

Non-Banking Financial Companies (NBFCs)

30. Recent years have witnessed significant increase in financial intermediation by the NBFCs. This is reflected in the proposal made by the latest Working Group on Money Supply for a new measure of liquidity aggregate incorporating NBFCs with public deposits worth Rs.20 crore and above (Box 3.1). For regulatory purposes, NBFCs have been classified into 3 categories: (a) those accepting public deposits, (b) those not accepting public deposits but engaged in financial business and (c) core investment companies with 90 per cent of their total assets as investments in the securities of their group/holding/subsidiary companies. The focus of regulatory attention is on NBFCs accepting public deposits.

31. As per the NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 1998, the quantum of public deposit in respect of NBFCs was linked to credit rating from an approved agency so as to enable the depositor to make informed decision. The NBFCs were also encouraged to broad-base their resources through borrowings from banks and financial institutions, inter-corporate deposits/ loans, secured bonds/debentures, etc., which were exempted from the definition of "public deposit". However, the Associations of NBFCs and the apex trade bodies brought to the notice of both the Government and the RBI the problem of asset-liability mismatches caused by frequent downgrading of the credit ratings of NBFCs and the consequent reduction in quantum of permissible public deposits. They also suggested that smaller NBFCs could be exempted from the requirement of credit rating for having public deposits upto a particular limit while larger NBFCs could be allowed higher limits of public deposits subject to minimum investment grade credit rating and higher capital adequacy requirements. The Task Force on NBFCs appointed by the Government of India submitted its report in October, 1998, which recommended rationalisation of regulations for NBFCs, improvement of the legislative framework for protecting the interests of depositors and development of NBFCs on sound and healthy lines (Box 3.4). The modified regulatory framework for NBFCs based on the recommendations made by the Task Force provides for the following:—

- NBFCs with net owned fund (NOF) of less than Rs. 25 lakh (with or without credit rating) are not entitled to accept public deposits (as hitherto).
- The unrated and underrated (rating below the minimum investment grade) NBFCs in the category of equipment leasing and hire purchase finance companies with NOF of Rs. 25 lakh and above are allowed to accept public deposits upto 1.5 times of their NOF or Rs. 10 crore, whichever is less, provided their CRAR is 15 per cent or above as per their last audited balance sheet.
- The unrated and underrated NBFCs in the category of loan and investment companies, irrespective of their NOF and CRAR, are not entitled to accept public deposits (as hitherto).
- NBFCs in the category of equipment leasing and hire purchase finance companies with NOF of Rs. 25 lakh and above as well as minimum investment grade credit rating can accept public deposits four times of NOF provided they have CRAR of not less than 10 per cent as on 31.3.1998 and shall have CRAR of not less than 12 per cent as on 31.3.1999.
- NBFCs in the category of loan and investment companies with NOF of Rs. 25 lakhs and above as well as minimum investment grade credit rating can accept public deposits not exceeding 1.5 times of NOF provided they have CRAR of 15 per cent or above with immediate effect.
- NBFCs in the category of equipment and hire purchase companies should endeavour to increase their CRAR to 15 per cent as early as possible
- NBFCs in the category of loan and investment companies which do not have minimum CRAR of 15 per cent as on date but otherwise comply with all the prudential norms and (a) have credit rating of AAA may accept or renew public deposits upto the level outstanding as at the close of business on December 18, 1998 or 1.5 times of the NOF whichever is more subject to the condition that they should attain CRAR of 15 per cent by March 31, 2000 and bring down the excess deposits, if any, by December 31, 2001 and (b) have credit rating of AA/A may accept or renew public deposits as per the existing provisions of Directions (0.5/1.0 time of their NOF) but

- they should attain the minimum CRAR of 15 per cent on or before March 31, 2000 as per their audited balance sheet, failing which they should regularise their position by repayment or otherwise by December 31, 2001.
- The above benefit will not be available to those companies whose CRAR is presently 15 per cent and above but slips down below the minimum level of 15 per cent subsequently.
- The disclosure norms for NBFCs accepting public deposits have been widened so as to enable depositors to make an informed decision.
- Stipulations on prudential norms, ceiling on interest rates, payment of brokerage on public deposits, etc. remain unchanged.
- NBFCs have been advised not to invest more than 10 per cent of their owned fund in land

