

NON-BANKING FINANCIAL COMPANIES

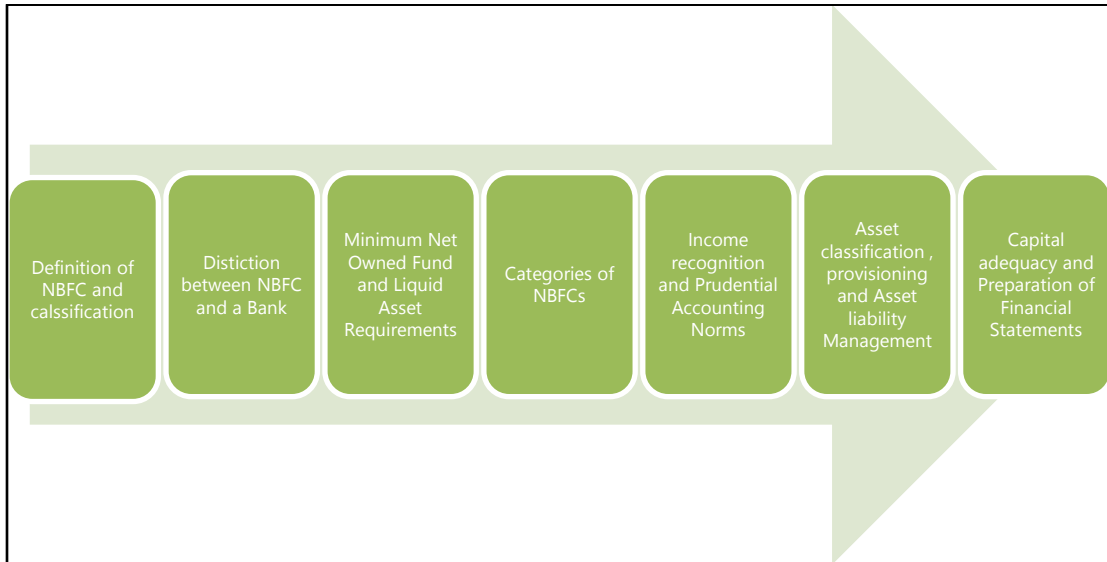


LEARNING OUTCOMES

After studying this chapter, you will be able to:

- Learn the definition of Non-Banking Financial Companies and their classification.
- Comeprehend with the regulations governing NBFC in India
- Familiarize with the requirements of the prudential accounting norms for NBFC

CHAPTER OVERVIEW



1. INTRODUCTION

Non-Banking Financial Companies (NBFC) play a crucial role in broadening access to financial services, enhancing competition and diversification of the financial sector. They are increasingly being recognized as complementary to the banking system, capable of absorbing shocks and spreading risks at times of financial distress. Simplified sanction procedures, orientation towards customers, attractive rates of return on deposits and flexibility and timeliness in meeting the credit needs of specified sectors (like equipment leasing and hire purchase), are some of the factors that enhanced the attractiveness of NBFCs.

2. DEFINITION OF NBFC

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act 1956/ 2013, engaged in the business of loans and advances, acquisition of shares, debentures and other securities, leasing, hire-purchase, insurance business and chit business. The term NBFC does not include any institution whose principal business is that of agriculture activity, industrial activity or sale of any good (other than securities) or providing any services and sale/purchase/construction of any immovable property.

Section 45 I(f) of Reserve Bank of India (Amendment) Act, 1997 defines a non-banking financial company as:

- (i) A financial institution which is a company;
- (ii) A non-banking institution which is a company with principal business of receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;
- (iii) Such other non-banking institution or class of such institutions, as the Reserve Bank with the previous approval of the Central Government may specify by notification in the Official Gazette.

For purposes of RBI (Reserve Bank of India) Directions relating to Acceptance of Public Deposits, non-banking financial company means only the non-banking institution which is a – “Loan company”, “Investment company”, “Hire purchase finance company”, “Equipment leasing company” and “Mutual benefit financial company”.

As per RBI FAQ (Frequently Asked Questions) dated 10 January 2017, Non-Banking Financial Company (NBFC)

- is a company registered under the Companies Act, 1956 or 2013;
- engaged in the business of loans and advances, acquisition of shares/stock/bonds/debentures/securities issued by Government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business;
- but does not include any institution whose **principal business** is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.

Residuary non-banking company - A non-banking institution which is a company and has its principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or any other manner, or lending in any manner is also a non-banking financial company.

What does conducting financial activity as “principal business” mean?

Financial activity as principal business is when a company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria will be registered as NBFC by RBI. The term 'principal

business' is not defined by the Reserve Bank of India Act. The Reserve Bank has defined it so as to ensure that only companies predominantly engaged in financial activity get registered with it and are regulated and supervised by it. Hence if there are companies engaged in agricultural operations, industrial activity, purchase and sale of goods, providing services or purchase, sale or construction of immovable property as their principal business and are doing some financial business in a small way, they will not be regulated by the Reserve Bank. Interestingly, this test is popularly known as 50-50 test and is applied to determine whether or not a company is into financial business.

3. REGISTRATION OF EVERY NBFC WITH RBI

In terms of Section 45-IA of the RBI Act, 1934, no Non-banking Financial company can commence or carry on business of a non-banking financial institution without a) obtaining a certificate of registration from the Bank and without having a Net Owned Funds of ₹ 25 lakhs (₹ Two crore since April 1999). However, in terms of the powers given to the Bank, to obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI viz. Venture Capital Fund/Merchant Banking companies/Stock broking companies registered with SEBI, Insurance Company holding a valid Certificate of Registration issued by IRDA, Nidhi companies as notified under Section 620A of the Companies Act, 1956, Chit companies as defined in clause (b) of Section 2 of the Chit Funds Act, 1982, Housing Finance Companies regulated by National Housing Bank, Stock Exchange or a Mutual Benefit company.

4. DISTINCTION BETWEEN AN NBFC AND A BANK

NBFCs perform functions similar to that of banks. However, there are following few differences:

S.No.	NBFC	Bank
1.	An NBFC cannot accept demand deposits.	A Bank can accept demand deposits.
2.	An NBFC is not a part of the payment and settlement system.	A Bank is a part of the payment and settlement system.
3.	An NBFC cannot issue cheques drawn on itself.	A Bank can issue cheques drawn on itself.

4.	Deposit insurance facility of the Deposit Insurance and Credit Guarantee Corporation (DICGC) is not available for NBFC depositors.	Deposit insurance facility of the Deposit Insurance and Credit Guarantee Corporation (DICGC) is available for banks.
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5. CLASSIFICATION OF NBFC

Does the Reserve Bank regulate all financial companies? No.

A. Companies exempted from registration under RBI

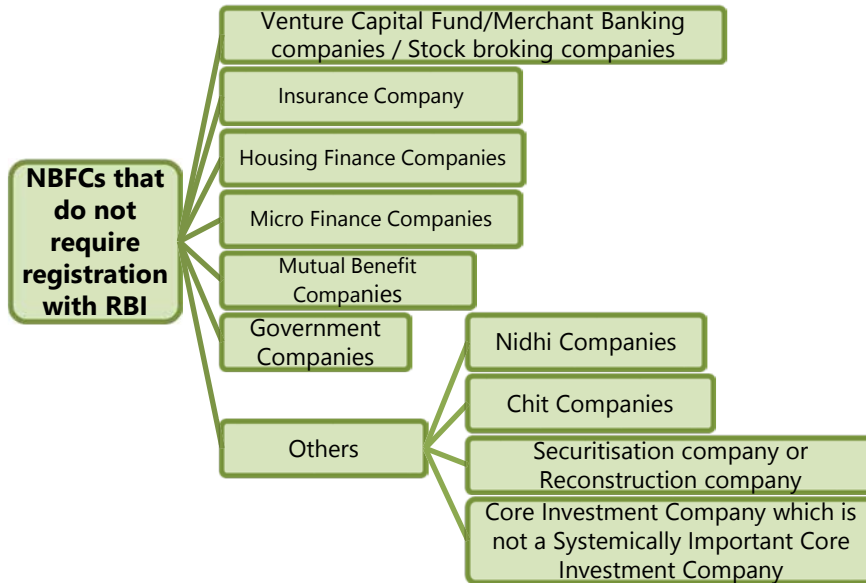
Companies that do financial business but are regulated by other regulators are given specific exemption by the Reserve Bank from its regulatory requirements for avoiding duality of regulation. Following NBFCs have been exempted from the requirement of registration under Section 45-IA of the RBI Act, 1934 subject to certain conditions.

- Housing Finance Companies (regulated by National Housing Bank);
- Merchant Banking Companies (regulated by Securities and Exchange Board of India);
- Stock Exchanges (regulated by Securities and Exchange Board of India);
- Companies engaged in the business of stock-broking/sub-broking (regulated by Securities and Exchange Board of India);
- Venture Capital Fund Companies (regulated by Securities and Exchange Board of India);
- Nidhi Companies (regulated by Ministry of Corporate Affairs, Government of India);
- Insurance companies (regulated by Insurance Regulatory and Development Authority); and
- Chit Fund Companies (regulated by the respective State Governments).

It may also be mentioned that Mortgage Guarantee Companies have been notified as Non-Banking Financial Companies under Section 45 I(f)(iii) of the RBI Act, 1934.

Core Investment Companies with asset size of less than ₹ 100 crore, and those with asset size of ₹ 100 crore and above but not accessing public funds are exempted from registration with the RBI.

NBFCs not registered with RBI are classified under following categories:



B. NBFCs mandated to register under RBI

NBFCs requiring registration with RBI are classified under following categories:



NBFCs registered with RBI are categorized as follows:

- a) in terms of the type of liabilities into Deposit and Non-Deposit accepting NBFCs;
- b) non deposit taking NBFCs by their size into systemically important and other non-deposit holding companies (NBFC-NDSI and NBFC-ND); and
- c) by the kind of activity they conduct.

