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RBI/2004-05/320
DNBS (PD) CC.No.46/02.02(RNBC)/2004-05

December 30, 2004

Residuary Non-Banking Companies (RNBCs)

Dear Sirs,

Mid Term Review of Annual Policy Statement for the year 2004-05 Road Map for Residuary Non-Banking Companies

Please refer to paragraphs 133 and 134 of the Mid-Term Review of Annual Policy Statement for the year 2004-05 (copy enclosed) announced by the Governor on October 26, 2004. Please also refer to our Company Circular DNBS (PD) CC. No. 40/02.01/2003-04 dated June 22, 2004 in terms of which RNBCs were inter-alia advised to reduce discretionary investment to 10 percent of their deposits by April 2005 and completely dispense with it from April 2006.

2. With a view to smoothen the process of transition of RNBCs to compliance with the revised Directions, it has been decided to make the following modifications :

i. Certificates of Deposit of specified financial institutions

The investments of RNBCs in Certificates of Deposit (CDs) of specified financial institutions which have a minimum rating of AA+ at the time of investment, if subsequently downgraded, will continue to be reckoned as eligible securities, as long as they have minimum investment grade rating.

ii. Balances in current accounts with commercial banks

Balances in current accounts with commercial banks would be considered as eligible investments subject to compliance with the following conditions :

- a) Balances held in current accounts with scheduled commercial banks only in the name of RNBC will be reckoned as eligible towards directed investments to the extent of quarterly average of the day-end balances.
- b) Only the balances certified by the respective bankers would be considered as eligible.

iii. Investments in bonds/debentures of listed companies

The investments of RNBCs in bonds and debentures of companies which have minimum rating of AA+ or equivalent grade rating and listed on stock exchange will be considered as eligible securities till the rating continues to be not below the minimum investment grade.

3. The Mid-Term Review had also indicated that to ensure that depositors are served appropriately and systemic risks are avoided, RBI intends to focus on improvements in the functioning of RNBCs including



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transparency of operations, connected lending relationships, corporate governance standards, avoiding untenable rates of commission to agents, adherence to "know your customer" rules and identifiable customer service contact. You are, therefore, instructed to take action as advised below :

i. Professionalisation of Boards and 'fit and proper' criteria for directors

For a sound and prudent management of the company it is necessary that the Board is professionally managed and consists of Directors who are 'fit and proper'. In this regard, you are advised to implement the guidelines on 'fit and proper' status given in Annexure I. A time bound plan for compliance must be submitted to RBI by January 31, 2005.

ii. Connected lending

The companies should comply with the guidelines on connected lending relationships, as detailed in Annexure II. The guidelines relate to credit facilities to the Directors, loans and advances to relatives of the RNBC's Directors or to the Directors of other companies and their relatives and other entities, timeframe for recovery of such loans, etc. Information in respect of loans and advances sanctioned to the directors as per Proforma 3 of the Annexure II should be submitted as on December 31, 2004 before January 31, 2005 and on a quarterly basis thereafter as indicated in the guidelines.

iii. Adherence to Know Your Customer (KYC) guidelines by RNBC and its agents and sub-agents

An obligation has been cast on the banking companies, financial institutions and intermediaries, by the Prevention of Money Laundering Act, 2002 (Chapter IV), to comply with certain requirements in regard to maintenance of record of the transactions of prescribed nature and value, furnishing of information relating to those transactions and verification and maintenance of the records of identity of all its clients in prescribed manner. Accordingly, instructions were issued to NBFCs in this respect vide our circular DNBS (PD) CC No. 34 /10.01/ 2003-04 dated January 05, 2004.

In respect of new customers acquired after April 1, 2004, KYC guidelines as stated in the above circular should be complied with in all cases. However, for the existing customers, initially, KYC guidelines should be complied in respect of large customers whose aggregate deposit exceeds Rs.1 lakh. For the remaining existing accounts, the companies should ensure that the details of the customers are updated at the time of renewal of the deposit. This should, however, not result in unnecessary harassment of customers. The RNBCs should report compliance to RBI by January 31, 2005.

As regards deposits collected by agents / sub-agents in as much as the agent / sub-agent is collecting the deposits on behalf of the RNBC, it shall be the sole responsibility of the RNBC to ensure full compliance with the KYC guidelines by its agents and sub-agents. The RNBC should make available all information to the regulator or his nominee to verify the compliance with the KYC guidelines and accept full consequences of any violation by the agent / sub-agent who is operating on its behalf.



