CHAPTER- 4

NBFCs: A Historical Analysis

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Chapter – 4 NBFCs: A Historical Analysis

In this chapter, evaluation**,** registration, resources, policy developments, regulatory measures, etc. of Non-Banking Financial Companies (NBFCs) have been discussed.

4.1 NBFC IN INDIA: A HISTORICAL BACKDROP

The beginning of NBFCs in India dates back to the early 1980s against the backdrop of a highly regulated banking sector comprising different categories of banks with different specific purposes. Low entry barriers coupled with simple and easy procedure of financing led to the formation of a host of NBFCs in the country. However, in many cases inefficient management and poor operational activities resulted in problems arising out of adverse portfolio selection, imprudent operations, inability to manage risk both in respect of asset and liability perspective. The significant source of fund for the NBFCs is the unsecured public deposits which they procure at comparatively higher rates of interest than the commercial banks. To deal with such high cost of deposits, some NBFCs are forced to arrange their funds in alternatives carrying high return involving high risk. This eventually resulted in higher risks for their depositors, which in some cases had concluded in the problem of confidence and credibility. The Reserve Bank of India Act, 1934 was amended on 1st December, 1964 to include provisions relating to nonbanking institutions receiving deposits and financial institutions. It was pragmatic that the existing regulatory and legislative framework was required to be subjected to further improvement and refinement because of the increasing number of defaulting NBFCs and also required for an efficient arrangement for redressal of grievances of individual depositors. So in this respect, it becomes necessary to initiate immediate action for the protection of depositors' interest. RBI issued the Non Banking Companies (Reserve Bank)

Directions, 1977, directives on prudential norms and various other clarifications, as per the need for governing the activities of NBFCs. The Union Government, during 1974, incorporated Section 58A in the Companies Act, 1956 empowering the Government to regulate acceptance and renewal of deposits and to frame rules in consultation with Reserve Bank of India (RBI), prescribing the ceiling, mode and the conditions subject to which deposits may be accepted and renewed by these companies. Given the need for sustained survival and growth of NBFCs, the Central Government in consultation with RBI framed Companies (Acceptance of Deposits) Rules, 1975 to build up a structure of prudential legislations and an administrative system to encourage the growth of healthy NBFCs and identifying the inefficient ones. To enrich this progression, RBI Act, 1934 was amended in 1997 which authorised the Reserve Bank to establish policies and directions to NBFCs regarding income recognition, accounting standards, NPAs, capital adequacy, etc. The amended Act, also provided for compulsory registration of all NBFCs into three broad categories as follows:

- NBFCs accepting public deposit;
- NBFCs not accepting/holding public deposit; and
- Core investment companies (i.e., those acquiring securities of their group/holding/ subsidiary companies to the extent of not less than 90 per cent of total assets and which do not accept public deposit).

Earlier, the prudential norms that were applicable to banking and nonbanking financial companies were not uniform. So far as the NBFCs were concerned, the prudential norms applicable to deposit accepting NBFCs (NBFCsD) were more rigorous than those for non-deposit taking NBFCs (NBFCsND). As the NBFCsND were not subjected to any specific exposure norms, they could take large level of

exposures. The nonexistence of capital adequacy requirements basically showed a high leverage by the NBFCs. From the year 2000, the RBI had formulated measures to reduce the scope of 'regulatory arbitrage' between banks, NBFCsD and NBFCsND.

4.2.1 Evolution of Non-Banking Financial Companies

After independence of India, several programmes for rapid industrialisation had taken place, which demanded more long term investment in capital assets. Basic industries requiring massive investments were set up by the Government of India in the public sector. The Government also extended guarantees whenever loan was advanced to the public sector industries by the foreign agencies. Two Public financial institutions were established i.e., the Industrial Development Bank of India (IDBI) and the Statutory Finance Corporations (SFC). IDBI provided assistance to large and medium industrial concerns directly and on the other hand, SFCs provided assistance to small and medium industrial concerns. These institutions issued bonds and also accepted deposits from the public. But the private sector mostly relied upon the financing by commercial banks which were not grown considerably to such an extent that they could provide corporate finances required by the promoters. Traditionally, banks concentrated mostly on financing manufacturing activities by providing working capital loan. But due to the shortage of financial resources against revenue expanding activities the companies were mostly dependent on credit deals. Capital goods such as machinery and equipment were financed on deferred payment modes.

With the inadequacy of the financial institutions and the services provided by existing financial institutions, companies were set up in the private sector under the Companies Act whose main functions were to do non-banking financial activities. To set up a non-banking financial company was a very striking proposition. There was

also no gestation period. The capital investment in equity was also not huge as in the case of manufacturing companies. In most of the companies, the equity was built up on long term basis by successful operation. The advantages of securing additional assets through non-banking financial companies came to be realised in the early seventies. Acquisition of equipment and capital assets through leasing was favoured to overcome the disabilities arising out of the Monopolistic and Restrictive Trade Practices under MRTP Act, 1969 which prescribed asset qualification for declaration of an undertaking as a giant. As per the provisions laid down in the MRTP Act, a company having a disclosed capital of Rs. 100 crore or more was an MRTP company. As assets secured on lease were owned by the lessor company and not by the lessee and were not also transferable to the lessee, the leased-in equipment or assets did not form the constituent of gross block of the borrowing manufacturing company. Many industrial groups or manufacturing companies set up non-banking financial companies as associate finance companies. There were no additional advantages derived under the MRTP Act then, as the concept of MRTP Company had lost its significance when the pre-entry sanctions under that Act were removed.

The NBFCs in India had recorded noticeable growth in terms of the number of NBFCs and their deposits in the recent years. Keeping this growing importance of NBFCs in view, the Banking Laws (Miscellaneous Provisions) Act, 1963 was introduced to regulate them, to enable the effective working of regulatory authorities, to develop different suitable policy measures. Also several committees had been appointed from time to time to carry out study in detail the activities of those institutions and to make suitable recommendations and suggestions for their significant growth, within the given regulatory framework and guidelines thereof. The suggestions or recommendations made by them in the context of the contemporary

financial scenario, formed the basis of the formulation of policy measures by the regulatory authorities including RBI. The different committees which had worked in these areas, as appointed by the Government, were the Bhabatosh Datta study group (1971), Chakravarty Committee (1985), James Raj study Group (1975), Narasimham Committee on Financial systems (1991), Vaghul Committee (1987), and Shah Committee (1992). The Shah Committee, as followed by the recommendation of the Narasimham Committee, was the first to suggest an all-inclusive regulatory framework and guidelines for NBFCs. On the basis of the recommendations of the Shah Committee and following the framework of regulations for NBFCs as suggested by them, the RBI had implemented most of its recommendations and included the same in the RBI Directions which controlled and supervised the subsequent working and operations of NBFCs. In the year 1996, The Khanna Group had recommended a few more areas of supervisory framework for NBFCs. In accordance with its recommendations, the RBI Act was duly amended in January 1997. After that, the directives of RBI on Acceptance of public deposits, the RBI-NBFCs Prudential norms and the RBI-NBFCs auditor's report directions were modified and amended and issued the same in January 1998. The RBI rules of acceptance of public deposits directions were again modified in December 1998 in accordance with other areas of recommendations as suggested by the Vasudev Task Force Group (1998).