Within the categorization mentioned in (c) above, (i.e. by the kind of activity they conduct) the different types of NBFCs are as follows:

1. Asset Finance Company (AFC)

- (i) AFC would be defined as any company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/ economic activity, such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines.
- (ii) Principal business for this purpose is defined as aggregate of financing real/physical assets supporting economic activity and income arising there from is not less than 60% of its total assets and total income respectively.

2. Investment Company (IC): It means a company which is a financial institution carrying on as its main business of the acquisition of securities.

3. Loan Company (LC): It means any company which is a financial institution carrying on as its main business by providing finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.

4. Infrastructure Finance Company (IFC): An IFC is defined as **non-deposit taking NBFC** that fulfills the criteria mentioned below:

- i. a minimum of 75 per cent of its total assets should be deployed in infrastructure loans as defined in Para 2(viii) of the Non Banking Financial (Non Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;
- ii. has a net owned funds of ₹ 300 crore or above;
- iii. has obtained a minimum credit rating 'A' or equivalent of CRISIL, FITCH, CARE, ICRA, Brickwork Ratings India Pvt. Ltd. or equivalent rating by any other crediting rating agency accredited by RBI;

- iv. has a Capital to Risk Asset Ratio (CRAR) of 15 percent (with a minimum Tier I capital of 10 percent).

5. Systemically Important Core Investment Companies (CICs-ND-SI): Core Investment Company means an NBFC carrying on the business of acquisition of shares and securities which satisfies the following conditions:

- i. it holds not less than 90% of its Total Assets in the form of investment in equity shares, preference shares, debt or loans in group companies;
- ii. its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not less than 60% of its Total Assets;
- iii. it does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;
- iv. it does not carry on any other financial activity referred to in section 45-I(c) and 45-I(f) of the RBI Act, 1934 except investment in bank deposits, money market instruments, government securities, loans and investments in debt issuances of group companies or guarantees issued on behalf of group companies.
- v. it accepts public funds.

- vi. Core Investment Companies (CIC) with an asset size of less than ₹ 100 crores.
- vii. Core Investment Companies (CIC) with total assets size of ₹ 100 crores or more either individually or in aggregate along with other Core Investment Companies in the groups and raises or holds public funds will be regarded as Systemically Important Core Investment Companies (CICs-ND-SI).
- viii. NBFCs whose asset size is of ₹ 500 cr or more as per last audited balance sheet are considered as systemically important NBFCs. Systemically Important Core Investment Companies will be required to get themselves registered with Reserve Bank of India.

A CIC-ND-SI which fulfills the following conditions, will not be required to meet the requirement for maintaining Net Owned Funds & capital adequacy and exposure norms as required under Non-Banking Financial (Non-Deposit Accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007:

- ix. Maintenance of minimum Capital Ratio where Adjusted Net Worth shall not be less than 30% of its Aggregate Risk Weighted Assets on Balance Sheet and risk adjusted value off-balance sheet items as on the date of the last audited Balance Sheet at the end of the financial year.
- x. Ensuring that its outside liabilities at all times doesn't not exceed 2.5 times of the Adjusted Net Worth as on last audited Balance Sheet date.

The above mentioned categories may further have the following sub-categories depending upon their business functions:

- (i) Equipment leasing company (EL) engaged in equipment leasing or financing of such activity.
- (ii) Hire purchase finance company engaged in hire purchase transaction or financing of such transactions.
- (iii) Investment company engaged in acquisition of securities and trading in such securities to earn a profit.
- (iv) Loan company engaged in providing finance by making loans or advances, or otherwise for any activity other than its own; excludes EL/HP/Housing finance Companies (HFCs).

6. Infrastructure Debt Fund - Non- Banking Financial Company (IDF-NBFC): "Infrastructure Finance Company" means a non-deposit taking NBFC that fulfills the following criteria:

- (a) a minimum of 75 per cent of its total assets deployed in "infrastructure loans";
- (b) Net owned funds of ₹ 300 crore or above;
- (c) minimum credit rating 'A' or equivalent of CRISIL, FITCH, CARE, ICRA, Brickwork Rating India Pvt. Ltd. (Brickwork) or equivalent rating by any other credit rating agency accredited by the Bank;
- (d) CRAR of 15 percent (with a minimum Tier I capital of 10 percent).

It invests only in Public Private Partnerships (PPP) and post commencement operations date (COD) infrastructure projects which have completed at least one year of satisfactory commercial operation and becomes a party to a Tripartite Agreement.

Infrastructure Debt Funds - Non- Banking Financial Company (IDFs-NBFC) facilitate the flow of long-term debt into infrastructure projects. The IDF-NBFC will be set up either as trust or as a company. A trust based IDF would normally be a

mutual fund while a company based IDF would normally be a NBFC i.e. IDF-NBFC. IDF-NBFC would raise resources through issue of either Rupee or Dollar denominated bonds of minimum 5 year maturity. The investors would be primarily domestic and off-shore institutional investors, especially insurance and pension funds which would have long term resources. IDF-NBFC would be regulated by the Reserve Bank.

7. Non-Banking Financial Company – Micro Finance Institution (NBFC-MFI): The Reserve Bank of India having considered it necessary in the public interest and being satisfied that for the purpose of enabling the Bank to regulate the credit system to the advantage of the country, gave the directions for the Non-Banking Financial Company-Micro Finance Institutions (Reserve Bank) Directions, 2011.

An NBFC-MFI is defined as a non-deposit taking NBFC (other than a company licensed under Section 25 of the Indian Companies Act, 1956 or Section 8 of the Companies Act, 2013) which satisfy the following criteria:

- i. Minimum Net Owned Funds of ₹ 5 crore. (For NBFC-MFIs registered in the North Eastern Region of the country, the minimum NOF requirement shall stand at ₹ 2 crore).
- ii. Not less than 85% of its net assets are in the nature of "qualifying assets."
For the purpose of ii above,

"Net assets" are defined as total assets other than cash and bank balances and money market instruments.

"Qualifying asset" shall mean a loan which satisfies the following criteria:-

- a. loan disbursed by an NBFC-MFI to a borrower with a rural household annual income not exceeding ₹ 1,00,000 or urban and semi-urban household income not exceeding ₹ 1,60,000;
- b. loan amount does not exceed ₹ 50,000 in the first cycle and ₹ 1,00,000 in subsequent cycles;
- c. total indebtedness of the borrower does not exceed ₹ 1,00,000;
- d. tenure of the loan not to be less than 24 months for loan amount in excess of ₹ 15,000 with prepayment without penalty;
- e. loan to be extended without collateral;

- f. aggregate amount of loans, given for income generation, is not less than 50 per cent of the total loans given by the MFIs;
- g. loan is repayable on weekly, fortnightly or monthly installments at the choice of the borrower.

8. Non-Banking Financial Company–Factors (NBFC-Factors): NBFC-Factor is a non-deposit taking NBFC engaged in the principal business of factoring. The financial assets in the factoring business should constitute at least 50 percent of its total assets and its income derived from factoring business should not be less than 50 percent of its gross income.

9. Mortgage Guarantee Companies (MGC): MGC are financial institutions for which at least 90% of the business turnover is mortgage guarantee business or at least 90% of the gross income is from mortgage guarantee business and net owned fund is ₹ 100 crore.

10. NBFC-Non-Operative Financial Holding Company (NOFHC) is financial institution through which promoter / promoter groups will be permitted to set up a new bank. It's a wholly-owned Non-Operative Financial Holding Company (NOFHC) which will hold the bank as well as all other financial services companies regulated by RBI or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.

6. REGISTRATION AND REGULATION OF NBFC

Under Section 45–IA of the Reserve Bank of India (Amendment) Act, 1997, no non-banking financial company is allowed to commence or carry on the business of a non-banking financial institution without obtaining a certificate of registration issued by the Reserve Bank of India.

A company incorporated under the Companies Act, 1956 and desirous of commencing business of non-banking financial institution as defined under Section 45 I(a) of the RBI Act, 1934 should comply with the following:

- i. it should be a company registered under Section 3 of the companies Act, 1956
- ii. It should have a minimum net owned fund of ₹ 200 lakh.

They can apply to Reserve Bank of India in prescribed form along with necessary documents for registration. The RBI issues Certificate of Registration after satisfying itself that the conditions as enumerated in Section 45-IA of the RBI Act, 1934 are satisfied.

However, to obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI

The Reserve Bank of India has issued directions to non-banking financial companies on acceptance of public deposits, prudential norms like capital adequacy, income recognition, asset classification, provision for bad and doubtful debts, risk exposure norms and other measures to monitor the financial solvency and reporting by NBFCs. Directions were also issued to auditors to report non-compliance with the RBI Act and regulations to the Reserve Bank, Board of Directors and shareholders. RBI has also issued Fair Practices Code to be adopted by all NBFCs while doing lending business. The guidelines inter alia, covered general principles on adequate disclosures on the terms and conditions of a loan and also adopting a non-coercive recovery method.

7. RESIDUARY NON-BANKING COMPANIES (RNBCS)

Residuary Non-Banking Company is a class of NBFC which is a company and has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner and not being Investment, Asset Financing, Loan Company. These companies are required to maintain investments as per directions of RBI, in addition to liquid assets. The functioning of these companies is different from those of NBFCs in terms of method of mobilization of deposits and requirement of deployment of depositors' funds as per Directions. Besides, Prudential Norms Directions are applicable to these companies also.

The minimum interest an RNBC should pay on deposits should be 5% (to be compounded annually) on the amount deposited in lump sum or at monthly or longer intervals; and 3.5% (to be compounded annually) on the amount deposited under daily deposit scheme. Interest here includes premium, bonus or any other advantage, that an RNBC promises to the depositor by way of return. An RNBC can accept deposits for a minimum period of 12 months and maximum period of 84 months from the date of receipt of such deposit. They cannot accept deposits repayable on demand. However, at present, the only RNBCs in existence (Peerless) has been directed by the Reserve Bank to stop collecting deposits, repay the deposits to the depositor and wind up their RNBC business as their business model is inherently unviable.

