भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA
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RBI/2021-22/149

DOR.CRE.REC.No.77/21.04.172/2021-22 January 05, 2022

All Scheduled Commercial Banks (excluding RRBs)

Madam/ Dear Sir,

Master Circular - Bank Finance to Non-Banking Financial Companies (NBFCs)

Please refer to our Master Circular DBR.BP.BC.No.5/21.04.172/2015-16 dated July 1, 2015 on the captioned subject. This Master Circular consolidates instructions on the above matter issued up to January 04, 2022.

Yours faithfully,

(Manoranjan Mishra)
Chief General Manager

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Master Circular on Bank Finance to Non-Banking Financial Companies (NBFCs)

Purpose

To lay down the Reserve Bank of India's regulatory policy regarding financing of NBFCs by banks.

Classification

A statutory guideline issued under Section 35A of Banking Regulation Act, 1949.

Previous guidelines

Master Circular DBR.BP.BC.No.5/21.04.172/2015-16 dated July 1, 2015 on 'Bank Finance to Non-Banking Financial Companies (NBFCs)'.

Application

To all Scheduled Commercial Banks (excluding Regional Rural Banks).

Structure

1. Introduction

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. With the amendment of the Reserve Bank of India Act, 1934 in January 1997, in terms of Section 45 IA of the said Act, and amendment of the National Housing Bank Act, 1987 in August 2019, in terms of Section 29 A of the National Housing Bank Act, 1987, all Non-Banking Financial Companies including Housing Finance Companies have to be mandatorily registered with the Reserve Bank of India.

1.1 Terminology

a. 'NBFCs' means the Non-Banking Financial Companies registered with the Reserve Bank of India, which shall also include Housing Finance Company (HFC) registered under Section 29 A of the National Housing Bank Act, 1987.

b. 'Current investments' means the investments classified in the balance sheet of the borrower as 'current assets' and are intended to be held for less than one year.

c. 'Long term investments' means all types of investments other than that classified as 'current assets'.

d. 'Unsecured loans' means the loans not secured by any tangible asset.

1.2 Background

The credit related matters of banks have been progressively deregulated by Reserve Bank of India. Consistent with the policy of bestowing greater operational freedom to banks in the matter of credit dispensation and in the context of mandatory registration of NBFCs with the Reserve Bank, most of the aspects relating to financing of NBFCs by banks have also been deregulated. However, in view of the sensitivities attached to financing of certain types of activities undertaken by NBFCs, restrictions on financing of such activities continue to be in force.

2. Bank Finance to NBFCs registered with RBI

2.1 The ceiling on bank credit linked to Net Owned Fund (NOF) of NBFCs has been withdrawn in respect of all NBFCs which are statutorily registered with RBI and are engaged in principal business of asset financing, loan, factoring and investment activities. Accordingly, banks may extend need based working capital facilities as well as term loans to all NBFCs registered with RBI and engaged in infrastructure financing, equipment leasing, hire-purchase, loan, factoring and investment activities subject to provisions of para 8 of these guidelines.

2.2 In the light of the experience gained by NBFCs in financing second hand assets, banks may also extend finance to NBFCs against second hand assets financed by them.

2.3 Banks may formulate suitable loan policy with the approval of their Boards of Directors within the prudential guidelines and exposure norms prescribed by the Reserve Bank to extend various kinds of credit facilities to NBFCs subject to the condition that the activities indicated in paragraphs 4 and 6 are not financed by them.

3. Bank Finance to NBFCs not requiring Registration[1]

In terms of "Master Direction - Exemptions from the provisions of RBI Act, 1934" dated August 25, 2016, few categories of non-banking financial companies are exempted from certain provisions of the Reserve Bank of India Act, 1934 (the RBI Act, 1934), including the need for registration with the Reserve Bank. For such NBFCs not needing registration with the Reserve Bank, 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. Activities not eligible for Bank Credit

4.1 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 -

[1] While financing NBFCs, which do not require registration with RBI, banks should also refer to the guidelines / notifications issued in this regard from time to time by the Ministry of Corporate Affairs, Government of India.

(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) and for purchase of shares from secondary market.

4.2 Leased and Sub-Leased Assets

As banks can extend financial assistance to equipment leasing companies, they should not enter into lease agreements departmentally with such companies as well as other Non-Banking Financial Companies engaged in equipment leasing.

