

**A HANDBOOK ON OVERVIEW OF LAWS RELATING TO NON-BANKING FINANCIAL
INSTITUTIONS**

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I. INTRODUCTION

Non Banking Finance Companies (NBFCs) are a constituent of the institutional structure of the organized financial system in India. The Financial System of any country consists of financial markets, financial intermediation and financial instruments or financial products. All these items facilitate transfer of funds and are not always mutually exclusive. Inter-relationships between these are a part of the system e.g. Financial Institutions operate in financial markets and are, therefore, a part of such markets.

The term "Finance" is often understood as being equivalent to "money". However, finance exactly is not money; it is the source of providing funds for a particular activity.

The word system, in the term financial system, implies a set of complex and closely connected or inter-linked Institutions, agents, practices, markets, transactions, claims, and liabilities in the economy. The financial system is concerned about money, credit and finance--the three terms are intimately related yet are somewhat different from each other.

- Money refers to the current medium of exchange or means of payment.
- Credit or loans is a sum of money to be returned, normally with interest; it refers to a debt of economic unit.
- Finance is monetary resources comprising debt and ownership funds of the state, company or person.

Total Finance sector in India can be divided into Formal and Informal Finance.

The Formal sector can be said to comprise of the Formal and necessarily regulated channels of financing like, finance provided by Banks, Financial Institutions, Non-Banking Financial Institutions, and Micro finance institutions.

The informal sector of finance may be said to refer to all economic activities that fall outside the formal sector that is regulated by economic and legal institutions

The Informal sector can be said to comprise of the money lenders, some channels of micro finance and the other not necessarily regulated sectors. Landlords, local shopkeepers, traders,

suppliers and professional money lenders, and relatives are the informal sources of micro-finance for the poor, both in rural and urban areas.

II. HISTORICAL BACKGROUND

The Reserve Bank of India Act, 1934 was amended on 1st December, 1964 by the Reserve Bank Amendment Act, 1963 to include provisions relating to non-banking institutions receiving deposits and financial institutions. It was observed that the existing legislative and regulatory framework required further refinement and improvement because of the rising number of defaulting NBFCs and the need for an efficient and quick system for redressal of grievances of individual depositors. Given the need for continued existence and growth of NBFCs, the need to develop a framework of prudential legislations and a supervisory system was felt especially to encourage the growth of healthy NBFCs and weed out the inefficient ones. With a view to review the existing framework and address these shortcomings, various committees were formed and reports were submitted by them. Some of the committees and its recommendations are given hereunder:

1. James Raj Committee (1974)

The James Raj Committee was constituted by the Reserve Bank of India in 1974. After studying the various money circulation schemes which were floated in the country during that time and taking into consideration the impact of such schemes on the economy, the Committee after extensive research and analysis had suggested for a ban on Prize chit and other schemes which were causing a great loss to the economy. Based on these suggestions, the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 was enacted.

2. Chakravarthy Committee (1984)

This Committee headed by Shri Sukhamoy Chakravarty was formed to review the Working of the Monetary System. It made several recommendations for the development of money market.

3. Vaghul Committee (1987)

As a follow-up to the Chakravarty committee, the RBI set up a Working Group on Money Market under the Chairmanship of Shri N. Vaghul, which submitted its Report in 1987 containing number of measures to widen and deepen the money market.

4. Narasimhan Committee (1991)

This committee was formed to examine all aspects relating to the structure, organization & functioning of the financial system.

5. Dr.A.C.Shah Committee (1992)

The Working Group on Financial Companies constituted in April 1992 i.e the Shah Committee set out the agenda for reforms in the NBFC sector. This committee made wide ranging recommendations covering, inter-alia entry point norms, compulsory registration of large sized NBFCs, prescription of prudential norms for NBFCs on the lines of banks, stipulation of credit rating for acceptance of public deposits and more statutory powers to Reserve Bank for better regulation of NBFCs.

6. Khanna Committee (1995)

This Group was set up with the objective of designing a comprehensive and effective supervisory framework for the non-banking companies segment of the financial system.

The important recommendations of this committee are as follows:

- i. Introduction of a supervisory rating system for the registered NBFCs. The ratings assigned to NBFCs would primarily be the tool for triggering on-site inspections at various intervals.
- ii. Supervisory attention and focus of the Reserve Bank to be directed in a comprehensive manner only to those NBFCs having net owned funds of Rs.100 lakhs and above.
- iii. Supervision over unregistered NBFCs to be exercised through the off-site surveillance mechanism and their on-site inspection to be conducted selectively as deemed necessary depending on circumstances.
- iv. Need to devise a suitable system for co-ordinating the on-site inspection of the NBFCs by the Reserve Bank in tandem with other regulatory authorities so that they were subjected to one-shot examination by different regulatory authorities.

- v. Some of the non-banking non-financial companies like industrial/manufacturing units were also undertaking financial activities including acceptance of deposits, investment operations, leasing etc to a great extent. The committee stressed the need for identifying an appropriate authority to regulate the activities of these companies, including plantation and animal husbandry companies not falling under the regulatory control of either Department of Company Affairs or the Reserve Bank, as far as their mobilisation of public deposit was concerned.
- vi. Introduction of a system whereby the names of the NBFCs which had not complied with the regulatory framework / directions of the Bank or had failed to submit the prescribed returns consecutively for two years could be published in regional newspapers.

Most of the recommendations of the Committee were accepted by the Reserve Bank after an in depth analysis and the revised framework for effective supervision of the NBFCs including off-site monitoring of NBFCs is being put in place.

7. Vasudev Committee (1998)

This committee emphasised the need for strengthening of the NBFC sector including entry norms and prudential norms, and dealt with framework for acceptance of public deposits, issues concerning unincorporated financial intermediaries and addresses issues of supervision of NBFCs.

The important recommendations of this committee are as follows:

- i. Present minimum capital requirement of Rs.25 lakhs to be reviewed upwards keeping in view the need to impart greater financial soundness and achieve economies of scale in terms of efficiency of operations and managerial skills.
- ii. As operations of NBFCs are concentrated in remote areas, the RBI may apprise the State Governments of the companies which have been granted registration as well as the companies whose applications have been rejected.
- iii. The present capital adequacy ratio requirement may be maintained at 12% for all rated NBFCs, higher rate of about 15% need to be prescribed by RBI for those NBFCs which seek public deposit without credit rating.

- iv. RBI may stipulate that the NBFCs should invest at least 25% of their reserves in marketable securities apart from the SLR securities already held by the NBFCs.
- v. Linking of quantum of public deposits with credit rating because apart from having the effect of conferring regulatory functions on the rating agencies, it also exposes the NBFCs to frequent asset liability mismatches arising out of changes in credit rating.
- vi. RBI should consider measures for easing the flow of credit from banks to NBFCs and then consider prescribing a suitable ratio as between secured and unsecured deposits for NBFCs.
- vii. Appointment of depositors' grievance Redressal authorities with specified territorial jurisdiction.
- viii. The procedure for liquidation of NBFCs to be substantially in line with those available for banks.
- ix. A separate instrumentality for regulation and supervision of NBFCs under the aegis of the RBI should be set up, so that there is a great focus in regulation and supervision of the NBFC sector.
- x. The Committee felt it was not judicious to introduce a deposit insurance scheme for the depositors in NBFCs because of the moral hazard issues, likelihood of assets stripping and likely negative impact on the growth of a healthy NBFC sector.
- xi. Reserve Bank could use the services of chartered accountants with suitable experience and capabilities to carry out inspection of the smaller NBFCs.

The non-banking financial companies (NBFCs) flourished in India in the decade of the 1980s against the backdrop of a highly regulated banking sector. The simplified sanction procedures and low entry barriers encouraged the entry of a host of NBFCs. However, in many cases mismanagement / lack of efficient management resulted in problems arising out of adverse portfolio selection, un-prudent operations, inability to manage risk both on asset and liability side. In many cases due to non availability of adequate credit from the banking sector NBFCs had to rely excessively on unsecured public deposits for their existence / survival by paying higher rate of interest. To service such high cost deposits, some NBFCs were forced to deploy

their funds which carried high return coupled with high risk . This ultimately resulted in higher risks for their depositors, which in some cases had culminated in the crisis of confidence and credibility.

Under this scenario, it was felt necessary to initiate immediate action for the protection of depositors' interest. RBI issued the Non Banking Companies (Reserve Bank) Directions, 1977, guidelines on prudential norms and various other Directions and clarifications, from time to time for governing the activities of NBFCs. Central Government, during 1974, introduced 58A in the Companies Act, 1956 which empowered Central Government to regulate acceptance and renewal of deposits and to frame rules in consultation with Reserve Bank of India (RBI) prescribing (a) the limit up to, (b) the manner and (c) the conditions subject to which deposits may be invited or accepted / renewed by companies. The Central Government in consultation with RBI framed Companies (Acceptance of Deposits) Rules, 1975.

Continuing this process, RBI Act, 1934 was amended in 1997 which authorised the Reserve Bank to determine policies, and issue directions to NBFCs regarding income recognition, accounting standards, NPAs, capital adequacy, etc. The amended Act, inter alia, provided for compulsory registration of all NBFCs into three broad categories, viz., (i) NBFCs accepting public deposit; (ii) NBFCs not accepting/holding public deposit; and (iii) core investment companies (i.e., those acquiring shares/securities of their group/ holding/subsidiary companies to the extent of not less than 90 per cent of total assets and which do not accept public deposit).

Until some years back, the prudential norms applicable to banking and non-banking financial companies were not uniform. Moreover, within the NBFC group, the prudential norms applicable to deposit taking NBFCs (NBFCs-D) were more stringent than those for non-deposit taking NBFCs (NBFCs-ND). Since the NBFCs-ND were not subjected to any exposure norms, they could take large exposures. The absence of capital adequacy requirements resulted in high leverage by the NBFCs. Since 2000 however, the Reserve Bank has initiated measures to reduce the scope of 'regulatory arbitrage' between banks, NBFCs-D and NBFCs-ND

Some of the recent measures include:

1. Advising NBFC on Advertisement in Electronic Media-In order to ensure transparency in the interest of depositors in the context of such advertisements, a provision was incorporated in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998, in terms of which companies are required to state that they have a valid Certificate of Registration issued by the Reserve Bank. However, the Reserve Bank does not accept any responsibility or guarantee about the present position as to the financial soundness of the company or for the correctness of any of the statements or representations made or opinions expressed by the company and for repayment of deposits/ discharge of the liabilities by the company.

2. Corporate Governance

Listed NBFCs which are required to adhere to listing agreement and rules framed by SEBI on Corporate Governance are already required to comply with SEBI prescriptions on Corporate Governance.

As per the RBI Circular RBI/2006-2007/385 DNBS.PD/CC 94/03.10.042/2006-07 dated 8.05.2007; guidelines for corporate governance have been proposed for

1. All Deposit taking NBFCs with deposit size of Rs 20 crore and above
2. All non-deposit taking NBFCs with asset size of Rs 100 crore and above (NBFC-ND-SI).

Some of the guidelines include -

- a) Constitution of Audit Committee in case of NBFC-D with deposit size of Rs 20 crore
- b) Constitution of Nomination committee: The guidelines state that it would be desirable that NBFC-D with deposit size of Rs 20 crore and above and NBFC-ND-SI may form a Nomination Committee to ensure 'fit and proper' status of proposed/ existing Directors

c) Constitution of Risk Management Committee-To manage the integrated risk, a risk management committee may be formed, in addition to the ALCO (Asset Liability Management Committee) in case of the above category of NBFCs.

d) Disclosure & Transparency - Certain information should be put up by the NBFC to the Board of Directors at regular intervals as may be prescribed by the Board in this regard.

e) Compliance with instructions on connected lending relationships

3. Revising Rate of Interest - The maximum interest rate payable on public deposits by NBFCs was revised to 12.5 per cent per annum on and from April 24, 2007.

4. Advising NBFCs for (a) not engaging telemarketers who do not have any valid registration Certificate from Department of Telecommunications (DoT), Government of India as Telemarketers, (b) furnishing list of telemarketers engaged by them alongwith the registered Tel.Nos. being used by them for making telemarketing calls to TRAI and (c) ensuring that all the agents presently engaged by them register themselves with DoT telemarketers in pursuance to the Telecom Regulatory Authority of India (TRAI) having framed Telecom Unsolicited Commercial Communications (UCC) Regulations for curbing UCC to the subscribers who do not want to receive UCC.

5. Reporting of Secondary Market Transactions

All NBFCs were advised to report their secondary market transactions in corporate bonds done in OTC market, on The Fixed Income Money Market and Derivatives Association of India's (FIMMDA's) reporting platform with effect from September 1, 2007

FIMMDA is an Association of Commercial Banks, Financial Institutions and Primary Dealers.

FIMMDA is a voluntary market body for the bond, Money And Derivatives Markets

6. Monitoring of Frauds in NBFCs

In March 2008 all deposit taking NBFCs (including RNBCs) were advised that the extant instructions with regard to monitoring of frauds were revised and as such cases of 'negligence

and cash shortages' and 'irregularities in foreign exchange transactions' were to be reported as fraud if the intention to cheat/defraud was suspected/proved. However, in cases where fraudulent intention was not suspected/ proved at the time of detection but involve cash shortages of more than ten thousand rupees and cases where cash shortages more than five thousand rupees were detected by management/auditor/inspecting officer and not reported on the occurrence by the persons handling cash, then such cases may also be treated as fraud and reported accordingly.

7. Issuing Guidelines on Registration, Operations, Prudential Norms and Investment Directions for Mortgage Guarantee Companies

8. Issuing guidelines on Treatment of Deferred Tax Assets (DTA) and Deferred Tax Liabilities (DTL) for Computation of Capital

As creation of deferred tax assets (DTA) or DTL gives rise to certain issues impacting the balance sheet of the company, NBFCs were advised on July 31, 2008 regarding the regulatory treatment to be given to these issues. As per these guidelines, the balance in DTL account will not be eligible for inclusion in Tier I or Tier II capital for capital adequacy purpose as it is not an eligible item of capital. DTA will be treated as an intangible asset and should be deducted from Tier I capital. NBFCs were advised to ensure compliance with these guidelines from the accounting year ending March 31, 2009

9. Instructing on the obligations of NBFC under PMLA Act,2002

Cash transaction reporting by branches/offices of NBFCs to their Principal Officer should be submitted on a monthly basis and the Principal Officer, in turn, should ensure to submit cash transaction report (CTR) for every month to the Financial Intelligence Unit – India (FIU-IND) within the prescribed time schedule.

10. Undertaking various Policy Initiatives for NBFCs-ND-SI in 2007-08 such as Guidelines on Capital Adequacy, Liquidity and Disclosure Norms; Issuance of Perpetual Debt Instruments and Access to Short-Term Foreign Currency Borrowings

11. Instructions on Capital adequacy norms for non- deposit taking NBFC

The Reserve Bank of India (RBI) on 2nd June 2008 asked non-deposit taking NBFCs to raise the minimum Capital to Risk-weighted Assets Ratio (CRAR) from 10% now to 12% with immediate

effect and further to 15% with effect from April 1, 2009.

III. NON-BANKING FINANCIAL COMPANY (NBFC) - MEANING

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 and is 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, sale/purchase/construction of immovable property. A non-banking institution which is a company and which has its principal business of receiving deposits under any scheme of arrangement or any other manner, or lending in any manner is also a non-banking financial company.

For this purpose, the definition of 'Principal Business' given, *vides* Press Release 1998-99/1269 dated April 8, 1999 may be followed:

“The company will be treated as a non-banking financial company (NBFC) if its financial assets are more than 50 per cent of its total assets (netted off by intangible assets) and income from financial assets is more than 50 per cent of the gross income. Both these tests are required to be satisfied as the determinant factor for principal business of a company.”

3.1 Definitions of NBFC

Whereas the 'Reserve bank of India Act 1934' itself defines the term NBFC, there is a different definition of the same term viz. NBFC in the 'Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1988' that the RBI itself has issued under the aforesaid Act of 1934.

A. NBFC under the RBI Act

Under section 45-I(a) of the RBI Act, 1934 'business of non banking financial institution', is defined in terms of the business of a financial institution and NBFC.

NBFI - Non-banking financial institution

Sec: 45-I(a) : "business of a non-banking financial institution" means carrying on of the business of a financial institution referred to in clause (c) and includes business of a non-banking financial company referred to in clause (f);]

FI- Financial Institution

The Act defines 'Financial Institution' (FI) u/s 45-I(c) as

"Financial institution" means any non-banking institution which carries on as its business or part of its business any of the following activities, namely :-

- (i) The financing, whether by way of making loans or advances or otherwise, of any activity other than its own;
- (ii) the acquisition of shares, stock, bonds, debentures or securities issued by a government or local authority or other marketable securities of a like nature;
- (iii) letting or delivering of any goods to a hirer under a hire-purchase agreement as defined in clause (c) of section 2 of the Hire-Purchase Act, 1972 (26 of 1972);
- (iv) The carrying on of any class of insurance business;
- (v) Managing, conducting or supervising, as foreman, agent or in any other capacity, of chits or kuries as defined in any law which is for the time being in force in any State, or any business, which is similar thereto;
- (vi) collecting, for any purpose or under any scheme or arrangement by whatever name called monies in lump sum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person,

But does not include-----."

The definition of FI uses the definition of a Non Banking Institution. (NBI)

NBI has been defined under the RBI Act 1934 as follows:

NBI

Sec.45-I(e) : "non-banking institution" means a company, corporation or co-operative society.

