Non-Banking Financial Companies: Regulatory Framework and Recent Developments

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Quick overview of the sector

- Was booming on the upswing of the equity market until the meltdown started
- Several pubic offers of NBFCs had come in the recent past
- Many of them were aggressively selling loans/ investment schemes/ mutual fund investments

Quick look at how many NBFCs take deposits

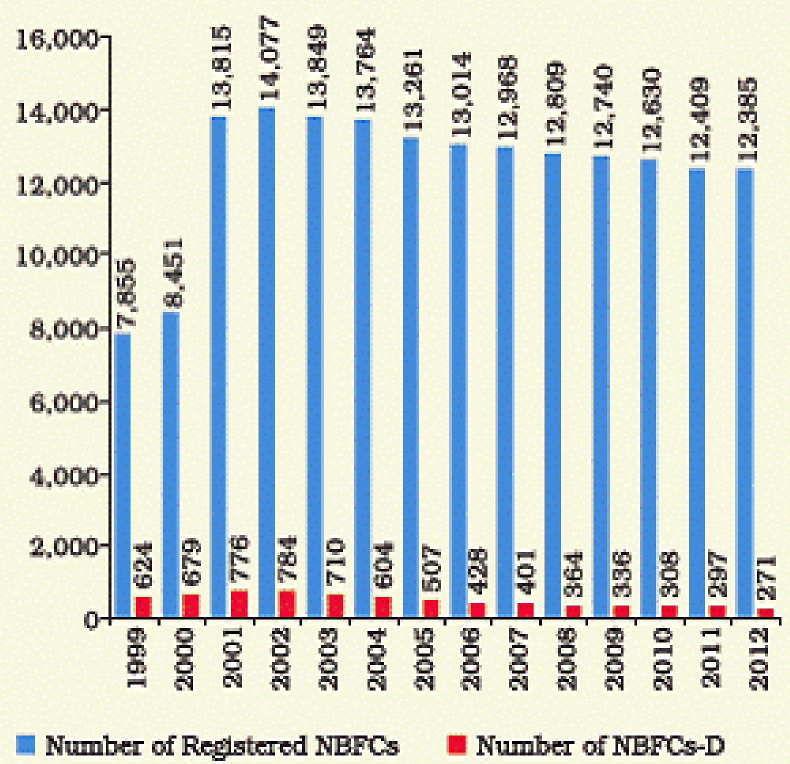


Chart VI.1: Number of NBFCs Registered with the Reserve Bank (As at end-March)

Number of NBFCs Registered with the Reserve Bank

End-June	Number of Registered NBFCs	Number of NBFCs-D
1	2	3
2001	13,815	776
2002	14,077	784
2003	13,849	710
2004	13,764	604
2005	13,261	507
2006	13,014	428
2007	12,968	401
2008	12,809	364
2009	12,740	336
2010	12,630	308
2011	12,409	297
2012	12,385	271

Declining figures in year 2011-2012

- However, the total number of NBFCs registered with Reserve Bank of India declined to 12,385 as at end March, 2012 from 12,409 as at end March 2011.There was also a decline in NBFCs-D in 2011-12.This decline was mainly for:
  - Cancellation of CoRs of NBFCs
  - Exit of NBFCs from deposit taking activities
  - Conversion of deposit taking companies into non-deposit taking companies
- Though decline recorded in number of NBFCs:
  - Total assets and NOF increased during 2011-12
  - Public deposits declined

Consolidated balance sheets – depository NBFC

(Amount in ` billion)

Item	As at end-March		Variation			
			2010-11		2011-12 P	
	2011	2012P	Absolute	Per Cent	Absolute	Per Cent
1	2	3	4	5	6	7
Paid-Up Capital	36	32	-3	-6.4	-4	-11.5
	(3.5)	(2.8)				
Reserves Surplus	135	162	13	10.9	27	20.2
	(12.8)	(13.9)				
Public Deposits	41	58	12	43.5	18	43.8
	(3.9)	(5.0)				
Borrowings	698	809	57	9.0	111	15.9
	(66.2)	(69.2)				
Other Liabilities	144	107	32	28.3	-37	-25.9
	(13.7)	(9.1)				
Total Liabilities/ Assets	1,054	1,169	112	11.9	114	10.8
	(100.0)	(100.0)				
Investments	211	159	26	14.1	-52	-24.8
(i) SLR Investments@	135	134	39	40.0	-1.0	-0.7
	(12.8)	(11.5)				
(ii) Non-SLR Investments	76	25	-12	-14.1	-51	-67.6
	(7.2)	(2.1)				
Loans and Advances	780	874	68	9.6	94	12.1
	(74.0)	(74.8)				
Other Assets	63	103	18	39.3	40	62.3

Profile of depository NBFCs and RNBCs

				(Amount in ` billion)
Item	As at end-March			
	2011		2012P	
	NBFCs	of which:*RNBCs*	NBFCs	of which:*RNBC*
1	2	3	4	5
Total Assets	1,169	115	1,244	76
		(9.8)		(6.1)
Public Deposits	120	79	101	43
		(66.0)		(42.2)
Net Owned Funds	180	30	225	31
		(16.6)		(13.7)

P:Provisional

Note: 1. NBFCs comprise NBFCs-D and RNBCs.
2. Figures in parentheses are percentage shares in respective total.
3. Of the 273 deposit-taking NBFCs, 196 NBFCs filed Annual Returns for the year ended March 2012 by the cut-off date, September 8, 2012.
Source: Annual/Quarterly Returns.

