

RESERVE BANK OF INDIA

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**To all Non-Banking Financial Companies (NBFCs)
and Residuary Non-Banking Companies (RNBCs)**

Dear Sir,

**Non-Banking Financial Companies –
Amendments to Directions**

Please refer to (i) Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 contained in Notification No.DFC.118/ DG (SPT)-98 dated January 31, 1998, (NBFC Directions on Acceptance of Public Deposits) (ii) Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998 contained in Notification No.DFC.119/ DG (SPT)/98 dated January 31, 1998, (NBFC Directions on Prudential Norms) (iii) Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 1998 contained in Notification No.DFC. 117/DG(SPT)-98 dated January 2, 1998 RBI (Directions to Auditors) and, (IV) Reserve Bank of India (Non-Banking Financial Companies) Returns Specifications 1997 contained in Notification No. DFC(COC) No.108/ED(JRP)-97 dated April 30, 1997 (RBI Directions on Return for Liquid Assets).

2. In terms of NBFC Directions on Acceptance of Public Deposits it was mandatory for an NBFC to obtain minimum investment grade credit rating for fixed deposits for acceptance of public deposits and the quantum of public deposit was linked to the level of credit rating from an approved agency for this purpose, with an objective to enable the depositor to make an informed decision. Credit rating based on the principle of Neutrality of Assessment and reflecting the financial and operational strength of the rated company was considered as an appropriate tool for indirect supervision and monitoring the NBFCs. It was felt that confidence of the depositors could be sustained only by continued good performance and compliance with prudential norms by an NBFC as reflected in the credit rating enjoyed by it. The NBFCs were encouraged to broad-base their resources by resorting to borrowings from banks and financial institutions, inter-corporate deposits/loans, secured debentures/bonds etc. which were exempted from the definition of "public deposit".

3. NBFCs, their Associations and the apex trade bodies had, however, in their representations to the Reserve Bank of India (RBI) and the Government of India brought

to focus that frequent downgrading of the credit ratings and consequent requirement of downward adjustment of quantum of public deposits caused asset liability mismatches for the NBFCs. It was also suggested that smaller NBFCs could be exempted from the requirement of credit rating for having public deposits up to a particular limit, and that larger NBFCs be allowed higher limits of public deposits subject to their obtaining minimum investment grade credit rating and complying with the higher capital adequacy requirements.

4. Government of India appointed a Task Force on NBFCs under the Chairmanship of Shri C.M. Vasudev, Special Secretary (Banking) where RBI was also represented. The Task Force, in its report dated October 28, 1988, has recommended rationalisation of regulations for NBFCs, improvement of the legislative framework for protecting the interests of depositors and development of NBFCs sector on sound and healthy lines. A summary of recommendations is enclosed for your information. The recommendations of the Task Force have been broadly accepted by the Government and RBI.

5. The regulatory framework has been modified in tune with the recommendations of the Task Force, with immediate effect. The significant changes are discussed below.

A. Amendments to Directions

1. Entitlement of public deposit and Requirement of credit rating

(A) NBFCs having Net Owned Fund below Rs 25 lakh cannot access any public deposits.

(B) The entitlement for quantum of public deposits vis-a-vis the credit rating would be as follows.

Net owned fund (NOF)	Quantum of deposits for	
	Equipment Leasing/ Hire Purchase Finance Companies	Loan Companies/ Investment Companies
Below Rs.25 lakh with or without credit rating	Nil	Nil
Rs.25 lakh and above without credit rating as credit rating less than the minimum investment grade	Public deposits not exceeding 1.5 times of NOF or public deposit or Rs.10 crore whichever is less provided the company has CRAR of 15% or above with immediate effect	Nil
Rs.25 lakh and above with minimum investment grade credit rating	4 times of NOF with CRAR of not less than 10% as on 31.3.1998 and shall have CRAR of not less than 12% as on 31.3.1999	Public deposits not exceeding 1.5 times of NOF provided the company has CRAR of 15% or above with immediate effect.

- Note :
1. The stipulations regarding ceiling on rate of interest, payment of brokerage, period of deposit, compulsory compliance with prudential norms, etc. remain unchanged.
 2. CRAR shall be reckoned with reference to the last audited balance sheet.

2. Equipment leasing and hire purchase finance companies

- (i) The NBFCs in this category
 - (a) not having CRAR of 15 percent or above or
 - (b) **not having minimum investment grade credit rating** irrespective of their compliance with the prudential norms are **not** entitled to accept public deposits, as hitherto.
- (ii) The unrated and underrated companies having rating below the minimum investment grade have been allowed to accept public deposits upto 1.5 times of their NOF or public deposits upto Rs.10 crore whichever is less provided their CRAR is 15 percent or above as per their last audited balance sheet.
- (iii) NBFCs ,
 - (a) having CRAR of 10 percent or above as on March 31, 1998 and attaining CRAR of 12 percent as on March 31,1999.
 - (b) complying with all other prudential norms; and
 - (c) having minimum investment grade credit rating may accept public deposits up to four times their NOF.