BOX 3.4

Major Recommendations of the Task Force on NBFCs

The Task Force on Non-banking Finance Companies (NBFCs) submitted its report on October 28, 1998. The major recommendations are as under:—

- The rising number of defaulting NBFCs and the need for a quick redressal system call for change in the existing legislative and regulatory framework for NBFCs.
- Extension of the period for attaining minimum Net Owned Funds (NOF) beyond three years (January 2000) should be made conditional on adequate steps having been taken by the concerned NBFCs. Also, the minimum prescribed NOF of Rs. 25 lakh be considered for upward revision.
- The Reserve Bank of India should draw up a time bound programme for disposal of applications for registration of NBFCs and keep States informed of registration granted/rejected in respect of NBFCs in the respective States.
- Higher CRAR of 15 per cent for NBFCs seeking public deposits without credit rating be prescribed by RBI, as against existing 12 per cent for rated NBFCs.
- Ceilings for exposures to real estate sector and investment in capital market, especially unquoted shares, be prescribed by the Reserve Bank of India.
- The Reserve Bank of India may stipulate 25 per cent of reserves of NBFCs to be invested in marketable securities in addition to SLR securities already held by them.
- The following ceilings may be prescribed for public deposits in respect of different categories of NBFCs.

Type of NBFC

*NBFC with NOF
less than Rs. 25 lakh*

*EL/HP Company without
credit rating*

*EL/HP Company with
investment grade credit rating*

*Loan/Investment Cos with
investment Grade credit rating*

Limit of Public Deposits

*No access to public
deposits*

*1.5 times NOF or Rs. 10 crore,
whichever is lower, subject to 15 per cent CRAR*

4 times NOF

*1.5 times NOF
(Higher CRAR of 15 per cent)*

- Prescription of a suitable ratio between secured and unsecured deposits for NBFCs to be preceded by measures to ease flow of bank credit to them.
- Liquid asset ratio to be increased from existing 12.5 per cent to 25 per cent of public deposit in a phased manner. Also, statutory provision be made to give to unsecured depositors first charge on liquid assets.
- Depositors' grievance redressal authority with specified territorial jurisdiction be appointed by the RBI with the help of the office of the Banking Ombudsman available in several states.
- Separate instrumentality for regulation and supervision of NBFCs be set up under the aegis of the RBI and entrusted under one Executive Director/supervised by a Deputy Governor.
- Strengthen the off-site surveillance mechanism to identify/control NPAs; sensitive market intelligence system be developed to trigger on site inspection, to be followed by appropriate regulatory response.
- Deposit taking by unregistered NBFCs be made a cognisable offence; State governments should set up special investigation wings for enforcing this provisions.
- Unauthorised deposit taking by unincorporated financial intermediaries should also be made a cognisable offence. State Governments should quickly enact legislation on the lines of the Tamil Nadu legislation.

and building except for their own use. The ceiling on investment in unquoted shares of companies other than their group/subsidiary companies has been fixed at 10 per cent of their owned fund for equipment leasing and hire purchase finance companies and 20 per cent of the owned fund for loan and investment companies. A time limit of 3 years has been given to the NBFCs to dispose off excess of such assets, including the assets acquired in satisfaction of their debts, wherever company surpasses the ceiling indicated above.

- The unincorporated bodies engaged in the business of a non-banking financial institution are not allowed to accept deposits except from

relatives specified and in the manner prescribed in the provision of Section 45-S of the RBI Act. However, such entities are now allowed to access loans from bodies with a corporate identity including NBFCs. Accordingly, the deposits from (a) the companies incorporated under the Companies Act; (b) Corporations established under any Statute; and (c) the Cooperative Societies registered under any State Law, have been exempted from the definition of 'deposit' under the RBI Act. Individuals, firms, associations of persons, Hindu Undivided Families and Partnership firms may accept deposit from the above mentioned corporate entities also for the purpose of their financial business.