Systemically important companies

- The show-stealer was the NBFC-ND-SI segment, which grew tremendously

(Amount in ` billion)

Item	2010-11	2011-12	Variation (Per cent)
1	2	3	4
1. Share Capital	382	505	32.1
2. Reserves & Surplus	1,599	1,901	18.9
3. Total Borrowings	5,175	6,398	23.6
A. Secured Borrowings	2,915	3,770	29.3
A.1. Debentures	984	1,732	76.0
A.2. Borrowings from Banks	1,006	1,441	43.2
A.3. Borrowings from FIs	103	90	-12.7
A.4. Interest Accrued	52	63	22.9
A.5. Others	770	444	-42.3
B. Un-Secured Borrowings	2,260	2,628	16.3
B.1. Debentures	753	1,218	61.7
B.2. Borrowings from Banks	461	436	-5.3
B.3. Borrowings from FIs	31	53	74.0
B.4. Borrowings from Relatives	13	12	-9.5
B.5. Inter-Corporate Borrowings	242	278	14.5
B.6. Commercial Paper	314	306	-2.8
B.7. Interest Accrued	44	69	59.0
B.8. Others	401	256	-36.3
4. Current Liabilities & Provisions	457	409	-10.6

NBFCs-ND-SI

- ND-SI sector is growing rapidly and unsecured borrowings comprise largest source of funds.
- The leverage ratio of the entire ND-SI sector remains the same during 2011-12 as in the previous year. Assets and borrowings significantly increased
- Financial performance of NBFCs-ND-SI sector deteriorated marginally as reflected in the decline in net profit

			(Amount in ` billion)
Item	As at end		
	March 2011	March 2012	June 2012
1	2	3	4
1. Total Income	752	948	263
2. Total Expenditure	529	740	192
3. Net Profit	160	139	51
4. Total Assets	7,613	9,213	9,608
Financial Ratios			
(i) Income to Total Assets (per cent)	9.9	10.3	2.7
(ii) Expenditure to Total Assets (per cent)	6.9	8.0	1.9
(iii) Net Profit to Total Income (per cent)	21.3	14.6	19.4
(iv) Net Profit to Total Assets (per cent)	2.1	1.5	0.5
Source: Monthly returns on ND-SI (`1 billion and above).			