4.2.2 Various Committees of NBFCs in India Regarding Policy Recommendation

As mentioned earlier, various committees were formed in India to review the existing framework and concentrate on the shortcomings in the activities of NBFCs. Some of the committees and their major recommendations are given below:

i. James Raj Committee (1974): The James Raj Committee was formed by the RBI in the year 1974. The committee carried out study on the different funds

circulation schemes which were popular in the country during that time after taking into consideration the impact of such schemes on the growth of economy. The Committee after wide-ranging research and analysis had recommended for prohibition of Prize Chit and other related schemes which resulted in a great financial defeat to the economy. Based on these recommendations, the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 was established.

ii. Chakravarthy Committee (1984): This Committee was guided by Shri Sukhamoy Chakravarty and established to review the effectiveness of the Monetary System on the workings of the NBFCs. It made various suggestions for the development of money market where the NBFCs have significant role to play.

iii. Vaghul Committee (1987): Following the recommendations of the Chakravarty Committee, the RBI established a Working Group on money market operations under the chairmanship of Shri N. Vaghul. The committee submitted the report in the year 1987 containing various measures to broaden and intensify the money market where the NBFCs have significant role to play.

iv. Narasimham Committee (1991): This committee was formed to examine and verify major aspects relating to the structure, organization, and functioning of the financial system in India indicating the various roles of NBFCs.

v. Dr. A. C. Shah Committee (1992): To work in a more wide aspect, a Working Group on Financial Companies was established in the year 1992, named Shah Committee, to set out the schedule for reforms in the NBFC sector. This Shah Committee made extensive range of recommendations covering, entry norms

and criteria, mandatory registration of large financing NBFCs, direction of prudential norms for NBFCs following the outline of banks, requirement of credit rating for acceptance of schemes of public deposits, and additional emphasis on statutory powers of RBI for better regulation and control of NBFCs.

vi. Khanna Committee (1995): This committee was set up with the objective of designing an all-inclusive and effective supervisory and regulative framework for the NBFCs in the Indian financial system. The important suggestions of this committee were as follows:

- Implementation of and regulative supervisory credit rating system for the registered NBFCs. The ratings to be allotted to the NBFCs would primarily be based on the mechanism for triggering onsite inspections including statutory compliances at various intervals as set by the appropriate authority.
- Significant supervisory emphasis and focus of the RBI to be directed in a wide-ranging manner for those NBFCs with having net owned funds of Rs.100 lakhs and above as pert the documentary evidence.
- Supervisory actions over unregistered NBFCs to be extended through the off-site scrutiny mechanism and their on-site assessment to be conducted selectively as found to be necessary depending on the various circumstances.
- To establish an appropriate system for coordinating the on-site scrutiny of the NBFCs by the RBI in accordance with the other regulatory authorities so that they were subjected to one-shot assessment by the different regulatory authorities at appropriate level.
- Some of the NBFCs had diversified activities considering its area of operations which involved various financial activities including acceptance of

deposits, leasing, investment operations, etc. to a great extent. The committee emphasised the requirement for identifying a suitable authority to regulate the financing activities of these NBFCs under the regulatory and supervisory control of Department of Company Affairs and RBI, as far as their management of public deposit are concerned.

- Implementation of a system whereby the list of the NBFCs which had not complied with the regulatory measures and directive actions as set by the appropriate authority or failed to submit the recommended returns for two successive years could be published in regional as well as national newspapers and financial magazines.

All the recommendations as stated above by the Khanna Committee were recognised by the RBI after a detail analysis and on the basis of that, the RBI revised the framework of effective supervision mechanism of the NBFCs including significant monitoring as newly recommended by the committee.

vii. Vasudev Committee (1998): This committee concentrated on the immediate need for strengthening of NBFCs including entry norms, exit norms, and prudential norms, and recognised a framework for acceptance of deposits from public. It also considered the issues relating to the unincorporated financial intermediaries and emphasised on the issues of supervision of NBFCs.

The important policy recommendations of this committee are stated below:

- The present norms of minimum capital requirement of Rs.25 lakhs to be revised and recommended for increase, keeping in view the basic need to impart higher financial reliability and achieve financial prudence of scale in terms of efficiency of operations, supervisions, and administrative skills.

- As activities of NBFCs were mainly concentrated in rural areas, the RBI might refer them to the State Governments which had granted the required primary registration. The committee set guidelines of NBFCs in this regard and also set criteria for the companies whose applications had been rejected.
- The prevalent ratio of capital adequacy obligation might have been preserved at 12% for all types of NBFCs, but the committee recommended a higher rate around 15% which was subsequently prescribed by RBI for those NBFCs which accepted public deposit without certified credit rating.
- It was recommended that the RBI needed to stipulate for the NBFCs in respect of investment of at least 25% of their accumulated reserves in current marketable securities apart from their SLR securities then held by the NBFCs.
- It was recommended for linking of quantum of deposits from public with certified credit rating because apart from having the effect of deliberate regulatory functions and approval on the rating agencies, it was also uncovering the NBFCs to frequent asset and liability disparities arising out of changes in reporting by credit rating.
- The committee recommended that RBI should contemplate the measures for facilitation of the flow of providing credit from banks to NBFCs and then think for recommending a suitable proportion as between secured and unsecured credit for NBFCs.
- The committee also recommended for appointment of depositors' grievance redressal establishments with specified regional jurisdiction which should be duly approved.
- The committee also recommended that the process for liquidation of NBFCs had to be substantially in line with those offered for banks.

- A distinct instrumentality for supervision and regulation of NBFCs under the guidance of the RBI should have been formed, such that a significant focus should have been made in supervision and regulation of the NBFCs.
- The Committee found that, it was not sensible to implement a deposit insurance scheme for all the depositors in NBFCs because of the moral hazard matters, likelihood of assets shedding, and likely negative impact on the growth of a strong NBFC sector considering the present working areas of NBFCs.
- It is advised that RBI could use the statutory and certified services of chartered accountants after suitable process of appointment and after that suitable measures and capabilities could be adopted to carry out the inspection of the smaller types of NBFCs operating in India.