8. MINIMUM NET OWNED FUND

On registration of NBFC with RBI, all NBFCs have to comply with certain requirements like maintenance of the minimum Net Owned Fund (NOF), creation of reserve fund, compulsory transfer of certain percentage of net profit etc.

NOF requirement for new companies applying for grant of CoR to commence business of an NBFC is stipulated at ₹ 200 lakh.

As per the definition:

Owned Fund = Aggregate of the paid-up equity capital, preference shares which are compulsorily convertible into equity, free reserves, balance in share premium account and capital reserves representing surplus arising out of sale proceeds of asset, excluding reserves created by revaluation of asset, after deducting therefrom accumulated balance of loss, deferred revenue expenditure and other intangible assets.

Net Owned Fund = Owned Fund – Investments in shares of subsidiaries/ companies in same group/Other NBFC – Book value of debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group (to the extent such sum exceeds 10% of owned fund)

In terms of Section 45-IC of the RBI Act, NBFCs are required to create a reserve fund and transfer therein a sum not less than twenty per cent of its net profit every year.

9. LIQUID ASSET REQUIREMENTS

In terms of Section 45-IB of the RBI Act, 1934 the minimum level of liquid asset to be maintained by NBFCs is 15 per cent of public deposits outstanding as on the last working day of the second preceding quarter. Of the 15%, NBFCs are required to invest not less than 10% in approved securities and the remaining 5% can be in unencumbered term deposits with any scheduled commercial bank. Thus, the liquid assets may consist of government securities, government guaranteed bonds and term deposits with any scheduled commercial bank.

The investment in government securities should be in dematerialised form which can be maintained in Constituents' Subsidiary General Ledger (CSGL) Account with a scheduled commercial bank (SCB) / Stock Holding Corporation of India Limited (SHICL). In case of Government guaranteed bonds the same may be kept in

dematerialised form with SCB/SHCIL or in a dematerialised account with depositories [National Securities Depository Ltd. (NSDL)/Central Depository Services (India) Ltd. (CDSL)] through a depository participant registered with Securities & Exchange Board of India (SEBI). However in case there are Government bonds which are in physical form the same may be kept in safe custody of SCB/SHCIL.

NBFCs have been directed to maintain the mandated liquid asset securities in a dematerialised form with the entities stated above at a place where the registered office of the company is situated. However, if a NBFC intends to entrust the securities at a place other than the place at which its registered office is located, it may do so after obtaining in writing the permission of RBI. It may be noted that the liquid assets in approved securities will have to be maintained in dematerialised form only. The liquid assets maintained as above are to be utilised for payment of claims of depositors. However, deposit being unsecured in nature depositors do not have direct claim on liquid assets.

10. CATEGORIES OF NBFCs

The Non-Banking Finance Company sector has evolved considerably in terms of its size, operations, technological sophistication, and entry into newer areas of financial services and products. NBFCs are now deeply interconnected with the entities in the financial sector, on both sides of their balance sheets. Being financial entities, they are as exposed to risks arising out of counterparty failures, funding and asset concentration, interest rate movement and risks pertaining to liquidity and solvency, as any other financial sector player. At the same time there are segments within the sector that do not pose any significant risks to the system.

Accordingly, NBFCs are categorized into following three groups for the purpose of administering prudential regulations:

1. Deposits taking NBFCs (NBFCs-D);
2. Non-deposit taking NBFCs (NBFCs-ND) (those with assets of less than ₹ 500 crore); and
3. Non-deposit taking systemically important NBFCs (NBFCs-ND-SI) (those with assets of ₹ 500 crore and above),

11. PRUDENTIAL ACCOUNTING NORMS

In order to ensure that NBFCs function on sound and healthy lines and make adequate disclosures in their financial reports, the Reserve Bank has issued prudential norms for all the Non-banking Financial Companies. The current prudential regulation mainly comprises the following elements:

- a) Norms relating to Income Recognition, Asset Classification and Provisioning norms;
- b) Capital to Risk Weighted Assets Ratio (CRAR); and
- c) Credit Concentration Norms

Note: [Above mentioned norms in points (b) and (c) are applicable to only NBFCs–D and NBFCs-ND-SI].

Currently, there are following two sets of Directions for prudential norms:

1. "Non-Banking Financial Company–Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016"

The provisions of "Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016", shall apply to

- (i) every non-banking financial company not accepting / holding public deposits which is not systemically important (as defined in paragraph 3 (xxviii) of the Directions;
- (ii) every NBFC-Factor registered with the Bank under section 3 of the Factoring Regulation Act, 2011 and having an asset size of below ₹ 500 crore;
- (iii) every Non-Banking Finance Company – Micro Finance Institution (NBFC-MFI) registered with the Bank under the provisions of RBI Act, 1934 and having an asset size of below ₹ 500 crore;
- (iv) every Non-Banking Finance Company - Infrastructure Finance Company (NBFC-IFC) registered with the Bank under the provisions of RBI Act, 1934 and having an asset size of below ₹ 500 crore.

2. "Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016"

The provisions of "Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016" shall apply to:

- (i) every Systemically Important Non-Deposit taking Non-Banking Financial Company (NBFC-ND-SI) registered with the Bank under the provisions of RBI Act, 1934;
- (ii) every Deposit taking Non-Banking Financial Company (NBFC-D) registered with the Bank under the provisions of RBI Act, 1934;
- (iii) every NBFC-Factor registered with the Bank under section 3 of the Factoring Regulation Act, 2011 and having an asset size of ₹ 500 crore and above;
- (iv) every Infrastructure Debt Fund –Non-Banking Finance Company (IDF-NBFC) registered with the Bank under the provisions of RBI Act, 1934;
- (v) every Non-Banking Finance Company –Micro Finance Institutions (NBFC-MFIs) registered with the Bank under the provisions of RBI Act, 1934 and having an asset size of ₹ 500 crore and above;
- (vi) every Non-Banking Finance Company - Infrastructure Finance Company (NBFC-IFC) registered with the Bank under the provisions of RBI Act, 1934 and having an asset size of ₹ 500 crore and above.



12. IMPORTANT DEFINITIONS

Break-up value means the equity capital and reserves as reduced by intangible assets and revaluation reserves, divided by the number of equity shares of the investee company.

Carrying cost means book value of the assets and interest accrued thereon but not received.

Earning value means the value of an equity share computed by taking the average of profits after tax as reduced by the preference dividend and adjusted for extraordinary and non-recurring items, for the immediately preceding three years and further divided by the number of equity shares of the investee company and capitalized at the following rate:

- (a) in case of predominantly manufacturing company, eight per cent;
- (b) in case of predominantly trading company, ten per cent; and

- (c) in case of any other company, including non-banking financial company, twelve per cent;

Note: If an investee company is a loss making company the earning value will be taken at zero.

Fair value means the mean of the earning value and the break-up value.

Net book value means:

(a) **in the case of hire purchase asset**, the aggregate of overdue and future instalments receivable as reduced by the balance of unmatured finance charges and further reduced by the provisions made as per paragraph 9(2)(i) of these Directions;

(b) **in the case of leased asset**, aggregate of capital portion of overdue lease rentals accounted as receivable and depreciated book value of the lease asset as adjusted by the balance of lease adjustment account.

Infrastructure Finance Company means a non-banking finance company which deploys at least 75 per cent of its total assets in infrastructure loans"

Subordinated debt means an instrument, which is fully paid up, is unsecured and is subordinated to the claims of other creditors and is free from restrictive clauses and is not redeemable at the instance of the holder or without the consent of the supervisory authority of the non-banking financial company. The book value of such instrument shall be subjected to discounting as provided hereunder:

<i>Remaining Maturity of the instruments</i>	<i>Rate of discount</i>
(a) Upto one year	100%
(b) More than one year but upto two years	80%
(c) More than two years but upto three years	60%
(d) More than three years but upto four years	40%
(e) More than four years but upto five years	20%

to the extent such discounted value does not exceed fifty per cent of Tier I capital.

Substantial interest means holding of a beneficial interest by an individual or his spouse or minor child, whether singly or taken together in the shares of a company, the amount paid up on which exceeds ten per cent of the paid up capital of the company; or the capital subscribed by all the partners of a partnership firm.

Systemically important non-deposit taking non-banking financial company means a non-banking financial company not accepting / holding public deposits

and having total assets of ₹ 500 crore and above as shown in the last audited balance sheet.

13. INCOME RECOGNITION

- (1) The income recognition shall be based on recognised accounting principles.
- (2) Income including interest/ discount or any other charges on NPA shall be recognised only when it is actually realised. Any such income recognised before the asset became non-performing and remaining unrealised shall be reversed.
- (3) In respect of hire purchase assets, where instalments are overdue for more than 12 months, income shall be recognised only when hire charges are actually received. Any such income taken to the credit of profit and loss account before the asset became nonperforming and remaining unrealized, shall be reversed.
- (4) In respect of lease assets, where lease rentals are overdue for more than 12 months, the income shall be recognised only when lease rentals are actually received. The net lease rentals taken to the credit of profit and loss account before the asset became non-performing and remaining unrealised shall be reversed.

Explanation

For the purpose of this paragraph, 'net lease rentals' mean gross lease rentals as adjusted by the lease adjustment account debited/credited to the profit and loss account and as reduced by depreciation at the rate applicable under Schedule XIV of the Companies Act, 1956 (1 of 1956)/ 2013.

14. INCOME FROM INVESTMENT

- (1) Income from dividend on shares of corporate bodies and units of mutual funds shall be taken into account on cash basis; provided that the income from dividend on shares of corporate bodies shall be taken into account on accrual basis when such dividend has been declared by the corporate body in its annual general meeting and the applicable NBFC's right to receive payment is established.
- (2) Income from bonds and debentures of corporate bodies and from Government securities/bonds shall be taken into account on accrual basis;

provided that the interest rate on these instruments is pre-determined and interest is serviced regularly and is not in arrears.