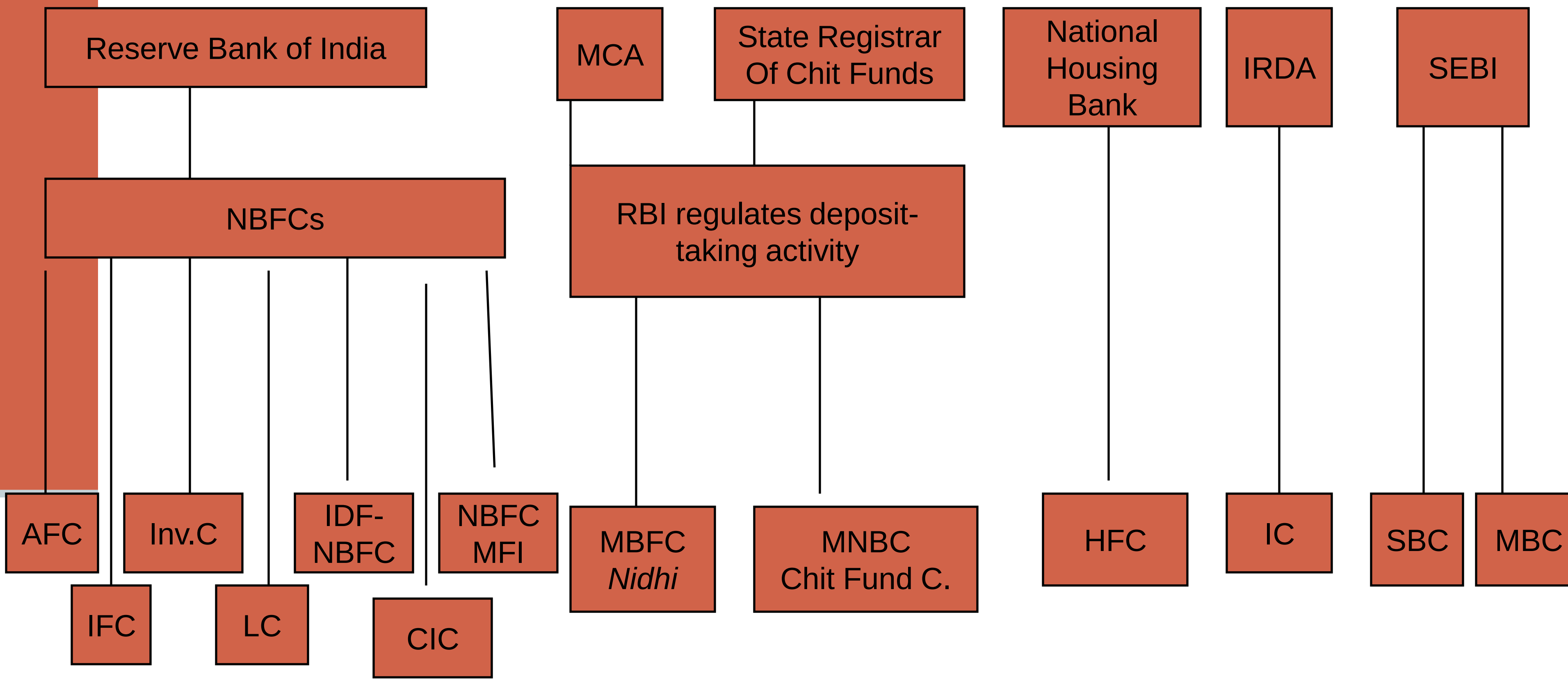
Profile of Systemically important NBFCs

1. Loans & Advances	4,709	5,900	25.3
1.1. Secured	3,406	4,486	31.7
1.2. Un-Secured	1,304	1,414	8.5
2. Hire Purchase Assets	502	635	26.5
3. Investments	1,507	1,595	5.9
3.1. Long-Term Investments	1,089	1,227	12.6
3.2. Current Investments	417	368	-11.7
4. Cash & Bank Balances	313	357	14.0
5. Other Current Assets	437	553	26.5
6. Other Assets	144	173	19.9
Memo Items			
1. Capital Market Exposure	822	799	-2.8
Of which: Equity Shares	347	253	-27.0
2. CME as per cent to Total Assets	10.8	8.7	
3. Leverage Ratio	2.84	2.83	2.95

Notes: Percentage variation could be slightly different because absolute numbers have been rounded off to ` billion.
Source: Monthly returns on ND-SI (`1 billion and above).

Regulatory framework - India

India works on a multi-regulator model



What is an NBFC?

- Sec 45I (c) of the RBI defines "financial institution". A non-banking company carrying business of financial institution will be an NBFC.
- Activities included in the definition:
  - Financing, whether by giving loans, advances or otherwise
  - Acquisition of shares, stocks or securities
  - Hire purchase
  - Insurance – excluded by notification
  - Management of chits, kuries, etc
  - Money circulation schemes
- If principal business is industrial, trading, etc., the company will not be an NBFC
- RBI circulars have specified majority of assets and majority of income as the criteria for defining NBFC
- Principality of activity is what is important: assets and turnover are indicative, but not definite test of what is an NBFC

Banks and Non-Banking Finance Companies

	Banks	NBFCs
Definition	Definition: banking is acceptance of deposits withdrawable by cheque or demand; NBFCs cannot accept demand deposits	NBFCs are companies carrying financial business
Scope of business	Scope of business for banks is limited by sec 6 (1) of the BR Act	There is no bar on NBFCs carrying activities other than financial activities
Licensing requirements	Licensing requirements are quite stringent. Transfer of shareholding also controlled by RBI	It is quite easy to form an NBFC. Acquisition of NBFCs is procedurally regulated but not approval required
Major limitations on business	No non-banking activities can be carried	Cannot provide checking facilities
Major privileges	Can exercise powers of recovery under SARFAESI and DRT law	Do not have powers under SRFAESI or DRT law
Foreign investment	Upto 74% allowed to private sector banks	Upto 100% allowed

Banks and NBFCs

	Banks	NBFCs
Regulations	BR Act and RBI Act lay down stringent controls over banks	Controls over NBFCs are relatively much lesser
SLR/CRR requirements	Banks are covered by SLR/ CRR requirements	NBFCs have to maintain a certain ratio of deposits in specified securities; no such requirement for non-depository companies
Priority sector lending requirements	Certain minimum exposure to priority sector required	Priority sector norms are not applicable to banks

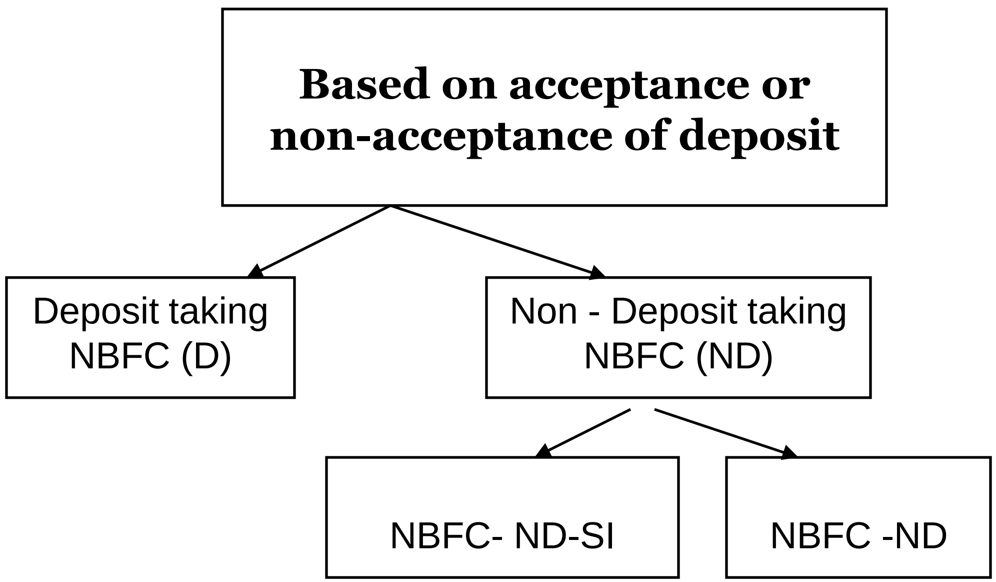
Basic regulatory framework on NBFCs

- Basic regulatory instruments:
  - RBI Act
  - NBFC (Acceptance of Public Deposits) Directions, 1998
  - NBFC (Deposit Accepting or Holding) Prudential Directions 2007
  - NBFC (Non Deposit Accepting or Holding) Prudential Directions 2007
  - NBFCs Auditors Directions 2008
  - Several circulars and press notes of the RBI issued from time to time