NBFC

'NBFC', itself is defined under sec. 45-I(f) of the Act, as under

Sec. 45-I(f):) "non-banking financial company" means-

(i) a financial institution which is a company;

(ii) a non banking institution which is a company and which has as its principal business the 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 bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

For this purpose, the definition of 'Principal Business' given, vide Press Release

1998-99/1269 dated April 8, 1999 may be followed: "The company will be treated as a non-banking financial company (NBFC) if its financial assets are more than 50 per cent of its total assets (netted off by intangible assets) and income from financial assets is more than 50 per cent of the gross income. Both these tests are required to be satisfied as the determinant factor for principal business of a company."

An analysis of forgoing provisions reveals that except for specifically notified categories, a company that is a FI, or a NBI receiving deposits, alone would qualify as an NBFC.

On reading jointly both of the definitions of FI and NBI reveals that for a company to be an NBFC it should either carry on any of the businesses as enumerated in (i) to (vi) of FI Sec. 45-I(c) or it should otherwise receive public deposits in any manner.

B. NBFC under the Non Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1988

Here the RBI has adopted definition of NBFC as follows:

NBFC- Non-banking financial company

Para 2(1)(xi) of the Directions defines NBFC as -

Non-banking financial company means only the non-banking institution which is a loan company or an investment company or an asset finance company (w.e.f 6.12.2006) or a mutual benefit financial company.

The terms used in the above definition are also defined in the Directions, as under:

Loan company para 2(1)(viii) of the directions

Loan company means any company which is a financial institution carrying on as it's principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.

Investment company para 2(1)(vi) of the directions

Investment Company is a company which is a financial institution carrying on as it's principal business the acquisition of securities.

Asset Finance Company para2(1)(ia) of the directions

Asset Finance Company means 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.

Mutual Benefit Financial Company para 2(1)(ix) of the directions

means a company which is a financial institution notified by The Central Government under section 620A of The Companies Act 1956

Each category of above notified companies is an NBFC for the Directions. As per the definition given in the directions, these companies are a 'financial institution'.

However, the directions do not define financial institution.

Therefore 'financial institution' mentioned under imports its meaning from the definition in section 45-I(c) of the RBI Act. This is consequent to Para 2(2) of the directions.

As a consequence, each of these four categories of NBFC's under the the Directions are also within the statutory meaning under the Act of the term NBFC.

Thus, NBFC's under the Reserve Bank of India Directions are a subset of the NBFC's under the Reserve Bank of India Act, 1934

3.2 Classification of NBFCs

1. With effect from December 6, 2006 the NBFCs registered with RBI have been reclassified as

(i) Asset Finance Company (AFC)

(ii) Investment Company (IC)

(iii) Loan Company (LC)

The above type of companies may be further classified into:

- NBFCs accepting public deposits (NBFCs - D), and
- NBFCs not accepting / holding public deposits (NBFCs - ND)

Systemically important NBFCs

IMF has framed principles for regulation of the financial sector, where it suggests that institutions performing similar functions should be subject to similar regulations. Accordingly, All NBFCs-ND with an asset size of Rs.100 crore and more as per the last audited balance sheet are now considered as **systemically important NBFCs-ND** (NBFC-ND-SI). NBFCs-ND- SI are required to maintain a minimum CRAR of 10 per cent. No NBFC-ND-SI is allowed to (i) lend to any single borrower/ group of borrowers exceeding 15 per cent / 25 per cent of its owned fund; (ii) invest in the shares of another company/ single group of companies exceeding 15 per cent / 25 per cent of its owned fund; and (iii) lend and invest (loans/ investments taken together) exceeding 25 per cent of its owned fund to a single party and 40 per cent of its owned fund to a single group of parties.

This classification is in addition to the present classification of NBFCs into deposit-taking, and non-deposit-taking NBFCs. [RBI on Financial Regulation of Systemically Important NBFCs and Banks' Relationship with them- dated 12.12.2006]

2. Residuary Non-Banking Companies [companies which have 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 mobilisation of deposits and requirement of deployment of depositors' funds. However, Prudential Norms Directions are applicable to these companies also]

3. Miscellaneous non-banking companies MNBCs (Chit Fund),

The Chit Companies, although governed by the Miscellaneous Non-banking Companies (MNBCs) (Reserve Bank) Directions, 1977, issued by the Reserve Bank with regard to acceptance of deposits, are regulated by the Registrar of Chits of the respective State Governments.

Furthermore, MNBCs, not accepting public deposits have been exempted from submitting returns to the Reserve Bank since December 27, 2005.

4. Mutual benefit financial companies (Nidhis and unnotified Nidhis)

Mutual benefit funds including Nidhi companies are not regulated by the Reserve Bank (except as pertaining to deposit taking activities) as they come under the regulatory purview of the Ministry of Corporate Affairs

5. Housing finance companies.

The National Housing Bank (NHB) regulates housing finance companies

6. Insurance companies

Insurance Companies are regulated by the Insurance Regulatory and Development Authority.

7. Stock broking companies and Merchant banking companies

These companies are regulated by the Securities and Exchange Board of India.

8. Mortgage Guarantee Companies have been notified as Non-Banking Financial Companies under Section 45 I(f)(iii) of the RBI Act, 1934.

NBFCS EXEMPTED FROM REGISTRATION WITH RBI

To obviate dual regulation, certain category of NBFCS which are regulated by other regulators are exempted from the requirement of registration with RBI.

Although, all the below mentioned are NBFCS but they have been exempted from the requirement of registration under Section 45-IA of the RBI Act, 1934 subject to certain conditions:

1. Housing Finance Companies

Housing Finance Companies are regulated by National Housing Bank (NHB) and therefore have to be registered with the NHB.

2. Merchant Banking Companies, Stock Exchanges, Companies engaged in the business of stock-broking/sub-broking, Venture Capital Fund Companies

Merchant Banker/Venture Capital Fund Company/stock-exchanges/stock brokers/sub-brokers are regulated by Securities and Exchange Board of India and have to be registered with it

3. Nidhi Companies

Nidhi Companies are regulated by Ministry of Corporate Affairs, Government of India for its operational matters and deployment of funds. It is regulated by RBI for its deposit taking activities.

4. Insurance companies

Insurance companies are regulated by Insurance Regulatory and Development Authority (IRDA) and have to register with the IRDA.

5. Chit Fund Companies

Chit Companies are regulated by the respective State Governments and have to apply for registration to the Registrar of Chits in the respective State where they are located.

IV. PRE-REQUISITE FOR CARRYING ON BUSINESS OF NBFC

4.1 Registration Requirements

In terms of Section 45-IA of the RBI Act, 1934, it is mandatory that every NBFC should be registered with RBI to commence or carry on any business of non-banking financial institution as defined in clause (a) of Section 45 I of the RBI Act, 1934.

Exemptions from the provisions of RBI Act, 1934

As laid down in Master Circular the following are some exemptions from the provisions of RBI Act, 1934 dated July 1, 2008 but subject to certain conditions,

- (i) A Housing Finance Institutions has been exempted from provisions of Chapter III B of the RBI Act, 1934
- (ii) A merchant banking company has been exempted from the provisions of Section 45-IA [Requirement of registration and net owned fund], Section 45-IB [Maintenance of liquid assets] and 45-IC [Creation of Reserve Fund] of the RBI Act, 1934 , Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 and Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998
- (iii) In the case of Micro Finance Companies and Mutual Benefit Companies- Sections 45-IA, 45-IB and 45-IC of the Reserve Bank of India Act, 1934 shall not apply
- (iv) In the case of Government Companies- Sections 45-IB and 45-IC of the Reserve Bank of India Act, 1934 paragraphs 4 to 7 of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 and Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998 except paragraph 13 A of the said directions relating to submission of information to Reserve Bank in regard to change of address, directors, auditors, etc shall not apply

- (v) In the case of Venture Capital Fund Companies Section 45-IA and Section 45-IC of the Reserve Bank of India Act, 1934 shall not apply
- (vi) In the case of Insurance/Stock Exchange/Stock Broker/Sub-Broker-The provisions of Section 45-IA, 45-IB, 45-IC, 45MB and 45MC of the Reserve Bank of India Act, 1934 and provisions of Non-Banking Financial Companies Acceptance of Public Deposit (Reserve Bank) Directions contained in Notification No. DFC.118 / DG(SPT)-98 dated January 31, 1998, the Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998 dated January 31, 1998 shall not apply
- (vii) In the case of Nidhi Companies, the provisions of Sections 45-IA, 45-IB and 45-IC of the Reserve Bank of India Act, 1934 shall not apply
- (viii) Chit Companies doing the business of chits exclusively are exempted

The list of registered NBFCs is available on the web site of Reserve Bank of India and can be viewed at www.rbi.org.in

The NBFC is required to submit its application for registration in the prescribed format along with necessary documents for Bank's consideration. The Bank issues Certificate of Registration after satisfying itself that the conditions as enumerated in Section 45-IA of the RBI Act, 1934 are satisfied

An indicative list of documents/information to be furnished along with the application. All documents/information is to be submitted in duplicate.

1.	Minimum NOF requirement Rs. 200 lakh.
2.	Application to be submitted in two separate sets tied up properly in two separate files.
3.	Annex II to be submitted duly signed by the director/Authorized

	signatory and certified by the statutory auditors.
4.	Annex III (directors' profile) to be separately filled up for each director. Care should be taken to give details of bankers in respect of firms/companies/entities in which directors have substantial interest.
5.	In case the directors are associated or have substantial interest in other companies, indicate clearly the activity of the companies (whether NBFC or not).
6.	Board Resolution specifically approving the submission of the application and its contents and authorising signatory.
7.	Board Resolution to the effect that the company has not accepted any public deposit, in the past (specify period)/does not hold any public deposit as on the date and will not accept the same in future without the prior approval of Reserve Bank of India in writing.
8.	Board resolution stating that the company is not carrying on any NBFC activity/stopped NBFC activity and will not carry on/commence the same before getting registration from RBI.
9.	Auditors Certificate certifying that the company is/does not accept/is not holding Public Deposit.
10.	Auditors Certificate certifying that the company is not carrying on any NBFC activity.
11.	Net owned fund as on date.
12.	Certifying compliance with section 45S of Chapter IIIC of the RBI Act, 1934 in which director/s of the company has substantial interest.
13.	Details of changes in the Memorandum and Articles of Association duly certified.
14.	Last three years Audited balance sheet along with directors & auditors

	report.
15.	Details of clauses in the memorandum relating to financial business.
16.	Details of change in the management of the company during last financial year till date if any and reasons thereof.
17.	Details of acquisitions, mergers of other companies if any together with supporting documents.
18.	Details of group companies/associate concerns/subsidiaries/holding companies.
19.	Details of infusion of capital if any during last financial year together with the copy of return of allotment filed with Registrar of Companies.
20.	Details of the bank balances/bank accounts/complete postal address of the branch/bank, loan/credit facilities etc. availed.
21.	Business plan for next three years indicating market segment to be covered without any element of public deposits.
22.	Cash flow statement, asset/income pattern statement for next three years.
23.	Brief background note on the activities of the company during the last three years and the reasons for applying for NBFC registration.
24.	II(b) is the company engaged in any capital market activity? If so, whether there has been any non-compliance with SEBI Regulations? (Statement to be certified by Auditors).
25.	Whether any prohibitory order was issued in the past to the company or any other NBFC/RNBC with which the directors/promoters etc. were associated? If yes, details there of.
26.	Whether the company or any of its directors was/is involved in any criminal case, including under section 138(1) of the Negotiable

	Instruments Act? If yes, details thereof.
27.	Whether the company was granted any permission by ECD to function as Full-fledged Money Changers?
28.	Whether the company was/is authorised by ECD to accept deposits from NRIs.
29.	Whether “Fit and Proper” Norms for Directors have been fulfilled.

1. Annex I - Identification particulars
2. Annex II - Statement on prudential norms
3. Annex III - Information about the management

All NBFCs registered with RBI should make sure that they continue to be eligible to retain the RBI Registration

4.2 Minimum Net-owned Fund

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 have a minimum net owned fund of Rs 25 lakh (raised to Rs 200 lakh w.e.f April 21, 1999).

Net Owned Fund is defined in the Explanation to Section 45-IA of the RBI Act 1934 as follows

(a) The aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance sheet of the company after deducting therefrom-

- (i) accumulated balance of loss;

(ii) Deferred revenue expenditure; and

(iii) Other intangible assets; and

(b) Further reduced by the amounts representing-

(1) Investments of such company in shares of-

(i) Its subsidiaries;

(ii) Companies in the same group;

(iii) All other non-banking financial companies; and

(2) The book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with-

(i) Subsidiaries of such company; and

(ii) Companies in the same group,

to the extent such amount exceeds ten per cent, of (a) above

Vide RBI/2007-08/369 -DNBS (PD) C.C. No. 114 /03. 02.059/2007-08 dated June 17, 2008

RBI has instructed all deposit taking NBFCs as follows

In order to strengthen the financial system in general and deposit taking entities in particular NBFCs accepting deposits should be adequately capitalized and at the same time also have a uniform minimum NOF.

To ensure a measured movement towards strengthening the financials of all deposit taking NBFCs by increasing their NOF to a minimum of Rs.200 lakh in a gradual, non-disruptive and non-discriminatory manner, it has been decided to prescribe that:

(a) As a first step, NBFCs having minimum NOF of less than Rs. 200 lakh may freeze their deposits at the level currently held by them.

(b) Further, Asset Finance Companies (AFC) having minimum investment grade credit rating and CRAR of 12% may bring down public deposits to a level that is 1.5 times their NOF while all other companies may bring down their public deposits to a level equal to their NOF by March 31, 2009.

(c) Those companies which are presently eligible to accept public deposits up to a certain level, but have, for any reason, not accepted deposits up to that level will be permitted to accept public deposits up to the revised ceiling prescribed

(d) Companies on attaining the NOF of Rs.200 lakh may submit statutory auditor's certificate certifying its NOF.

(e) The NBFCs failing to achieve the prescribed ceiling within the stipulated time period, may apply to the Reserve Bank for appropriate dispensation in this regard which may be considered on case to case basis.

Category of NBFC	Present Ceiling on public deposits	Revised Ceiling on public deposits
AFCs maintaining CRAR of 15% without credit rating and having NOF more than Rs 25 lakh but less than Rs 200 lakh	1.5 times of NOF or Rs 10 crore whichever is less	Equal to NOF
AFCs with CRAR of 12% and	4 times of NOF	1.5 times of NOF

having minimum investment
grade credit rating and having
NOF more than Rs 25 lakh but less
than Rs 200 lakh

LCs/ICs with CRAR of 15% and 1.5 times of NOF

Equal to NOF

having minimum investment
grade credit rating and having
NOF more than Rs 25 lakh but less
than Rs 200 lakh

AFCs – Asset Finance Companies

LCs – Loan Companies

ICs – Investment Companies

V. ACCEPTANCE OF PUBLIC DEPOSITS

All NBFCs are not entitled to accept public deposits. Only those NBFCs holding a valid Certificate of Registration with authorisation to accept Public Deposits can accept/hold public deposits. NBFCs authorised to accept/hold public deposits besides having minimum stipulated Net Owned Fund (NOF) should also comply with the Directions such as investing part of the funds in liquid assets, maintain reserves, rating etc. issued by the Bank.

5.1 Public Deposit

The term 'deposit' is defined under Section 45 I(bb) of the RBI Act, 1934. 'Deposit' includes and shall be deemed always to have included any receipt of money by way of deposit or loan or in any other form but does not include:

- i. amount raised by way of share capital, or contributed as capital by partners of a firm;

- ii. amount received from scheduled bank, co-operative bank, a banking company, State Financial Corporation, IDBI or any other institution specified by RBI;
- iii. amount received in ordinary course of business by way of security deposit, dealership deposit, earnest money, advance against orders for goods, properties or services;
- iv. amount received by a registered money lender other than a body corporate;
- v. amount received by way of subscriptions in respect of a 'Chit'.

Paragraph 2(1)(xii) of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 defines a ' public deposit' as a 'deposit' as defined under Section 45 I(bb) of the RBI Act, 1934 and further excludes the following:

- i. amount received from the Central/State Government or any other source where repayment is guaranteed by Central/State Government or any amount received from local authority or foreign government or any foreign citizen/authority/person;
- ii. any amount received from financial institutions;
- iii. any amount received from other company as inter-corporate deposit;
- iv. amount received by way of subscriptions to shares, stock, bonds or debentures pending allotment or by way of calls in advance if such amount is not repayable to the members under the articles of association of the company;
- v. amount received from shareholders by private company;
- vi. amount received from directors or relative of the director of a NBFC;
- vii. amount raised by issue of bonds or debentures secured by mortgage of any immovable property or other asset of the company subject to conditions;
- viii. the amount brought in by the promoters by way of unsecured loan;
- ix. amount received from a mutual fund;
- x. any amount received as hybrid debt or subordinated debt;
- xi. any amount received by issuance of Commercial Paper.

5.2 Minimum Credit rating

An unrated NBFC, except certain Asset Finance companies (AFC), cannot accept public deposits. An exception is made in case of unrated AFC companies with CRAR of 15% which can accept public deposit up to 1.5 times of the NOF or Rs 10 crore whichever is lower without having a credit rating. A NBFC may get itself rated by any of the four rating agencies namely, CRISIL, CARE, ICRA and FITCH Ratings India Pvt. Ltd.