5. Bank Finance to Factoring Companies

Notwithstanding the restrictions mentioned at Paragraph 4.1 (i) and 4.1 (iv) above, banks can extend financial assistance to support the factoring business of Factoring Companies, which comply with the following criteria:

(a) The companies qualify as factoring companies and carry out their business under the provisions of the Factoring Regulation Act, 2011 and Notifications issued by the Reserve Bank in this regard from time to time.

(b) They derive at least 50 per cent of their income from factoring activity.

(c) The receivables purchased / financed, irrespective of whether on 'with recourse' or 'without recourse' basis, form at least 50 per cent of the assets of the Factoring Company.

(d) The assets / income referred to above would not include the assets / income relating to any bill discounting facility extended by the Factoring Company.

(e) The financial assistance extended by the Factoring Companies is secured by hypothecation or assignment of receivables in their favour.

6. Other Prohibitions on Bank Finance to NBFCs

6.1 Bridge loans / interim finance

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. Banks should strictly follow these instructions and ensure that they 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).

6.2 Advances against collateral security of shares to NBFCs

Shares and debentures cannot be accepted as collateral securities for secured loans granted to NBFC borrowers for any purpose.

6.3 Restriction on guarantees for placement of funds with NBFCs

Banks should not execute guarantees covering inter-company deposits / loans thereby guaranteeing refund of deposits / loans accepted by NBFCs / firms from other NBFCs / firms. The restriction would cover all types of deposits / loans irrespective of their source, including deposits / loans received by NBFCs from trusts and other institutions. Guarantees should not be issued for the purpose of indirectly enabling the placement of deposits with NBFCs. However, banks are permitted to provide partial credit enhancement (PCE) to bonds issued by NBFC-ND-SIs and Housing Finance

Companies (HFCs) as per guidelines contained at para 2.4 of the Master Circular on Guarantees and co-acceptances dated November 09, 2021, as updated from time to time.

7. Prudential ceilings for exposure of banks to NBFCs

7.1 The definition and method of computation of exposure would be as prescribed in the circular on Large Exposures Framework dated June 03, 2019 and amendments made from time to time.

7.2 Banks' exposures to a single NBFC (excluding gold loan companies) will be restricted to 20 percent of their eligible capital base (Tier I capital). However, based on the risk perception, more stringent exposure limits in respect of certain categories of NBFCs may be considered by banks. Banks' exposures to a group of connected NBFCs or group of connected counterparties having NBFCs in the group will be restricted to 25 percent of their Tier I Capital as detailed in circular on Large Exposures Framework dated June 03, 2019 read with circular on Large Exposures Framework dated September 12, 2019.

7.3 The exposure of a bank to a single NBFC which is predominantly engaged in lending against collateral of gold jewellery (i.e. such loans comprising 50 per cent or more of their financial assets), shall not exceed 7.5 per cent of the bank's capital funds (Tier I plus Tier II Capital). However, this exposure ceiling may go up by 5 per cent, i.e., up to 12.5 per cent of banks' capital funds if the additional exposure is on account of funds on-lent by such NBFCs to the infrastructure sector as detailed in circular on Bank Finance to NBFCs Predominantly Engaged in lending against Gold dated May 18, 2012.

7.4 Banks may also consider fixing internal limits for their aggregate exposure to all NBFCs put together.

7.5 Banks should have an internal sub-limit on their aggregate exposures to all NBFCs, having gold loans to the extent of 50 per cent or more of their total financial assets, taken together. This sub-limit should be within the internal limit fixed by the banks for their aggregate exposure to all NBFCs put together as prescribed in paragraph 7.4 above.

7.6 Infusion of eligible capital funds after the published balance sheet date may also be taken into account for the purpose of computing exposure ceiling. Banks should obtain an external auditor's certificate on completion of the augmentation of capital and submit the same to the Reserve Bank of India (Department of Supervision) before reckoning the additions to capital funds

7.7. Banks shall adhere to the intra-group limits in accordance with Guidelines on Management of Intra-Group Transactions and Exposures dated February 11, 2014.

8. Restrictions regarding investments made by banks in securities / instruments issued by NBFCs

8.1 Banks should not invest in Zero Coupon Bonds (ZCBs) issued by NBFCs unless the issuer NBFC builds up sinking fund for all accrued interest and keeps it invested in liquid investments / securities (Government bonds).