Types of NBFCs by assets

- **Based on the nature of business**
  - Asset Finance Companies
  - Loan companies
  - Investment Companies
  - Infrastructure debt fund companies
  - Micro Finance Companies
  - Core Investment Companies
  - Infrastructure Finance Companies

Types of NBFCs by regulatory intensity



Classes of NBFCs

- The existing “equipment lease” and “hire purchase” classification was dropped in Dec 2006, and “asset finance company” was brought in
  - If the company qualifies as asset finance company, it may approach the regional office for reclassification
- Further vide circular dated Sept 15, 2008 three categories of NBFCs emerged
  - Asset finance company
  - Loan company
  - Investment company
- Further following categories introduced:

  - NBFC-IFC (**by notification dated Feb 12, 2010)**
  - NBFC-CIC (**by notification dated April 21, 2010)**
  - NBFC-IDF (**by notification dated Nov 21, 2011)**
  - NBFC-MFI (**by notification dated Dec 02, 2011)**

Major provisions of NBFC (Deposit) Directions 1998: Meaning of Deposit

- Mostly concerned with acceptance of deposits
- Deposits
  - As defined in RBI Act
  - As further excluded in the Directions
- Deposits as defined in sec 45I (bb):
  - Any receipt of money by way of a loan or deposit or in any other form
    - Monetary deposits only
    - Excludes
      - Share capital
      - Security deposit, advances against orders
      - Amount received from a registered money lender
- As per exclusions given in the Directions
  - Amount received from Public financial institutions
  - Amount received from any other company
  - Share/debenture application money
  - Amount received from directors, or shareholders in case of a private company
  - Amount received by issue of secured mortgage bonds, or convertible bonds
  - Promoters' loans brought according to loan agreement with term lending institutions
  - Amount received from mutual funds
  - Hybrid debt or subordinated debt, maturity not less than 60 months
  - Amount received on issue of commercial paper

Restrictions on acceptance of deposits

- Minimum credit rating: investment grade (requirement not applicable to leasing/hire purchase company
- Tenure of deposit – 12-60 months
- Capital Adequacy: 15% for deposit accepting companies and 12% for non-depository companies
- Rate of interest – as specified from time to time
- Brokerage – 2%, expenses 0.5%
- Interest on overdue deposits – may be paid if deposit renewed
- Detailed provisions about the content of the application form
- Detailed provisions about the content of the advertisement
- Provisions on premature repayment of deposits
- Appointment of branches and agents to receive deposits

Other provisions

- Opening of a CSGL account with a commercial bank or SHCIL for custody of SLR securities
- balance sheet to be filed with the RBI within 15 days of the general meeting
- Auditors' certificate that the liabilities to depositors are properly reflected in the balance sheet
- Returns to be submitted to the RBI
- Submission of half yearly return within three months, i.e. as on September and March in NBS 2
- NBFC having assets of Rs. 50Crore and above shall constitute an Audit Committee

New set of NBFC Regulations

- Pursuant to the Governor's mid-term credit policy 2006-7, there was a proposal for comprehensive review of NBFC directions
- The basic object of the Govt was to remove regulatory arbitrage between NBFCs and banks, such that if the activities are substantially similar, the regulation applicable is similar too
- Consequently a new class of NBFCs, called "systemically important NBFCs" was envisaged by the Nov 3 2006 draft rules.
- Finally, in Feb 2007, two different sets of Regulations were announced.
  - NBFC- D
  - NBFC – ND
- Consequently, we now have 4 classes:
  - NBFC –D – SI
  - NBFC – D
  - NBFC- ND
  - NBFC – ND- SI
- The new sets are not very different from the existing regulations

Accounting requirement for Investments

- Quoted current investments for each category shall be valued at cost or market value whichever is lower.
- Unquoted equity shares in the nature of current investments shall be valued at cost or break up value, whichever is lower.

Capital Adequacy Requirement

- Minimum capital ratio consisting of Tier I and Tier II capital:
  - 15% in case of NBFC-D
  - 10% in case of NBFC-ND-SI of its aggregate risk weighted assets on balance sheet and of risk adjusted value of off-balance sheet items. To be increased to 12% CRAR by March 31, 2010 and 15% CRAR by March 31, 2011.
- Total of Tier II capital: Not exceeding 100% of Tier I capital
- Risk Weights
  - On balance sheet items
  - Off balance sheet items viz. guarantees, underwriting obligations, lease contracts

Restriction on NBFCs

- Loan against NBFC's own shares prohibited
- NBFC accepting public deposits, not allowed to invest
  - in land & building (more than 10% of its owned fund)
  - Unquoted shares of another company (more than 20% of its owned fund)
- NBFC which has defaulted in repaying public deposit are prohibited from making loans and investments as long as the default continues

Concentration of Credit/ Investment

NBFC-D
&
NBFC-ND-SI

Lend or Invest

15% of owned fund to single borrower

25% of owned fund to a single group of borrowers

Lend and Invest

25% of owned fund to single borrower

40% of owned fund to a single group of borrowers

Exception: Asset Finance Company can further exceed the ceilings by 5%

What is systemically important?