Approved Credit Rating Agencies and Minimum Investment Grade Credit Rating

The names of approved credit rating agencies and the minimum credit rating shall be as follows:-

Name of the agency Rating	Minimum investment Grade
(a) The Credit Rating Information Services of India Ltd. (CRISIL)	FA-(FA Minus)
(b) ICRA Ltd.	MA-(MA Minus)
(c) Credit Analysis & Research Ltd. (CARE)	CARE BBB(FD)
(d) Fitch Ratings India Private Ltd.	tA-(ind)(FD)]

Upgrading/ downgrading of credit rating

In the event of upgrading or downgrading of credit rating of any non-banking financial company to any level from the level previously held by the non banking financial company, it shall within fifteen working days of its being so rated inform, in writing, of such upgrading/ downgrading to the Reserve Bank of India.

If rating of a NBFC is downgraded to below minimum investment grade rating, it has to stop accepting public deposit, report the position within fifteen working days to the RBI and reduce within three years from the date of such downgrading of credit rating, the amount of excess public deposit to nil or to the appropriate extent permissible under

paragraph 4(4) of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998; however such NBFC can renew the matured public deposits subject to repayment stipulations specified above and compliance with other conditions for acceptance of deposits.

NBFCs also issue financial products like Commercial Paper, Debentures etc. to which rating is assigned by rating agencies. The ratings assigned to such products may undergo changes for various reasons ascribed to by the rating agencies.

It has been clarified vide DNBS (PD) CC. No.134/03.10.001 / 2008-2009 February 04, 2009 that all NBFCs (both deposit taking and non-deposit taking) with asset size of Rs 100 crore and above shall furnish the information about downgrading / upgrading of assigned rating of any financial product issued by them, within fifteen days of such a change in rating, to the Regional Office of the Bank under whose jurisdiction their registered office is functioning.

The NBFCs are allowed to accept/renew public deposits for a minimum period of 12 months and maximum period of 60 months. The RNBCs have different norms for acceptance of deposits

5.3 Period of Deposit

The NBFCs are allowed to accept/renew public deposits for a minimum period of 12 months and maximum period of 60 months. The RNBCs have different norms for acceptance of deposits

5.4 Prohibition from accepting demand deposit

No NBFC can accept/renew any public deposit which is payable on demand.

5.5 Interest on Public Deposit

NBFCs cannot offer interest rates higher than the ceiling rate prescribed by RBI from time to time. The present ceiling is 12.5 per cent per annum (on and from April 24, 2007). The interest may be paid or compounded at rests not shorter than monthly rests. This is the maximum permissible rate an NBFC can pay on its public deposits and they may offer lower rates.

5.6 Payment of brokerage

On and from January 31, 1998 no non-banking financial company shall pay to any broker on public deposit collected by or through him, -

- (i) brokerage, commission, incentive or any other benefit by whatever name called, in excess of two per cent of the deposit so collected; and
- (ii) Expenses by way of reimbursement on the basis of relative vouchers/bills produced by him, in excess of 0.5 percent of the deposit so collected.

5.7 Particulars to be specified in application form soliciting public deposits

No non-banking financial company shall accept or renew any public deposit except on a written application from the depositor in the form to be supplied by the company, which form shall contain all the particulars specified in the Non-Banking Financial Companies and Miscellaneous Non-Banking Companies (Advertisement) Rules, 1977, made under section 58A of the Companies Act, 1956 and also contain the specific category of the depositor, i.e. whether the depositor is a shareholder or a director or a promoter of the company or a member of public.

The application form should also contain the following :-

- (a) the credit rating assigned for its fixed deposit and the name of the credit rating agency which rated the company;
- (b) in case of non-repayment of the deposit or part thereof as per the, the depositor may approach Company Law Board;
- (c) in case of any deficiency of the company in servicing its deposit, the depositor may approach the National Consumers Disputes Redressal Forum, the State Level

Consumers Disputes Redressal Forum or the District Level Consumers Disputes Redressal Forum for relief;

(d) a statement that the financial position of the company as disclosed and the representations made in the application form are true and correct and that the company and its Board of Directors are responsible for the correctness and veracity thereof;

(e) the financial activities of the company are regulated by the Reserve Bank of India;

(f) at the end of application form but before the signature of the depositor, the following verification clause by the depositor should be appended:

“I have gone through the financials and other statements / particulars / representations furnished / made by the company and after careful consideration I am making the deposit with the company at my own risk and volition”.

5.8 Furnishing of receipts to depositors

Every non-banking company shall furnish to every depositor or his agent, a receipt for every amount which has been or which may be received by the company by way of deposit

The said receipt shall be duly signed by an officer entitled to act for the company in this behalf and shall state the date of deposit, the name of the depositor, the amount in words and figures received by the company by way of deposit, the rate of interest payable thereon and the date on which the deposit is repayable.

5.9 Liquid Asset Requirement

In terms of Section 45-IB of the RBI Act, 1934, from 13th February 2009, 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 shall be entitled to invest an amount equal to or in excess of 10% of public deposits, in unencumbered approved securities and the remaining 5% in

unencumbered (a) term deposits in any scheduled commercial bank, Small Industries Bank (SIDBI) or National Bank for Agriculture and Rural Development (NABARD) or (b) bonds issued by SIDBI or NABARD.

Provided further that, the aggregate of the amount invested in unencumbered approved securities, term deposits and the bonds as aforesaid shall not be less than 15 percent of public deposits.

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 an 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 the permission of RBI in writing. It may be noted that 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.

5.10 Register of deposits

Every non-banking company shall keep one or more registers in which shall be entered separately in the case of each depositor the following particulars, namely-

- (a) name and address of the depositor,
- (b) date and amount of each deposit,
- (c) duration and the due date of each deposit,
- (d) date and amount of accrued interest or premium on each deposit,
- (e) date of claim made by the depositor,

- (f) date and amount of each repayment, whether of principal, interest or premium,
- (g) the reasons for delay in repayment beyond five working days and

- (h) any other particulars relating to the deposit.

The register or registers aforesaid shall be kept at the registered office of the company and shall be preserved in good order for a period of not less than eight calendar years following the financial year in which the latest entry is made of the repayment or renewal of any deposit of which particulars are contained in the register:

5.11 Information to be included in the Board's report

In every report of the Board of Directors laid before the company in general meeting under sub-section (1) of section 217 of the Companies Act, 1956 (1 of 1956) after the date

of commencement of these directions, there shall be included in the case of non-banking company, the following particulars or information, namely:

(a) the total number of depositors of the company whose deposits have not been claimed by the depositors or paid by the company after the date on which the deposit became due for repayment or renewal; and

(b) the total amount due to the depositors and remaining unclaimed or unpaid beyond the dates referred to as aforesaid.

(2) The said particulars or information shall be furnished with reference to the position as on the last date of the financial year to which the report relates and if the amounts remaining unclaimed or undisbursed as referred to above exceed in the aggregate the sum of rupees five lakhs, there shall also be included in the report a statement on the steps taken or proposed to be taken by the Board of Directors for the repayment of the amounts due to the depositors and remaining unclaimed or undisbursed.

5.12 Register of deposits

Every non-banking company shall keep one or more registers in which shall be entered separately in the case of each depositor the following particulars, namely-

(a) name and address of the depositor,

(b) date and amount of each deposit,

(c) duration and the due date of each deposit,

(d) date and amount of accrued interest or premium on each deposit,

(e) date of claim made by the depositor,

(f) date and amount of each repayment, whether of principal, interest or premium,

(g) the reasons for delay in repayment beyond five working days and

(h) any other particulars relating to the deposit.

The register or registers aforesaid shall be kept at the registered office of the company and shall be preserved in good order for a period of not less than eight calendar years following the financial year in which the latest entry is made of the repayment or renewal of any deposit of which particulars are contained in the register:

5.13 Information to be included in the Board's report

In every report of the Board of Directors laid before the company in general meeting under sub-section (1) of section 217 of the Companies Act, 1956 (1 of 1956) after the date of commencement of these directions, there shall be included in the case of non-banking company, the following particulars or information, namely:

(a) the total number of depositors of the company whose deposits have not been claimed by the depositors or paid by the company after the date on which the deposit became due for repayment or renewal; and

(b) the total amount due to the depositors and remaining unclaimed or unpaid beyond the dates referred to as aforesaid.

(2) The said particulars or information shall be furnished with reference to the position as on the last date of the financial year to which the report relates and if the amounts remaining unclaimed or undisbursed as referred to above exceed in the aggregate the sum of rupees five lakhs, there shall also be included in the report a statement on the steps taken or proposed to be taken by the Board of Directors for the repayment of the amounts due to the depositors and remaining unclaimed or undisbursed.

5.14 Default in repayment of Deposit

If a NBFC defaults in repayment of deposit, the depositor can approach

a) Company Law Board (CLB) or / and

b) Consumer Forum or file a civil suit to recover the deposits.

A depositor can approach any or all of these redressal authorities' i.e consumer forum, court or CLB.

a) Depositor approaches the CLB

Where a non-banking financial company fails to repay any deposit or part thereof in accordance with the terms and conditions of such deposit, the Company Law Board (CLB) either on its own motion or on an application from the depositor directs, by order, the non-banking financial company to make repayment of such deposit or part thereof forthwith or within such time and subject to such conditions as may be specified in the order.

The depositor can approach CLB by mailing an application in prescribed form to the appropriate bench of the Company Law Board according to its territorial jurisdiction with the prescribed fee.

Relevant Forms as laid down in Company law Board Regulations, 1991 are:

Form 1 - Form of petition to company law board

Form 2- Interlocutory application

Form 3- Reference to Company Law Board

Form 4- Application By Depositor / Debenture Holder Under Section 58A(9) or Section 117C(4) of the Act Or Section 45QA of The Reserve Bank Of India Act, 1934

The details of addresses and territorial jurisdiction of the bench officers of CLB are as under:

Sr. No.	Addresses	Territorial Jurisdiction
1.	Bench Officer, Company Law Board, Northern Region Bench, Shastri Bhavan, 'A' Wing, 5 th Floor,	Uttar Pradesh, Jammu & Kashmir, Punjab, Himachal Pradesh, Rajasthan, Haryana and Union

	Dr. Rajendra Prasad Road, New Delhi 110 001.	Territories of Chandigarh and Delhi
2.	Bench Officer, Company Law Board, Southern Region Bench, Shastri Bhavan, 'A' Wing, 5 th Floor, Block 8, No 26, Haddows Road, Chennai 600 006.	Tamil Nadu, Andhra Pradesh, Kerala, Karnataka, Union Territories of Amindivi, Minicoy and Lakshadweep Islands and Pondicherry
3.	Bench Officer, Company Law Board, Western Region Bench, 2 nd Floor, N.T.C. House, 15, Narottam Morarjee Marg, Ballard Estate, Mumbai-400 038.	Maharashtra, Gujarat, Madhya Pradesh, Goa and Union Territories of Dadra & Nagar Haveli, Daman and Diu.
4.	Bench Officer, Company Law Board, Eastern Region Bench, 9, Old Post Office Street, 6 th Floor, Kolkata 700 001.	West Bengal, Orissa, Bihar, Assam, Tripura, Manipur, Nagaland, Meghalaya, Arunachal Pradesh, Mizoram, Union Territories of Andaman and Nicobar Islands.
5.	Bench Officer, Company Law Board, Principal Bench at New Delhi, Shastri Bhavan, 'A' Wing, 5 th Floor, Dr. Rajendra Prasad Road, New Delhi 110 001.	All Principal Bench matters all over India.

b) Depositor approaches the Court and an official liquidator is appointed :

In a number of cases official liquidators have been appointed on the defaulting NBFCs. Official Liquidator is appointed by the court after giving the company reasonable opportunity of being heard in a winding up petition. The liquidator performs duties of winding up and such duties in reference thereto as the court may impose.

Where the court has appointed an official liquidator or provisional liquidator, he becomes custodian of the property of the company and runs the day-to-day affairs of the company. He has to draw up a statement of affairs of the company in prescribed form containing particulars of assets of the company, its debts and liabilities, names/residences/occupations of its creditors, the debts due to the company and such other information as may be prescribed. The scheme is drawn up by the liquidator and same is put up to the court for approval. The liquidator realizes the assets of the company and arranges to repay the creditors according to the scheme approved by the court. The liquidator generally inserts advertisement in the newspaper inviting claims from depositors/investors in compliance with court orders. Therefore, the investors/depositors should file the claims within due time as per such notices of the liquidator. The Reserve Bank also provides assistance to the depositors in furnishing addresses of the official liquidator.

c) No Ombudsmen

There is no Ombudsman for hearing complaints against NBFCs. However, in respect of credit card operations of an NBFC, if a complainant does not get satisfactory response from the NBFC within a maximum period of 30 days from the date of lodging the complaint, the customer will have the option to approach the Office of the concerned Banking Ombudsman for redressal of his grievance/s.

5.14 Interest on overdue matured deposits

As per Reserve Bank's Directions, overdue interest is payable to the depositors in case the company has delayed the repayment of matured deposits, and such interest is payable from the date of receipt of such claim by the company or the date of maturity of the deposit whichever is later, till the date of actual payment. If the depositor has lodged his claim after the date of maturity, the company would be liable to pay interest for the period from the date of claim till the date of repayment. For the period between the date of maturity and the date of claim it is the discretion of the company to pay interest.

5.15 Prepayment of deposits

A NBFC accepts deposits under a mutual contract with its depositors. In case a depositor requests for pre-mature payment, Reserve Bank of India has prescribed Regulations for such an eventuality in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 wherein it is specified that NBFCs cannot grant any loan against a public deposit or make premature repayment of a public deposit within a period of three months (lock-in period) from the date of its acceptance, however in the event of death of a depositor, the company may, even within the lock - in period, repay the deposit at the request of the joint holders with survivor clause / nominee / legal heir only against submission of relevant proof, to the satisfaction of the company.

An NBFC subject to above provisions, if it is not a problem company, may permit after the lock-in period premature repayment of a public deposit at its sole discretion, at the rate of interest prescribed by the Bank.

A problem NBFC is prohibited from making premature repayment of any deposits or granting any loan against public deposits/deposits, as the case may be. The prohibition

shall not, however, apply in the case of death of depositor or repayment of tiny deposits i.e. up to Rs. 10000/- subject to lock in period of 3 months in the latter case.

VI SUBMISSION OF RETURNS

A. NBFCs accepting public deposits

- i. Audited balance sheet of each financial year and an audited profit and loss account in respect of that year as passed in the general meeting together with a copy of the report of the Board of Directors and a copy of the report and the notes on accounts furnished by its Auditors;
- ii. Statutory Annual Return on deposits - NBS 1;
- iii. Certificate from the Auditors that the company is in a position to repay the deposits as and when the claims arise;
- iv. Quarterly Return on liquid assets;
- v. Half-yearly Return on prudential norms;
- vii. Half-yearly Asset Liability Management (ALM) Returns by companies having public deposits of Rs. 20 crore and above or with assets of Rs. 100 crore and above irrespective of the size of deposits ;
- viii. Monthly return on exposure to capital market by companies having public deposits of Rs. 50 crore and above; and
- ix. A copy of the Credit Rating obtained once a year along with one of the Half-yearly Returns on prudential norms as at (v) above.

B. MNBCs

- i. Statutory Annual Return on deposits - NBS 1;

C. RNBCs

- i. Annual Return by RNBCs (in NBS 1A)
- ii. Half Yearly Statement of Capital Funds, Risk Assets, Asset Classification etc. (NBS 2)
- iii. Quarterly Return on Statutory Liquid Assets (NBS 3A)

iv. Quarterly Monetary and Supervisory Return (in NBS 5) by RNBCs holding Public Deposits of Rs. 20 crore and above as per the last balance sheet.

v. Monthly Return on Capital Market Exposure (NBS 6) by RNBCs having aggregate liabilities to the depositors of Rs. 50 crores and above.

D. NBFCs having assets of Rs. 100 crore and above but not accepting public deposits

i. The NBFCs having assets of Rs. 100 crore and above but not accepting public deposits are required to submit a Monthly Return on important financial parameters of the company. All companies not accepting public deposits have to pass a board resolution to the effect that they have neither accepted public deposit nor would accept any public deposit during the year.

ii. NBFCs with asset size of Rs 50 crore and above but less than Rs 100 crore were advised to submit online, a quarterly return on important financial parameters, the first such return to be submitted within first week of December 2008. Further the above return has to be submitted as hard copy and soft copy (via e-mail in Excel format) to the Regional Office of the Department of Non-Banking Supervision in whose jurisdiction their company is registered, within a period of one month from the close of the quarter, till the online procedure in this regard is advised.

E. NOTES

1. All NBFCs (including non-deposit taking) should submit a certificate from their Statutory Auditors every year to the effect that they continue to undertake the business of NBFIs requiring holding of CoR under Section 45-IA of the RBI Act, 1934.

2. RBI has powers to cause Inspection of the books of any company and call for any other information about its business activities. For this purpose, the NBFC is required to furnish the information in respect of any change in the composition of its Board of Directors, address of the company and its Directors and the name/s and official designations of its principal officers and the name and office address of its Auditors. With effect from April 1, 2007, non-deposit taking NBFCs with assets of Rs 100 crore and above were advised to maintain minimum CRAR of 10% and also comply with

single/group exposure norms. The companies have to achieve CRAR of 12% by March 31, 2009 and 15% by March 31, 2010.