4.2.3 Highlights of Recent Regulatory Measures on NBFC

i. Instructing NBFC on advertisement in electronic media: For the awareness of the depositors and in direction to ensure transparency, different advertisements should have been made in the context of different schemes of NBFCs. A provision was inserted in the NBFCs Acceptance of Public Deposits (Reserve Bank) Directions, 1998 in this respect where the companies were required to disclose through electronic media and paper advertisement that they had a valid certificate of registration from appropriate authority and RBI. However, the RBI did not agree to take any responsibility or assurance about the current situation as to the financial consistency of the company or for the correctness of any of the statements or illustrations made or opinions articulated by the company and for repayment of deposits of the liabilities by the company through advertisement.

ii. Corporate Governance: The NBFCs which were listed should comply with the listing agreement and the regulations given by SEBI in respect of Corporate Governance practices. It was also required to comply with specific guidelines as per SEBI prescriptions related to NBFCs on Corporate Governance. According to the RBI Circular (No: RBI/200910/17/DNBS (PD)CC-No.156/03.10.001/200910 dated 01-07-2009, specific guidelines on corporate governance of NBFCs had been recommended in respect of all types of deposit taking NBFCs (NBFCD) having deposit volume of Rs 20 crore and above and all other non-deposit taking NBFCs (NBFCND) with asset volume of Rs 100 crore and above. The different corporate governance guidelines of NBFCs included the following:

- Formation of an Audit Committee for the category of NBFCD having deposit volume of Rs 20 crore or more.
- Formation of Nomination Committee for the NBFCs. It was proposed that NBFCD having deposit volume of Rs 20 crore and above should form a Nomination Committee for a certain period with approval from appropriate authority to ensure 'fit and proper' status on periodic basis in respect of the constitution of proposed and existing Directors of the company.
- Formation of Risk Management Committee for the NBFCs. The committee proposed to manage the integrated risk of the NBFCs on periodic basis. For that purpose, a specific risk management committee with approval from appropriate authority might have been formed. It was also a supplementary committee of the existing ALCO (Asset Liability Management Committee) for each category of NBFCs.

- Standarised format of Disclosure and Transparency for the NBFCs on periodic basis. It was proposed that standardised and preset information should have been disclosed as supported by documentary evidence and compliance of law by the NBFCs to the Board of Directors. It was also proposed to submit the same at regular intervals as recommended by the appropriate authority in this regard.
- Disclosure and compliance of lending relationships on periodic basis for all types of NBFCs as per the instructions as proposed by the appropriate authority.

iii. Revision of Interest Rate: It was proposed that from April 24, 2007 the maximum permissible interest rate payable on all types of public deposits taken by NBFCs was revised to 12.5% P.A.

iv. Advising mechanism for NBFCs: For telemarketing of the NBFCs the following measures had been implemented:

  - NBFCs engaging telemarketers should have a valid registration certificate obtained from Department of Telecommunications (DoT), Government of India.
  - NBFCs should publish the list of telemarketers associated with them along with their registered contact numbers and the schedule of making telemarketing calls to the beneficiaries.
  - NBFCs should assure that all the certified agents presently engaged by them should register themselves in pursuance with the Telecom Regulatory Authority of India (TRAI) as with DoT certified telemarketers. In this respect the telemarketers should follow the regulations associated with the Telecom Unsolicited Commercial

Communications (UCC) rules for those subscribers who did not want to receive UCC.

v. Reporting Criteria of Secondary Market Transactions: All registered NBFCs were recommended to report their secondary market transactions relating to corporate bonds performed in 'Over the Counter' (OTC) market. With effect from September 1, 2007, the Fixed Income Money Market and Derivatives Association of India (FIMMDAI) has been formed and a reporting policy of those transactions were implemented in association with the involvement of Commercial Banks, related Primary Dealers, and other related financial institutions. Basically FIMMDA in India was a voluntary market body to look after the disclosure of the bond, money and derivatives market transactions of NBFCs.

vi. Frauds Monitoring of NBFCs: From March 2008 onwards, all deposit taking NBFCs registered by appropriate authority were recommended to comply with the guidelines with respect to monitoring of frauds to a maximum extent which recognised the optimum control over the same. Some existing measures had been revised, being associated with the 'negligence and cash deficits' of NBFCs and 'irregularities in compliances of foreign exchange transactions' of NBFCs in specific cases. The external body duly appointed by appropriate authority should report the frauds, if any, or any of the intentions to deceive the same as suspected and found it to be true during verification. However, the cases where specific intention of fraudulent approach is not detected during regular verification process but subsequently detected, involving cash deficit of more than ten thousand rupees should be reported externally treating as fraud, to the appropriate authority so that necessary legal action can be

undertaken. In cases where cash shortages of more than five thousand rupees were detected by duly appointed representative of management or auditor or inspecting officer of the NBFCs, then the same should be reported indicating the persons handling cash so that necessary actions can be undertaken for that fraud reported accordingly.

vii. Issuing Guidelines: A number of guidelines have been taken for NBFCs such as

- Guidelines on registration.
- Guidelines on operations and prudential norms
- Guidelines on investment directions for mortgage guarantee companies.
- Guidelines on treatment of Deferred Tax Assets (DTA) and Deferred Tax Liabilities (DTL) as per the Income Tax Act for computation of capital and net worth of the NBFCs. The reasons behind these guidelines can be that creation of DTA or DTL gives effect to the component of the financial items impacting the balance sheet of the company. In this respect specific guidelines have been issued for NBFCs with effect from July 31, 2008 regarding the treatment to be made with these issues. According to these guidelines, the balance in DTL would not be eligible for addition to Tier I or Tier II capital for capital adequacy norms of NBFCs. DTA would be treated separately as an item of intangible assets and should be deducted from Tier I capital. All the NBFCs were suggested to ensure the compliance of these guidelines from the financial year ending on March 31, 2009.

viii. Compliances under Prevention of Money Laundering Act (PMLA Act), 2002: Reports of cash transactions were to be submitted by all the branches of NBFCs to their Principal Officer at the registered office on a monthly basis in a specified format. The Principal Officer would be responsible for verification of the same and would ensure to submit a cash transaction report (CTR) on monthly basis to the Financial Intelligence Unit of India (FIUIND) within the stipulated time schedule. Different other measures taken in accordance with the PMLA Act, in respect of financing policy initiatives for Systemically Important Non-Deposit taking Non-Banking Financial Company (NBFC-ND-SI) in financial year 2007-08 which were as follows:

- Maintenance of capital adequacy.
- Liquidity (Short Term and Long Term) and disclosure norms.
- Issuing guidelines on Perpetual Debt.
- Instruments and admittance to short term foreign currency borrowings.
- Instructions on specific capital adequacy norms for non-deposit taking NBFCs.
- Compliance with the RBI guidelines as on 2nd June 2008 for non-deposit taking NBFCs to enhance the minimum Capital to Risk Weighted Assets Ratio (CRAR) from 10% to 12% and adjust with the same in reporting by NBFCs. The CRAR was again increased to 15% with effect from April 1, 2009 as per the approval of the RBI. The change was also needed to incorporate the matters reported by the NBFCs.
- Submission of compliance reports in the specified formats as and when required by the appropriate authority.