8.2 Banks are permitted to also invest in Non-Convertible Debentures (NCDs) with original or initial maturity up to one year issued by NBFCs. However, while investing in such instruments banks should be guided by the extant prudential guidelines in force, ensure that the issuer has disclosed the purpose for which the NCDs are being issued in the disclosure document and such purposes are eligible for bank finance in terms of instructions given in the preceding paragraphs.

Appendix

List of Circulars Consolidated in the Master Circular

Sl No.	Circular No	Date	Subject
1.	DBOD.No.FSC.BC.71/C.469 /91-92	22.01.1992	Restriction on credit to certain sectors
2.	IECD. No. 14/08.12.01/94-95	28.09.1994	Lending to Non-Banking Financial Companies
3.	IECD.No.42/08.12.01/94-95	21.04.1995	Lending to Non-Banking Financial Companies
4.	DBOD.No.FSC.BC.101/24.0 1.001/95-96	20.09.1995	Equipment Leasing, Hire Purchase and Factoring etc. Activities
5.	IECD. No. 17/03.27.026/96-97	06.12.1996	Bank Finance for Purchase/Lease of Existing Assets
6.	IECD.No.1 5/08.12.01/97-98	04.11.1997	Guidelines for Lending by Banks - Assessment of Working Capital
7.	DBOD.No.Dir.BC.90/13.07.0 5/98-99	28.08.1998	Bank Finance against Shares & Debentures
8.	DBOD.No.Dir.BC.107/13.07. 05/98-99	11.11.1998	Rediscounting of Bills by Banks
9.	IECD.No.29/08. 12.01/98-99	25.05.1999	Lending to Non-Banking Financial Companies (NBFCs)
10.	DBOD.No.Dir.BC.173/13.07. 05/99- 2000	12.05.2000	Rediscounting of Bills by Banks
11.	DBOD.No.BP.BC.51/21.04.1 37/2000- 01	10.11.2000	Bank Financing of Equities and Investment in Shares

12.	RBI/273/2004-05 DBOD.IECS.BC.No.57/08.12.01 (N)/2004-05	19.11.2004	Mid-Term Review of the Annual Policy Statement for the year 2004-05 - Bank Finance to NBFCs
13.	RBI/2004-05/68 DBOD.No.Dir.BC.18/13.03.00/2004-05	23.07.2004	Master Circular – Guarantees and Co-acceptances
14.	RBI/2006-07/205 DBOD.No.FSD.BC.46/24.01.028/2006-07	12.12.2006	Financial Regulation of Systematically Important NBFCs and Bank's Relationship with them - Final Guidelines
15.	RBI/2007-08/235 DBOD.BP.BC.No.60/08.12.01/2007-08	12.02.2008	Bank Finance to Factoring Companies
16.	RBI/2009-10/317 DBOD.No.BP.BC.74/21.04.172/2009-10	12.02.2010	Risk Weights and Exposure Norms in respect of Bank Exposure to NBFCs categorised as 'Infrastructure Finance Companies'
17.	RBI/2010-11/219 DBOD.No.BP.BC.44/21.04.141/2010-11-11	29.09.2010	Prudential Norms on Investment in Zero Coupon Bonds
18.	RBI/2010-11/349 DBOD.BP.BC.No.72/21.04.141/2010-11	31.12.2010	Investment in Non-SLR Securities - Non-Convertible Debentures (NCDs) of maturity up to one year
19.	RBI/2011-12/568 DBOD.BP.BC.No.106/21.04.172/2011-12	18.05.2012	Bank Finance to NBFCs Predominantly Engaged in lending against Gold
20.	RBI/2012-13/199 DBOD.BP.BC.No.40/21.04.172/2012-13	11.09.2012	Bank Finance to Factoring Companies

21.	RBI/2013-14/487 DBOD.No.BP.BC.96/21.06.102/2013-14	11.02.2014	Guidelines on Management of Intra-Group Transactions and Exposures
22.	RBI/2015-16/247 DBR.BP.BC.No.55/21.04.172/2015-16	26.11.2015	Bank Finance to Factoring Companies
23.	RBI/2018-19/196 DBR.No.BP.BC.43/21.01.003/2018-19	03.06.2019	Large Exposures Framework
24.	RBI/2019-20/60 DBR.No.BP.BC.18/21.01.003/2019-20	12.09.2019	Large Exposures Framework