3. The Ministry of Company Affairs has taken over the entire regulation of Mutual Benefit Financial Companies (Notified Nidhis) and Mutual Benefit Companies (Potential Nidhis). The position regarding submission of Annual Returns by MBFCs and MBCs has been reviewed by the Department and it has been decided not to call for Annual Return in First Schedule, audited balance sheet & profit and loss account, auditor's certificate and other particulars as contained in paragraph 8 of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998. However, once the application of MBCs (Potential Nidhis) for grant of nidhi status is rejected by the Ministry of Company Affairs, the provisions of the said Directions as applicable to NBFCs would apply to such companies.

6.1 Returns and Forms to be filed by NBFCs

a. ANNUAL

1. FORM NBS-1

^ (Annual Return on deposits as on 31st March 20-----)

- To be submitted by all NBFCs accepting/holding public deposits and MNBCs - Except RNBCs
- To be submitted to the Regional Office of Deptt. Of Non Banking Supervision, RBI, where the NBFCs/MNBCs registered office is situated.
- To be submitted Once a year after 31st March and latest by September 30th, with reference to its position as on 31st March, irrespective of the date of closing of the financial year of the Company concerned

- A Certificate from the Auditors of the Company should be appended to the Return in the prescribed format
- In respect of Part 3 of the Return (pertaining to Net Owned Fund)- the information should be furnished as per the latest balance sheet but preceding the date of the return.

In terms of Notification No.DNBS.135/CGM\ (VSNM)-2000, dated 13-1-2000, NBFCs shall prepare their balance sheets and profit and loss accounts as on March 31, every year with effect from its accounting year ending with 31st March 2001. Therefore with effect from accounting year ending 31st March 2001, the information in Part 3 of the return shall be as on the date of current balance sheet thus coinciding with the date of return.

- Submission of the Return should not be delayed for any reason such as the finalisation/ completion of the audit of the annual accounts. The compilation of the Return should be on the basis of the figures available in the books of accounts of the company and should be certified by its Statutory Auditors.
- The number of accounts should be given in actual figures while the amounts of deposits should be shown in lakhs of rupees. The amount should be rounded off to the nearest lakh. Illustratively, an amount of Rs.4,56,100 should be shown as 5 and not as 4.6 or 5,00,000. Similarly, an amount of Rs.61,49,500 is to be shown as 61 and not as 61.5 or 61,00,000.
- The Return should be signed by a Manager (as defined in Section 2 of the Companies Act, 1956) and if there is no such Manager, by Managing Director or any official of the Company who has been duly authorised by the Board of Directors and whose Specimen Signature has been furnished to the Reserve Bank of India for the purpose. In case the Specimen Signature has not been furnished in the prescribed card, the Return must be signed by the authorised official and his Specimen Signature furnished separately.
- In case there is nothing to report in any part / item of the Return, the relevant part/ item may be marked '*Nil*' in the column meant for "*No. of accounts*" and *00s* may be indicated in the column meant for "*Amount*".

- 'Subsidiaries' and 'Companies in the same group' mentioned in this Return have the same meanings assigned to them in Section 4 and Section 372 (11) respectively, of the Companies Act, 1956 as appearing prior to amendment to the Companies Act dated 31st October 1998.
- In case this return is being filed through electronic media(internet), to the specified Web Server, a hard -copy of the same may be submitted to the concerned Regional Office duly signed .

2. FORM NBS-7

(Annual Statement of Capital Funds, Risk assets/exposures and Risk Asset Ratio etc., as at end of March 20---)

Introduced vide Circular No. DNBS.PD/CC.No.93/03.05.002/2006-2007, dated 27.04.2007.

b. HALF YEARLY

FORM NBS- 2

(Half Yearly Statement of Capital Funds, Risk Assets / Exposures and Risk Asset Ratio etc. as at the end of March/ September 20----)

Form NBS-2 introduced vide Notification No. DNBS.192/DG (VL)-2007, dated 22-2-2007.

This Return is divided into 10 parts- A,B,C,D,E,F,G,H,I,J.

It has to be accompanied by a certification from the MD/CEO of the Company.

It has to be accompanied by a Auditor's Report from the Statutory auditors of the Company

c. QUARTERLY RETURN

FORM NBS-3

Quarterly Return on Statutory Liquid Assets for the 4 quarters (ended March/June/September/December 20--)

Its divide into 3 parts- A,B and C and is accompanied by 4 Annexures.

Annexure 1: List of Approved Securities Held Towards Liquid Asset Requirement

Annexure 2: List of Deposits Held with Scheduled Commercial Banks

Annexure 3: Name and Address of the Designated Bank/ Depository through a Depository Participant /the Bank where the Constituents' Subsidiary General Ledger Account is maintained.

d. MONTHLY RETURNS

1. Monthly Return by NBFCs not accepting deposits and having asset size of Rs.100cr and above.

It is the monthly return on important parameters of NBFCs not accepting/holding public deposits and having asset size of Rs.100cr and above.

It gives information on:

- Co. profile
- Sources of Funds
- Application of Funds
- Requirements as to profit and loss account
- Asset classification
- Percentage of NPAs
- Banks/Fis exposure on the Co.
- Co.'s exposure to group/ associate/ related parties
- Details of Capital Market Exposure
- Foreign Sources of Funds

It has Certification by the Managing Director and is also Certified by the Aiditors of the Co.

Enclosures to this return include:

1. Specimen Signature cards
2. List of Principal Officers and names & addresses of Directors
3. A copy of the Audited Balance Sheet(with schedules) for the quarter ended March.

2. FORM NBS-6 Monthly Return on Exposure to Capital Market

- Introduced vide Notification No. DNBS.192/DG (VL)-2007, dated 22-2-2007.
- This return is to be filled by all deposit taking NBFCs having total assets of Rs 100 crore and above as on March 31 of the previous year

(e.g. for the return for the month of April 2007 or October 2007 the base date total assets would be March 2007, similarly for the return for the month of March 2008 base date total assets would be March 2007). In the absence of audited figures, provisional figures may be taken for the purpose.

- The return should be submitted to the Regional Office of the Department of Non-Banking Supervision, Reserve Bank of India under whose jurisdiction its Registered Office is situated.
- **Definition of capital market exposure (CME)**

The CME, for the purpose of this return, would be the aggregate of exposures of the company in the form of:

- (i) investment in quoted equity shares, quoted compulsorily convertible preference shares (CCPS), quoted convertible bonds and debentures and quoted units of primarily equity oriented mutual funds;
- (ii) loans and advances against securities at (i) above, including those for financing of IPOs, etc.

- (iii) secured and unsecured loans and advances to and guarantees issued on behalf of stock brokers; and
- (iv) underwriting commitments in respect of equity related primary issues including through book building route; and
- (v) any other equity related exposure to capital market.

The CME does not cover acceptance of shares, debentures, units of mutual funds, etc. assigned to the NBFCs and RNBCs as collateral or additional security, if they are accepted as per normal business practice and appraisal procedure, as also the investments by RNBCs in compliance with the provisions of paragraph 6 of the Residuary Non-Banking Companies (Reserve Bank) Directions, 1987.

- ‘Subsidiaries’ and ‘Companies in the same group’ mentioned in this Return have the same meanings assigned to them in Section 4 and Section 372 (11) respectively, of the Companies Act, 1956.
- Turnover means total of sales and purchases in the same category of investments.
- In case there is nothing to report in any part / item of the Return, **00s** may be indicated in the column(s) meant for “Amount”.
- The Return should be signed by any of the Principal Officers as given in the Annual return on deposits (NBS-1/NBS-1A).
- The term Gross Purchases indicates exposures which result in increase in capital market exposure and Gross Sales means exposure which result in decline in capital market exposure of the NBFC/RNBC.

The Return is divided into 3 parts:

Part 1= Quoted Investments

Part2= Unquoted Investments

Part3= Position as per last audited Balance Sheet

3. Form - NBS - 4 Monthly return on repayment of deposits

The Reserve Bank has put in place comprehensive regulatory and supervisory mechanism for Non-Banking Financial Companies (NBFCs) to ensure that these companies work on sound and healthy lines and the interests of the depositors are adequately protected. RBI Amendment Act, 1997 has made it mandatory for NBFCs to obtain Certificate of Registration from the Bank as a pre-requisite for commencing or continuing the business of a NBFC. On application, the Bank grants CoR to the companies under Section 45-1A of RBI Act, 1934 on fulfillment of criteria laid down therein. Further companies can hold CoR only as long as they continue to fulfil these requirements. In case a company does not fulfil the conditions for grant of CoR or continuance of CoR, the Bank rejects the application of the company or cancels the CoR granted to it, as the case may be.

The regulatory and supervisory attention of the Bank is being focussed on companies which are holding public deposits.

In order to protect the interests of depositors and to monitor the repayment of public deposits of companies holding public deposits and whose applications have been rejected or Certificates of Registration have been cancelled, the Bank has devised a new return, NBS-4, to be submitted by such companies on a monthly basis to the Regional Office under whose jurisdiction the registered office of the company is located.

The return has been introduced from June 30, 2000 and the rejected companies have been advised accordingly.

4. FORM NBS-5 Monetary and Supervisory Return

To be submitted by all Non-Banking Financial Companies, and Residuary Non-Banking Companies covered by Para 8 (3) of Notification No.DFC.118/DG(SPT)-98 dated January 31, 1998 and para 2 of the RNBC (Reserve Bank) Directions 1987

respectively , holding public deposits of Rs 20 Crore and above as per the last audited balance sheet

NBFC's not accepting public deposits but having asset size of Rs.100crore and above

In order to monitor the activities of nonbanking financial companies not accepting/ holding public deposits (NBFCs-ND), a system of quarterly reporting was introduced in respect of companies having asset size of Rs.500 crore and above. The reporting system in the prescribed format for such NBFCs-ND was put in place beginning September 2004. The arrangement was reviewed and it was felt that the intervening period of one quarter was too long to take informed and timely decisions. The periodicity for the submission of the return was, therefore, changed from quarterly to monthly from September 2005.

Similarly, with a view to increasing the coverage of NBFCs, the threshold level was raised by making the reporting system applicable to NBFCs with asset size of Rs.100 crore and above, beginning September 2005, instead of Rs.500 crore and above earlier.

Documents / Compliance required to be submitted to the Reserve Bank of India by the NBFCs not accepting/holding public deposits

a. RBI DNBS Circular No. DNBS.PD/ CC.No.130 / 03.05.002 /2008-09- Dated 24.09.2008
-Monitoring Framework for non-deposit taking NBFCs

Reserve bank of India has decided to call for the basic information from non-deposit taking NBFCs with asset size of Rs 50 crore and above but less than Rs 100 crore at quarterly intervals and returns for the quarter ended September 2008 may be submitted by first week of December 2008. At the end of each quarter , these quarterly return could be filed online with the Regional Office of the Department of Non-Banking Supervision in whose jurisdiction company is registered.

b. The NBFCs having assets size of Rs. 100 crore and above but not accepting public deposits are required to submit a Monthly Return on important financial parameters of the company. All companies not accepting public deposits have to pass a board resolution to the effect that they have neither accepted public deposit nor would accept any public deposit during the year.

c. All NBFCs including non-deposit taking should submit a certificate from their Statutory Auditors every year to the effect that they continue to undertake the business of NBFI requiring holding of CoR under Section 45-IA of the RBI Act, 1934.

VII REGULATORY FRAMEWORK OF NBFC

All NBFCs, being companies registered under the Companies Act, have to fulfill compliance relating to the Board of Directors, Share Capital, Management Structure, Audits, Meetings, maintenance as well as publication of books of accounts and general conduct as per the requirements of the Companies Act 1956.

In addition, they have to fulfill the specific requirements of the RBI as set out in the Directions and various notifications and amendments by the RBI.

7.1 Relevant Regulations

I. GENERAL

1. Principle business of NBFC
2. Chapters IIIB, IIIC and V of the Reserve Bank of India Act,1934
3. Master Circular- Exemptions from the provisions of RBI Act, 1934 -July 01,2008
4. Sec 58A, 58AA,58AAA and 58 B of the Companies Act,1956
Section 58A: Deposits not to be invited without issuing an advertisement
Section 58AA: Small Depositors
Section 58AAA: Default in acceptance or refund of deposits to be cognizable

Section 58B. Provisions relating to prospectus to apply to advertisement

5. Companies (Acceptance of Deposit) Rules, 1975
6. Companies (Acceptance of Deposits Amendment) Rules, 1997
7. Companies (Application for Extension of time or Exemption under sub-section (8) of section 58A) Rules, 1979
8. Foreign Exchange Management (Deposit) Regulations, 2000 [FEMA-5]
9. Foreign Exchange Management (Transfer or issue of Security by a Person Resident outside India) Regulations, 2000][FEMA 20]
10. Guidelines for issue of Commercial paper- July 01,2008
11. Securities Contracts (Regulation) Act 1956

CHAPTER IIIB OF RBI ACT 1934

Provisions relating to Non banking Institutions receiving deposits and Financial Institutions

45H : Chapter IIIB not to apply in certain cases

45 I : Definitions

45-IA : Requirement of Registration and Net owned Fund

45-IB: Maintenance of percentage of assets

45-IC: Reserve Fund

45J: Regulation by Bank on Prospectus

45JA: Power of RBI to determine Policy and issue Directions

45K: Power of RBI to collect information from NBI as to deposits and give Directions

45L: Power of RBI to call information from FI and give Directions

45M: Duty of NBI to furnish statements etc. required by Bank

45MA: Powers & Duties of Auditors

45MB: Power of RBI to prohibit acceptance of deposit and alienation of assets

45MC: Power of RBI to file winding up petition

45N: Inspection

45NA: Deposits not to be solicited by unauthorized person

45NB: Disclosure of Information

45NC: Power of Bank to exempt

45Q: Chapter IIIB to override other laws

45QA: Power of CLB to offer repayment of deposit

45QB: Nomination by Depositors

II. Non Banking Financial Companies

1. Reserve Bank of India (Non Banking Financial Companies) Returns Specifications, 1997

2. Non Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998.
3. Non Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2008
4. Minimum Net Owned Fund (NOF) for commencement of business of a Non-Banking Financial Institution (NBFI)- April 20, 1999
5. 'Know Your Customer' (KYC) Guidelines - Anti Money Laundering Standards -[all NBFC, MNBC, RNBC]-February 21, 2005
6. KYC for persons authorised by NBFCs including brokers/agents etc. to collect public deposit on behalf of NBFCs - October 11, 2005 [excluding RNBC]
7. Financial Regulation of Systemically Important NBFCs and Banks Relationship with them-12.12.2006 [All Non-Banking Financial Companies (deposit taking and non-deposit taking)
8. Guidelines on Corporate Governance - May 8, 2007
9. Guidelines on Fair Practices Code for Non-Banking Financial Companies- October 10, 2007
10. FIMMDA Reporting Platform for Corporate Bond Transactions- July 31, 2007
11. Non Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007
12. Non Banking Financial (Non Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.
13. Master circular- Bank Finance to Non-Banking Financial Companies (NBFCs)- July 2, 2007
14. Draft Guidelines issued by RBI for NoC to open Offices or Undertaking Investment Abroad by NBFCs - January 24, 2008
15. Frauds - Future approach towards monitoring of frauds in NBFCs- July 01, 2008 [all NBFC including RNBC]

16. Section 45-IA, 45K and 45L of the RBI Act - Grant of CoR - Requirement of minimum NOF of Rs. 200 lakh for all deposit taking NBFCs[All deposit taking NBFCs - June 17, 2008]
17. Master Circular - "Non-Banking Financial (Non - Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007" - July 1, 2008
18. Reclassification of NBFC[excluding RNBC]- September 15, 2008
19. Regulation of excessive interest charged by NBFC- Jan 02,2009
20. Rating of NBFC- Feb 04,2009
21. Prevention of Money Laundering Act, 2002 - Obligation of NBFCs in terms of Rules notified there under - Aug 05,2008
22. Section 45-IA, 45K and 45L of the RBI Act - Grant of CoR - Requirement of minimum NOF of Rs. 200 lakh for all deposit taking NBFCs - June 17,2008

III. The Housing Finance Companies (NHB) Directions 2001

IV. Mortgage Guarantee Companies

1. Mortgage Guarantee Companies Prudential Norms (Reserve Bank) Directions, 2008 and Mortgage companies Investment (Reserve Bank) Directions, 2008
2. Regulatory Framework for Mortgage Guarantee Company- January 15, 2008
3. Mortgage Guarantee Company (Reserve Bank) Guidelines, 2008

V. Securitisation Companies and Reconstruction Companies

1. The Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003
2. Schedule to The Securitisation Companies or Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003

3. Exemption to Securitisation or Reconstruction Companies from RBI Act- August 28, 2003
4. Quarterly Statement to be submitted by Securitisation Companies/Reconstruction Companies registered with the Reserve Bank of India under Section 3(4) of the SARFAESI Act - September 26,2008
5. Guidelines on declaration of Net Asset Value of Security Receipts issued by Securitisation Company/ Reconstruction Company- May 28, 2007
6. Master Circular on directions/instructions issued to the Securitisation Companies and Reconstruction Companies - July 01,2008
7. Regulation of SCs/RCs-submission of returns and audited balance sheet by SCs/RCs - March 5, 2008

VI Miscellaneous Non-Banking Companies

1. Non-banking Financial Companies and Miscellaneous Non-Banking Companies (Advertisement) Rules, 1977.
2. Miscellaneous Non Banking Companies (Reserve Bank) Directions, 1977
3. Chit Funds Act,1982

VII Residuary Non Banking Companies (Reserve Bank) Directions, 1987

VIII Micro Financial Sector (Development and Regulation) Bill, 2007

IX Reports on Money Lending and Nidhis

1. Report of the Technical Group to Review Legislations on Money Lending
2. Report Of The Expert Group On Nidhis

X. State Laws on protection of interests of depositors in financial establishments

Some State Laws -

- a. Tamil Nadu Protection of Interest of Depositor's (Financial Establishments) Act 1997 [Tamil Nadu is the first state to enact such an act in the country]

- b. Maharashtra Protection of Interests of Depositors (In Financial Establishments) Act 1999
- c. The Delhi Protection Of Interests Of Depositors (In Financial Establishments) Act, 2001
- d. Bihar Protection of Interests of Depositors (In Financial Establishments) Act 2002
- e. Gujarat Protection of Interests of Depositors (In Financial Establishments) Act 2003
- f. The Madhya Pradesh protection of Depositor's Interest Act 2000

7.2 Prudential Norms

Two sets of detailed directions on Prudential Norm have been issued by Reserve Bank of India (RBI).

1. Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 [Contained in Notification No. DNBS. 192/ DG (VL)-2007 dated February 22, 2007 for deposit taking NBFCs]
2. Non-Banking Financial (Non- Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 [Contained in Notification No. DNBS.193/ DG (VL)-2007 dated February 22, 2007 for non-deposit taking NBFCs]

The directions interalia, prescribe guidelines on income recognition, asset classification and provisioning requirements applicable to NBFCs, exposure norms, constitution of audit committee, disclosures in the balance sheet, requirement of capital adequacy, restrictions on investments in land and building and unquoted shares.

Compliances to be made under the Directions are:

1. **Framing & Implementing Policies:** The Board of Directors shall frame investment policy for the company and implement the same. Also The BOD of every NBFC granting/intending to grant demand/call loans shall frame a policy for the company and implement the same.

2. **Accounting Standards and Guidance Notes** issued by “ICAI” shall be followed in so far as they are not inconsistent with any of these Directions.

3. **Disclosure in Balance Sheet** - Every NBFC shall separately disclose in its balance sheet the provisions made as per paragraph 9 of the Directions without netting them from the income or against the value of assets.

[According to Para 9 - Every NBFC shall, after taking into account the time lag between an account becoming non-performing, its recognition as such, the realisation 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 in the Paragraph]

4. A NBFC having assets of Rs. 50 crore and above as per its last audited balance sheet shall **constitute an Audit Committee**, consisting of not less than 3 members of its Board of Directors.

Explanation I: The Audit Committee constituted by a NBFC as required under Section 292A of the Companies Act, 1956 (1 of 1956) shall be the Audit Committee for the purposes of this paragraph.

Explanation II: The Audit Committee constituted under this paragraph shall have the same powers, functions and duties as laid down in Section 292A of the Companies Act, 1956 (1 of 1956).

5. Every NBFC shall **prepare its balance sheet and profit and loss account as on March 31**

every year.

Where a NBFC intends to extend the date of its balance sheet as per provisions of the Companies Act, it should take prior approval of the RBI before approaching the Registrar of Companies for this purpose.

Further, even in cases where the Bank and the ROC grant extension of time, the NBFC 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.

6. Every NBFC shall **append to its balance sheet**, the particulars in the schedule as set out in Annex to the Directions.

7. No NBFC shall undertake any **transaction in government security** in physical form through any broker. (It can undertake only through its CSGL Account or its Demat Account)

8. Submission of Statutory Auditor Certificate:

Every NBFC shall submit a Certificate from its Statutory Auditor that it is engaged in the business of NBFI requiring it to hold a Certificate of Registration under Section 45-IA of the RBI Act.

A certificate from the Statutory Auditor in this regard with reference to the position of the company as at end of the financial year ended March 31 may be submitted to the Regional Office of the Department of Non-Banking Supervision under whose jurisdiction the non-banking financial company is registered, latest by June 30, every year.

Such certificate shall also indicate the asset / income pattern of the NBFC for making it eligible for classification as Asset Finance Company, Investment Company or Loan Company.

9. Capital Adequacy Requirement: Every systemically important non-deposit taking NBFC 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 10% of its aggregate risk weighted assets on balance sheet and of risk adjusted value of off balance sheet items.

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

10. Loans against NBFCs own shares is prohibited

11. **Concentration of credit/investment:** The directions give the ceiling on the investment in shares of other companies by systemically important non-deposit taking NBFCs

12. There are prescribed norms relating to **Infrastructure Loans**

13. **Information in regard to change of address, directors, auditors, etc. to be submitted:**

Every NBFC not accepting/holding public deposit shall communicate, not later than 1 month from the occurrence of any change in:

- (a) the complete postal address, telephone number/s and fax number/s of the registered/corporate office;
- (b) the names and residential addresses of the directors of the company;
- (c) the names and the official designations of its principal officers;
- (d) the names and office address of the auditors of the company; and
- (e) the specimen signatures of the officers authorised to sign on behalf of the company

to the Regional Office of the Department of Non-Banking Supervision of the RBI as indicated in the Second Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998.

14. **Submission of half yearly return**

As per Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 all Deposit Accepting or Holding NBFCs including RNBCs shall submit a half-yearly return within 3 months of the expiry of the relative half-year as on September and March every year, in the format NBS 2 provided in Annex 2 to the Regional

Office of the Department of Non-Banking Supervision of the RBI under whose jurisdiction the registered office of the company is located as per Second Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 and Schedule B to Residuary Non-Banking Companies (Reserve Bank) Directions, 1987.

15. Exposure to Capital Market

As per Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 all Deposit Accepting or Holding NBFC (inclgd. RNBC) with total assets of Rs. 100 crore and above according to the previous audited balance sheet, shall submit a monthly return within a period of 7 days of the expiry of the month to which it pertains in the format NBS 6 provided in Annex 3 to the Regional Office of the Department of Non-Banking Supervision of the RBI as indicated in the Second Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 and Schedule B to the Residuary Non-Banking Companies (Reserve Bank) Directions, 1987.

7.3 Anti- Money Laundering Standards

Obligation of NBFCs in terms of The Prevention of Money Laundering Act, 2002 and Rules notified there under:

The Prevention of Money Laundering Act, 2002 (PMLA) is in force since 1st July 2005. Under PMLA certain exclusive and concurrent powers are conferred on the Director, Financial Intelligence Unit, India (FIU-IND).

Financial Intelligence Unit - India (FIU-IND) was set by the Government of India vide order dated 18th November 2004 as the central national agency responsible for receiving, processing, analyzing and disseminating information relating to suspect financial transactions. FIU-IND is an independent body reporting directly to the Economic Intelligence Council (EIC) headed by the Finance Minister.

Section 13(2) of the Prevention of Money Laundering Act, 2002, empowers the Director, FIU-IND to impose fine on any banking company, financial institution or intermediary for failure to

comply with the obligations of maintenance of records, furnishing information and verifying the identity of clients. The amount of fine may vary from ten thousand rupees to one lakh rupees for each failure.

Section 12 of the Prevention of Money Laundering Act, 2002 lays down following obligations on banking companies, financial institutions and intermediaries.

"12. (1) Every banking company, financial institution and intermediary shall -

(a) maintain a record of all transactions, the nature and value of which may be prescribed, whether such transactions comprise of a single transaction or a series of transactions integrally connected to each other, and where such series of transactions take place within a month;

(b) furnish information of transactions referred to in clause (a) to the Director within such time as may be prescribed;

(c) verify and maintain the records of the identity of all its clients, in such a manner as may be prescribed.

Provided that where the principal officer of a banking company or financial institution or intermediary, as the case may be, has reason to believe that a single transaction or series of transactions integrally connected to each other have been valued below the prescribed value so as to defeat the provisions of this section, such officer shall furnish information in respect of such transactions to the Director within the prescribed time. (2) The records referred to in sub-section (1) shall be maintained for a period of ten years from the date of cessation of the transactions between the clients and the banking company or financial institution or intermediary, as the case may be."

Obligations as per the RBI Notifications

- NBFCs were advised to go through the provisions of PMLA, 2002 and the Rules notified there under and take all steps considered necessary to ensure compliance with the requirements of section 12 of the Act

- NBFCs should also report information in respect of all transactions referred to in Rule 3 of the Prevention of Money Laundering Rules to the Director, Financial Intelligence Unit-India (FIU-IND).
- NBFCs are required to prepare a profile for each customer based on risk categorization. The need for periodical review of risk categorization has been emphasized.
- As a part of transaction monitoring mechanism, NBFCs are required to put in place an appropriate software application to throw alerts when the transactions are inconsistent with risk categorization and updated profile of customers.
- to ensure electronic filing of cash transaction report (CTR) and Suspicious Transaction Reports (STR) to FIU-IND. In case of NBFCs, where all the branches are not yet fully computerized, the Principal Officer of the NBFC should cull out the transaction details from branches which are not computerized and suitably arrange to feed the data into an electronic file with the help of the editable electronic utilities of CTR/STR as have been made available by FIU-IND on their website <http://fiuindia.gov.in>.
- make Cash Transaction Reports (CTR) to FIU-India for every month latest by 15th of the succeeding month. It is further clarified that cash transaction reporting by branches/offices of NBFCs to their Principal Officer should invariably be submitted on monthly basis (not on fortnightly basis) and the Principal Officer, in turn, should ensure to submit CTR for every month to FIU-IND within the prescribed time schedule.
- In regard to CTR, it is reiterated that the cut-off limit of Rupees ten lakh is applicable to integrally connected cash transactions also.
- pay special attention to all complex, unusual large transactions and all unusual patterns of transactions, which have no apparent economic or visible lawful purpose. The background including all documents/office records/memorandums pertaining to such transactions and purpose thereof should, as far as possible, be examined and the findings at branch as well as Principal Officer level should be properly recorded. These records are required to be preserved for ten years as is required under PMLA, 2002. Such records and related documents should be made available to help auditors in their work relating to scrutiny of transactions and also to Reserve Bank/other relevant authorities.

- The customer should not be tipped off on the STRs made by them to FIU-IND. It is likely that in some cases transactions are abandoned/aborted by customers on being asked to give some details or to provide documents. NBFCs should report all such attempted transactions in STRs, even if not completed by customers, irrespective of the amount of the transaction.
- NBFCs should make STRs if they have reasonable ground to believe that the transaction involve proceeds of crime generally irrespective of the amount of transaction and/or the threshold limit envisaged for predicate offences in part B of Schedule of PMLA, 2002 .

Know Your Customer (KYC) Guidelines

The RBI vide its Circular DNBS(PD).CC No. 34/10.01/2003-04 dated January 6, 2004 had issued guidelines on 'Know Your Customer' norms. NBFCs were advised to follow certain customer identification procedure for opening of accounts and monitoring transactions of a suspicious nature for the purpose of reporting it to appropriate authority.

These 'Know Your Customer' guidelines had been revisited in the context of the Recommendations made by the Financial Action Task Force (FATF) on Anti Money Laundering (AML) standards and on Combating Financing of Terrorism (CFT). These standards have become the international benchmark for framing Anti Money Laundering and combating financing of terrorism policies by the regulatory authorities.

Compliance with these standards by the banks/financial institutions/NBFCs in the country had become necessary for international financial relationships. The Department of Banking Operations and Development of Reserve Bank had issued detailed guidelines to the banks based on the Recommendations of the Financial Action Task Force and the paper issued on Customer Due Diligence(CDD) for banks by the Basel Committee on Banking Supervision.

These KYC guidelines are equally applicable to NBFCs. All NBFCs were advised to adopt the same with suitable modifications depending on the activity undertaken by them and ensure that a proper policy framework on 'Know Your Customer' and Anti-Money Laundering measures is formulated and put in place with the approval of the Board. It may also be ensured that NBFCs are fully compliant with the provisions of this circular before December 31, 2005.

Guidelines on 'Know Your Customer' Norms, contain the following -

- 'Know Your Customer' Standards
- Customer Acceptance Policy (CAP)
- Customer Identification Procedure (CIP)
- Monitoring of Transactions
- Risk Management
- Customer Education

7.4 Fair Practices code

Guidelines on Fair Practices Code- [DNBS (PD) CC No. 80 / 03.10.042 / 2005-06 dated September 28, 2006]

NBFCs were advised on September 28, 2006 to prescribe the broad guidelines on fair practices that are to be framed and approved by the boards of directors of all non-banking financial companies (including RNBCs). The fair practices code so framed and approved by the board of directors is to be published and disseminated on the website of the company, if any, for the information of the public

Draft Guidelines on Fair Practices Code for NBFCs

(i) Applications for loans and their processing

(a) Loan application forms should include necessary information which affects the interest of the borrower, so that a meaningful comparison with the terms and conditions offered by other NBFCs can be made and informed decision can be taken by the borrower.

(b) The NBFCs should devise a system of giving acknowledgement for receipt of all loan applications. Preferably, the time frame within which loan applications will be disposed of should also be indicated in the acknowledgement.

(ii) Loan appraisal and terms/conditions

The NBFCs should convey in writing to the borrower, the amount of loan sanctioned along with the terms and conditions including annualised rate of interest and method of application thereof and keep the acceptance of these terms and conditions by the borrower on its record.

(iii) Disbursement of loans including changes in terms and conditions

The NBFCs should give notice to the borrower of any change in the terms and conditions including disbursement schedule, interest rates, service charges, prepayment charges etc. NBFCs should also ensure that changes in interest rates and charges are effected only prospectively. A suitable condition in this regard should be incorporated in the loan agreement.

(iv) Post disbursement supervision

(a). Post disbursement supervision by NBFCs should be constructive and the genuine difficulties which the borrower may face, may be given due consideration.

(b) Before taking a decision to recall / accelerate payment or performance under the agreement or seeking additional securities, NBFCs should give notice to borrowers in consonance with the loan agreement.

(c) NBFCs should release all securities on repayment of all dues or on realisation of the outstanding amount of loan subject to any legitimate right or lien for any other claim NBFCs may have against borrower. If such right of set off is to be exercised, the borrower shall be given

notice about the same with full particulars about the remaining claims and the conditions under which NBFCs are entitled to retain the securities till the relevant claim is settled /paid.

(v) General

(a) NBFCs should refrain from interference in the affairs of the borrower except for the purposes provided in the terms and conditions of sanction of the loan (unless new information, not earlier disclosed by the borrower, has come to the notice of the lender).

(b) In case of receipt of request for transfer of borrowal account, either from the borrower or from a lender which proposes to take over the account, the consent or otherwise i.e. objection of the NBFC, if any, should be conveyed within 21 days from the date of receipt of request. Such transfer shall be as per transparent contractual terms in consonance with law.

(c) In the matter of recovery of loans, the NBFCs should not resort to harassment.

(vi) Grievance Redressal Mechanism

The Board of Directors of NBFCs should also lay down the appropriate grievance redressal mechanism within the organization to resolve disputes arising in this regard. Such a mechanism should ensure that all disputes arising out of the decisions of lending institutions' functionaries are heard and disposed of at least at the next higher level. The Board of Directors should also provide for periodical review of the compliance of the Fair Practices Code and the functioning of the grievances redressal mechanism at various levels of management. A consolidated report of such reviews may be submitted to the Board at regular intervals, as may be prescribed by it.

(vii) Fair Practices Code based on the guidelines outlined hereinabove should be put in place by all NBFCs with the approval of their Boards at the earliest possible, but not later than June 30, 2006. NBFCs will have the freedom of drafting the Fair Practices Code, enhancing the scope of the guidelines but in no way sacrificing the spirit underlying the above guidelines. The same should be put up on their web-site, if any, for the information of various stakeholders.

7.5 Reporting of Frauds

While the primary responsibility for preventing frauds lies with NBFCs themselves, a reporting system for frauds is prescribed in the following paragraphs, which may be adopted by NBFCs.

- NBFCs should ensure that a reporting system is in place so that frauds are reported without any delay.
- NBFCs should fix staff accountability in respect of delays in reporting of fraud cases to the Reserve Bank.
- NBFCs may, strictly adhere to the fixed timeframe fixed for reporting fraud cases to the Reserve Bank failing which NBFCs would be liable for penal action as prescribed under the provisions of Chapter V of the RBI Act, 1934.
- NBFCs should specifically nominate an official of the rank of General Manager or equivalent who will be responsible for submitting all the returns
- In order to have uniformity in reporting, frauds have been classified as under based mainly on the provisions of the Indian Penal Code:

- (a) Misappropriation and criminal breach of trust.
- (b) Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.
- (c) Unauthorised credit facilities extended for reward or for illegal gratification.
- (d) Negligence and cash shortages.
- (e) Cheating and forgery.
- (f) Irregularities in foreign exchange transactions.
- (g) Any other type of fraud not coming under the specific heads as above.

Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' referred to in items (d) and (f) above are to be reported as fraud if the intention to cheat / defraud is suspected / proved. However, the following cases where fraudulent intention is not suspected / proved, at the time of detection, will be treated as fraud and reported accordingly:

- (a) cases of cash shortages more than Rs.10,000/- and
(b) cases of cash shortages more than Rs. 5000/- if detected by management / auditor / inspecting officer and not reported on the occurrence by the persons handling cash.

- NBFCs having overseas branches/offices should report all frauds perpetrated at such branches/offices also to the Reserve Bank as per the given format and procedure
- Frauds involving Rs. 1 lakh and above
Fraud reports should be submitted in all cases of fraud of Rs. 1 lakh and above perpetrated through misrepresentation, breach of trust, manipulation of books of account, fraudulent encashment of FDRs unauthorised handling of securities charged to the NBFC, misfeasance, embezzlement, misappropriation of funds, conversion of property, cheating, shortages, irregularities, etc.