4.3 THE RESOURCES OF NBFCS:

The main source of resources of NBFCS are generated from approved schemes of deposits (regulated and exempted), and net owned funds. The concepts of the sources are discussed below:

- In case of NBFCs, deposit means, any amount received by way of a deposit or loan or in any other form. But it does not include deposits arising out of inter-operate loans and borrowing from shareholders by NBFCs operated as the constitution of a private limited company.
- For NBFCs, regulated deposit implies any deposit which is subject to approved schemes imposed by regulatory measures with certain ceiling and other preset restrictions. It basically includes non-convertible debentures (NCD), deposits received from their shareholders by the companies, deposits guaranteed by directors in accordance with certain laws, approved fixed deposits received from the public and interoperate deposits in accordance with certain laws.
- Exempted deposits of NBFCs mean those types of deposits or borrowings which are outside the purview of the general regulatory measures and guidelines. It basically includes borrowings from banks, specified financial institutions, amount received from central or state or foreign Governments, security deposits, advances received against orders and convertible bonds.
- The net-owned funds imply the aggregate amount of paid up capital and accumulated reserves.

4.4 REGISTRATION OF NBFCs

According to Section 45IA of the RBI Act, 1934, it is mandatory that every NBFCs primarily operating in India should be registered with RBI. After getting registration they can commence or carry on any business which can be permitted under the prescribed activities of non-banking financial institution as defined in Section 45I [clause (f)] of the RBI Act, 1934. However, to prevent dual regulation, certain categories of NBFCs which are regulated by other regulators as per the Government notification, are exempted from the requirement of mandatory registration with RBI. Following are the institutions which are exempted from registration with RBI subject to certain conditions.

- Housing Finance Companies
- Merchant Banking Companies
- Stock Exchanges
- Companies engaged in the business of stock-broking and sub-broking
- Venture Capital Fund Companies
- Nidhi Companies
- Insurance companies, and
- Chit Fund Companies.

The regulating authorities of these financial institutions are stated below:

- Housing Finance Companies are regulated by National Housing Bank (NHB).
- Merchant Banker, Venture Capital Fund Company, Stock Exchanges, Stock brokers, and Sub-brokers are regulated by Securities and Exchange Board of India (SEBI).
- Insurance companies are regulated by Insurance Regulatory and Development Authority of India (IRDA).

- Chit Fund Companies are regulated by the respective State Governments.
- Nidhi Companies are regulated by Ministry of Corporate Affairs, Government of India.

It is to be noted that the Mortgage Guarantee Companies (MCG) operating in India are notified as NBFCs as per the provisions of Section 45I (f) (iii) of the RBI Act, 1934.

As per the RBI Act, 1934, it is mandatory for all the NBFCs, except the NBFCs stated above, are required to get registered with the RBI to act as a deposit taking company. For that purpose, the NBFCs need to comply with the criteria and conditions of the registration authorises of the RBI.

1. NBFCs that are required to be registered with the RBI, should be a company incorporated under the provisions of Companies Act, 1956/Companies Act, 2013.
2. For registration, an application in the prescribed format along with the necessary statutory and credential documents should be submitted by the company in accordance with the norms of the RBI. In this respect a rigorous verification process is to be carried out by the concerned authority of the RBI.
3. For registration of business of non-banking financial institution, minimum net owned fund (NOF) should be of Rs 25 lakh as per the last financial statement. From April 21, 1999, it has been enhanced to Rs 200 lakh. Here, 'NOF' implies paid-up capital plus accumulated free reserves minus accumulated losses, deferred revenue expenditure and other intangible assets. For computation of NOF the following are also deducted if applicable to that specific NBFCs:

- Value of investments in subsidiary companies in the same group and all other associated NBFCs;
- The book value of bonds and outstanding loans & advances including financing in hire-purchase and lease finance in subsidiary companies in the same group in excess of 10% of the gross owned funds.

After successful completion of the above mentioned process the RBI issues a Certificate of Registration to perform as registered NBFC in accordance with the provisions of the RBI Act, 1934. All these registered NBFCs should disclose this certificate in all their offices. Only the NBFCs that hold a valid Certificate of Registration with RBI can accept and hold public deposits in accordance with the rules of RBI in this regard.

4.5 POLICY DEVELOPMENTS RELATING TO NBFCs

4.5.1 NBFCs Registered and Regulated by RBI

- **Monetary and Credit Policy Statements:** The governing monetary and credit policy environment of the NBFCSs were firstly reviewed in the year 2000-01 and the outcome was published in October 2000 and the second review had been made in the 2001 and published in April 2001. Policy changes in respect of the same included changes in rate of interest on public deposits and beginning of new asset-liability management mechanism for certain categories of NBFCs. A Financial Stability Review (FSR) based on half-yearly data of Macro Prudential Indicators (MPI) had been prepared, which was relevant to certain categories of NBFCs.
- **Reduction in Rate of Interest on Deposits:** From April 1, 2001, the maximum rate of interest that NBFCs could be permitted for their different public deposit schemes was reduced from 16% to 14% P.A. This measure had

been taken after taking into consideration the recent market situation and changes in other interest rates in the financial system. The ceiling of maximum interest rate on the deposits accepted by Miscellaneous Non-Banking Companies (Chit Fund companies) was also brought down to 14%. From November 1, 2001, the maximum ceiling on rate of interest had been further brought down to 12.5% for all categories of NBFCs registered with RBI.