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iv. Due diligence of agents / Sub-agents

As an extension of the KYC Guidelines, RNBCs should put in place a process of due diligence in respect of the agents / sub-agents collecting deposits on behalf of the company through a uniform policy for appointment and detailed verification. Details of due diligence conducted may be kept on record with the company for verification. Compliance in this regard should be reported to RBI by January 31, 2005.

In the depositors' interest and for enhancing transparency of operations, the companies should have systems in place to ensure that the books of accounts of their agents / sub-agents, so far as they relate to agency functions of the company, are available for audit and inspection whenever required.

v. Customer service in terms of identifiable contact with agents / sub-agents

All deposit receipts should bear the name of the RNBC and must invariably indicate the name of the agent / sub-agent and their addresses who mobilised the deposit and the link branch with the telephone number in order that there is a clear indication of the identifiable contact with the field agents and matters such as unclaimed / lapsed deposits, discontinued deposits, interest payments and other customer grievances are appropriately addressed. The companies may also evolve suitable review procedures to identify agents in whose cases the incidence of discontinued deposits is high for taking suitable action.

vi. Agency Commission Structure

The agency commission structure should be devised in a manner that is not detrimental to the interests of the depositors. The rates, structure and the actual amounts paid should be reported to the Regional Office of RBI on a quarterly basis. The first report should be submitted as on December 31, 2004 by January 31, 2005. A format for reporting this information is being sent separately.

4. Please acknowledge receipt of the circular to the Regional Office under whose jurisdiction the registered office of your company is located and also report to that Regional Office the action taken, by January 31, 2005.

Yours faithfully,

(D.S. Nagi)
Chief General Manager

Encls.: As above



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EXTRACT OF PARAGRAPH 133 AND 134 FROM THE MID-TERM REVIEW OF ANNUAL POLICY STATEMENT FOR THE YEAR 2004-05

NON-BANKING FINANCE COMPANIES

(A) ROAD MAP FOR RESIDUARY NON-BANKING COMPANIES

133. With a view to smoothening the process of transition of RNBCs to compliance with RBI's directions, the following approach is proposed:

- Investments of RNBCs in certificates of deposit of financial institutions which have a minimum rating of AA+ at the time of investment will be reckoned as eligible securities as long as they have minimum investment grade rating.
- Current account balances of RNBCs with commercial banks would be considered as eligible investments.
- The investments of RNBCs in bonds and debentures of companies which meet stipulated listing and rating requirements at the time of investment will be considered as ineligible investments if they migrate to below the investment grade rating.

134. In order to ensure that the depositors are served appropriately and systemic risks are avoided, RBI intends to focus on improvements in the functioning of RNBCs. These include: (i) transparency of operations, especially in the connected lending relationships; (ii) corporate governance standards including professionalisation of the Boards and ensuring 'fit and proper' criteria in consonance with the standards in banks; (iii) avoiding untenable rates of commission to agents; (iv) adherence to 'know your customer' rules through systems consistent with their business but subject to regulator's close oversight; and (v) customer service in terms of clear indication of the identifiable contact with the field agents so that matters such as unclaimed deposits are appropriately addressed. Detailed guidelines in regard to action to be taken by RNBCs on the above would be issued separately.



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Annexure I

'Fit and proper' criteria for directors of RNBCs

1. The Boards of RNBCs should undertake a process of due diligence to determine the suitability of the person for appointment / continuing to hold appointment as a director on the Board, based upon qualification, expertise, track record, integrity and other 'fit and proper' criteria. For assessing integrity and suitability, features like criminal record, financial position, civil actions initiated to pursue personal debts, refusal of admission to or expulsion from professional bodies, sanctions applied by regulators or similar bodies, previous questionable business practices, etc. may be considered. The Board of Directors may assess 'fit and proper' by calling for information by way of self-declaration, verification reports from market, etc. RNBCs should obtain necessary information and declaration from the proposed / existing directors for the purpose in Proforma 1.
2. The process of due diligence should be undertaken by the RNBCs at the time of appointment / renewal of appointment.
3. The Boards of the RNBCs should constitute Nomination Committees to scrutinise the declarations.
4. Based on the information provided in the signed declaration, Nomination Committees should decide on the acceptance and may make references, where considered necessary to the appropriate authority / persons, to ensure their compliance with the requirements indicated.
5. RNBCs should obtain annually as on 31st March a simple declaration that the information already provided has not undergone change and where there is any change, requisite details are furnished by the directors forthwith.
6. Further, the candidate should normally not exceed 70 years of age, should not be a Member of Parliament / Member of Legislative Assembly / Member of Legislative Council.
7. Any change in directors during the year should be reported to the concerned Regional Office of DNBS in the Proforma 1 enclosed.
8. The Directors will execute a Covenant (as per Proforma 2 attached) binding them to discharge their responsibilities, to the best of their abilities, individually and collectively.