The Bank intends to increase the CRAR to 15 percent over a period of time for **all NBFCs** including those having a minimum investment grade rating. The companies should, therefore, endeavour to increase their CRAR as early as possible.

3. Loan and investment companies

- (i) The unrated and underrated companies irrespective of their CRAR, are not entitled to accept public deposits, as hitherto.
- (ii) Companies having **both, a minimum investment grade credit rating and CRAR of 15 per cent** or above may accept public deposits upto 1.5 times of the NOF.
- (iii) The loan/investment companies **not** having minimum CRAR of 15 percent as on date but otherwise complying with all the prudential norms and
 - (a) having credit rating of AAA may accept or renew public deposits up to the level outstanding as at the close of business on December 18, 1998 or 1.5 times of the NOF whichever is more, subject to the condition that they should attain CRAR of 15 per cent by March 31, 2000 and bring down the excess public deposits, if any, by December 31, 2001.
(Note: The loan / investment companies having credit rating of AAA and CRAR of 15 percent and above, and complying with all the prudential norms should bring down the quantum of excess deposits by December 31, 2001 in manner as shown above.)
 - (b) having credit rating of AA / A may accept or renew public deposits as

per the existing provisions of Directions i.e. up to 0.5/1.0 time of their NOF but they should attain the minimum CRAR of 15% on or before March 31, 2000 as per their audited balance sheet, failing which they should regularise their position by repayment or otherwise by December 31, 2001.

This benefit will, however, not be available to those companies whose CRAR is presently 15 percent or above but slips down below the minimum level of 15 percent subsequently.

**4. Downgrading of credit rating and holding
of excess deposits – Regularisation**

- (i) It has come to our notice some NBFCs were repaying only a part (say 1/3rd) of the maturing deposit by misinterpreting RBI's direction that the excess deposits are to be reduced by at least 1/3rd of the excess at the end of each year. This is tantamount to forcing the depositors to renew their deposit and is violative of the provisions of Section 45QA(1) of the RBI Act. **RBI would view such violations seriously.** Deposits must be repaid on maturity. Further, it is clarified that deposits can be renewed at the sole discretion and violation of the depositors for which a fresh application form should be obtained from them.
- (ii) In order to mitigate the genuine liquidity problems faced by NBFCs in reducing their excess deposits in compliance with the existing repayment stipulations, the excess deposits arising out of downgrading of the credit rating as also due to regulatory ceilings have been allowed to be repaid at the time of maturity of such deposits. The NBFCs should not accept fresh public deposits until the quantum of such deposits held by them is within the ceilings permissible as per new directions. During the interregnum, they may renew such deposits. However, only AAA rated loan / investment companies may accept fresh deposits or renew maturing deposits as stated in paragraph 3(iii)(a) above even if they are holding excess public deposit.
- (iii) The auditors of the NBFCs are specifically being advised to report to the RBI the steps taken by the companies to regularise the excess deposits.

**5. Disclosure norms for acceptance
of public deposits by NBFCs**

The disclosure norms for the NBFCs accepting public deposits have been widened so as to enable depositors to make an informed decision.

- (i) **Status of rating and quantum of deposit**
The unrated and under-rated equipment leasing and hire purchase finance companies accepting public deposits are required to disclose in their application forms and advertisements issued, if any, for soliciting deposits that the company is unrated or if it is rated, the latest rating even if it is below the investment grade along with name of the rating agency. Equipment Leasing and Hire Purchase Companies having 15 percent CRAR soliciting public deposit without any rating shall also have to disclose in their application forms that quantum of public deposit held, if any, is less than one and one-half times of the NOF or Rs.10 crore, whichever is less.

(ii) **Exposure to Group/connected companies**

An NBFC soliciting public deposit, shall also disclose in the application form and advertisement, if any, its total exposure (including the non-fund based facilities) to companies in the same group, subsidiaries, and other entities as also business ventures in which directors as well as the NBFC is holding substantial interest as defined in the Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998.

6. Prudential Norms

(i) **Investments in land and building and unquoted shares**

NBFCs are directed to restrict their investment in land and building to not more than 10 percent of their owned fund, except for their own use. The ceiling on investments in unquoted shares of companies other than those in the same group and their subsidiaries has been fixed at 10 percent of the owned fund for equipment leasing / hire purchase finance companies and 20 percent of owned fund for the loan / investment companies. A period of three years has been allowed for disposal of the excess holdings of such assets. The assets acquired by the company in satisfaction of its debts should be disposed off within three years from the date of their acquisition. RBI may consider granting extension of time for disposal of such assets on merits of each case.