- (3) Income on securities of corporate bodies or public sector undertakings, the payment of interest and repayment of principal of which have been guaranteed by Central Government or a State Government shall be taken into account on accrual basis.



15. ACCOUNTING FOR INVESTMENTS

1.
 - (a) The Board of Directors of every non-banking financial company shall frame investment policy for the company and implement the same;
 - (b) The criteria to classify the investments into current and long term investments shall be spelt out by the Board of the company in the investment policy;
 - (c) Investments in securities shall be classified into current and long term, at the time of making each investment;
 - (d)
 - (i) There shall be no inter-class transfer on ad-hoc basis;
 - (ii) The inter-class transfer, if warranted, shall be effected only at the beginning of each half year, on April 1 or October 1, with the approval of the Board;
 - (iii) The investments shall be transferred scrip-wise, from current to long-term or vice-versa, at book value or market value, whichever is lower;
 - (iv) The depreciation, if any, in each scrip shall be fully provided for and appreciation, if any, shall be ignored;
 - (v) The depreciation in one scrip shall not be set off against appreciation in another scrip, at the time of such inter-class transfer, even in respect of the scrips of the same category.
2. Quoted current investments shall, for the purposes of valuation, be grouped into the following categories, viz.,
 - (a) equity shares,
 - (b) preference shares,
 - (c) debentures and bonds,

- (d) Government securities including treasury bills,
- (e) units of mutual fund, and
- (f) others.

Quoted current investments for each category shall be valued at cost or market value whichever is lower. For this purpose, the investments in each category shall be considered scrip-wise and the cost and market value aggregated for all investments in each category. If the aggregate market value for the category is less than the aggregate cost for that category, the net depreciation shall be provided for or charged to the profit and loss account. If the aggregate market value for the category exceeds the aggregate cost for the category, the net appreciation shall be ignored. Depreciation in one category of investments shall not be set off against appreciation in another category.

3. Unquoted equity shares in the nature of current investments shall be valued at cost or break-up value, whichever is lower. However, non-banking financial companies may substitute fair value for the break-up value of the shares, if considered necessary. Where the balance sheet of the investee company is not available for two years, such shares shall be valued at one Rupee only.
4. Unquoted preference shares in the nature of current investments shall be valued at cost or face value, whichever is lower.
5. Investments in unquoted Government securities or Government guaranteed bonds shall be valued at carrying cost.
6. Unquoted investments in the units of mutual funds in the nature of current investments shall be valued at the net asset value declared by the mutual fund in respect of each particular scheme.
7. Commercial papers shall be valued at carrying cost.
8. A long term investment shall be valued in accordance with the Accounting Standard issued by ICAI.

Note: Unquoted debentures shall be treated as term loans or other type of credit facilities depending upon the tenure of such debentures for the purpose of income recognition and asset classification.

16. APPLICABILITY OF PRUDENTIAL NORMS

One of the main objectives of prudential regulation is to address systemic risks. The systemic risks posed by NBFCs functioning exclusively out of their own funds and NBFCs accessing public funds cannot be equated and hence cannot be subjected to the same level of regulation. Hence, as a principle, enhanced prudential regulations has been made applicable to NBFCs wherever public funds are accepted and conduct of business regulations are made applicable wherever customer interface is involved.

Accordingly, the regulatory approach in respect of NBFCs-ND with an asset size of less than ₹ 500 crore is as under:

- (i) They shall not be subjected to any regulation either prudential or conduct of business regulations viz., Fair Practices Code (FPC), KYC, etc., if they have not accessed any public funds and do not have a customer interface.
- (ii) Those having customer interface will be subjected only to conduct of business regulations including FPC, KYC etc., if they are not accessing public funds.
- (iii) Those accepting public funds will be subjected to limited prudential regulations but not conduct of business regulations if they have no customer interface.
- (iv) Where both public funds are accepted and customer interface exist, such companies will be subjected both to limited prudential regulations and conduct of business regulations.

All NBFCs-ND with assets of ₹ 500 crore and above, irrespective of whether they have accessed public funds or not, has to comply with prudential regulations as applicable to NBFCs-ND-SI. They has to also comply with conduct of business regulations if customer interface exists.

Note: For this purpose, the term 'public funds' includes "funds raised 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 5 years from the date of issue".

17. ASSET CLASSIFICATION

Every NBFC shall, after taking into account the degree of well-defined credit weaknesses and extent of dependence on collateral security for realization, classify

its lease/hire purchase assets, loans and advances and any other forms of credit into the following classes namely, -

- (a) Standard assets;
- (b) Sub-standard assets;
- (c) Doubtful assets; and
- (d) Loss assets.

(a) Standard asset means an asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any problem nor carry more than normal risk attached to the business.

(b) Sub-standard asset : As per Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016, sub-standard asset means (a) an asset which has been classified as non-performing asset for a period not exceeding 14 months for the financial year ending March 31, 2017; (b) an asset where the terms of the agreement regarding interest and / or principal have been renegotiated or rescheduled or restructured after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled or restructured terms.

For the existing loans, a one-time adjustment of the repayment schedule, which shall not amount to restructuring will, however, be permitted.

Note: The above **14 months** criteria for classification of sub-standard asset is till the financial year ending March 31, **2017**. However, in future, for all loan and hire-purchase and lease assets, sub-standard asset would mean an asset that has been classified as NPA for a period not exceeding 12 months for the financial year ending March 31, 2018 and thereafter.

However, as per Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016, sub-standard asset shall mean:

- (a) an asset which has been classified as non-performing asset for a period not exceeding 18 months;
- (b) an asset where the terms of the agreement regarding interest and / or principal have been renegotiated or rescheduled or restructured after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled or restructured terms

- (c) **Doubtful asset** : As per Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016, doubtful asset means (a) a term loan, or (b) a lease asset, or (c) a hire purchase asset, or (d) any other asset, which remains a sub-standard asset for a period exceeding **14 months** for the financial year ending **March 31, 2017**;

Note: The above **14 months** criteria for classification of doubtful asset is till the financial year ending **March 31, 2017**. However, in future, for all loan and hire-purchase and lease assets, doubtful asset would mean an asset that has remained sub-standard for a period exceeding 12 months for the financial year ending March 31, 2018 and thereafter.

However, as per Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016, "doubtful asset" shall mean (a) a term loan, or (b) a lease asset, or (c) a hire purchase asset, or (d) any other asset, which remains a sub-standard asset for a period exceeding 18 months.

- (d) **Loss asset** means (i) an asset which has been identified as loss asset by the NBFC or its internal or external auditor or by the Reserve Bank during the inspection of the NBFC, to the extent it is not written off by the NBFC; and (ii) an asset which is adversely affected by a potential threat of non-recoverability due to either erosion in the value of security or non-availability of security or due to any fraudulent act or omission on the part of the borrower.

The class of assets referred to above shall not be upgraded merely as a result of rescheduling, unless it satisfies the conditions required for the up gradation.

18. NON-PERFORMING ASSET (NPA)

'Non-performing asset' means:

- (a) an asset, in respect of which, interest has remained overdue for a period of six months or more;
- (b) a term loan inclusive of unpaid interest, when the instalment is overdue for a period of six months or more or on which interest amount remained overdue for a period of six months or more;
- (c) a demand or call loan, which remained overdue for a period of six months or more from the date of demand or call or on which interest amount remained overdue for a period of six months or more;

- (d) a bill which remains overdue for a period of six months or more;
- (e) the interest in respect of a debt or the income on receivables under the head 'other current assets' in the nature of short term loans/advances, which facility remained overdue for a period of six months or more;
- (f) any dues on account of sale of assets or services rendered or reimbursement of expenses incurred, which remained overdue for a period of six months or more;

Note : As per Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016, the above six months criteria for the assets covered under (a) to (f) is 4 months for the financial year ending March 31, 2017; and from next year ending March 31, 2018 and thereafter it will be 3 months.

It implies that as per Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016, the criteria is 6 months only.

- (g) the lease rental and hire purchase instalment, which has become overdue for a period of twelve months or more;

Note: The above twelve months criteria for the assets covered under (g) is 6 months for the financial year ending March 31, 2017 and from next year ending March 31, 2018 and thereafter it will be 3 months.

- (h) in respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities (including accrued interest) made available to the same borrower/beneficiary when any of the above credit facilities becomes non-performing asset:

Provided that in the case of lease and hire purchase transactions, a non-banking financial company may classify each such account on the basis of its record of recovery;



19. PROVISIONING REQUIREMENTS

Every NBFC shall, after taking into account the time lag between an account becoming non-performing, its recognition as such, the realization of the security and the erosion over time in the value of security charged, make provision against sub-standard assets, doubtful assets and loss assets as provided hereunder:

A. Loans, advances and other credit facilities including bills purchased and discounted

The provisioning requirement in respect of loans, advances and other credit facilities including bills purchased and discounted shall be as under:

1. Loss Assets

The entire asset shall be written off. If the assets are permitted to remain in the books for any reason, 100% of the outstanding should be provided for.

2. Doubtful Assets

- (a) 100% provision to the extent to which the advance is not covered by the realisable value of the security to which the NBFC has a valid recourse shall be made. The realisable value is to be estimated on a realistic basis.
- (b) In addition to item (a) above, depending upon the period for which the asset has remained doubtful, provision to the extent of 20% to 50% of the secured portion (i.e. estimated realisable value of the outstanding) shall be made on the following basis: -

<i>Period for which the asset has been considered as doubtful</i>	<i>% of provision</i>
Up to one year	20
One to three years	30
More than three years	50

3. Sub-standard asset

A general provision of 10% of total outstanding shall be made.

4. Standard asset

A general provision at **0.35** per cent of the outstanding standard assets shall be made by the end of March 2017. The provision for standard assets as per Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016, is being increased to 0.40% by the end of March 2018.

Note: As per Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016, every applicable NBFC shall make provision for standard assets at 0.25 percent of the outstanding amount.