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Proforma 1

Information about new Directors / change of Directors of the Residuary Non- Banking Company

1. Name :
2. Designation :
3. Nationality :
4. Age :
5. Business Address :
6. Residential Address :
7. Educational/professional qualifications :
8. Line of business or vocation :
9. Name/s of other companies in which the person has held the post of Chairman/ Managing Director/ Director/ Chief Executive Officer :
10. (i) Whether associated as promoter, Managing Director, Chairman or Director with any NBFC including a Residuary Non- Banking Financial Company which has been prohibited from accepting deposits/ prosecuted by RBI? :
(ii) If yes, the name/s of the company/ies :
11. (i) Whether prosecuted/convicted for any economic offence either in the individual capacity or as a partner/ director of any firm/ company :
(ii) If yes, particulars thereof :
12. Experience in the business of NBFC (number of years) :
13. Equity shareholding in the company :
No. of shares :
Face value :
Percentage to total equity share capital of the company: :
14. Name/s of the companies, firms and propriety concerns in which the person holds substantial interest (primarily to assess contravention of Section 45 S of RBI Act, 1934, if any) :



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15. Names of the principal bankers to the concerns at 14 above :

Signature	:	Name	:
Date	:	Designation	:
Place	:	(Chief Executive Officer)	:
		Company	:

Proforma 2

PROFORMA OF DEED OF COVENANTS WITH A DIRECTOR

THIS DEED OF COVENANTS is made this _____ day of _____ Two thousand _____ between _____, having its registered office at _____ (hereinafter called the 'Company") of the one part and Mr/Ms _____ of _____ (hereinafter called the "Director") of the other part.

WHEREAS

- A. The director has been appointed as a director on the Board of Directors of the Company and is required as a term of his/her appointment to enter into a Deed of Covenants with the Company.
- B. The director has agreed to enter into this Deed of Covenants, which has been approved by the Board, pursuant to his said terms of appointment.

NOW IT IS HEREBY AGREED AND THIS DEED OF COVENANTS WITNESSETH AS FOLLOWS:

- The director acknowledges that his/her appointment as director on the Board of the Company is subject to applicable laws and regulations including the Memorandum and Articles of Association of the Company and the provisions of this Deed of Covenants.
- The director covenants with the Company that :
 - The director shall disclose to the Board the nature of his/her interest, direct or indirect, if he/she has any interest in or is concerned with a contract or arrangement or any proposed contract or arrangement entered into or to be entered into between the Company and any other person, immediately upon becoming aware of the same or at meeting of the Board at which the question of entering into such contract or arrangement is taken into consideration or if the director was not at the date of that meeting concerned or interested in such proposed contract or arrangement, then at the first meeting of the Board held after he/she becomes so concerned or interested and in case of any other contract or arrangement, the



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required disclosure shall be made at the first meeting of the Board held after the director becomes concerned or interested in the contract or arrangement.

(ii) The director shall disclose by general notice to the Board his/her other directorships, his/her memberships of bodies corporate, his/her interest in other entities and his/her interest as a partner or proprietor of firms and shall keep the Board apprised of all changes therein.

(iii) The director shall provide to the Company a list of his/her relatives as defined in the Companies Act, 1956 and to the extent the director is aware directorships and interests of such relatives in other bodies corporate, firms and other entities.

