i) Bills discounted/rediscounted by NBFCs, **except** for rediscounting of bills discounted by NBFCs arising from sale of -

(a) commercial vehicles (including light commercial vehicles), and

(b) two wheeler and three wheeler vehicles, subject to the following conditions:

- the bills should have been drawn by the manufacturer on dealers only;
- the bills should represent genuine sale transactions as may be ascertained from the chassis/engine number; and

- before rediscounting the bills, banks should satisfy themselves about the *bona fides* and track record of NBFCs which have discounted the bills.

(ii) Investments of NBFCs both of current and long-term nature, in any company/entity by way of shares, debentures, etc. However, Stock Broking Companies may be provided need-based credit against shares and debentures held by them as stock-in-trade.

(iii) Unsecured loans/ inter-corporate deposits by NBFCs to/in any company.

(iv) All types of loans and advances by NBFCs to their subsidiaries, group companies/entities.

(v) Finance to NBFCs for further lending to individuals for subscribing to Initial Public Offerings (IPOs)

(vi) Banks are precluded from granting term loans for acquisition of existing assets (except imported second hand machinery). Bank finance to leasing concerns should cover purchases of only new equipment. Banks should not extend finance against existing assets whether by way of term loans for purchase of such assets or by way of finance to leasing companies for purchase and release of such assets.

6.2 ***Leased and Sub-Leased Assets***

(i) Banks should not enter into lease agreements departmentally with equipment leasing companies as well as other Non-Banking Financial Companies engaged in equipment leasing.

(ii) As banks can only support lease rental receivables arising out of lease of equipment/machinery owned by the borrowers, lease rentals receivables arising out of sub-lease of an asset by a Non-Banking Non Financial Company (undertaking nominal leasing activity) or by a Non-Banking Financial Company should be excluded for the purpose of computation of bank finance for such company.

7. PROHIBITION ON BRIDGE LOANS/INTERIM FINANCE

7.1 Banks should not grant bridge loans of any nature, or interim finance against capital/debenture issues and/or in the form of loans of a bridging nature pending raising of long-term funds from the market by way of capital, deposits, etc. to all categories of Non-Banking Financial Companies, i.e., equipment leasing and hire-purchase finance companies, loan and investment companies and also Residuary Non-Banking Companies (RNBCs).

7.2 Banks should strictly follow these instructions and ensure that these are not circumvented in any manner whatsoever by purport and/or intent by sanction of credit under a different nomenclature like unsecured negotiable notes, floating rate interest bonds, etc., as also short-term loans, the repayment of which is proposed/expected to be made out of funds to be or likely to be mobilised from external/other sources and not out of the surplus generated by the use of the asset(s).

Appendix

Master Circular

LENDING TO NON-BANKING
FINANCIAL COMPANIES (NBFCs)

List of Circulars Consolidated in the Master Circular

No.	Circular No.	Date	Subject	Para No.
1.	IECD.No.29/08.12.01/98-99	25.05.99	Lending to Non-Banking Financial Companies (NBFCs)	2, 3, 4.1, 5.1, 5.4.1
2.	IECD.No.15/08.12.01/97-98	04.11.97	Guidelines for Lending by Banks - Assessment of Working Capital	5.3
3.	IECD.No.17/03.27.026/96-97	06.12.96	Bank Finance for Purchase/Lease of Existing Assets	5.4.1(vi)
4	DBOD.No.FSC.BC.101/24.01.001/ 95-96	20.09.95	Equipment Leasing, Hire Purchase and Factoring etc. Activities	5.4.2
5.	IECD.No.42/08.12.01/94-95	21.04.95	Lending to Non-Banking Financial Companies	6.1, 6.2
6	DBOD.No.FSC.BC.71/C.469/91-92	22.01.92	Restriction on Credit to Certain Sectors	5.2
7.	IECD.No.14/08.12.01/94-95	28.09.94	Lending to Non-Banking Financial Companies	6.1

List of Other Circulars containing Instructions/Guidelines/
Directives related to Non-Banking Financial Companies (NBFCs)

No.	Circular No.	Date	Subject	Para No.
1.	DBOD.No.Dir.BC.107/13.07.05/98-99	11.11.98	Rediscounting of Bills by Banks	5.4.1 (i) (a)
2.	DBOD.No.Dir.BC.173/13.07.05/99-2000	12.05.2000	Rediscounting of Bills by Banks	5.4.1 (i) (b)
3.	DBOD.No.Dir.BC.90/13.07.05/98	28.08.98	Bank Finance against Shares & Debentures	5.4.1 (ii)
4.	DBOD.No.BP.BC.51/21.04.137/ 2000-01	10.11.2000	Bank Financing of Equities and Investment in Shares	5.4.1 (v)

Index to Key Words