- In case of depository and non-depository companies, mean companies holding assets of Rs 100 crore or more as per last balance sheet
  - Assets mean total assets
  - Assets mean book value of assets
  - On the face of it, current liabilities cannot be netted off from current assets
  - In case of subsidiaries, assets do not have to be consolidated
  - Miscellaneous expenditure pending write off is not an asset
- Is it as per last balance sheet? A 4th July 2009 circular makes a departure. Says as and when NBFCs attain asset size of Rs 100 crore, they may start complying with the norms.
  - Obvious difficulty is to find when does the asset size exceed Rs 100 crore
    - There may be a profit on sale of an asset, which may be used to pay off liabilities. Asset size does go up temporarily
- However, if size of assets comes down, it will remain SI company “till specific dispensation is obtained from the RBI”.

What are the additional regulatory/ reporting requirements for NBFC-ND-SI

- All prudential norms apply to NBFC-ND-SI
- Monthly reporting requirement
  - Primarily capital market exposure
- Asset liability management framework applies
- Additional disclosures in balance sheet apply
- CRAR required for these companies is 12%
- Liquidity adjustment facility of the RBI extended to NBFC-ND-SI
- Capital Adequacy for NBFC-ND-SI was enhanced to 12% on 31.03.2010 & 15% on 31.03.2011

New regulations for NBFC - D

- Not much of a change
- The word 'asset finance companies' seems to be replacing the erstwhile "equipment leasing" and "hire purchase companies"
- Limit on investment in unquoted equity shares and real estate:
  - Was there earlier
  - 20% in case of asset finance companies
  - 10% in case of loan/investment companies
- SI companies have to make monthly disclosure of their capital market exposure within 7 days of the end of the month
- Several new provisions about project loans

New regulations for NBFC-ND

- The most significant change is that there is no exemption from prudential guidelines for NBFC – ND- SI
  - In other words, capital adequacy and concentration limits apply to such companies.
  - Also required to make additional disclosures in Balance Sheet from the year ending March 31, 2009 relating to
    - CRAR,
    - exposure to real estate sector and
    - assets and liabilities mismatches.
  - Further three new reports have also been introduced for ALM reporting.
    - Statement of short term dynamic liquidity - monthly
    - Statement of structural liquidity – half yearly
    - Statement of Interest Rate Sensitivity - half yearly
- In case of Systemically unimportant companies, existing exemption from capital requirements and concentration continues to apply

Carrying on of business

- Oct 19, 2006 notification reiterated an old requirement of 1999:
  - All NBFCs should annually submit a certificate from auditors that the NBFC carries on a principal business as such
- Para 15 of the new Prudential Regulations require an annual certificate:
  - Should mention the asset/income pattern for the purpose of its classification as NBFC
- Time limit for submission of such Certificate extended by Circular dated Oct, 22, 2009: Certificate to be submitted-
  - within one month from the date of finalization of the balance sheet and in any case not later than December 30th of that year

Corporate Governance guidelines

- May 8, 2007 notification
- Addressed to all NBFC – D with deposits of Rs 20 crore or more, and NBFC-ND-SI
  - Presumably applicable to these NBFCs only
- Audit committee required where:
  - Assets are Rs 50 crore or more
  - Deposits of Rs 20 crore or more
- Nomination committee in the above cases:
  - To ensure directors are fit and proper
- Asset liability management committee also in the above cases:
  - To understand asset liability mismatch risk, etc
- Connected lending relationships:
  - Rules were intended to make regulations at par with banks
  - However, they are actually much more stringent

Corporate Governance guidelines (Cont..)

- Rotation of partners of Statutory Auditors firm where:
  - Public deposits/Deposits are of Rs. 50 crore or above
  - Partners of CA firm be rotated every 3 years
- Asset liability management committee required when:
  - Asset are Rs. 100 crore or above
  - Deposits are Rs. 20 crore or above
  - To understand asset liability mismatch risk, etc
- The company must put before the board a periodic statement about progress made towards risk management system and conformity with corporate governance standards.