Fraud reports should also be submitted in cases where central investigating agencies have initiated criminal proceedings suo moto and/or where the Reserve Bank has directed that they be reported as frauds.

Wherever information is available, NBFCs may also report frauds perpetrated in their subsidiaries and affiliates/joint ventures. Such frauds should, however, not be included in the report on outstanding frauds and the quarterly progress reports referred to below.

- The fraud reports in the prescribed format should be sent to the Central Office (CO) of the Reserve Bank of India, Department of Banking Supervision, Frauds Monitoring Cell where the amount involved in fraud is Rs 25 lakhs and above and to Regional Office of the Reserve Bank of India, Department of Non-Banking Supervision under whose jurisdiction the Registered Office of the NBFC falls where the fraud amount involved in fraud is less than Rs 25 lakh , in the format given in FMR – 1, within three weeks from the date of detection.
- A copy of FMR-1 where the amount involved in the Fraud is Rs 25 lakhs and above should also be submitted to the Regional Office of the Department of Non-Banking Supervision of Reserve Bank of India under whose jurisdiction the Registered Office of

the NBFC falls.

- Frauds involving Rs. 25 lakh and above - In respect of frauds involving Rs. 25 lakh and above, in addition to the requirements given above, NBFCs may report the fraud by means of a D.O. letter addressed to the Chief General Manager-in-charge of the Department of Banking Supervision, Reserve Bank of India, Frauds Monitoring Cell, Central Office and a copy endorsed to the Chief General Manager-in-charge of the Department of Non-Banking Supervision, Reserve Bank of India, Central Office within a week of such frauds coming to the notice of the NBFC. The letter may contain brief particulars of the fraud such as amount involved, nature of fraud, modus operandi in brief, name of the branch/ office, names of parties involved (if they are proprietorship/ partnership concerns or private limited companies, the names of proprietors, partners and directors), names of officials involved, and whether the complaint has been lodged with the Police. A copy of the D.O. letter should also be endorsed to the Regional Office of Reserve Bank, Department of Non-Banking Supervision under whose jurisdiction the Registered Office of the NBFC is functioning.
- NBFCs should submit a copy of the Quarterly Report on Frauds Outstanding in the format given in FMR - 2 to the Regional Office of the Reserve Bank of India, Department of Non-Banking Supervision under whose jurisdiction the Registered Office of the NBFC falls irrespective of amount within 15 days of the end of the quarter to which it relates.
- NBFCs should furnish a certificate, as part of the above report, to the effect that all individual fraud cases of Rs. 1 lakh and above reported to the Reserve Bank in FMR - 1 during the quarter have also been put up to the NBFC's Board and have been incorporated in Part - A (columns 4 and 5) and Parts B and C of FMR - 2.
- Progress Report on Frauds - NBFCs should furnish case-wise quarterly progress reports on frauds involving Rs. 1 lakh and above in the format given in FMR - 3 to the Central Office (CO) of the Reserve Bank of India, Department of Banking Supervision, Frauds Monitoring Cell where the amount involved in fraud is Rs 25 lakhs and above and to Regional Office of the Reserve Bank of India, Department of Non-Banking Supervision under whose jurisdiction the Registered Office of the NBFC falls where the fraud

amount involved in fraud is less than Rs 25 lakh within 15 days of the end of the quarter to which it relates.

- NBFCs should ensure that all frauds of Rs. 1 lakh and above are reported to their Boards promptly on their detection. Such reports should, among other things, take note of the failure on the part of the concerned officials, and consider initiation of appropriate action against the officials responsible for the fraud.
- Quarterly Review of Frauds
- Annual Review of Frauds
- Guidelines to be followed for reporting Frauds to the Police

7.6 Relevant Provisions of the Companies Act, 1956

The following Sections in the Companies Act, 1956 relate to Public deposits

- a) Sec 58A- Deposits not to be invited without issuing an advertisement
- b) Sec 58AA- Small depositors
- c) Sec 58AAA-Default in acceptance or refund of deposits to be cognizable
- d) Sec 58B- Provisions relating to prospectus to apply to advertisement

The relevant rules framed there under include:

- a) Companies (Acceptance of Deposit) Rules, 1975
- b) Companies (Application for Extension of time or Exemption under sub-section (8) of section 58A) Rules, 1979

The important provisions of the Act and the Rules are summarised as under:

1. The rules do not apply to banking companies and financial companies for which RBI have separately prescribed rules.
2. Deposit means deposit of money and include any amount borrowed by a company, but does not include certain types of borrowings; viz. amount received:
 - i. From Government, Local Authority, Foreign Government or any other foreign person, citizen or authority or any amount guaranteed by Government.
 - ii. From Banks.

- iii. From various Government or semi-Government financial Cos. Or Corporation/insurance Cos. Or a Public financial institution as may be notified by the CG.
 - iv. From any other company.
 - v. By way of security deposit from an employee./td>
 - vi. By way of security or advance from any purchasing, selling or other agents in the course of business or any advance received against orders for supply of goods, properties or services.
 - vii. By way of subscription to any share, stock, bonds or debentures pending allotment. Any amount received by way of calls in advance so long as this is not repayable under the Articles.
 - viii. In trust or in transit.
 - ix. From a director in case of any company or from a shareholder in case of a private company out of his own funds (that is not borrowed or accepted from others) including a Company which has become public u/s.43A so long as it retains S. 3(1)(iii) conditions in its Articles. The director/shareholder concerned however has to furnish a declaration in writing to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting from others.
 - x. By issue of bonds or debentures secured by the mortgage of any immovable property or with an option to convert them into shares. Provided the amount does not exceed the market value of property.
 - xi. From promoters by way of unsecured loans pursuant to agreement with financial institutions for loans so long as such loans are outstanding.
3. Acceptance of deposits
- a) No company shall accept or renew any deposit which is repayable on demand or on notice or after a period of less than six months or more than thirty six months from the date of acceptance or renewal of such deposit

- b) No company shall invite or accept or renew any deposits in any form, on a rate of interest exceeding 12.5 per cent per annum at rests which shall not be shorter than monthly rests
 - c) no company shall pay brokerage to any broker at a rate, exceeding one per cent of the deposits for a period up to one year, one and half per cent of the deposits for a period of more than one year but up to two years, and two percent of the deposits for a period exceeding two years collected by or through such broker, and such payment shall be on one time basis.
 - d) No company with a net owned fund of less than rupees one crore shall invite public deposits
 - e) Any person who is authorised by a company, in writing, to solicit deposits on its behalf and through whom deposits are procured will only be entitled to brokerage
4. Invitations of deposits by a company can be made only by means of an advertisement specifying the financial position, management structure and other particulars relating to a company. A company which has defaulted in repayment of deposit or interest thereon is prohibited from inviting deposits.
 5. The depositors shall fill the application form supplied by the company. The company in return issues a deposit receipt which is an acknowledgement of debt by the company. The terms and conditions of the deposit are printed on the back of the receipt.
 6. The company shall maintain a register of deposits containing the prescribed particulars. Such registers shall be preserved in good order for a period of not less than eight calendar years from the financial year in which the latest entry is made in the register
 7. Every company shall file returns of deposits duly certified by their auditor with a Registrar on or before 30th June of every year.
 8. The expression 'small depositor' means "a depositor who has deposited (in a financial year) a sum not exceeding twenty thousand rupees in a company and includes his successors, nominees and legal representatives". In case of any default

by the company in paying back to them, it shall inform the Tribunal within sixty days from the date of default. The Tribunal will then direct the company to repay to small depositors within a period of thirty days from the date of receipt of intimation of default. On failure to comply with the orders of the Board, the company and its directors shall be punishable with imprisonment and payment of daily fine during the period in which such non-compliance continues. However, if such a defaulting company wants to invite deposits from small depositors, it shall state the complete nature of default in all its future advertisements and application form.

9. Section 58AAA, any default / contravention under sections 58A and 58AA, relating to deposits, will be treated as a cognizable offence. In other words, under this provision, the directors of the defaulting company can be arrested and put behind bars. Incidentally, the courts will take cognizance only of the complaint of the central government or any of its authorised officers.

Some of the other relevant provisions in the companies Act, 1956 are laid down in:

Section 209- Books of account to be kept by company

Section 217-Board's report

Section 227 - Powers and duties of auditors

Section 292A - Audit Committee

Section 370-Loans etc to companies under same management

Section 372A- Inter corporate loans and investments

Section 620A- Power to modify Act in its application to Nidhi's etc

Section 637A - Powers of Central Government or Company Law Board to accord approval etc subject to conditions and to prescribe fees on applications

7.7 Relevant provisions in FEMA

The relevant regulations are laid down in Foreign Exchange Management (Deposit) Regulations, 2000 [FEMA-5]. Accordingly, Effective from April 24, 2004, NBFCs cannot accept deposits from NRI except deposits by debit to NRO account of NRI provided

such amount do not represent inward remittance or transfer from NRE/FCNR (B) account.

Schedule 6 of the said regulation contains the procedure regarding Acceptance of deposits by a Company incorporated in India (including a NBFC registered with RBI) on repatriation basis from a NRI or a person of Indian origin resident outside India

Schedule 7 of the said regulation contains the procedure regarding

Acceptance of deposits by Indian Proprietorship concern/ firm or company (including a NBFC registered with RBI) on non-repatriation basis from a NRI or a person of Indian origin resident outside India

Inbound Investment- Sectoral cap on Investments by Persons Resident outside India - Annexure B- schedule I of FEMA 20 [Foreign Exchange Management (Transfer or issue of Security by a Person Resident outside India) Regulations, 2000]

Item 2

FDI /NRI/ investments allowed in the following 19 NBFC activities shall be as per the levels indicated below:

a) Activities covered:

1. Merchant Banking
2. Under writing
3. Portfolio Management Services
4. Investment Advisory Services.
5. Financial Consultancy
6. Stock-broking
7. Asset Management
8. Venture Capital
9. Custodial Services
10. Factoring
11. Credit Reference Agencies

12. Credit Rating Agencies
13. Leasing & Finance
14. Housing Finance
15. Forex-broking
16. Credit Card Business
17. Money-changing Business
18. Micro-credit
19. Rural credit

Note: The Union Cabinet on 30th January 2008 reviewed and approved the FDI policy for further liberalization and deleted 'Credit Reference Agencies' from the list

b) Minimum Capitalisation norms for fund based NBFCs

- i. for FDI upto 51%, US \$ 0.5 million to be brought in upfront
- ii. If the FDI is above 51 % and upto 75 %, US \$ 5 million to be brought upfront
- iii. If the FDI is above 75 % and upto 100 %, US \$ 50 million out of which \$ 7.5 million to be brought in upfront and the balance in 24 months

c) Minimum Capitalisation norms for non-fund based activities.

Minimum Capitalisation norm of US\$0.5 million is applicable in respect of non-fund based NBFCs with foreign investment.

d) Foreign investors can set up 100% operating subsidiaries without the condition to disinvest a minimum of 25% of its equity to Indian entities, subject to bringing in US \$ 50 million as at b) (iii) above (without any restriction on number of operating subsidiaries without bringing in additional capital)

e) Joint Venture operating NBFCs that have 75% or less than 75% foreign investment will also be allowed to set up subsidiaries for undertaking other NBFC activities, subject to the subsidiaries also complying with the applicable minimum capital inflow i.e, (b)(i) and (b)(ii) above.

f) FDI in the NBFC sector is put on automatic route subject to compliance with guidelines of the Reserve Bank of India. RBI would issue appropriate guidelines in this regard

7.8 Accounting for taxes on income- Accounting Standard 22- Treatment of deferred tax assets (DTA) and deferred tax liabilities (DTL) for computation of capital

Text of the RBI Circular RBI/2008-09/107 DNBS (PD) C.C. No. 124/ 03.05.002/ 2008-09 dated July 31, 2008 :

In terms of Accounting Standard 22 issued by the Institute of Chartered Accountant of India (ICAI), on 'Accounting for Taxes on Income', taxable income is calculated in accordance with tax laws and the requirements of these laws to compute taxable income differ from the accounting policies applied to determine accounting income. The tax effects of timing differences are included in the tax expense in the statement of profit and loss and as deferred tax assets (DTA) (subject to the consideration of prudence) or as deferred tax liabilities (DTL) in the balance sheet.

2. As creation of DTA or DTL would give rise to certain issues impacting the balance sheet of the company, it is clarified that the regulatory treatment to be given to these issues are as under :-

- The balance in DTL account will not be eligible for inclusion in Tier I or Tier II capital for capital adequacy purpose as it is not an eligible item of capital.

- DTA will be treated as an intangible asset and should be deducted from Tier I Capital.

- NBFCs may keep the above clarifications in mind for all regulatory requirements including computation of CRAR and ensure compliance with effect from the accounting year ending March 31, 2009. NBFCs which are unable to comply with the regulatory CRAR requirement due to giving effect to the norms as above will be given an appropriate transition period to comply with the same. Such companies may approach the Regional Office of the Bank in the jurisdiction

of which their Registered Office is located for suitable dispensation in accordance with the spirit of these norms within a period of thirty days of the issue of the instructions in this regard.

7.9 Submission of Statutory Auditor Certificate

Every NBFC shall submit a Certificate from its Statutory Auditor that it is engaged in the business of NBFI requiring it to hold a Certificate of Registration under Section 45-IA of the RBI Act.

A certificate from the Statutory Auditor in this regard with reference to the position of the company as at end of the financial year ended March 31 may be submitted to the Regional Office of the Department of Non-Banking Supervision under whose jurisdiction the non-banking financial company is registered, latest by June 30, every year.

Such certificate shall also indicate the asset / income pattern of the NBFC for making it eligible for classification as Asset Finance Company, Investment Company or Loan Company

“Non-Banking Financial Companies Auditor’s Report (Reserve Bank) Directions, 1998”

This direction applies to every auditor of a non-banking financial company. In addition to the report made by the auditor under the Companies Act, 1956 with regard to accounts of a non-banking financial company for every financial year, the auditor should also make a separate report to the Board of Directors of the Company under the RBI directions

Audit checklist

A) In case of All NBFCs:

- Whether the NBFC Has applied for registration with the RBI
- Whether the NBFC Is incorporated before January 9, 1997.
- Whether the NBFC Has received any communication about grant/refusal of Certificate of Registration and
- Whether the NBFC Has obtained a COR of incorporation on/after January 9,1997

B) In case of NBFCs accepting / Holding Public Deposits:

- Whether the public deposits accepted by the NBFC together with other borrowings, namely, issue of unsecured nonconvertible debentures/bonds to public, from shareholders and any other deposit not excluded from the definition of the NBFCs Acceptance of Public Deposits Directions, 1998 are within the limits admissible under the provisions of these directions.
- Whether the credit rating for fixed deposits assigned by the rating agency on the specified date is in force, and the aggregate amount of the outstanding deposits at any point of time during the year has exceeded the limit specified by the rating agency.
- Whether the NBFC has defaulted in paying to its depositors the interest and/or principal amount of the deposits after such interest and/or principal became due.
- Whether the NBFC has complied with the prudential norms on income recognition, accounting standards, asset classification, provisioning for bad and doubtful debts and concentration of credit/investments as specified by the NBFCs Prudential Norms Directions, 1998.
- Whether the CAR as disclosed in the return submitted to the RBI in terms of RBI Prudential Norms Directions, 1998 has been correctly **determined** and such ratio is in conformity / compliance with the minimum CRAR prescribed by the RBI.
- Whether the NBFC has complied with the liquidity requirements and kept the approved securities with a designated bank.

- Whether the NBFC has furnished to the RBI within the stipulated period the half yearly return on the specified prudential norms and
- Whether The NBFC has furnished to the RBI within the stipulated period the return on deposits as specified in the first schedule to the NBFC Acceptance of Public Deposit Directions, 1998.
- Whether in case of opening of new branches or offices to collect deposits or closure thereof or in case of appointment of agent, the company has complied with the requirements contained in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998

C) In Case of NBFC not Accepting Public Deposits:

- Whether the board of directors of the NBFC has passed a resolution for the non-acceptance of any public deposits
- Whether the NBFC has accepted any public deposits during the period and
- Whether the NBFC has complied with the prudential norms relating to income recognition, accounting standards, asset classification **and** provisioning for bad and doubtful debts as applicable to it

D) In the case of a non-banking financial company which is an investment company not accepting public deposits and which has invested not less than 90 percent of its assets in the securities of its group/holding/subsidiary companies as long term investments

- Whether The BOD has passed a resolution for the non-acceptance of public deposits
- Whether The IC has accepted any public deposit during the relevant period/year
- Whether The NBFC has through a resolution of BOD identified the group/ holding/ subsidiary companies.

- Whether The cost of investment in group/ holding/ subsidiary companies is not less than 90 percent of the cost of the total asset of the NBFC/IC at any point of time throughout the accounting period and
- Whether The IC has continued to hold securities of group/ holding/ subsidiary companies as long term investments and has not traded in those investments during the accounting period / year.

If any of the above matter is un-favourable or qualified, the auditors should state the reasons therefore. Where he is unable to express any opinion on any of the above matters, his report should indicate such fact together with reasons therefore.

Report to RBI

The auditor is obliged to make a report to RBI in the following situations -

- When the statement regarding any of the specified matters is un-favourable or qualified;
- Where the auditor forms an opinion to the effect that the NBFC has not complied with RBI Directions relating to acceptance of deposits or Prudential Norms to the extent applicable to NBFC, or that the NBFC **has** not complied with the provisions of Chapter III B of the RBI Act, 1934.