(iv) The director shall in carrying on his/her duties as director of the Company

- (a) use such degree of skill as may be reasonable to expect from a person with his/her knowledge or experience;
- (b) in the performance of his/her duties take such care as he/she might be reasonably expected to take on his/her own behalf and exercise any power vested in him/her in good faith and in the interests of the Company;
- (c) shall keep himself/herself informed about the business, activities and financial status of the Company to the extent disclosed to him/her;
- (d) attend meetings of the Board and Committees thereof (collectively for the sake of brevity hereinafter referred to as "Board") with fair regularity and conscientiously fulfill his/her obligations as director of the Company;
- (e) shall not seek to influence any decision of the Board for any consideration other than in the interests of the Company;
- (f) shall bring independent judgement to bear on all matters affecting the Company brought before the Board including but not limited to statutory compliances, performance reviews, compliances with internal control systems and procedures, key executive appointments and standards of conduct;
- (g) shall in exercise of his/her judgement in matters brought before the Board or entrusted to him/her by the Board be free from any business or other relationship which could materially interfere with the exercise of his/her independent judgement; and
- (h) shall express his/her views and opinions at Board meetings without any fear or favour and without any influence on exercise of his/her independent judgement;

(v) The director shall have :

- (a) fiduciary duty to act in good faith and in the interests of the Company and not for any collateral purpose;



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- (b) duty to act only within the powers as laid down by the Company's Memorandum and Articles of Association and by applicable laws and regulations; and
 - (c) duty to acquire proper understanding of the business of the Company.
- (vi) The director shall :
- (a) not evade responsibility in regard to matters entrusted to him/her by the Board;
 - (b) not interfere in the performance of their duties by the whole-time directors and other officers of the Company and wherever the director has reasons to believe otherwise, he/she shall forthwith disclose his/her concerns to the Board; and
 - (c) not make improper use of information disclosed to him/her as a member of the Board for his/her or someone else's advantage or benefit and shall use the information disclosed to him/her by the Company in his/her capacity as director of the Company only for the purposes of performance of his/her duties as a director and not for any other purpose.
3. The Company covenants with the director that :
- (i) the Company shall apprise the director about :
- (a) Board procedures including identification of legal and other duties of Director and required compliances with statutory obligations
 - (b) control systems and procedures
 - (c) voting rights at Board meetings including matters in which Director should not participate because of his/her interest, direct or indirect therein
 - (d) qualification requirements and provide copies of Memorandum and Articles of Association
 - (e) corporate policies and procedures
 - (f) insider dealing restrictions
 - (g) constitution of, delegation of authority to and terms of reference of various committees constituted by the Board
 - (h) appointments of Senior Executives and their authority;
 - (i) remuneration policy,
 - (j) deliberations of committees of the Board, and



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- (k) communicate any changes in policies, procedures, control systems, applicable regulations including Memorandum and Articles of Association of the Company, delegation of authority, Senior Executives, etc. and appoint the compliance officer who shall be responsible for all statutory and legal compliance.
- (ii) the Company shall disclose and provide to the Board including the director all information which is reasonably required for them to carry out their functions and duties as a director of the Company and to take informed decisions in respect of matters brought before the Board for its consideration or entrusted to the director by the Board or any committee thereof;
- (iii) the disclosures to be made by the Company to the directors shall include but not be limited to the following:
- (a) all relevant information for taking informed decisions in respect of matters brought before the Board
 - (b) Company's strategic and business plans and forecasts
 - (c) organisational structure of the Company and delegation of authority
 - (d) corporate and management controls and systems including procedures
 - (e) economic features and marketing environment
 - (f) information and updates as appropriate on Company's products
 - (g) information and updates on major expenditure
 - (h) periodic reviews of performance of the Company
 - (i) report periodically about implementation of strategic initiatives and plans
- (iv) the Company shall communicate outcome of Board deliberations to directors and concerned personnel and prepare and circulate minutes of the meeting of Board to directors in a timely manner and to the extent possible within two business days of the date of conclusion of the Board meeting; and
- (v) advise the director about the levels of authority delegated in matters placed before the Board.
4. The Company shall provide to the director periodic reports on the functioning of internal control system including effectiveness thereof.
5. The Company shall appoint a compliance officer who shall be a Senior executive reporting to the Board and be responsible for setting forth policies and procedures and shall monitor adherence to the applicable laws and regulations and policies and procedures including but not limited to directions of Reserve Bank of India and other concerned statutory and governmental authorities.
6. The director shall not assign, transfer, sublet or encumber his/her office and his/her rights and obligations as director of the Company to any third party provided that nothing herein contained shall be construed to prohibit delegation



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of any authority, power, function or delegation by the Board or any committee thereof subject to applicable laws and regulations including Memorandum and Articles of Association of the Company.