Connected lending relationships

- By notification of July 11 2007, this part of the corporate governance guidelines is kept on hold
- Loans/non-fund based facilities to the following should not be granted to:
  - Directors/their relatives
  - Firms in which directors are partners/employees
  - An individual in respect of which director is a guarantor
  - Companies in which directors hold substantial interest
    - Substantial interest is paid up value of Rs 5 lacs or more or 10% of paid up capital whichever is higher
    - As Rs 5 lacs is such a small value, there would be lots entities falling within "connected lending relationships"
    - All NBFCs falling within the guidelines must ensure listing of all such entities regularly
  - Any company in India/outside where the flagship name reflects association with the NBFC
- Existing relations should not continue beyond the agreed term
- Quarterly information about such loans needs to be given to the regional office
- If no term has been fixed, such loans must be recovered within 1 year

Ceiling on rates of interest for deposits and SLR requirements

- 24th April 2007 notification increases the maximum rate of interest to 12.5%
- SLR requirements remain 15%
  - Deposits in NABARD and SIDBI also now qualify

Specific auditor duties – Non Depository Companies – SI and Non-SI

- All directions are applicable to SI companies
- Non SI – exemption from only two requirements – concentration and capital adequacy
- Income recognition : as per GAAPs
- Income on non performing assets not to be recognized
- Investments to be classified into long term and current – requirements same as before
- Audit committee required in case of companies with assets of Rs 50 crore or above
- Balance sheet to have a schedule as per Prudential guidelines

New auditors' Directions, Sept 18, 2008

- Salient features
  - Applicable to all NBFCs - depository, non depository, systemically important or unimportant
  - Virtually amounts to appointing the auditors the compliance agents of the RBI
  - Applicable to all financial years closing on or after Sept 18 – that is, to apply to financial year 2008-09 onwards.
  - Report to be given to board of directors
    - In addition to sec 227 report, not an annexure to it
    - Hence, it is not mandatory to circulate the report to members
  - Requires reasons for unfavourable opinion
  - Requires additional reporting by the auditor to:
    - Board of directors
    - In case of exceptions, to the regional office of the RBI

Exception report

- Para 5 casts the scope of the exception report wide enough
- Not only adverse comments in the report, but
  - Any violation of
    - The RBI Act
    - the Acceptance of Deposit Directions
    - the Prudential Directions needs to be reported
- Saving grace – only contravention needs to be reported, not compliance

Additional reporting

- In case of all NBFCs:
  - Whether the company is engaged in NBFC business, and has obtained a CoR
    - Hence, the reporting is not restricted to registered NBFCs
  - Based on the asset/income pattern as on 31st March, whether the NBFC should continue to hold the CoR
  - Is the NBFC correctly classed as “asset finance company”
- In case of non-depository companies:
  - Whether the board has passed a resolution for non-acceptance of deposits
  - Whether the company has accepted any deposits during the relevant period
  - Has the complied with the prudential norms on income recognition, accounting standards, asset classification and provisioning, to the extent applicable to non-depository companies
- In case of ND-SI:
  - CRAR
  - Additional reporting as laid down by Prudential standards

Perpetual Debt Instruments

- Systemically Important Non Deposit taking NBFCs may augment their capital funds by issue of Perpetual Debt Instruments (PDI).
- Eligible for inclusion as Tier I capital upto 15%, excess may be included in Tier II capital.
- Minimum investment of at least Rs. 5 lakhs by a single investor.
- Shall not be treated as public deposit.
- NBFCs-ND-SI shall issue PDI as plain vanilla instruments only. However, may be issued with a call option.
- Superiority of claims of PDI investors.
- Disclosure requirements.

Short term foreign funds

- NBFC-ND-SI allowed to raise short term foreign currency borrowing under approval route.
  - On availment furnish monthly return within 10 days from end of the month of taking loan.
- Maximum amount: not to exceed 50% on NOF or USD 10 million, whichever is higher.
- Maturity: should not exceed 3 years.
- End-use: only for refinancing of short term liabilities.

Fair practices code 10th Oct 2007

- Sets an important point – borrowers must be aware of the rate of interest
- Copies of loan agreements to be furnished to all borrowers

New class of NBFCs – monitored NBFCs, vide circular dated 24th Sept,2008

- Applicable to NBFC – ND with Asset size >= 50 crore but < 100 crore
  - Quarterly return – hard and soft copy
    - Within one month from close of quarter
    - Basic information
      - Position of assets and liabilities as at the end of quarter
      - Sources and application of funds
      - Capital market exposure

Interest regulation, 2nd Jan, 2009

- Applicable to all NBFCs
  - Adopt interest rate model based on:
    - Cost of funds
    - Margin and risk premium, etc.
  - Disclose to borrowers or customer
    - Rate of interest
    - Method of risk gradation
    - Rationale for differential rate to different borrowers
  - Interest rates to be annualised rates.

Credit Rating reporting

- All NBFCs (Excluding RNBCs)
  - NBFC-D
  - NBFC-ND
    - Asset size 100 crore and above
- Report RBI of any change in rating
  - Upgrading/downgrading of financial product
    - Commercial paper, debentures, etc.
    - In writing within 15 days of change from previous level.

Liquidity constraints

- Applicable to NBFCs-ND-SI meeting following eligibility:
  - CRAR as per guidelines
  - Net profit in previous 2 years
  - Net NPAs as per last Balance Sheet date not exceeding 5%
- Liquidity met through SPVs
  - IDBI SASF Trust notified SPV
    - Purchase short term papers- CPs and NCDs
    - Residual maturity not more than 3 months
    - Investment grade
    - Issued after 31st March 2009

Investments by NBFCs

- All NBFCs other than RNBCs
  - In unencumbered approved securities
    - Not less than 15% of public deposit
    - 10% or more of public deposits in:
      - Unencumbered approved securities
      - Unencumbered term deposits with scheduled commercial bank, SIDBI or NABARD
      - Bonds issued by SIDBI or NABARD
        - Aggregate amount not to be less than 15% of public deposits.