(ii) The NBFC Directions on Prudential Norms and the Half-Yearly return on Prudential Norms have been amended to include the above changes .

7. Maintenance of registers of deposits at branches

Avoidable inconvenience was caused to depositors by some NBFCs in repayment of their deposits at their branches on the plea that deposit records were held at the registered office as per the requirements of RBI. To remove any scope for such a plea, henceforth, the companies are required to maintain register of deposits in respect of the deposit accounts opened at any branch at that branch, apart from maintaining a consolidated register of deposits for all the branches at the registered office of the company.

8. Custody of Liquid Asset Securities

In addition to scheduled commercial banks, the Stock Holding Corporation of India Ltd. (SHCIL) has also been permitted to act as custodian of securities for liquid assets to be maintained by NBFCs for compliance with the provisions of paragraph 6 of the NBFC Directions on acceptance of public deposits. NBFCs desirous of availing of such services of SHCIL should obtain prior approval of the concerned Regional Office of RBI.

9. Maintenance of liquid assets

The requirement of maintenance of liquid assets which is presently 12.5 percent of the public deposits will be 15 percent of such deposits on and from April 1, 1999 as already notified vide our Notification No.122 of January 31, 1998. The recommendations of the Task force to increase the liquid assets ratio to 25 percent will, however, be implemented over a period of time.

B. Strengthening of Supervisory Mechanism

The Reserve Bank of India has instituted a comprehensive supervisory mechanism over NBFCs comprising of on-site inspections, off-site surveillance, Market Intelligence and enlarged role of statutory auditors.

- (i) **On-site Inspection**
The On-site inspection process structured on the CAMELS (Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Systems and Procedure) pattern aims at ascertaining the level and quality of adherence by the NBFCs to the regulatory norms prescribed by RBI in this regard.
 - (ii) **Off-site Surveillance system.**
Performance of companies will be monitored through Off-site Surveillance involving scrutiny of Statutory Returns, Balance Sheets, Profit & Loss Account, Auditors' Reports etc. The statutory returns will be analysed using sophisticated software for determining the quality of company's performance and adherence to regulatory standards prescribed by the Bank. Supervisory action will be triggered against the non-compliant NBFCs.
 - (iii) **Market Intelligence**
Market intelligence system has been strengthened with a view to using it as an important tool of effective supervision and for picking up early warning signals of aberrations in the NBFC sector, which may call for supervisory intervention.
 - (iv) **Role of Auditors – Responsibility to report to RBI to be included in Appointment letter**
As you are aware, in terms of RBI Directions to Auditors, the statutory auditors are required to report to RBI by exception, the violations or irregularities, if any, noticed by them in the course of audit of an NBFC. NBFCs are advised to include this requirement of compliance by auditors with the above directions in the appointment letter to be issued by them to the auditors so as to ensure that they are aware of their obligations.
- C. Responsibility of the NBFC for submission of returns to RBI**
- (i) NBFCs not accepting public deposits are not required to submit periodical returns. However, they are required to obtain registration under the provisions of Section 45IA of the RBI Act and furnish information as per paragraph 8(4) of the NBFC Directions on Acceptance of Public Deposits. The compliance of the regulations by such companies will be monitored on the basis of exception reports received from the auditors and market intelligence system.
 - (ii) The NBFCs accepting/holding public deposits are required to furnish to the RBI the following returns :
 - (a) Quarterly returns on liquid assets;
 - (b) Half-yearly returns on prudential norms;
 - (c) Annual returns on deposits; and
 - (d) Information as per paragraph 8(4) of the NBFC Directions on Acceptance of Public Deposit.
 - (iii) Companies having assets of Rs.100 crore and above have been directed to furnish detailed operational data for the last three years.
 - (iv) Some companies holding public deposits as on date, have not submitted the returns on liquid assets and prudential norms. This has been viewed seriously by the Bank. It may be noted that non-compliance with the directions and regulations of the Bank attracts penal provisions of section 58B(5) of RBI Act calling for imprisonment for a term upto three years and fine upto twice the amount of the deposit received besides the cancellation of certificate of registration issued to the company or rejection of its application.

6. A copy each of the amending Notifications Nos. 127, 128, 129, 130 and 131 are enclosed for your information and meticulous compliance. Should you require upto date copies of the Notification Nos.108 (relating to maintenance of liquid assets), 118 (relating to acceptance of public deposits) and 119 (relating to prudential norms) incorporating the amendments made, you may approach our Regional Office under the jurisdiction of which your registered office is located.
7. Please acknowledge receipt of this letter to the General Manager/Deputy General Manager of the Regional Office of Reserve Bank of India, Department of Non-Banking Supervision, under whose jurisdiction your registered office is situated.

Yours faithfully,

Sd/-

(V.S.N. Murty)

Chief General Manager

Encls: As above