7. The failure on the part of either party hereto to perform, discharge, observe or comply with any obligation or duty shall not be deemed to be a waiver thereof nor shall it operate as a bar to the performance, observance, discharge or compliance thereof at any time or times thereafter.

8. Any and all amendments and/or supplements and/or alterations to this Deed of Covenants shall be valid and effectual only if in writing and signed by the director and the duly authorised representative of the Company.

9. This Deed of Covenants has been executed in duplicate and both the copies shall be deemed to be originals.

IN WITNESS WHEREOF THE PARTIES HAVE DULY EXECUTED THIS AGREEMENT ON THE DAY, MONTH AND YEAR FIRST ABOVE WRITTEN.

For the Company

Director

By

Name

Name

Title

In the presence of :

1.

2.



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Annexure II

Guidelines on the Connected Lending Relationships

The RNBCs should evolve appropriate operating procedures and information systems for ascertaining the interest of their own Directors as also the interest of the Directors of other companies for the purpose of implementing these instructions and for monitoring ongoing compliance therewith.

1. Credit facilities to the Directors

1.1 In order to obviate conflict of interest in the lending operations of the RNBC, it should not grant any loan, advance or non-fund based facility or any other financial accommodation / facility to :

- a. its directors or their relatives;
- b. to any firm in which any of its Directors is interested as Partner, Manager, Employee or Guarantor;
- c. any individual in respect of whom any of its Directors is a Guarantor;
- d. any company of which, or the subsidiary or the holding company of which, any of the Directors of the RNBC is a Director, Managing Agent, Manager, Employee or Guarantor or in which he holds substantial interest.
- e. Any entity, whether incorporated or not which uses as a part of its name or in connection with its business, the name of the RNBC or any such word as would show its association with the RNBC.

1.2 Any existing arrangements may be allowed to continue up to the date when they are due. They should, however, not be renewed or extended any further.

1.3 RNBCs are required to submit information pertaining to loans and advances granted to their directors, relatives and other entities referred to item 1.1 above for each quarter end (i.e. 31st March, 30th June, 30th September and 31st December) in the enclosed Proforma 3 to the Regional Office concerned of this Department within 15 days from the close of the respective quarter.

2. Timeframe for recovery of loans

2.1 In cases where the RNBC has already entered into transactions covered within the prohibitions stipulated above, immediate steps should be initiated to recover the amounts due to the RNBC on account of the loan or advance together with interest, if any, due thereon within the period stipulated at the time of grant of the loan or advance.

2.2 In case there is no repayment date fixed for any facility, the same may be recovered within a period of one year from the date of this circular.

3. Definitions

3.1 The term "substantial interest" for the purpose of these instructions :



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(i) in relation to a company, means the holding of a beneficial interest by an individual or his spouse or minor child, whether singly or taken together, in the shares thereof, the amount paid-up on which exceeds five lakhs of rupees or ten per cent of the paid-up capital of the company, whichever is less;

(ii) in relation to a firm, means the beneficial interest held therein by an individual or his spouse or minor child, whether singly or taken together, which represents more than ten per cent of the total capital subscribed by all the partners of the said firm;

3.2 The scope of the term "relative" shall be as defined in Section 45 S (3) of the Reserve Bank of India Act, 1934.

Proforma 3

Information in respect of Loans and Advances Sanctioned to the Directors of RNBCs, their relatives and other entities mentioned in para 1.1 of Annexure I

Name of the RNBC :
Position as on :

Sr. No.	Name of the Borrowers	Limits Sanctioned (Rs. in lakhs)							
		Date of Sanction/ Renewal	Type of Facility		Secured	Unsecured	Nature and Value of Security	Due Date/ Date of Maturity	
			Funded	Non-funded					
1	2	3	4	5	6	7	8	9	

Amount Outstanding (Rs. in Lakhs)				
Secured	Unsecured	Total (100% of Funded and 50% of Non-funded Limits)	Whether in Excess of Exposure Norms/Limits stipulated by RBI	Action initiated in case of Overdue/ NPA Accounts
10	11	12	13	14

Note: Different types of facilities sanctioned to a borrower should be indicated separately against column 4 and 5.