The provisions on standard assets should not be reckoned for arriving at net NPAs. The provisions towards Standard Assets need not be netted from gross advances but shown separately as 'Contingent Provisions against Standard Assets' in the balance sheet.

B. Lease and hire purchase assets

The provisioning requirements in respect of hire purchase and leased assets shall be as under:

Hire purchase assets

- (i) In respect of hire purchase assets, the total dues (overdue and future installments taken together) as reduced by
- (a) the finance charges not credited to the profit and loss account and carried forward as unmatured finance charges; and
 - (b) the depreciated value of the underlying asset,
- shall be provided for.

Explanation:

For the purpose of this paragraph,

- (a) the depreciated value of the asset shall be notionally computed as the original cost of the asset to be reduced by depreciation at the rate of twenty per cent per annum on a straight line method; and
- (b) in the case of second hand asset, the original cost shall be the actual cost incurred for acquisition of such second hand asset.

Additional provision for hire purchase and leased assets

- (ii) In respect of hire purchase and leased assets, additional provision shall be made as under:

(a) Where hire charges or lease rentals are overdue upto 12 months	Nil
(b) where hire charges or lease rentals are overdue for more than 12 months but upto 24 months	10 percent of the net book value
(c) where hire charges or lease rentals are overdue for more than 24 months but upto 36 months	40 percent of the net book value

(d) where hire charges or lease rentals are overdue for more than 36 months but upto 48 months	70 percent of the net book value
(e) where hire charges or lease rentals are overdue for more than 48 months	100 percent of the net book value

- (iii) On expiry of a period of 12 months after the due date of the last installment of hire purchase/leased asset, the entire net book value shall be fully provided for.

Here, 'Net book value' means

- (a) in the case of hire purchase asset, the aggregate of overdue and future instalments receivable as reduced by the balance of unmatured finance charges and further reduced by the provisions made as per paragraph 9(2)(i) of these Directions;
- (b) in the case of leased asset, aggregate of capital portion of overdue lease rentals accounted as receivable and depreciated book value of the lease asset as adjusted by the balance of lease adjustment account.

Notes:

- (1) The amount of caution money/margin money or security deposits kept by the borrower with the non-banking financial company in pursuance of the hire purchase agreement may be deducted against the provisions stipulated under clause (i) above, if not already taken into account while arriving at the equated monthly installments under the agreement. The value of any other security available in pursuance to the hire purchase agreement may be deducted only against the provisions stipulated under clause (ii) above.
- (2) The amount of security deposits kept by the borrower with the non-banking financial company in pursuance to the lease agreement together with the value of any other security available in pursuance to the lease agreement may be deducted only against the provisions stipulated under clause (ii) above.
- (3) It is clarified that income recognition on and provisioning against NPAs are two different aspects of prudential norms and provisions as per the norms are required to be made on NPAs on total outstanding balances including the depreciated book value of the leased asset under reference after adjusting the balance, if any, in the lease adjustment account. The fact that income on an NPA has not been recognised cannot be taken as reason for not making provision.

- (4) An asset which has been renegotiated or rescheduled as referred to in paragraph (2) (1) (xvi) (b) of these Directions shall be a sub-standard asset or continue to remain in the same category in which it was prior to its renegotiation or reschedulement as a doubtful asset or a loss asset as the case may be. Necessary provision is required to be made as applicable to such asset till it is upgraded.
- (5) The balance sheet to be prepared by the non-banking financial company may be in accordance with the provisions contained in sub-paragraph (2) of paragraph 10.
- (6) All financial leases written on or after April 1, 2001 attract the provisioning requirements as applicable to hire purchase assets.
- (7) In case of NBFC-MFIs, if the advance covered by Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH) guarantee becomes non-performing, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for as per the extant guidelines on provisioning for non-performing advances.



20. DISCLOSURE IN THE BALANCE SHEET

Every non-banking financial company shall finalize its balance sheet within a period of 3 months from the date to which it pertains.

- (a) Every NBFC shall, separately disclose in its balance sheet the provisions made as per requirements without netting them from the income or against the value of assets.
- (b) The provisions shall be distinctly indicated under separate heads of accounts as (i) provisions for bad and doubtful debts and (ii) provisions for depreciation in investments.
- (c) Such provisions shall not be appropriated from the general provisions and loss reserves held, if any, by the NBFC.
- (d) Such provisions for each year shall be debited to the profit and loss account. The excess of provisions, if any, held under the heads general Provisions and loss reserves may be written back without making adjustment against them.
- (e) Every systemically important non-deposit taking non-banking financial company shall disclose the following particulars in its Balance Sheet:
 - i. Capital to Risk Assets Ratio (CRAR);

- ii. Exposure to real estate sector, both direct and indirect; and
- iii. Maturity pattern of assets and liabilities.

21. ACCOUNTING YEAR

Every non-banking financial company shall prepare its balance sheet and profit and loss account as on March 31 every year. Whenever a non-banking financial company intends to extend the date of its balance sheet as per provisions of the Companies Act, it should take prior approval of the Reserve Bank of India before approaching the Registrar of Companies for this purpose.

Further, even in cases where the Bank and the Registrar of Companies grant extension of time, the non-banking financial company shall furnish to the Bank a proforma balance sheet (unaudited) as on March 31 of the year and the statutory returns due on the said date. Every non-banking financial company shall finalise its balance sheet within a period of 3 months from the date to which it pertains.

22. PREPARATION OF FINANCIAL STATEMENTS OF NBFCs

All NBFCs should comply with the Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India, so far as these are not inconsistent with the prudential norms directions of the Reserve Bank of India.

On 30th March, 2016 the Ministry of Corporate Affairs of India (MCA) has issued the roadmap for implementation of Ind AS by Non-Banking Financial Companies;

As per the notification

- (a) The following NBFCs shall comply with the Indian Accounting Standards (Ind AS) for accounting periods beginning on or after the 1st April, 2018, with comparatives for the periods ending on 31st March, 2018, or thereafter—
 - (A) NBFCs having net worth of rupees five hundred crore or more;
 - (B) holding, subsidiary, joint venture or associate companies of companies covered under item (A),
- (b) The following NBFCs shall comply with the Indian Accounting Standards (Ind AS) for accounting periods beginning on or after the 1st April, 2019, with comparatives for the periods ending on 31st March, 2019, or thereafter—

- (A) NBFCs whose equity or debt securities are listed or in the process of listing on any stock exchange in India or outside India and having net worth less than rupees five hundred crore;
- (B) NBFCs, that are unlisted companies, having net worth of rupees two-hundred and fifty crore or more but less than rupees five hundred crore; and
- (C) holding, subsidiary, joint venture or associate companies of companies covered under item (A) or item (B) of sub-clause (b),

Other NBFCs shall prepare their financial statements based on the Companies (Accounting Standards) Rules, 2006.



23. REQUIREMENT AS TO CAPITAL ADEQUACY

NBFCs-ND with asset size of less than ₹ 500 crore, are exempted from the requirement of maintaining CRAR and complying with Credit Concentration Norms.

A leverage ratio of 7 is being introduced for all such NBFCs-ND to link their asset growth with the capital they hold. For this purpose, leverage ratio is defined as Total Outside Liabilities / Owned Funds.

At present, all NBFCs-D and NBFCs-ND-SI are required to have minimum CRAR of 15%. Consequently, Tier 1 capital cannot be less than **10%**. For Infrastructure Finance Companies (IFCs), however, Tier 1 capital cannot be less than 10%. Similarly, NBFCs primarily engaged in lending against gold jewellery have to maintain a minimum Tier 1 capital of 12% w.e.f. April 01, 2014.

The minimum Tier 1 capital requirement for NBFCs primarily engaged in lending against gold jewellery remains unchanged for the present.

The total of Tier II capital, at any point of time, shall not exceed one hundred percent of Tier I capital.

"Tier I Capital" means owned fund as reduced by investment in shares of other non-banking financial companies and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten per cent of the owned fund;

"Tier II capital" includes the following:

- (a) preference shares other than those which are compulsorily convertible into equity;

- (b) revaluation reserves at discounted rate of fifty five percent;
- (c) general provisions and loss reserves to the extent these are not attributable to actual diminution in value or identifiable potential loss in any specific asset and are available to meet unexpected losses, to the extent of one and one fourth percent of risk weighted assets;
- (d) hybrid debt capital instruments; and
- (e) subordinated debt
- (f) perpetual debt instruments issued by a Systemically important non-deposit taking non-banking financial company which is in excess of what qualifies for Tier I Capital

to the extent the aggregate does not exceed Tier I capital.

"*Subordinated debt*" means an instrument, which is fully paid up and is unsecured and is subordinated to the claims of other creditors and is free from restrictive clauses and is not redeemable at the instance of the holder or without the consent of the supervisory authority of non-banking financial company. The book value of such instrument shall be subjected to discounting as provided hereunder:

	<i>Remaining Maturity of the instruments</i>	<i>Rate of discount</i>
(a)	Upto one year	100%
(b)	More than one year but upto two years	80%
(c)	More than two years but upto three years	60%
(d)	More than three years but upto four years	40%
(e)	More than four years but upto five years	20%

to the extent such discounted value does not exceed fifty per cent of Tier I capital.

Every systemically important non-deposit taking non-banking financial company shall maintain, with effect from April 1, 2007, a minimum capital ratio consisting of Tier I and Tier II capital which shall not be less than ten per cent of its aggregate risk weighted assets on balance sheet and of risk adjusted value of off balance sheet items.