The report (to be submitted to the concerned RO of the DNBS) should contain the details of such un-favourable or qualified statements, and/or about the non-compliance, as the case may be.

Where RBI has rejected the application for issuing Certificate of Registration or has cancelled the Certification of Registration, the auditor should include in his report to RBI as to whether:

- The NBFC had immediately stopped accepting deposits from public.
- Arranged to refund the public deposit forthwith and Complied with all the instructions contained in the communication forwarded by RBI to the NBFC

advising about rejection of the application or cancellation of the Certificate of Registration, as the case may be

7.9 Compliance Audit of Provisions Relating To Non- Banking Financial Companies

The scope of this audit would include detailed examination of applicability of various laws, regulations and directions, scrutiny of various records including financial statements, balance sheets etc. and issuance of report on compliance or non-compliance of laws by these establishments along with remedial action, wherever required. Examination of total compliance adherence would start from the top of the organizational hierarchy and go down into the core business processes of a company's operations.

Basis of applicability of legislations:-

	Description	Compliance Requirement	Remarks
1.	Financial institution, if yes, Banking company	<ul style="list-style-type: none"> • Banking Regulation Act, 1949 • Companies Act, 1956 • Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980 • Bankers' Books Evidence Act, 1891 • Banking Secrecy Act, 1970 • Negotiable Instruments 	

		Act, 1881	
2.	Financial institution, if yes, Non-Banking Financial company, if yes, carrying on business of Money lending	<ul style="list-style-type: none"> • Chapter III B, IIIC and V of RBI Act, 1934 	
3.	Financial institution, if yes, carrying on the business of merchant banking.	<ul style="list-style-type: none"> • SEBI Act, 1992 • SEBI Merchant Banking Regulations, 1992 ✚ Exempted from Secs.45-IA, 45-IB and 45-IC of Reserve Bank of India Act, 1934, NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 1998 and Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 	
4.	Non-banking financial company, if yes, Venture Capital Fund company	<ul style="list-style-type: none"> • SEBI Act, 1992 ✚ Exempted from Secs.45-IA and 45-IC of Reserve Bank of India Act, 1934, NBFC Acceptance of Public 	

		Deposits (Reserve Bank) Directions, 1998 and Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007	
5.	Non-Banking Financial company, if yes, carrying on business of acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature.	<ul style="list-style-type: none"> • SEBI Act, 1992 • Securities Contracts, Regulation Act, 1992 ✚ Exempted from Secs.45-IA, 45-IB, 45-IC, 45MB and 45MC of Reserve Bank of India Act, 1934, NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 1998 and Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 	
6.	Non-Banking Financial company, if yes, a housing finance	<ul style="list-style-type: none"> • National Housing Bank Act, 1987 	

	institution	<ul style="list-style-type: none"> Exempted from provisions of Chapter III B of the Reserve Bank of India Act, 1934 	
7.	Non-Banking Financial company, if yes, carrying on business of hiring / leasing goods.	<ul style="list-style-type: none"> Hire Purchase Act, 1972 Chapter III B of Reserve Bank of India Act, 1934 	
8.	Non-Banking Financial company, if yes, carrying on business of insurance	<ul style="list-style-type: none"> Insurance Act, 1938 Insurance Regulatory and Development Authority (IDRA) Act, 1999 Exempted from Secs.45-IA, 45-IB, 45-IC, 45MB and 45MC of Reserve Bank of India Act, 1934, NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 1998 and Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 	
9.	Non-Banking Financial	<ul style="list-style-type: none"> Chit Funds Act, 1982 	

	company, if yes, Chit Fund company	<ul style="list-style-type: none"> • Miscellaneous Non-banking Companies (Reserve Bank) Directions, 1977 • 'Know your Customer' Guidelines for NBFCs 	
10.	Non-Banking Financial company, if yes, Nidhi company - Mutual benefit Financial company	<ul style="list-style-type: none"> • Section 620A of the Companies Act, 1956 ✚ Exempted from Secs.45-IA, 45-IB and 45-IC of Reserve Bank of India Act, 1934 	
11.	Non-Banking Financial company, if yes, Mutual benefit company	<ul style="list-style-type: none"> • Section 637A of the Companies Act, 1956 	
12.	Non-banking financial company, if yes, Micro finance company	<ul style="list-style-type: none"> • Micro Financial Sector (Development and Regulation) Bill 2007 ✚ Exempted from Secs.45-IA, 45-IB and 45-IC of Reserve Bank of India Act, 1934, 	
13.	Non-banking financial company, if yes, Residuary Non-banking company	<ul style="list-style-type: none"> • Residuary Non-banking Companies (Reserve Bank) Directions, 1987 • Non-Banking Financial (Deposit Accepting or 	

		<p> Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007</p> <ul style="list-style-type: none"> • 'Know your Customer' Guidelines for NBFCs • Guidelines for Asset-Liability Management (ALM) system in NBFCs • RBI guidelines for issue of Certificates of Deposit (CD) 	
14.	<p>Non-Banking Finance company, if yes Asset Finance company / Loan company / Investment company accepting public deposits</p>	<ul style="list-style-type: none"> • Chapter III B, IIIC and V of RBI Act, 1934 • Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 • NBFCs Acceptance Of Public Deposits (RBI) Directions, 1998 • Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 1998 • Reserve Bank of India 	

		<p>(NBFC) Returns Specification, 1997</p> <ul style="list-style-type: none"> • Fair Practice Code for NBFCs • Guidelines on Corporate Governance for NBFCs • Companies (Acceptance of Deposits) Rules, 1975 • 'Know your Customer' Guidelines for NBFCs • Guidelines for Asset-Liability Management (ALM) system in NBFCs • RBI guidelines for issue of Commercial Paper (CP) • RBI guidelines for issue of Certificates of Deposit (CD) 	
15.	<p>Company not accepting public deposits /systemically important non-deposit taking non-banking financial companies</p>	<ul style="list-style-type: none"> • Chapter III B, and V of RBI Act, 1934 • Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 	

		<ul style="list-style-type: none"> • Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 1998 • Reserve Bank of India (NBFC) Returns Specification, 1997 • Fair Practice Code for NBFCs • Guidelines on Corporate Governance for NBFCs • Guidelines for Asset-Liability Management (ALM) system in NBFCs 	
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Checklist on compliance requirements of NBFCs

Chapter IIIB of Reserve Bank of India Act, 1934		
Provisions relating to Non-Banking Institutions receiving deposits and financial institutions		
Sl.No.	Description/ Compliance requirement	Comments
1.	Non-banking financial company, if yes, obtained Certificate of Registration	
2.	What is the net owned fund of the company?	
3.	Has the NBFC invested in unencumbered approved securities, if yes	
	Is the investment less than 5 % or higher than 25% of the deposits outstanding at the close of business on	

	the last working day of the second preceding quarter?	
4.	Has the NBFC created a reserve fund? If yes	
	Is the amount in the reserve fund less than 20% of its net profit as disclosed in the profit and loss account and before the declaration of dividend.	
	Has any amount been appropriated from the Reserve fund? If yes	
	Has it been reported to the Reserve Bank within 21 days of such withdrawal?	

Submission of returns		
Returns to be submitted by NBFCs / MNBCs / RNBCs		
Sl.No.	Description / Compliance requirement	Comments
1.	Is the company a NBFC accepting / holding public deposits or a miscellaneous non-banking company? If yes Has the company submitted annual return on deposits in Form NBS 1?	
2.	Has the NBFC submitted the half yearly returns in Form NBS 2 containing the details of capital funds, risk assets/exposures and risk asset ratio etc., as at the end of March / September?	
3.	Has the NBFC submitted the quarterly return on Statutory Liquid Assets in Form NBS 3 for the quarter ended March/June/September/December?	

4.	<p>Is the NBFC a non-deposit accepting company and having asset size of Rs.100 crore and above. If yes</p> <p>Has the company submitted monthly returns on important financial parameters like sources of funds, application of funds, requirements as to profit and loss account, asset classification etc.</p>	
5.	<p>Is the NBFC a deposit accepting company and having total assets of Rs.100 crore and above. If yes</p> <p>Has the company submitted the monthly return on exposure to capital market in Form NBS 6.</p>	
6.	<p>Has the NBFC submitted the annual statement of capital funds, risk assets/exposures etc in Form NBS 7.</p>	
7.	<p>Is the company a residuary non-banking company, if yes</p> <p>Has the company submitted the annual return on deposits in Form NBS 1A</p> <p>Has the company submitted quarterly returns on Statutory Liquid Assets in Form NBS 3A for the quarter ended March/June/September/December.</p>	

Miscellaneous Non-banking Companies (Reserve Bank) Directions, 1977

This Direction is applicable to all Miscellaneous non-banking companies.

Sl.No.	Description / Compliance requirement	Comments
1.	Does the company collect money as a promoter, foreman, agent or in any other capacity for giving prizes, gifts in cash or in kind to specified number of subscribers or for refunding the subscription, contributions or other monies collected.	
2.	Does the company collect any form of chit or kuri?	
3.	Does the company accept deposits? Verify if the total amount of deposits exceed 15% of its net owned funds.	
4.	What are the particulars mentioned in the application form soliciting deposit?	
5.	Verify if receipts given to the depositors.	
6.	Does the company maintain the register of deposits containing particulars of the depositors and deposits?	
7.	Has the information with regard to total number of deposits not claimed or not paid by the company mentioned in the report to the Board of Directors?	
8.	Does the rate of interest payable on deposits exceed twelve and half percent per annum?	
9.	Verify the rate of brokerage charges paid to brokers for deposits collected through him.	
10.	What is the procedure for renewal of	

	deposits before maturity?	
11.	What is the procedure for renewal of overdue deposits?	
12.	Is the minimum lock in period for repayment of deposits, three months?	
13.	What is the procedure for repayment of public deposits in case the company is not a problem miscellaneous non-banking company?	
14.	How is the public deposits repaid in case the company is a problem miscellaneous non-banking company.	
15.	Has the company submitted the copies of balance sheet and accounts together with the director's report to the Reserve Bank within 15 days of the Board meeting?	
16.	Verify if the company has submitted the annual return on deposits in Form NBS 1 to the Department of Supervision, Reserve Bank.	

Non-Banking Financial Companies and Miscellaneous Non-Banking Companies (Advertisement) Rules, 1977		
This Direction prescribes the form and particulars of advertisement to followed by all non-banking financial companies and miscellaneous non-banking companies. .		
Sl.No.	Description / Compliance requirement	Comments
1.	Has the company issued an advertisement in a English newspaper and vernacular newspaper	

	of the state in which the registered office of the company is situated, before inviting deposits from the public.	
2.	<p>Does the advertisement contain the following details:</p> <ul style="list-style-type: none"> • Details of company including name, date of incorporation and business activities • Brief particulars of management of company • Details of profit, dividends etc in the last three financial years before issue of advertisement. • Summarised financial position of the company 	
3.	Verify if the approved copy of the advertisement was filed with the Reserve Bank on or before the date of issue of the advertisement.	

Residuary Non-banking Companies (Reserve Bank) Directions, 1987		
These directions will apply to every residuary non-banking companies which have 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		
Sl.No.	Description / Compliance requirement	Comments
1.	Does the company accept deposits, if yes	

	Is the maturity period of deposits less than 12 months or more than 84 months.	
2.	Verify if the company accepts any amount towards processing or maintenance charges from the depositors / subscribers for meeting its revenue expenditure.	
3.	Does the company have branches or has it appointed agents to collect deposits, if yes	
	Has it been notified to the Reserve Bank.	
4.	Is the rate of interest on deposits received less than 5% per annum in case of deposits in lump sum or monthly or longer intervals.	
	Is the rate of interest on deposits received less than three and half percent per annum in case of deposits under daily deposit schemes?	
5.	Verify the procedure followed for repayment of deposits in case the company is not a problem residuary non-banking company.	
6.	Verify the procedure for repayment of deposits in case the company is a problem non residuary company.	
7.	Verify the rate of interest on premature repayment of deposits.	
8.	Verify the procedure for acceptance / renewal of repatriable deposits from non-resident indians (NRIs).	

9.	<p>Verify the means of investments made by the company.</p> <p>Is the amount of investment less than 10% of aggregate amount of liabilities to depositors in fixed deposits / certificate of deposits?</p> <p>Is the amount less than 75% of the aggregate amount of liabilities to depositors in government securities?</p>	
10.	<p>What is the procedure followed by the company for safe custody of approved securities? Is it Constituents' Subsidiary General Ledger (CSGL) account or dematerialized account with a depository?</p>	
11.	<p>Verify if the company has forfeited any amount deposited by the depositor or any interest, premium, bonus or other advantage accrued thereon.</p>	
12.	<p>What are the particulars mentioned in the application form soliciting deposit?</p>	
13.	<p>Verify if receipts given to the depositors.</p>	
14.	<p>Does the company maintain the register of deposits containing particulars of the depositors and deposits?</p>	
15.	<p>Has the information with regard to total number of deposits not claimed or not paid by the company mentioned in the report to the Board of Directors?</p>	
16.	<p>Verify if the copies of balance sheet and</p>	

	accounts together with the directors' report have been submitted to the Reserve Bank.	
17.	Verify if the company has submitted the annual return on deposits in Form NBS 1A to the Department of Supervision, Reserve Bank of India.	

NBFCs Acceptance Of Public Deposits (RBI) Directions, 1998		
This Direction prescribes the rules to be followed by NBFCs accepting public deposits. This RBI direction is applicable to all NBFCs accepting public deposits.		
Sl.No.	Description / Compliance requirement	Comments
1.	What is the credit rating obtained by the company?	
2.	Has the quantum of acceptance of deposits exceeded one and one half times of its Net owned Fund.	
3.	Has the credit rating been downgraded, if yes	
	Has the excess deposit been regularised?	
4.	Does the interest rate for acceptance or renewal of public deposits exceed twelve and half percent per annum?	
5.	Does the brokerage amount paid exceed 2% of the deposit collected?	
6.	What is the procedure followed by the company for premature repayment of deposit?	
7.	Has the company opened branches and	

	appointed agents to collect deposits, if yes, has it been notified to the Reserve Bank?	
8.	Has the information with regard to total number of accounts of public deposit not claimed or not paid by the company mentioned in the report to the Board of Directors?	
9.	What is the procedure followed by the company for safe custody of approved securities? Is it Constituents' Subsidiary General Ledger (CSGL) account or dematerialized account with a depository?	
10.	Has the company submitted the balance sheet and accounts together with the Directors' report to the reserve bank within 15 days of meeting of the board of directors? If yes Has the company submitted the auditors certificate containing details of liabilities, interest payable and the financial position of the company.	
11.	Has the company submitted the annual return on deposits in Form NBS 1 to the Reserve Bank?	

Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 1998

This direction applies to every auditor of a non-banking financial company. In

addition to the report made by the auditor under the Companies Act, 1956 with regard to accounts of a non-banking financial company for every financial year, the auditor should also make a separate report to the Board of Directors of the Company under the RBI directions.

Sl.No.	Description / Compliance requirement	Comments
1.	In case of all non-banking financial companies	
	Verify if the company has applied for registration under the Reserve Bank of India, Act, 1934.	
2.	In case of a non-banking financial company accepting/holding public deposits	
	Verify if the public deposits accepted by the company together with borrowings are within the prescribed limits.	
	Check the credit rating of the company.	
	Verify if there has been any default in payment to depositors.	
	Verify if the company has complied with the prudential norms.	
	Check if the company has complied with the prescribed liquidity requirement and kept the approved securities with a designated bank.	
	Verify if the company has submitted the necessary returns.	
3.	In case of a non-banking financial company not accepting public deposits	
	Whether the Board of Directors has passed a resolution for non- acceptance of any public	

	deposits.	
	Check if the company has accepted any public deposits during the relevant year.	
	Check if the company has complied with the prudential norms.	
4.	In case of NBFC which is an investment company not accepting public deposits and which has invested not less than 90 percent of its assets in the securities of its group/holding/subsidiary companies as long term investments	
	Check whether the company has through a Board resolution identified the group / holding / subsidiary companies.	
	Verify whether the company has continued to hold securities of group or holding or subsidiary companies as long term investments and has not traded in those investments during the accounting year / period.	
5.	Has there been any non-compliance of the above mentioned matters, if yes	
	Send the details of non-compliance of the company to the Regional office of the Reserve Bank under whose jurisdiction the registered office of the company is located.	

Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007

This RBI direction prescribes the norms to be followed by deposit accepting or holding companies with regard to their investments, assets, capital adequacy ratio etc. It is applicable to a non-banking financial company and a residuary non-banking company. It will not apply to a mutual benefit company and a Government non-banking financial company.

Sl.No.	Description / Compliance requirement	Comments
1.	How is the income recognition done on NPA / hire purchase assets / lease assets?	
2.	Is there an investment policy in place?	
3.	Is there a Policy on Demand / Call Loans in case the company grants or intends to grant demand / call loans	
4.	Has the company classified the lease/hire purchase assets, loans and advances and other forms of credit into standards assets, sub-standard assets, doubtful assets and loss assets?	
5.	Does the NBFC have assets of Rs.50 crore and above, if yes, has the company constituted an Audit Committee.	
6.	How are the transactions in government securities done?	
7.	Has the company submitted a certificate from the Statutory Auditor to the Reserve Bank containing details of registration and the company's classification as Asset Finance Company, Investment Company or Loan Company?	
8.	What is the minimum capital ratio maintained	

	by the company?	
9.	Has the company invested more than 10% of its owned fund in land and buildings and unquoted shares?	
10.	What is the concentration of credit / investment?	
11.	Does the company submit half yearly returns in Form NBS 2 to the RBI?	
12.	Does the company submit monthly returns in Form NBS 6 (if it has total assets of Rs.100 crore and above according to the previous audited balance sheet)	

Non-Banking Financial (Non - Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007

These directions will apply to every non-banking financial company not accepting / holding public deposits. Provisions of this direction with regard to Requirement as to capital adequacy and Concentration of credit/investment will not apply to (a) a loan company (b) an investment company and (c) an asset finance company, which is not a systemically important non-deposit taking non-banking financial company. '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 Rs 100 crores and above as shown in the last audited balance sheet.