- **Issue of Commercial Paper by NBFCs:** From October 10, 2000, the RBI proposed guidelines for issue of Commercial Paper (CP) by NBFCs. It also suggested the specific provision in respect of issue of commercial paper in a comparative structure of issue of public deposit instruments by NBFCs.
- **Asset Liability Management (ALM) System for NBFCs:** The RBI recommended the ALM guiding principle for NBFCs for efficient risk management system. All the NBFCs with asset size of Rs.100 crore or more or public deposits of Rs.20 crore or more, as per last financial statement as on March 31, 2001, were required to implement ALM systems mandatorily. In this respect, the NBFCs were instructed to form an ALM Committee which was comprised of Chief Executive Officer (CEO) as chairman of the committee and senior Executives including specialist persons as members of the committee. The ALM committee should have been formal and published. From March 31, 2002, the implementation of ALM system became mandatory for the NBFCs. In case of registered NBFCs holding public deposits of Rs.20 crore or more, the ALM return need to be submitted, which had to consist of structural liquidity and rate of interest sensitivity on short-term basis. NBFCs not having public deposits, but having asset value of Rs.100 crore or more should have been advised to introduce a supervisory framework in this regard.

The Chit Funds companies were kept out of the purview of these ALM guidelines. It was advisable by the RBI to introduce ALM system by NBFCs not presently covered under the ALM compliance criteria for betterment of their growth in the long run as the RBI had then already plan to make it mandatory for all types of NBFCs irrespective of their asset size in future.

- **Rationalisation of the Requirement of Introduction for Depositors of NBFCs:** For proper identification of depositors to avoid fictitious names, certain norms of introduction for depositors had been started in June 2000. To rationalise this procedure and to make that viable for record keeping, a standardised format of introduction for depositors had been formulated. So, for the interested depositors, NBFCs were required to obtain the copies of identification of depositors and to keep the records with proper nomenclature. For identification purpose, different documents were required such as passport, voter ID card, ration card, PAN Card, and Government identity, if any.
- **Rationalisation of Returns Submitted by NBFCs:** All the NBFCs were required to submit the return in the prescribed format containing certain information, at quarterly, half-yearly, and annual basis. To improve the reporting system of the supervisory information in the return, RBI also implemented electronic processing. All these formats of returns were prescribed in accordance with the directions issued under RBI Act. Chit Fund companies were also covered under this system. A monthly return on repayment schedule of deposits was prescribed for NBFCs having public deposits in accordance with the provisions of Section 45-IA of RBI Act, 1934.

- **Emphasis on Large NBFCs with Public Deposit exceeding Rs. 20 crores:** To control over supervisory aspect and to make early warning signals for deterioration of financial health of the NBFCs having large public deposits, different measures had been adopted by the RBI. The parameters for this purpose were quantum and limit of holding public deposits, submission of quarterly return, compliances of monetary aggregates, net owned fund, NPA position, credit rating, key ratios, cash flow, asset-liability position, etc. But it was applicable only for those NBFCs having public deposits of Rs.20 crores and more. A format of return was also recommended for furnishing all this information at a certain interval. It basically enabled closer monitoring system for large NBFCs.
- **Special Guidelines of Residuary Non-Banking Companies (RNBCs):** RNBCs were basically operating in the activities associated with various public savings schemes, term deposit schemes, and recurring deposit schemes, somehow similar to the banks. The acceptances of these various schemes were governed by the provisions laid down in the Residuary Non-Banking Companies (Reserve Bank) Directions, 1987. These directions included the followings:

  The minimum (more than 12 months) and maximum (not more than 84 months) period of deposits.

  i. Restriction on forfeiture of any portion of the deposit or accrued interest;
  ii. Disclosure procedures in the application forms;
  iii. Advertisements soliciting deposits;

iv. Various periodical returns and reports to be furnished to the RBI at the end of certain interval;

v. Provisions in respect of linkage of deposits in respect of NOF;

vi. Provisions of security of the depositors' interests;

vii. Provisions to invest not less than 80% of aggregate deposit liabilities as per the investment pattern prescribed by the RBI; and

viii. Provisions of withdrawal and repayment of deposits.

The RNBCs were the only category of NBFCs which were entrusted to pay a minimum rate of interest on their deposits. This rate of interest on deposits was also specified in the RBI RNBC Directions, 1987. No upper limit had been suggested for RNBCs like other NBFCs which were required to pay interest subject to the maximum ceiling recommended by RBI. The basic interest rate payable by RNBCs was revised and decreased from 6% to 4% P.A (compounded annually). In respect of daily deposit schemes, interest rate was decreased from 8% to 6% P.A (compounded annually). Generally, duration of deposit was higher in this regard. The provisions of prudential norms relating to RNBCs were governed by NBFC Prudential Norms (RB) Directions, 1998. The compliance of prudential norms as suggested by this direction was mandatory for RNBCs and a precondition for acceptance of deposits.

4.5.2 NBFCs not registered with the RBI

- **Mutual Benefit Financial Companies (MNFC):** MNFCs (Nidhis) were of the category of NBFCs which was notified under section 620A of the Companies Act, 1956. These companies were mainly regulated by Department of Company Affairs (DCA). The department also followed the directions issued under Section 637A of the Companies Act, 1956. The MNFCs were basically exempted from the basic provisions of the RBI Act in respect to

NBFCs. An Expert Committee had been formed in March 2000 (Chairman: Shri P. Sabanayagam) by Government of India to examine and verify the various aspects of activities of the MNFCs. The committee recommended a suitable policy framework and supervision procedure for overall improvement of these categories of NBFCs. All these recommendations had been implemented with a view to smoothen the progress of their healthy functioning and to establish a healthy platform for the public investment.

- **Miscellaneous Non-Banking Companies (MNBCs):** MNBCs were mainly involved in the Chit Fund (CF) business. In this business, the term 'deposit' as explained in section 45 I(bb) of the RBI Act, 1934 was different from the subscription payable in Chit Funds schemes. The CF companies had been exempted from all the basic provisions of Chapter IIIB of the RBI Act, 1934 including the provisions of registration. There were certain directions in this regard which was known as Miscellaneous Non-Banking Companies (RNBC) Directions. Under that direction, the RNBCs could accept deposits up to 25% from public and 15% of the NOF from shareholders. The period of deposits could be made from a period of 6 months to 36 months. RNBCs could not accept any deposits repayable on demand. The RBI Act only regulated the deposits accepted by the RNBCs, but it was not applicable to the activities of Chit Fund (CF) business. The activities of CF business were governed by the offices of Registrars of Chits under different State Governments. The Chit Funds Act, 1982 was a central act which provided uniform provisions that were applicable to all CF companies throughout the country. All the State Governments were required to comply with and formulate the rules in accordance with the provisions of the Chit Funds Act, 1982 respective to their

jurisdictions. Presently, 16 States and 6 Union Territories had already adopted provisions of the Chit Funds Act, 1982.