Treatment of Deferred tax assets and liabilities in computing CAR – 31st July 2008 circular

- DTA or DTL in balance sheet
- Balance in DTL excluded from Tier I or Tier II for CAR
- DTA being intangible asset will be deducted from Tier I capital
- A 9th June 2009 circular clarifies:
  - DTL will be created by debiting P/L or revenue reserves and will appear as a part of "other liabilities and provisions"
  - DTA will be created by credit P/L or revenue reserves and will be part of "others"
- All intangible assets will be deducted from Tier 1 capital
- DTL shall not be adjusted against brought forward losses nor added to Tier 1 capital

PMLA obligations of NBFCs – Aug 2008

- NBFCs should have in place software that throws info about transactions inconsistent with the categorization and profile of customers
- To regularly file cash transactions report and suspicious transactions report with Financial Intelligence Unit- India
- This report to be submitted every month
- CTR requirements:
  - all cash transactions of the value of more than rupees ten lakhs or its equivalent in foreign currency;
  - all series of cash transactions integrally connected to each other which have been valued below rupees ten lakhs or its equivalent in foreign currency where such series of transactions have taken place within a month;
  - all cash transactions where forged or counterfeit currency notes or bank notes have been used as genuine or where any forgery of a valuable security or a document has taken place facilitating the transactions;
  - all suspicious transactions whether or not made in cash
- STR requirements
  - gives rise to a reasonable ground of suspicion that it may involve the proceeds of crime; or
  - appears to be made in circumstances of unusual or unjustified complexity; or
  - appears to have no economic rationale or bonafide purpose; or
  - gives rise to a reasonable ground of suspicion that it may involve financing of the activities relating to terrorism

Revised Reporting Format for NBFCs under Project FINnet

- The prescribed multiple data file reporting format while furnishing reports under Rule 3 of PML Rules to FIU-IND is replaced by a new single XML file format
- comprehensive reporting format guide has been prepared by the Financial Intelligence Unit-India (FIU-IND) to describe the specifications of prescribed reports to FIU-IND

Repossession of assets -24th April 2009

- Agreement should contain the following:
  - (a) notice period before taking possession;
  - (b) circumstances under which the notice period can be waived;
  - (c) the procedure for taking possession of the security;
  - (d) a provision regarding final chance to be given to the borrower for repayment of loan before the sale / auction of the property;
  - (e) the procedure for giving repossession to the borrower and
  - (f) the procedure for sale / auction of the property.
- A copy of such terms and conditions must be made available to the borrowers
- Copy of the loan agreement and all enclosures must be furnished to the borrower

Regulation of excess interest – 2 Jan 2009

- An atrocious circular has been issued on 2 Jan 2009. Presumably for regulating excess interest charged by NBFCs
- Apparently no distinction has been made for SI and non-SI NBFCs – hence, this circular is apparently applicable to all
- As there is no control on rate of interest, what is "excess interest" is not understood
- NBFC should adopt an interest rate model for charging differential rates from different categories of borrowers
- The rationale for charging different rates of interest from different borrowers should be disclosed to the borrowers
- Rates of interest and categories of borrowers should also be disclosed on the websites of the NBFCs

NBFC (Deposit Accepting) (Approval of Acquisition or Transfer of Control) Directions, 2009

- Directions notified on Sept 17, 2009
- Prior written approval of RBI shall be required in cases of acquisition or transfer of control of deposit taking NBFCs

Additional Certification for FDI compliance- circular dated Feb 4, 2010

- NBFCs having FDI whether under automatic route or under approval route required to submit a certificate from their Statutory Auditors on half yearly basis certifying compliance with the existing terms and conditions of FDI
- To be submitted not later than one month from the close of the half year to which the certificate pertains

New category: NBFC-IFCs

- Fourth category of NBFC "Infrastructure Finance Companies“ (IFCs)
- IFC is defined as NBFC-ND which has:
  - a minimum 75% of total assets deployed in infrastructure loan
  - NOF of Rs. 300 crore or above
  - Minimum credit rating "A" or equivalent of CRISIL, FITCH, ICRA, CARE or equivalent rating by any other CRA
  - CRAR of 15% (with minimum Tier I capital of 10%)
- The extant prudential norms for income recognition, asset classification and provisioning norms shall apply

Relaxation to IFCs: Concentration of Credit/Investment

IFC

Exceed in lending by

10% of owned fund to single borrower

15% of owned fund to a single group of borrowers

Exceed in lending and Investing by

5% of owned fund to single borrower

10% of owned fund to a single group of borrowers

Risk weights & exposure norms in respect of bank exposure to IFCs

- Banks' exposures to NBFC-IFCs will henceforth be risk weighted as per the ratings assigned by the CRA accredited by the RBI

- Exposure of bank to IFCs should not exceed 15 % of its capital funds as per its last audited balance sheet, with a provision to increase it to 20% if the same is on account of funds on-lent by the IFCs to the infrastructure sector

RBI regulatory framework for Core Investment Companies (CICs)