Sl.No.	Description / Compliance requirement	Comments
1.	How is the income recognition done on NPA / hire purchase assets / lease assets?	
2.	Is there an investment policy in place?	
3.	Is there a Policy on Demand / Call Loans in	

	case the company grants or intends to grant demand / call loans?	
4.	Has the company classified the lease/hire purchase assets, loans and advances and other forms of credit into standards assets, sub-standard assets, doubtful assets and loss assets?	
5.	Does the NBFC have assets of Rs.50 crore and above, if yes, has the company constituted an Audit Committee.	
6.	How are the transactions in government securities done?	
7.	Has the company submitted a certificate from the Statutory Auditor to the Reserve Bank containing details of registration and the company's classification as Asset Finance Company, Investment Company or Loan Company?	
8.	What is the minimum capital ratio maintained by the company?	
9.	What is the concentration of credit / investment?	
10.	Verify if the particulars mentioned in the Schedule to the Directions has been appended to the balance sheet prescribed under the Companies Act, 1956.	
11.	Verify if information with regard to change of address, directors, auditors etc have been submitted to the Reserve Bank.	

RBI Guidelines on Corporate Governance for NBFCs

This guideline is applicable to all deposit taking NBFCs with deposit size of Rs.20 crore and above and all non-deposit taking NBFCs with asset size of Rs.100 crore and above.

Sl.No.	Description / Compliance requirement	Comments
1.	Is there an audit committee. Obtain details of the committee.	
2.	Is there a Nomination Committee? This committee is formed to ensure 'fit and proper status' of the proposed / existing directors.	
3.	Has the company constituted a Risk Management Committee?	
4.	Does the company have its own internal guidelines on corporate governance, if yes, has it been published on the company's website.	

Guidelines on Fair Practices Code

The Guidelines on Fair Practices Code is applicable for all Non-Banking Financial Companies including Residuary Non-Banking Companies

Sl.No.	Description / Compliance requirement	Comments
1.	Does the company have a fair practices code, if yes	
	Has the code been approved by the Board of Directors, if yes	
	Has the code been published and disseminated on the company's website for the information of	

	the public.	
	Does the fair practice code contain the practice to be followed in the following matters: <ul style="list-style-type: none"> • Applications for loans and their processing • Loan appraisal and terms / conditions • Disbursement of loans including changes in terms and conditions • Recovery of loans 	
2.	Does the company have a grievance redressal mechanism to resolve disputes?	
3.	Is periodical review of the compliance of the Fair Practices Code and the functioning of the grievances redressal mechanism done?	

RBI Guidelines for Asset-Liability Management (ALM) system in NBFCs		
This note lays down broad guidelines in respect of interest rate and liquidity risks management systems in NBFCs which form part of the Asset Liability Management (ALM) function. This is applicable to all NBFCs and Residuary non-banking companies meeting the criteria of asset base of Rs.100 crore, whether accepting deposits or not, or holding public deposits of Rs.20 crore or more.		
Sl.No.	Description / Compliance requirement	Comments
1.	What is the ALM Information system followed by the company?	
	How is the information required for asset liability management collected and analysed?	

2.	Is there an asset liability committee (ALCO) consisting of the company's senior management to decide the business strategy of the NBFC., if yes, what is the composition of the committee	
	Does the company have ALM support groups to analyse, monitor and report the risk profiles to the committee?	
3.	What is the process in place to address liquidity risks and interest rate risks?	
4.	Does the company submit half yearly returns in ALM-Annexure I, II and III to the Reserve Bank?	

RBI guidelines for issue of Commercial Paper (CP)

Commercial Paper is an unsecured money market instrument issued in the form of a promissory note that can be issued by corporates, primary dealers and all India financial institutions.

Sl.No.	Description / Compliance requirement	Comments
1.	Is the company a financial institution, if yes,	
	Has the company obtained permission from the RBI to raise short term resources in the form of commercial paper?	
2.	Is the company a corporate, if yes	
	Is the tangible net worth of the company more than Rs.4 crores as per the latest audited balance sheet?	
	Has the company been sanctioned working capital limit by banks or all India financial	

	institutions	
	Is the borrowal account of the company classified as a standard asset by the financial bank / institution	
3.	What is the credit rating obtained by the company for issuance of commercial paper?	
	Is the credit rating in force	
	Has the credit rating fallen due for review?	
4.	What is the maturity period for which the commercial papers (CP)s have been issued? It may be between a minimum period of 7 days and up to a maximum period of one year but not exceed the date up to which the credit rating is valid.	
5.	Is the CP issued in denominations of Rs.5 lakh or multiples thereof? Amount invested by an investor should not be less than Rs.5 lakh.	
6.	Is the Commercial Paper issued as a stand alone product?	
	Is the aggregate amount of CP within the limit approved by its Board of Directors or within the quantum indicated by the Credit Rating Agency whichever is lower?	
7.	Is the company issuing CPs a financial institution, if yes, does it issues CP together with other instruments like term deposits, certificates of deposit, inter corporate deposits	

	etc., if yes	
	The total limit including CPs not to exceed 100 percent of its net owned funds, as per the latest audited balance sheet.	
8.	Which scheduled bank has been appointed as Issuing and Paying Agent (IPA) for issuance of CP?	
	Has the investor been given a copy of the IPA certificate to show that there is valid agreement with the IPA?	
9.	Who have invested in CP of the company? Obtain a list of the same.	
10.	Is the CP issued in the form of a promissory note?	
11.	Is the CP issued in dematerialised form through depositories, if yes?	
	Is the depository approved and registered with the SEBI?	
12.	What is the form of payment of commercial paper?	
13.	Has the company provided unconditional and irrevocable guarantee for credit enhancement for commercial paper?	

RBI guidelines for issue of Certificates of Deposit (CD)

Certificates of Deposit (CDs) is a negotiable money market instrument and issued in dematerialised form or as a Usance Promissory Note, for funds deposited at a bank or other eligible financial institution for a specified time period.

Sl.No.	Description / Compliance requirement	Comments
1.	Is the company a financial institution, if yes,	
	Has the company obtained permission from the RBI to raise short term resources in the form of certificates of deposits (CDs)	
2.	Does the company issue CDs together with other instruments like term deposits, commercial paper, inter corporate deposits etc., if yes	
	The total limit including CDs not to exceed 100 percent of its net owned funds, as per the latest audited balance sheet.	
3.	Is the minimum amount of certificate of deposit, Rs.1 lakh. The minimum deposit that could be accepted from a single subscriber should not be less than Rs.1 lakh.	
4.	What is the maturity period of the CDs issued by the company?	
	Is it for a period of less than 1 year or more than 3 years from the date of issue?	
5.	Does the company issue CDs on floating rate basis, if yes	
	What is the methodology of compiling the floating rate?	
6.	Does the company grant loans against CDs? (Loans cannot be granted against CDs)	
7.	What is the format of CDs?	

8.	What is the security action taken in case of physical certificates of deposits?	
9.	Has the company accounted the issue price under the head "CDs issued" and showed it under deposits.	
10.	Does the company maintain a register of certificate of deposits issued with all the particulars?	
11.	Has the company submitted fortnightly returns in Form SFR III-D to the Financial Markets Division, Reserve Bank of India?	

"Know your Customer" (KYC) guidelines for NBFCs

These guidelines relate to identification of depositors.

Sl.No.	Description / Compliance requirement	Comments
1.	Verify if proper introduction of new depositors is obtained before opening accounts and accepting deposits.	
2.	Check if written confirmation is obtained from the introducers.	
3.	What is the procedure followed by the company for identification of depositor or borrower.	
4.	How are the cash transactions monitored?	
	Are there large cash withdrawals and deposits, if yes, check if a separate register is maintained for this purpose?	
	Check if the register is maintained for a period of at least 10 years.	

5.	Check the policy of the company in monitoring the compliance of its branches.	
6.	Check the measures taken by the company in adoption of "Know your customer" norms.	
7.	Has the company given adequate training to the staff and management to enable strict adherence to the KYC norms.	

7.10 The Financial Companies Regulation Bill, 2000

The Government of India framed the Financial Companies Regulation Bill, 2000 to consolidate the law relating to NBFCs and unincorporated bodies with a view to ensure depositor protection. The salient features of this Bill are:

- All NBFCS will be known as Financial Companies instead of NBFCs;
- NBFCs holding public deposits would not be allowed to carry on any non-financial business without the prior approval of RBI;
- RBI would have the powers to prescribe minimum net-worth norms;
- Unsecured depositors would have first charge on liquid assets and assets created out of deployment of part of the reserve fund;
- Financial Companies would require prior approval of RBI for any change in name, management or registered office;
- Regulation of unincorporated bodies would be in the hands of the respective State Governments;
- Penalties have been rationalized with the objective that they should serve as a deterrent and investigative powers have been vested with District Magistrates and Superintendents of Police;
- RBI would be empowered to appoint Special Officer(s) on delinquent financial companies;
- Any sale of property in violation of RBI order would be void;

- The Company Law Board will continue to be the authority to adjudicate the claims of depositors.

Financial companies would have no recourse to the CLB to seek deferment of the depositors' dues.

The Bill has been introduced in Parliament in 2000 and has since been referred to the Standing Committee on Finance.

8.0 Anomalies in the NBFC regulations

I. Clarity in Definition of NBFC:

The clause (a) of the section 45 I of the RBI Act define the term 'Business of A Non Banking Financial Institution'. Herein, it has been stated that, "business of a non-banking financial institution" means carrying on of the business of a financial institution referred to in clause (c) and includes business of a non-banking financial company referred to in clause (f).' Therefore, to understand what the business of Non Banking Financial Institution is a reference has to be made to two other clauses (c) and (f). Clause (c) defines the term 'Financial Institution' and clause (f) defines NBFC itself. However, the clause (f) contains a comprehensive and exclusive definition an NBFC. As per this clause a "non-banking financial company" means-

- (i) a financial institution which is a company;
- (ii) a non-banking institution which is a company and which has as its principal business the 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 Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

Therefore, we can say an NBFC is always a company and can be a corporation or a co-operative only if notified by RBI with approval of Central Government. However, no co operative or corporation has been notified till now. The definition of NBFC should have been simple to understand and need to cross references to other clauses could have been avoided. The definition of NBFC in our view could have been:

“non-banking financial company” means-

(A) a non banking company which carries on as its business or part of its business any of the following activities, namely:-

(i) the financing, whether by way of making loans or advances or otherwise, of any activity other than its own:

(ii) the acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature:

(iii) letting or delivering of any goods to a hirer under a hire-purchase agreement as defined in clause (c) of section 2 of the Hire-Purchase Act, 1972:

(iv) the carrying on of any class of insurance business;

(v) managing, conducting or supervising, as foreman, agent or in any other capacity, of chits or kuries as defined in any law which is for the time being in force in any State, or any business, which is similar thereto;

(vi) collecting, for any purpose or under any scheme or arrangement by whatever name called, monies in lumpsum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person,

but does not include any institution, which carries on as its principal business,-

(a) agricultural operations; or

(aa) industrial activity; or]

(b) the purchase or sale of any goods (other than securities) or the providing of any services; or

(c) the purchase, construction or sale of immovable property, so however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of immovable property by other persons

(B) a non banking company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;

(C) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

2. Clarification regarding what in Principle Business:

The sub clause (ii) of clause (f) which defines NBFC states that a non banking company that has as its **principal business** the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner is regarded as NBFC. Moreover, clause (c) that defined 'financial institution' also refers to the phrase Principle business when it states that financial institution does not include institution that carries on as its principle business(a) agricultural operations; or (aa) industrial activity; or (b) the purchase or sale of any goods (other than securities) or the providing of any services; or (c) the purchase, construction or sale of immovable property, so however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of immovable property by other persons. In the absence of a definition of the term 'principal business' in the Act itself, it is not clear what should be the guidelines to be followed to determine the 'principal business' of a company?

In case of a company engaged exclusively in financial business or a company doing exclusively non-financial business, the 'principal business' will be evident enough and it may not be necessary to dwell upon what constitutes 'principal business' of such a company. However, in the case of companies which are carrying on multiple activities, both financial and non-financial, in some what equal or near equal proportions, determining the 'principal business' assumes considerable significance. It would be necessary to define what constitutes the 'principal business' of these companies, in the context of the obligations cast by the amended provisions of the RBI Act on the NBFCs, viz., requirement of applying for registration in case of existing companies and prior registration in case of new companies, penalties for non-compliance with registration requirements, etc.

3. Applicability of Accounting Standards:

The clause 5 of the "Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007" states that Accounting Standards and Guidance notes issued by the Institute of Chartered Accountants of India shall be followed in so far as they are not inconsistent with any of the Directions. This clause should be rectified as ICAI has issued Companies (Accounting Standards) Rules 2006, which are applicable to accounting periods commencing on or after 7-12-2006.

4. Inconsistencies in the provision regarding submission of auditors report

The paragraph 2 of the NBFC Auditor's Report (Reserve Bank) Direction, 1998 states that in addition to every report made by auditor under section 227 of the Companies Act, 1956, the companies auditor shall also make a separate report to the board of directors on the matter specified in paragraph 3 and 4 of the direction. Here it should be noted that the auditors of the company have an obligation to report to the members of the company under section 227(2) of the Companies Act and not to the Board of Directors of the company. Therefore, this direction is inconsistent with the provisions of the Co, 1956.

Moreover, as per the paragraph 5 of the above mentioned direction, the auditors of the Non Banking Financial Companies have been entrusted with the responsibility of direct reporting to RBI, along with other contraventions, if any, on the matters of non-compliance with the directions of RBI. This is against the code of ethics of Chartered Accountants who are required to see to the secrecy of the clients' information. Therefore, there is an urgent need to amend the directions to include auditor's report as an annexure to the Auditors report u/s 227(2) of the companies act, 1956.

5. Errors in Directions:

The RBI directions relating to NBFC has various incidences of faulty drafting. Some of them have been highlighted below:

- RBI by its Notification No. DNBS 189/CGM(PK)-2006 dated 6-12-2006, has amended the classification of the NBFC companies to the effect that equipment leasing companies and hire purchase finance companies have been brought under one category that is asset finance company. However, Paragraph 2 of the 'The Residuary Non-Banking Companies (Reserve Bank) Directions, 1987.' (As amended up to June 2008) refers to the earlier classification.
 - i) an equipment leasing company
 - ii) a hire purchase finance company
 - iii) a housing finance company
 - iv) an insurance company
 - v) an investment company
 - vi) a loan company

- vii) a mutual benefit financial company
- viii) a miscellaneous non-banking company
- ix) a mutual benefit company
- The paragraph 6 of the NBFC Auditor's Report (Reserve Bank) Direction, 1998 which has been updated on June 2008 still refers to **Non-Banking Financial Companies (Reserve Bank) Directions 1998**. This direction is now Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998.
- All directions are scattered and the chances of any key direction/circular being overlooked is high. It is recommended that there is one direction with separate annexure for Miscellaneous Non-Banking Companies, Residuary Non-Banking Companies and NBFCs. This will not only facilitate the readers but also the regulators who will be able to make the amendment comprehensively without omitting certain directions.

9.0 Finance Industry Development Council (FIDC)

<http://fidcindia.org/mission.asp>

FIDC, a self regulatory organisation, was formed by non-banking financial companies which are registered with the RBI and authorised to accept public deposits. The Council is essentially crafted to monitor and streamline the small and medium NBFCs into a systemised code of conduct. But it will also have the participation of the big NBFCs.

The main objective of FIDC is to work towards bringing discipline amongst FIDC members by enforcing a model code of conduct, besides presenting a unified face of this sector to the regulators and other authorities for more effective understanding of our problems and issues.

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Mr. Rajkumar Adukia is an eminent consultant, writer, and speaker. He is a rank holder from Bombay University and did his graduation from Sydenham College of Commerce & Economics. He passed the Chartered Accountancy, Company secretary and Cost Accountancy Course and was among the top rank holders in the courses. Mr. Adukia also holds a degree in law. He has been involved in the activities

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He has been coordinating with various professional institutions, associations' universities, University Grants Commission and other educational institutions and has actively participated with accountability and standards-setting organizations in India and at the international level.

Based on his rich experience, he has written numerous articles on varied topics like in finance, real estate, International Trade, Climate Change and Carbon Credits Mechanism etc. His authoritative articles appear in financial papers like Business India, Financial Express, Economic Times and professional and business magazines. He has authored several books on vast range of topics. His books are known for their practicality and for their proactive approaches to meeting practice needs.

Mr. Adukia is a frequent speaker at seminars and conferences organized by the Institute of Chartered Accountants of India, various chambers of Commerce, income tax offices and other professional and industry associations. He has extensive experience as a speaker, moderator and panelist at workshops and conferences held for both students and professionals across the country and abroad.