4.6 BRIEF OVERVIEW OF REGULATIONS OF NBFCs

The basic objectives of framing regulation of NBFCs is to ensure the proper functioning and surveillance in an effective way with their adequate quality supervision in accordance with the mission of RBI over the NBFCs. For developments of the NBFCs and also to provide an effective supervision on Asset-Liability Management (ALM) and Risk Management System (RMS) a proper regulatory environment was necessary. The basic aspects of regulation of NBFCs as framed by RBI were as follows:

Certificate of Registration: All the NBFCs should obtain a valid certificate of registration in accordance with the provisions Section 45-1A of the RBI Act, 1934 before commencement of business. The procedure of registration is already discussed in **Para 4.4** (Registration of NBFCs) as stated above.

i. **Maintenance of Liquid Assets:** NBFCs should invest in approved securities. The investment value does not exceed the current market price. The variation, if any, should be ranged from 5% to 25% as specified by RBI in respect of the deposits outstanding at the end of working day.

ii. **Creation of Reserve Fund (RF):** It is mandatory for all NBFCs to create a reserve fund and transfer every year not less than 20% of the net profit before declaring dividend. It is also mandatory for all NBFCs to create the RF irrespective of the situation whether it accepts public deposits or not. Further, no appropriation of RF can be made without prior written approval from RBI.

iii. Acceptance of Deposit related Regulations

Ceiling on quantum of public deposits: For Loan and Investment companies having NOF of Rs. 25 lakhs or more the public deposits should be 1.5 times of NOF. For that purpose, the company should have Minimum Investment Grade (MIG) credit rating, and minimum 15% Capital to Risk Assets Ratio (CRAR). Equipment leasing and hire purchase finance companies having NOF of Rs. 25 lakhs or more should have the following ceiling of public deposits.

- Public deposits 4 times of NOF with MIG credit rating and 12% CRAR.
- Public deposits 1.5 times of NOF without MIG credit rating and 15% CRAR.

Period of Deposits: No demand deposits.

- Period of deposits for NBFCs other than RNBCs and MNBCs: Minimum 12 months to maximum 60 months.
- Period of deposits for RNBCs: Minimum 12 months to maximum 84 months.
- Period of deposits for RNBCs: MNBCs (Chit Funds) – Minimum 6 months to maximum 36 months.

Ceiling of deposit interest rate: With effect from March 4, 2003 deposit interest rate for all NBFCs other than RNBCs was maximum 11 % (effective).

For RNBCs, the minimum interest rate was 4% on daily deposits and 6% on all other deposits. It was to be noted that the interest was payable on compounded basis. **Advertisement style for acceptance of deposits:** NBFCs which would accept deposits by way of publishing the schemes trough advertisement were required to comply with the advertisement rules recommended in this regard by RBI. In this respect the advertisement of deposits schemes should have been transparent and the deposit acceptance application form should have contained all necessary prescribed

information as required. In this respect all the NBFCs should have issued receipt for deposits and have regularly maintained a deposit register in the prescribed format.

Obligation of submission of returns: All the NBFCs accepting public deposits were required to submit a periodical return in a prescribed format to RBI. The return was to be submitted at quarterly, half yearly, and annual basis considering the nature of the return forms prescribed by RBI.

iv. **Prudential Norms applicable to only the NBFCs accepting or holding public deposits**

Capital to Risk Assets Ratio (CRAR): The minimum ratios that were required to be maintained by NBFCs in respect to CRAR have already been discussed above in a paragraph on Ceiling on quantum of public deposits, as stated above. CRAR comprised of Tier I and Tier II capital which were to be maintained on a daily basis.

Tier I capital which was also known as core capital or NOF also included convertible preference shares (CPS) for CRAR. Tier II Capital comprised of all quasi-capital like all preference shares except CPS, subordinated debt, and convertible debentures. Tier II Capital should not exceed tier I capital. In this respect the general provisions and reserves for losses should not exceed 1.25% of the risk-weighted assets. It was to be noted for this purpose that subordinated debt should have been issued for a period of 60 months or more.

Restrictive norms: For any NBFCs, the acceptance of any scheme of public deposits was not permissible if all prudential norms were not fully satisfied. If any NBFC was found to be in default in repayment of the matured value of the deposits at the end of its tenure, then such NBFC would have been prohibited from any financial activities till the defaults were fully regularised.

For any NBFCs, the value of investments in real estate was restricted to 10% of the Owned Fund. But the value of investment in real estate for owner/s' use was not included. The value of investments in the unquoted shares was restricted as follows:

- For Equipment Leasing and Hire Purchase Companies - 10 % of owned fund;
- For Loan and Investment Companies - 20% of owned fund.

It was worth noting for that purpose that no additional investments could be allowed in real estate in respect of the situation of excess investment beyond the above prescribed limit till it reached the limits as prescribed. The period of adjustment could be allowed by RBI.

Credit and investment concentration norms: Followings were the limit norms in that regard:

- For a single borrower the credit exposure limit – 15% of owned fund;
- For a single group of borrower, the credit exposure limit – 25% of owned fund.

Reporting System: In respect of the prudential norms of accepting deposit return, it appears that it is to be submitted on half-yearly basis i.e. at the end of September and March every year. The return is required to be submitted within 3 months from the end of a quarter. All the return is to be certified by statutory auditors as appointed by the NBFCs. However, any unaudited figures will be rejected.

v. Prudential Norms applicable to NBFCs not only accepting and holding public deposits.

Norms of Income Recognition: The credit of income on any NPA is allowed under cash basis system. Any unrealised income which is recognised in the earlier period is required to be reversed in the current period.

Norms of NPA: Before identifying any assets as NPA the income should be credited on accrual basis. The NPA norms are as follows

- For Lease and Hire Purchase finance, an asset is considered NPA if it remains unrealised (outstanding) for more than 12 months.
- For other Loans and Advances, an outstanding period of just more than 6 months is enough for an asset to be considered as NPA.

Restrictive Norms: Any loans and advances against own shares are not permissible.

Policy on 'demand and call' loans: All the policies regarding cut-off date, rate of interest, periodicity of accrual of interest of all demand and call loans should be predetermined and should be approved by RBI. A periodical review of the performance should also be made.

Compliance of Accounting Standards: All the Accounting Standards (AS) and Guidance Notes (GN) as issued by the Institute of Chartered Accountants of India (ICAl) are applicable to all types of NBFCs. The AS and GN are also consistent with the guidelines as prescribed by RBI. So the compliances with the provisions of those AS and GN are obligatory.

Accounting for investments: There should a well defined investment policy of accounting for all types of NBFCs. All the investments are classified into two categories - one is long term investments and the other is current investments.

Any long term investments should be valued as per AS issued by ICAI. On the other hand, current investments are again classified into two groups - one is quoted and the other is unquoted.