- CIC defined as:
  - not less than 90% of their assets were in investments in shares, debt, loans in group companies for the purpose of holding stake in the investee companies
  - Atleast 60% in equity of group companies
  - not trading in these shares except for block sale (to dilute or divest holding)
  - not carrying on any other financial activities,
  - not holding / accepting public deposits

Regulatory framework for CICs-SI

- CICs with asset size < Rs 100 crore exempted from the requirement of registration with RBI
- All CICs having an asset size of Rs.100 crore or more and raising public funds would be required to obtain CoR from the RBI
- Capital requirements:
  - Minimum Capital Ratio to be maintained at all times
  - Adjusted Net Worth shall not be less than 30% of its aggregate risk weighted assets on balance sheet and risk adjusted value of off balance sheet items as on the date of the last audited balance sheet.
- Leverage ratio: The Outside liabilities of a CIC-ND-SI shall not exceed 2.5 times of its Adjusted Net Worth calculated as on the date of the last audited balance sheet;

Group Companies and Public Funds for CICs

- Companies in group- a wider definition and includes all possible connections by way of:
  - *an arrangement involving two or more entities related to each other through any of the following relationships : Subsidiary – parent (defined in terms of AS 21), Joint venture (defined in terms of AS 27), Associate (defined in terms of 4 AS 23), Promoter-promotee (as provided in the SEBI (Acquisition of Shares and Takeover) Regulations, 1997) for listed companies, a related party (defined in terms of AS 18), Common brand name, and investment in equity shares of 20% and above.*
- Public Funds to include funds raised either directly or indirectly through public deposits, Commercial Papers, debentures, inter-corporate deposits and bank finance but excludes funds raised by issue of instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue

Adjusted Net Worth defined

- The aggregate of
  - Owned Funds as defined in Non Banking Financial (Non Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;
  - 50% of the amount standing to the credit of the Revaluation Reserve arising from valuation of shares, if any, as per the latest audited Balance Sheet; and
  - an amount equal to 50% of the appreciation in the book value of quoted investment (calculated as the excess of the aggregate market value of quoted investments over the book value of such investment as appearing in the latest audited Balance Sheet).
- reduced by the amount of diminution in the aggregate book value of quoted investments

Exemptions

- CICs exempted from:
  - maintenance of statutory minimum NOF
  - requirements of Prudential norms for non-deposit accepting NBFC.

- CICs-ND-SI required to submit an annual certificate from their statutory auditors regarding compliance with the Directions

NBFCs-IDF

- **IDF is defined as NBFC-ND which has:**
  - Minimum NoF of Rs.300 crores
  - should be investing only in PPP which have completed at least one year of satisfactory commercial operation, and
  - It should be a party to a Tripartite Agreement
  - minimum grade of ‘A’ of CRISIL or equivalent rating issued by other accredited rating agencies is required
- **Capital Adequacy**
  - a) A minimum CRAR of 15 percent is must
  - b) Tier II Capital of IDF–NBFC shall not exceed Tier I

Eligibility for NBFC-IDFs

- **Eligibility Parameters for NBFCs as Sponsors of IDF-MFs**
  - minimum (NOF) of Rs. 300 crore and CRAR of 15%;
  - net NPAs should be less than 3% of net advances;
  - should have been in existence for at least 5 years.

Eligibility criteria for IFCs setting up IDF-NBFCs

- Sponsor IFCs would be allowed to contribute a maximum of 49 % to the equity of the IDF-NBFCs with minimum equity holding of 30 % of the equity of IDF-NBFCs,:
- Post investment in the IDF-NBFC, the sponsor NBFC-IFC must maintain minimum CRAR and NOF prescribed for IFCs
- There are no supervisory concerns with respect to the IFC

NBFC-MFIs

- Seventh category of NBFC "**Micro Finance Institutions"(-MFIs)**
- MFI is defined as NBFC-ND which has:
  - a minimum 85% of net assets in the nature of "qualifying assets"
  - NOF of Rs. 5 crore or above
  - Minimum credit rating "A" or equivalent of CRISIL, FITCH, ICRA, CARE or equivalent rating by any other CRA
  - CRAR of 15% of its aggregate risk weighted assets (consisting of Tier I and Tier II Capital)
- The extant prudential norms for income recognition, asset classification and provisioning norms shall apply

Credit Pricing Requirements

- Credit Pricing requirements for NBFC-MFIs:
  - maintain an aggregate margin cap of not more than 12%
  - Interest on individual loans not more than 26% p.a.

    (to be calculated on reducing balance basis)
  - Processing charges - not more than 1 % of gross loan amount.

Loans against Gold Jewellery

- Master Circular February 2, 2011
- Not entitled under Agriculture sector when:
  - Loans sanctioned to NBFCs for on lending to individuals or other entities against gold jewellery
  - Investments made by banks in securitised assets originated by NBFCs, underlying assets are gold jewellery
  - Purchase/assignment of gold loan portfolio from NBFCs

Exemptions from provisions of RBI Act, 1934

- Some entities exempted from requirement of Chapter III B of RBI Act, 1934
  - Housing Finance Institutions
  - Merchant Banking Company
  - Government Companies
  - Venture Capital Fund Companies
  - Insurance/Stock Exchange/Stock Broker/Sub- Broker
  - Nidhi Companies
  - Chit Companies
  - Mortgage Guarantee
  - Mortgage and Reconstruction Companies