On balance sheet assets - Degrees of credit risk expressed as percentage weightages have been assigned to balance sheet assets. Hence, the value of each asset/item requires to be multiplied by the relevant risk weights to arrive at risk adjusted value of assets. The aggregate shall be taken into account for reckoning the minimum capital ratio. The risk weighted asset shall be calculated as the weighted aggregate of funded items as detailed hereunder:

<i>Weighted risk assets – On-Balance Sheet items</i>	<i>Percentage weight</i>
(i) Cash and bank balances including fixed deposits and certificates of deposits with banks	0
(ii) <u>Investments</u>	
(a) Approved securities [Except at (c) below]	0
(b) Bonds of public sector banks	20
(c) Fixed deposits/certificates of deposits/bonds of public financial institutions	100
(d) Shares of all companies and debentures/bonds/commercial papers of all companies and units of all mutual funds	100
(e) All assets covering PPP and post commercial operations date (COD) infrastructure projects in existence over a year of commercial operation	50
(iii) <u>Current assets</u>	
(a) Stock on hire (net book value)	100
(b) Inter-corporate loans/deposits	100
(c) Loans and advances fully secured against deposits held by the company itself	0
(d) Loans to staff	0
(e) Other secured loans and advances considered good	100
(f) Bills purchased/discounted	100
(g) Others (To be specified)	100
(iv) <u>Fixed Assets (net of depreciation)</u>	
(a) Assets leased out (net book value)	100
(b) Premises	100
(c) Furniture & Fixtures	100
(v) <u>Other assets</u>	
(a) Income tax deducted at source (net of provision)	0
(b) Advance tax paid (net of provision)	0
(c) Interest due on Government securities	0

(d) Others (to be specified)	100
(vi) Domestic Sovereign	
(a) fund based claims on the Central Government	0
(b) Direct loan / credit / overdraft exposure and investment in State Government securities	0
(c) Central Government guaranteed claims	0
(d) State Government guaranteed claims, which have not remained in default/ which are in default for a period not more than 90 days	20
(e) State Government guaranteed claims, which have remained in default for a period of more than 90 days	100

Notes:

- (1) Netting may be done only in respect of assets where provisions for depreciation or for bad and doubtful debts have been made.
- (2) Assets which have been deducted from owned fund to arrive at net owned fund shall have a weightage of ₹ zero'.
- (3) While calculating the aggregate of funded exposure of a borrower for the purpose of assignment of risk weight, non-banking financial companies may net off the amount of cash margin / caution money/security deposits (against which right to set-off is available) held as collateral against the advances out of the total outstanding exposure of the borrower.
- (4) For loans guaranteed by Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH) NBFC-MFIs may assign zero risk weight for the guaranteed portion. The balance outstanding in excess of the guaranteed portion would attract a risk-weight as per extant guidelines.

Off-Balance Sheet Items - It has been considered necessary to expand the off-balance sheet regulatory framework to introduce greater granularity in the risk weights and credit conversion factors for different types of off balance sheet items. For this purpose, NBFCs will need to calculate the total risk weighted off-balance sheet credit exposure as the sum of the risk-weighted amount of the market related and non-market related off-balance sheet items. The risk-weighted amount of an off-balance sheet item that gives rise to credit exposure will be calculated by means of a two-step process:

- (a) the notional amount of the transaction is converted into a credit equivalent amount, by multiplying the amount by the specified credit conversion factor or by applying the current exposure method; and
- (b) the resulting credit equivalent amount is multiplied by the risk weight applicable viz; zero percent for exposure to Central Government/State Governments, 20 percent for exposure to banks and 100 percent for others.

(1) Non-market-related off- balance sheet items

- i. The credit equivalent amount in relation to a non-market related off-balance sheet item will be determined by multiplying the contracted amount of that particular transaction by the relevant credit conversion factor (CCF).

<i>Sr. No.</i>	<i>Instruments</i>	<i>Credit Conversion Factor</i>
i.	Financial & other guarantees	100
ii.	Share/debenture underwriting obligations	50
iii.	Partly-paid shares/debentures	100
iv.	Bills discounted/rediscouted	100
v.	Lease contracts entered into but yet to be executed	100
vi.	Sale and repurchase agreement and asset sales with recourse, where the credit risk remains with the NBFC.	100
vii.	Forward asset purchases, forward deposits and partly paid shares and securities, which represent commitments with certain draw down.	100
viii.	Lending of NBFC securities or posting of securities as collateral by NBFC, including instances where these arise out of repo style transactions	100
ix.	Other commitments (e.g., formal standby facilities and credit lines) with an original maturity of up to one year over one year	20 50
x.	Similar commitments that are unconditionally cancellable at any time by the NBFC without prior notice or that effectively provide for automatic cancellation due to deterioration in a borrower's credit worthiness'.	0

xi.	Take-out Finance in the books of taking-over institution	
	(i) Unconditional take-out finance	100
	(ii) Conditional take-out finance	50
	Note: As the counter-party exposure will determine the risk weight, it will be 100 percent in respect of all borrowers or zero percent if covered by Government guarantee.	
xii.	Commitment to provide liquidity facility for securitization of standard asset transactions	100
xiii.	Second loss credit enhancement for securitization of standard asset transactions provided by third party	100
xiv.	Other contingent liabilities (To be specified)	50
xv.	Non-fund based claims on the Central Government	0

Note:

- i. Cash margins/deposits shall be deducted before applying the conversion factor
- ii. Where the non-market related off-balance sheet item is an undrawn or partially undrawn fund-based facility, the amount of undrawn commitment to be included in calculating the off-balance sheet non-market related credit exposures is the maximum unused portion of the commitment that could be drawn during the remaining period to maturity. Any drawn portion of a commitment forms a part of NBFC's on-balance sheet credit exposure.

For example:

A term loan of ₹ 700 cr is sanctioned for a large project which can be drawn down in stages over a three year period. The terms of sanction allow draw down in three stages – ₹ 150 cr in Stage I, ₹ 200 cr in Stage II and ₹ 350 cr in Stage III, where the borrower needs the NBFC's explicit approval for draw down under Stages II and III after completion of certain formalities. If the borrower has drawn already ₹ 50 cr under Stage I, then the undrawn portion would be computed with reference to Stage I alone i.e., it will be ₹ 100 cr. If Stage I is scheduled to be completed within one year, the CCF will be 20 per cent and if it is more than one year then the applicable CCF will be 50 per cent'.

(2) Market Related Off-Balance Sheet Items

- i. NBFCs should take into account all market related off-balance sheet items (OTC derivatives and Securities Financing Transactions such as repo / reverse repo/ CBLO etc.) while calculating the risk weighted off-balance sheet credit exposures.
- ii. The credit risk on market related off-balance sheet items is the cost to an NBFC of replacing the cash flow specified by the contract in the event of counterparty default. This would depend, among other things, upon the maturity of the contract and on the volatility of rates underlying the type of instrument.
- iii. Market related off-balance sheet items would include:
 - a. interest rate contracts - including single currency interest rate swaps, basis swaps, forward rate agreements, and interest rate futures;
 - b. foreign exchange contracts, including contracts involving gold, - includes cross currency swaps (including cross currency interest rate swaps), forward foreign exchange contracts, currency futures, currency options;
 - c. Credit Default Swaps; and
 - d. any other market related contracts specifically allowed by the Reserve Bank which give rise to credit risk.
- iv. Exemption from capital requirements is permitted for -
 - a. foreign exchange (except gold) contracts which have an original maturity of 14 calendar days or less; and
 - b. instruments traded on futures and options exchanges which are subject to daily mark-to-market and margin payments.
- v. The exposures to Central Counter Parties (CCPs), on account of derivatives trading and securities financing transactions (e.g. Collateralised Borrowing and Lending Obligations – CBLOs, Repos) outstanding against them will be assigned zero exposure value for counterparty credit risk, as it is presumed that the CCPs' exposures to their counterparties are fully collateralised on a daily basis, thereby providing protection for the CCP's credit risk exposures.
- vi. A CCF of 100 per cent will be applied to the corporate securities posted as collaterals with CCPs and the resultant off-balance sheet exposure will be assigned risk weights appropriate to the nature of the CCPs. In the case of

Clearing Corporation of India Limited (CCIL), the risk weight will be 20 per cent and for other CCPs, the risk weight will be 50 percent.

- vii. The total credit exposure to counterparty in respect of derivative transactions should be calculated according to the current exposure method as explained below:

Current Exposure Method:

The credit equivalent amount of a market related off-balance sheet transaction calculated using the current exposure method is the sum of a) current credit exposure and b) potential future credit exposure of the contract.

- a) Current credit exposure is defined as the sum of the gross positive mark-to-market value of all contracts with respect to a single counterparty (positive and negative marked-to-market values of various contracts with the same counterparty should not be netted). The Current Exposure Method requires periodical calculation of the current credit exposure by marking these contracts to market.
- b) Potential future credit exposure is determined by multiplying the notional principal amount of each of these contracts, irrespective of whether the contract has a zero, positive or negative mark-to-market value by the relevant add-on factor indicated below according to the nature and residual maturity of the instrument.

Credit Conversion Factors for interest rate related, exchange rate related and gold related derivatives		
<i>Credit Conversion Factors (%)</i>		
<i>Interest Rate Contracts</i>	<i>Exchange Rate Contracts & Gold</i>	
One year or less	0.50	2.00
Over one year to five years	1.00	10.00
Over five years	3.00	15.00

- i. For contracts with multiple exchanges of principal, the add-on factors are to be multiplied by the number of remaining payments in the contract.
- ii. For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be set equal to the time until the next reset

date. However, in the case of interest rate contracts which have residual maturities of more than one year and meet the above criteria, the CCF or add-on factor is subject to a floor of 1.0 per cent.

- iii. No potential future credit exposure would be calculated for single currency floating / floating interest rate swaps; the credit exposure on these contracts would be evaluated solely on the basis of their mark-to-market value.
- iv. Potential future exposures should be based on 'effective' rather than 'apparent notional amounts'. In the event that the 'stated notional amount' is leveraged or enhanced by the structure of the transaction, the 'effective notional amount' must be used for determining potential future exposure. For example, a stated notional amount of USD 1 million with payments based on an internal rate of two times the lending rate of the NBFC would have an effective notional amount of USD 2 million.