Any current quoted investments should be valued at lower of actual cost or market value. The block valuation of current quoted investments is also permitted. Any notional gains or losses within the block should be valued at net of these two. But

inter-block and net notional gains are to be ignored for this purpose. But any notional losses are to be accounted for.

The valuation norms for current unquoted investments are as follows:

- In case of equity shares, valuation should be made at lower of actual cost or breakup value or fair value.
- If the financial statement of the investee company is not available for a period of immediate last two years then Re 1/- is to be shown for the entire unquoted block of holding.
- The value of preference shares should be valued at lower of actual cost or face value.
- The Government securities should be valued at actual carrying cost of investment.
- Mutual Fund (MF) units should be valued at Net Asset Value (NAV) for each individual scheme separately.
- Commercial paper (CP) should be valued at its actual carrying cost.

Asset Classification and Non-Performing Assets (NPA) Provision: For all types of NBFCs the credits and receivables are classified as follows:

- Standard asset (SA)
- Sub-standard asset (SSA)
- Doubtful asset (DA)
- Loss asset (LA).

As stated earlier, for NBFCs, an asset is to be classified as Non-Performing Asset (NPA) when the interest is overdue for a period of 6 months or more in case of loans and advances and interest is overdue for a period of 12 months or more in case of lease and hire purchase schemes.

For SA - No provision for NPA is required.

For SSA- Provision to be made for 10% of the outstanding balance of NPA.

For DA – Provision to be made for 100% on unsecured portion and 20% or 30% or 50% on secured portion following the age of the NPA.

For LA - Provision to be made for 100% of the outstanding NPA.

Some special provisions are required for NPA of Equipment, Lease and Hire Purchase accounts. If these accounts are found to be NPA then unsecured portion of these accounts is to be fully provided as NPA provision. An additional provision is to be made on Net Book Value (NBV) of these assets. These accelerated additional provisions for NPAs should be provided in the following ways:

- If NPA is more than 12 months but less than 24 months -10% of NBV as NPA provision.
- If NPA is more than 24 months but less than 36 months – 40% of NBV as NPA provision.
- If NPA is more than 36 months but less than 48 months - 70% of NBV as NPA provision.
- If NPA is more than 48 months – 100% of NBV as NPA provision.

In this regard it should be noted that reclassification of the NPA will not upgrade for a period upto 12 months of satisfactory performance of the payments of the outstanding as per the new terms as imposed by NBFCs.

Risk Weights and Credit Conversion factors:

A risk weight should be applied to all assets of NBFCs except the intangible assets.

The risk weights should be applied after the adjustment of provisions made against relative assets.

The risk weights are to be given as 0%, 20% and 100% as mentioned below:

- Risk weight 0%: For any asset deducted from owned fund like coverage to subsidiaries or companies within the same group or intangibles.
- Risk weight 20%: Exposures to All India Financial Institutions (AIFIs).
- Risk weight 100%: For all other assets as stated above.

It is to be noted for this purpose that the off-balance sheet items are required to be factored as per the rule prescribed by RBI then to be converted for risk weights.

Disclosure requirements:

- All NBFCs are required to disclose the NPA provision, if any, separately (not clubbed under any other provision like income tax) in the balance sheet without netting the values from the income or against the value of respective assets.
- All the provisions should be distinctly indicated under separate heads of accounts as provision for bad and doubtful assets and provisions for depreciation in investments.
- All these provisions should not be appropriated from any other provisions and reserves, if any.
- All these provisions for each year should be debited to the profit and loss account.

It should be noted that Nidhis and Chit Fund companies to some extent are exempted from these practices.

RBI Supervision: The RBI has introduced a comprehensive supervisory system for NBFCs. It basically focuses on prudential supervision to ensure that NBFCs are functioning in the way of avoiding higher risk taking. In this respect the RBI implemented the supervisory framework based on on-site inspection system, off-site monitoring system, market intelligence method, and exception reporting of statutory

auditors as appointed by NBFCs. All these supervision mechanisms are based on the asset size of the NBFCs.

The system of on-site assessment started in the year 1997 on the basis of CAMELS (Capital, Assets, Management, Earnings, Liquidity, and Systems and Procedures) method of evaluation. This approach is similar to the model adopted by RBI for evaluation of the banking system. The method of market intelligence system is also a much strengthened tools of supervision. Under this process, a continuous and on-going supervision is implemented to facilitate warning signals for RBI. It will finally help for a triggering supervisory action for RBI.

A monitoring system is also implemented by RBI in respect of mandatory submission of returns of NBFCs at different intervals to widen the scope of supervisory control by RBI in respect to various interest groups.

Regarding all these assessments the companies not having public deposits and asset size of Rs.100 crores and above are being subjected to annual inspection by RBI. For all other companies it is applicable by rotation once in every 5 years.

The exception reports, if any, received from the statutory auditors as appointed by the NBFCs are also examined at periodic intervals by RBI. These are treated as main tools for statutory compliances of these companies in accordance with the RBI regulations.

Policy Developments: The RBI introduced various measures to improve the regulatory and supervisory principles of this sector as per the changing scenario of Indian Financial System. Different policy development as discussed earlier in Para 4.5 (Policy Developments Relating to NBFCs) adopted time to time to aim at aligning the interest rates, monetary policy and services of this sector in accordance with the prevalent rates and policies in the rest of the economy. It is also used as a tool of

tightening the prudential norms and standardising operating procedures in accordance with the RBI's regulations and act.

Protection of Depositors' Interest: With the objective of protecting the interest of all types of depositors, RBI issues the current list of NBFCs time to time and also issues press advertisements in case of any winding up of NBFCs. If any petitions are filed by the RBI as admitted in Court, then the same also intimates the RBI through press advertisements. The same procedure is adopted for appointment of liquidators and criminal proceedings and summons of Court have been initiated by the RBI.