Credit conversion factors for Credit Default Swaps (CDS):

NBFCs are only permitted to buy credit protection to hedge their credit risk on corporate bonds they hold. The bonds may be held in current category or permanent category. The capital charge for these exposures will be as under:

- (i) For corporate bonds held in current category and hedged by CDS where there is no mismatch between the CDS and the hedged bond, the credit protection will be permitted to be recognised to a maximum of 80% of the exposure hedged. Therefore, the NBFC will continue to maintain capital charge for the corporate bond to the extent of 20% of the applicable capital charge. This can be achieved by taking the exposure value at 20% of the market value of the bond and then multiplying that with the risk weight of the issuing entity. In addition to this, the bought CDS position will attract a capital charge for counterparty risk which will be calculated by applying a credit conversion factor of 100 percent and a risk weight as applicable to the protection seller i.e. 20 per cent for banks and 100 per cent for others.
- (ii) For corporate bonds held in permanent category and hedged by CDS where there is no mismatch between the CDS and the hedged bond, NBFCs can recognise full credit protection for the underlying asset and no capital will be required to be maintained thereon. The exposure will stand fully substituted by the exposure to the protection seller and attract risk weight as applicable to the protection seller i.e. 20 per cent for banks and 100 per cent for others.

24. ASSET-LIABILITY MANAGEMENT (ALM)

ALM is a risk management tool that helps a bank/NBFC to manage its liquidity risk and interest rate risk. This is a powerful tool that helps banks/NBFCs plan long term financial, funding, and capital strategy using present value analysis. With ALM, a bank/NBFC can model interest income and expenses for analysis and re-price assets and liabilities. Based on ALM position, banks/NBFCs can also model effect of competitive pricing to create innovative and imaginative new banking products. ALM also helps regulatory compliance for banks/NBFCs by through appropriate investment / disinvestment decisions to maintain the required statutory liquidity ratio (SLR), credit reserve ratio (CRR) and other ratios as per Reserve Bank of India (RBI) guidelines. ALM involves the analysis of Structural Liquidity Gap Analysis, Interest Rate Gap Analysis, Net Interest Income (NII) Analysis, Net Interest Margin (NIM) Analysis, Tolerance Analysis, Cost to Close Analysis, Duration Gap Analysis, Trend Analysis, Comparative Analysis, Present Value Analysis, Forward Analysis and Scenario Analysis The Reserve Bank of India has announced its ALM guidelines for NBFCs for effective risk management. The NBFCs covered under the system are required to submit ALM returns comprising of statements on structural liquidity, short-term dynamic liquidity and interest rate sensitivity, to the Reserve Bank of India.

Miscellaneous Illustrations

Illustration 1

Templeton Finance Ltd. is a non-banking finance company. The extracts of its balance sheet are given below:

<i>Liabilities</i>	<i>Amount</i>	<i>Assets</i>	<i>Amount</i>
	<i>₹ in 000</i>		<i>₹ in 000</i>
<i>Paid-up equity capital</i>	100	<i>Leased out assets</i>	800
<i>Free reserves</i>	500	<i>Investment:</i>	
<i>Loans</i>	400	<i>In shares of subsidiaries and</i>	
<i>Deposits</i>	400	<i>group companies</i>	100

		<i>In debentures of subsidiaries and group Companies</i>	100
		<i>Cash and bank balances</i>	200
		<i>Deferred expenditure</i>	<u>200</u>
	<u>1,400</u>		<u>1,400</u>

You are required to compute 'Net owned Fund' of Templeton Finance Ltd. as per Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

Solution

Statement showing computation of 'Net Owned Fund'

		₹ in 000
Paid up Equity Capital		100
Free Reserves		<u>500</u>
		600
Less: Deferred expenditure		<u>(200)</u>
	A	<u>400</u>
Investments		
In shares of subsidiaries and group companies		100
In debentures of subsidiaries and group companies		<u>100</u>
	B	<u>200</u>
10% of A		40
Excess of Investment over 10% of A (200-40)	C	160
Net Owned Fund [(A) - (C)] (400-160)		240

Illustration 2

Bright Finance Ltd. is a non-banking financial company. It provides you with the following information regarding its outstanding amount, ₹ 200 lakhs of which installments are overdue on 200 accounts for last two months (amount overdue ₹ 40 lakhs), on 24 accounts for three months (amount overdue ₹ 24 lakhs), on 10 accounts for more than 30 months (amount overdue ₹ 20 lakhs) and on 4 accounts for more than three years (amount over due ₹ 20 lakhs-already identified as sub-standard assets) and one account of ₹ 10 lakhs which has been identified as non-recoverable

by the management. Out of 10 accounts overdue for more than 30 months, 6 accounts are already identified as sub-standard (amount ₹ 6 lakhs) for more than fourteen months and other are identified as sub-standard asset for a period of less than fourteen months.

Classify the assets of the company in line with Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

Solution

Statement showing classification as per Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016

		(₹ in lakhs)
<u>Standard Assets</u>		
Accounts (Balancing figure)	86.00	
200 accounts overdue for a period for 2 months	40.00	
24 accounts overdue for a period by 3 months	24.00	150.00
Sub-Standard Assets		
4 accounts identified as sub-standard asset for a period less than 14 months		14.00
<u>Doubtful Debts</u>		
6 accounts identified as sub-standard for a period more than 14 months		6.00
4 accounts identified as sub-standard for a period more than 3 years		20.00
<u>Loss Assets</u>		
1 account identified by management as loss asset		10.00
Total overdue		200.00

Illustration 3

While closing its books of account on 31st March, 2017 a Non-Banking Finance Company has its advances classified as follows:

	₹ in lakhs
Standard assets	16,800
Sub-standard assets	1,340
Secured portions of doubtful debts:	
– upto one year	320
– one year to three years	90
– more than three years	30
Unsecured portions of doubtful debts	97
Loss assets	48

Calculate the amount of provision, which must be made against the Advances as per

- (i) the Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016; and
- (ii) Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

Solution

Calculation of provision required on advances as on 31st March, 2017 as per the Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016

	Amount ₹ in lakhs	Percentage of provision	Provision ₹ in lakhs
Standard assets	16,800	0.25	42.00
Sub-standard assets	1,340	10	134.00
Secured portions of doubtful debts–			
– upto one year	320	20	64.00
– one year to three years	90	30	27.00
– more than three years	30	50	15.00
Unsecured portions of doubtful debts	97	100	97.00
Loss assets	48	100	<u>48.00</u>
			<u>427.00</u>

Calculation of provision required on advances as on 31st March, 2017 as per the Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016

	<i>Amount ₹ in lakhs</i>	<i>Percentage of provision</i>	<i>Provision ₹ in lakhs</i>
Standard assets	16,800	0.35	58.80
Sub-standard assets	1,340	10	134.00
Secured portions of doubtful debts–			
– upto one year	320	20	64.00
– one year to three years	90	30	27.00
– more than three years	30	50	15.00
Unsecured portions of doubtful debts	97	100	97.00
Loss assets	48	100	<u>48.00</u>
			<u>443.80</u>

SUMMARY

- The term NBFC does not include any institution whose principal business is that of agriculture activity, industrial activity or sale/purchase/construction of immovable property. For purposes of RBI Directions relating to Acceptance of Public Deposits, non-banking financial company means only the non-banking institution which is a – Loan company, Investment company, Hire purchase finance company, Equipment leasing company and Mutual benefit financial company”.
- No non-banking financial company is allowed to commence or carry on the business of a non-banking financial institution without obtaining a certificate of registration issued by the Reserve Bank of India.
- Functions of Non-Banking Financial Companies are similar to banks. However, there are a few differences:
 - (a) A NBFC cannot accept demand deposits;
 - (b) Non-Banking Financial Companies do not take part in the payment and settlement system and hence cannot issue cheques to its customers; and
 - (c) Deposit Insurance and Credit Guarantee Corporation (DICGC) does not insure the NBFC deposits.

- **Owned fund** means paid up equity capital, preference shares which are compulsorily convertible into equity, free reserves, balance in share premium account and capital reserves representing surplus arising out of sale proceeds of asset, excluding reserves created by revaluation of asset, as reduced by accumulated loss balance, book value of intangible assets and deferred revenue expenditure, if any;
- **Net Owned Fund** = Owned Fund – Investments in shares of subsidiaries/ companies in same group/Other NBFC. – Book value of debentures, bonds, outstanding loans and advances made to and deposits with subsidiaries and companies in the same group (to the extent such sum exceeds 10% of owned fund).
- **Revised Regulatory Framework for NBFCs:** RBI vide notification no. DNBR (PD)CC.No. 002/03.10.001/2014-15 dated November 10, 2014 has revised the regulatory provisions relating to the functioning of NBFCs (except primary dealers) in India. The changes introduced to the regulatory framework are delineated below.

a. Requirement of Minimum NOF of ₹ 200 lakh

Although the requirement of minimum NOF stands at ₹ 200 lakh, the minimum NOF for companies that were already in existence before April 21, 1999 was retained at ₹ 25 lakh. but the revised regulatory framework has mandated all NBFCs to attain a minimum NOF of ₹ 200 lakh by the end of March 2017, as per the milestones given below:

₹ 100 lakh by the end of March 2016

₹ 200 lakh by the end of March 2017

b. Deposit Acceptance

As per extant NBFCs Acceptance of Public Deposit (Reserve Bank) Directions, 1998, an unrated Asset Finance Company (AFC) having NOF of ₹ 25 lakh or more, complying with all the prudential norms and maintaining capital adequacy ratio of not less than fifteen per cent, is allowed to accept or renew public deposits not exceeding one and half times of its NOF or up to ₹ 10 crore, whichever is lower. AFCs which are rated and complying with all the prudential regulations are allowed to accept deposits up to 4 times of their NOF.

c. Systemic Significance

The threshold for defining systemic significance for NBFCs-ND has been revised in the light of the overall increase in the growth of the NBFC sector with asset size of ₹ 500 crore and above as per the last audited balance sheet. With this revision in the threshold for systemic significance, NBFCs-ND shall be categorized into two broad categories viz., i. NBFCs-ND (those with assets of less than ₹ 500 crore) and ii. NBFCs-ND-SI (those with assets of ₹ 500 crore and above).

d. Multiple NBFCs

NBFCs that are part of a corporate group or are floated by a common set of promoters will not be viewed on a standalone basis. The total assets of NBFCs in a group including deposit taking NBFCs, if any, will be aggregated to determine if such consolidation falls within the asset sizes of the above two categories.

e. Prudential Norms

The regulatory approach in respect of NBFCs-ND with an asset size of less than ₹ 500 crore will be as under:

- (i) They shall not be subjected to any regulation either prudential or conduct of business regulations if they have not accessed any public funds and do not have a customer interface.
- (ii) Those having customer interface will be subjected only to conduct of business regulations if they are not accessing public funds.
- (iii) Those accepting public funds will be subjected to limited prudential regulations but not conduct of business regulations if they have no customer interface.
- (iv) Where both public funds are accepted and customer interface exist, such companies will be subjected both to limited prudential regulations and conduct of business regulations.
- (v) Registration under Section 45 IA of the RBI Act will be mandatory.