4.7 FAIR PRACTICES CODE (FPC)

All the NBFCs should put up the FPC on their website for the information of various stakeholders. Guidelines on FPC were introduced on September 28, 2006 to prescribe the guiding principle on fair practices by NBFCs including RNBCs. All the FPCs should be framed and approved by the boards of directors of the NBFCs. The various guidelines on FPC practices are as follows:

- Standardised applications for loans and their processing in accordance with the guidelines of the RBI
- Guidelines of filing of loan application forms for interest of the borrower
- Disclosure of terms and conditions offered by NBFCs
- Comparison of terms and conditions with other NBFCs but it should be made in accordance with the guidelines of RBI
- Comparison of schemes of NBFCs
- Providing acknowledgement for receipt of all loan applications
- Disclosure of processing time of loans
- Disclosure of legal requirements
- Sanctioning methodologies

- Financial indicators for sanctioning of loans
- KYC compliances
- Disclosure of scheme wise rate of interest
- Procedure for disbursement of loans
- Issue of notice to the borrower of any changes in the terms and conditions
- Condition for prepayment charges
- Post disbursement supervision
- Conditions of releasing all securities after repayment of all dues or on subject to any justifiable right or lien for any other claim of NBFCs
- Procedure of issue of notice to the borrower regarding the claims and the circumstances under which NBFCs are permitted to hold the securities till the relevant outstanding is paid
- Disclosure of procedural aspects of transfer of borrowed account
- Issue procedure of no objection certificate for transfer of loan account
- Procedural aspects of objections raised by NBFCs within 21 days from the date of application of request
- Disclosure requirements for transfer of loan as per transparent preset contractual terms and conditions in accordance with law
- In the course of recovery of loans, transparent adoption of policies to avoid the harassment of the beneficiaries
- Disclosure of grievance redressal mechanism
- Time frame to resolve the disputes arising in the services of NBFCs
- Proper hierarchy and its function in respect to the redressal of disputes by the lending institutions

In this respect it should be noted that a review mechanism of the Board of Directors in compliance with the implementation of FPCs to be made in certain intervals. A consolidated report based on these reviews is to be submitted to the Board before adoption of subsequent FPC. NBFCs will have the autonomy of drafting the FPC but within the scope of the guidelines recommended by RBI. The NBFCs should perform in accordance with the guidelines of FPCs without sacrificing the underlying spirit of FPCs.

As per our discussion in Chapter 1, our scope of study is mainly concerned with two categories of NBFCs, namely, Asset Finance Companies and Investment Companies. Below are presented the overviews of these two categories.

4.8 ASSET FINANCE COMPANIES (AFCs): AN OVERVIEW

AFCs have been playing a balancing role to the other financial institutions including banks to meet up the funding needs in respect of asset creation of the economy. The Standing Committee on finance as set up by the Parliament has recognised that the financial intermediaries like AFCs have an explicit and significant role to play in a developing economy. AFCs at present are well regulated and supervised somehow similar to the commercial banks. All the AFCs are required to accomplish the following:

i. Mandatory registration with RBI
ii. Compliances with prudential norms recommended by RBI in respect to the capital adequacy, asset liability management (ALM), credit and investment norms, income recognition, assets classification, accounting standards, NPA provision and various disclosure requirements
iii. Compliances with KYC norms as recommended by RBI
iv. Adoption of a sound Fair Practice Code (FPC)

Presently AFCs play a vital role on financing distribution of funds towards acquisition of commercial vehicle which helps in the development of the Indian road transport industry from urban to rural areas. AFCs are also involved in creation of assets through financing in equipments in the projects of infrastructure development and construction. In India, the road transport segment comprises nearly 70% of goods movement and 80% of passenger movement. So the growth and development of this sector has been historically recognised by various committees set up by the Government and RBI in the recent period. AFCs are significantly present in the rural markets in respect of their financing in assets in this sector. The activities of AFCs also include the assets used for agricultural produce and transportation. Finally, for improvements in productivity and generating employments of the transportation sector especially in rural areas, AFCs will continue to play a significant role in the Indian context.

AFCs also established mechanisms for creation of productive national assets through lease financing and other modes of financing. In fact, it has been observed in various economic reviews that most developed economies have heavily relied on lease financing route in their economic development process.

In India, AFCs have been playing a significant role to promote leasing, hire purchase, infrastructure asset creation through various schemes suitable in urban as well as rural areas. AFCs are also playing a major role to ensure a cost-effective delivery of credit to the weaker and the unbanked segments of various parts of the country. It acts as an intermediary between the banking sector and borrower in the rural markets in creation of productive assets which have a multiplier effect on employment generation.

4.9 INVESTMENT COMPANIES (ICs): AN OVERVIEW

According to the NBFCs' Acceptance of Public Deposits (Reserve Bank) Direction, 1998, an IC is defined as follows:

- A company, which acquires securities within its own group and subsidiary companies;
- A company which does not involve in trading of the Securities, and
- A company which does not accept or hold any public deposit.

The RBI imposed certain conditions to treat NBFCs as ICs in respect of activities of acquisition of shares and securities. These are as follows:

- The ICs should hold not less than 90% of its total assets in the form of investment in equity shares, preference shares, debt, long term and short term loans in group companies.
- The investments in only equity shares in group companies should not be less than 60% of its total assets. For this purpose, it should also include the financial instruments that can compulsorily be converted into equity shares within a stipulated period which does not exceed 10 years from the date of issue of that instruments.
- The ICs should not carry all other financial activities except some specified activities as referred to under section 45I(c) and 45I (b) of the RBI Act, 1934. The activities which are not restricted under those sections are investment in bank deposits (short term and long term), money market securities, Government securities, debt, loan to group companies and guarantee issuance on behalf of the group companies.

- There are some flexibilities for the ICs in advancing to other investment group companies which is restricted to a minimum ceiling of 60% of total assets into equity.

As per the RBI Act, 1934 following are some regulatory measures of the ICs.

- Initially a company satisfying the above mentioned criteria in respect of the ICs was not mandatorily required to be registered with RBI, but now under section 45I (c) of the RBI Act,1934 any NBFC which carries the business of ICs following the conditions stated above are mandatorily required to be registered with RBI.
- All the NBFCs that are registered as ICs are required to ensure that its external liabilities do not exceed 2.5 times of their respective adjusted net worth (NW) as per the latest audited balance sheet.
- Every IC has compulsory obligation to maintain a minimum capital adequacy. Under this, the adjusted net worth should be at least 30% of their total risk weighted assets and risk adjusted value of the off-balance sheet items as per the latest audited balance sheet.
- If any IC complies with the above regulations as stated above, it may be exempted from maintenance of a minimum net owned funds (NOF) and also from certain requirements of the Non-Banking Financial (Non accepting or Holding) Companies prudential norms (Reserve Bank) Directions,2007, relating to the capital adequacy and exposure norms.
- If any IC ~~is~~ fails to get itself registered with RBI within a period of six months from the commencement of business, then it will be treated as contravention of provisions under section 45IA of the RBI Act, 1934. It is punishable with a

fine between Rs. 1-5 lakhs and imprisonment for a period of 1 to 5 years for all the members of the board of directors of the company.

The activities of ICs can be briefly stated as follows:

The ICs collect funds from different stakeholders and invest in different securities and other notified schemes. The profits made are distributed proportionately among the different stakeholders and the public after deduction of any cost involved in it. These companies mainly provide specialized services and mostly offer a higher rate of interest.

4.10 REFERENCES

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