Prudential Regulations Applicable to NBFCs-ND with Assets less than ₹ 500 crore

NBFCs-ND with asset size of less than ₹ 500 crore are exempted from the requirement of maintaining CRAR and complying with Credit Concentration Norms. A leverage ratio of 7 is being introduced for all such NBFCs-ND to link their asset

growth with the capital they hold. For this purpose, leverage ratio is defined as Total Outside Liabilities / Owned Funds.

Prudential Regulations Applicable to NBFCs-ND-SI (asset of ₹ 500 crore and above) and all NBFCs-D

Tier 1 Capital

All NBFCs-ND which have an asset size of ₹ 500 crore and above, and all NBFCs-D, shall maintain minimum Tier 1 Capital of 10%. The compliance to the revised Tier 1 capital will be phased in as follows: 8.5% by end of March 2016 and 10% by end of March 2017.

“**Tier I Capital**” means owned fund as reduced by investment in shares of other non-banking financial companies and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten per cent of the owned fund;

“**Tier II capital**” includes the following:

- (a) preference shares other than those which are compulsorily convertible into equity;
- (b) revaluation reserves at discounted rate of fifty five percent;
- (c) general provisions and loss reserves to the extent these are not attributable to actual diminution in value or identifiable potential loss in any specific asset and are available to meet unexpected losses, to the extent of one and one fourth percent of risk weighted assets;
- (d) hybrid debt capital instruments; and
- (e) subordinated debt to the extent the aggregate does not exceed Tier I capital.

Asset Classification

In the interest of harmonization, the asset classification norms for NBFCs-ND-SI and NBFCs-D are being brought in line with that of banks, in a phased manner, as given below.

Lease Rental and Hire-Purchase Assets shall become NPA:

- i. if they become overdue for 9 months (currently 12 months) for the financial year ending March 31, 2016;
- ii. if overdue for 6 months for the financial year ending March 31, 2017; and

- iii. if overdue for 3 months for the financial year ending March 31, 2018 and thereafter.

Assets other than Lease Rental and Hire-Purchase Assets shall become NPA:

- i. if they become overdue for 5 months for the financial year ending March 31, 2016;
- ii. if overdue for 4 months for the financial year ending March 31, 2017; and
- iii. if overdue for 3 months for the financial year ending March 31, 2018 and thereafter.

For all loan and hire-purchase and lease assets, sub-standard asset would mean:

- i. an asset that has been classified as NPA for a period not exceeding 16 months (currently 18 months) for the financial year ending March 31, 2016;
- ii. an asset that has been classified as NPA for a period not exceeding 14 months for the financial year ending March 31, 2017; and
- iii. an asset that has been classified as NPA for a period not exceeding 12 months for the financial year ending March 31, 2018 and thereafter.

For all loan and hire-purchase and lease assets, doubtful asset would mean:

- i. an asset that has remained sub-standard for a period exceeding 16 months (currently 18 months) for the financial year ending March 31, 2016;
- ii. an asset that has remained sub-standard for a period exceeding 14 months for the financial year ending March 31, 2017; and
- iii. an asset that has remained sub-standard for a period exceeding 12 months for the financial year ending March 31, 2018 and thereafter.

For the existing loans, a one-time adjustment of the repayment schedule, which shall not amount to restructuring will, however, be permitted.

- Income from dividend on shares of corporate bodies and units of mutual funds shall be taken into account on cash basis.
- However, income from dividend on shares of corporate bodies may be taken into account on accrual basis when such dividend has been declared by the corporate body in its annual general meeting and the NBFC's right to receive payment is established. Income from bonds and debentures of corporate bodies and from Government securities/bonds may be taken into account on accrual basis.
- Income on securities of corporate bodies or public sector undertakings, the payment of interest and repayment of principal of which have been

guaranteed by Central Government or a State Government may be taken into account on accrual basis.

The assets are classified as:

- (a) **Standard assets;** (b) **Sub-standard assets;** (c) **Doubtful assets;** and (d) **Loss assets.**

Provisioning Requirements

Loss Assets

100% of the outstanding should be provided for.

Doubtful Assets

- (a) 100% provision to the extent to which the advance is not covered by the realisable value of the security to which the NBFC has a valid recourse shall be made.
- (b) In addition to item (a) above, depending upon the period for which the asset has remained doubtful, provision to the extent of 20% to 50% of the secured portion (i.e. estimated realisable value of the outstanding) shall be made on the following basis:

Period for which the asset has been considered as doubtful	% of provision
Upto one year	20
One to three years	30
More than three years	50

Sub-standard asset

A general provision of 10% of total outstanding shall be made.

Standard Assets

The provision for standard assets for NBFCs-ND-SI and for all NBFCs-D has being increased to 0.40% (at present 0.25%). The compliance to the revised norm will be phased in as given below:

- 0.30% by the end of March 2016
- 0.35% by the end of March 2017
- 0.40% by the end of March 2018

This provision towards standard asset need not be netted from gross advances but shown separately as 'Contingent provision against standard assets' in the Balance Sheet.

TEST YOUR KNOWLEDGE

MCQs

- For the purpose of RBI Directions relating to Acceptance of Public Deposits, non-banking financial company means the non-banking institution which is a
 - Loan company or investment company.
 - Hire-purchase finance company or equipment leasing company.
 - Both (a) and (b).
- For Sub-standard assets in the case of NBFC, a general provision of
 - 5% of total outstanding shall be made.
 - 10% of total outstanding shall be made.
 - 15% of total outstanding shall be made.
- "Owned fund" excludes
 - paid up capital.
 - free reserves, balance in share premium account.
 - reserves created by revaluation of asset.

Theoretical Questions

Question 1

Write short notes on:

- "Non-Performing Assets" as per NBFC Prudential Norms (RBI) directions.
- Earning value (Equity share).

Practical Questions

Question 1

While closing its books of account on 31st March, 2017 a Non-Banking Finance Company has its advances classified as follows:

	₹ in lakhs
Standard assets	16,800

Sub-standard assets	1,340
Secured portions of doubtful debts:	
– upto one year	320
– one year to three years	90
– more than three years	30
Unsecured portions of doubtful debts	97
Loss assets	48

Calculate the amount of provision, which must be made against the advances as per

- the Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016; and
- Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

Question 2

Peoples Financiers Ltd. is an NBFC providing Hire Purchase Solutions for acquiring consumer durables. The following information is extracted from its books for the year ended 31st March, 2017:

Asset Funded	Interest Overdue but recognized in Profit & loss		Net Book Value of Assets outstanding
	Period Overdue	Interest Amount	
		(₹ in crore)	(₹ in crore)
LCD Televisions	Upto 12 months	480.00	20,123.00
Washing Machines	For 24 months	102.00	2,410.00
Refrigerators	For 30 months	50.50	1,280.00
Air Conditioners	For 45 months	26.75	647.00

You are required to calculate the amount of provision to be made.

ANSWERS/ HINTS

MCQs

1. (c); 2. (b); 3. (c)

Theoretical Questions

Answer 1

- (i) Refer para 18
(ii) Refer para 12

Practical Questions

Answer 1

Calculation of provision required on advances as on 31st March, 2017 as per the Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016

	<i>Amount ₹ in lakhs</i>	<i>Percentage of provision</i>	<i>Provision ₹ in lakhs</i>
Standard assets	16,800	0.25	42.00
Sub-standard assets	1,340	10	134.00
Secured portions of doubtful debts–			
– upto one year	320	20	64.00
– one year to three years	90	30	27.00
– more than three years	30	50	15.00
Unsecured portions of doubtful debts	97	100	97.00
Loss assets	48	100	<u>48.00</u>
			<u>427.00</u>

Calculation of provision required on advances as on 31st March, 2017 as per the Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016

	<i>Amount ₹ in lakhs</i>	<i>Percentage of provision</i>	<i>Provision ₹ in lakhs</i>
Standard assets	16,800	0.35	58.80

Sub-standard assets	1,340	10	134.00
Secured portions of doubtful debts–			
– upto one year	320	20	64.00
– one year to three years	90	30	27.00
– more than three years	30	50	15.00
Unsecured portions of doubtful debts	97	100	97.00
Loss assets	48	100	<u>48.00</u>
			<u>443.80</u>

Answer 2

On the basis of the information given, in respect of hire purchase and leased assets, additional provision shall be made as under:

			(₹ in crore)
(a)	Where hire charges are overdue upto 12 months	Nil	-
(b)	Where hire charges are overdue for more than 12 months but upto 24 months	10% of the net book value 10% x 2,410	241
(c)	Where hire charges are overdue for more than 24 months but upto 36 months	40 percent of the net book value 40% x 1,280	512
(d)	Where hire charges or lease rentals are overdue for more than 36 months but upto 48 months	70 percent of the net book value 70% x 647	452.90
		Total	<u>1,205.90</u>