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NON-BANKING FINANCE COMPANIES

TOPICS

» CLASSIFICATION OF NBFCS UNDER THE RBI ACT, 1934

Originally, NBFCs registered with RBI were classified as: (i) Equipment Leasing Company; (ii) Hire-Purchase Company; (iii) Loan Company; and (iv) Investment Company. However, with effect from December 6, 2006 the above NBFCs registered or to be registered with RBI have been reclassified as: (i) Investment Company and (ii) Loan Company; and (iii) Asset Finance Company. Whilst re-classifying NBFCs, RBI has retained the categories of Loan Company and Investment Company but introduced a new category of NBFC i.e. Asset Finance Company.

(i) Investment Company. An 'Investment Company' means any company which is a financial institution, carrying on its principal business of acquisition of securities.

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

(iii) Asset Finance Company. An Asset Finance Company is defined as any company which is a financial institution carrying on as its principal business of financing 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.

A company is treated as a NBFC if its financial assets are more than 50% of its total assets (netted off by intangible assets) and income from financial assets is more than 50% of the gross income. This dual test is applied to determine the 'principal business' of a company and consequently if such company is required to be registered with the RBI as a NBFC. Taking a view as to whether a company is an NBFC or not has serious repercussions including monetary penalty and imprisonment.

The NBFCs may be further classified into those accepting deposits or those not accepting deposits (NBFC-ND). Whilst RBI has framed stricter norms for deposit accepting NBFCs, NBFC - ND were subject to minimal regulations. RBI has in recent past realized that the application of marginal regulation to NBFC-ND that are large and systemically important and also have access to public funds can be a potential source of systemic risk. Therefore, in order to ensure that all systemically relevant NBFCs are brought under a suitable regulatory framework to contain systemic risk, RBI has categorized all NBFC-ND having an asset size of Rs. 100 crores and more as per the last audited balance sheet as 'Systemically Important Non-Deposit Accepting NBFC' (NBFC-ND-SI). This is in addition to the present classification of NBFCs into deposit-accepting and non-deposit-accepting NBFCs. The RBI has also issued prudential norms for NBFC-ND-SI which provides for caps on borrowings by NBFC-ND-SI, capital adequacy requirement and exposure norms, which were hitherto not applicable to a non-deposit accepting NBFCs.

Recently, Securities Exchange Board of India (SEBI) included systemically important NBFCs and certain other types of NBFCs not accepting public deposits as "qualified institutional buyer" for the purposes of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFESI Act). This amendment would entitle these NBFCs to subscribe to security receipts issued by securitization and reconstruction companies and would become entitled to protections accorded to qualified institutional buyers under the SARFESI Act.

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» CLASSIFICATION OF NBFCS UNDER THE FDI POLICY

Whilst the RBI recognizes three categories of NBFCs, the Government of India has, under the foreign direct investment policy (FDI Policy), specifically listed 18 categories of NBFCs that are eligible to receive foreign investments, including merchant banking, underwriting, portfolio management services, investment advisory services, financial consultancy, stock broking, asset management, venture capital, custodial services, leasing & finance, housing finance etc.

Foreign Direct Investment (FDI) upto 100% is permitted in the above 18 NBFC activities subject to minimum capitalization norms depending upon various shareholding thresholds.

FDI in companies engaged in financial services segment, which are not included in the above 18 activities, such as depository services, fund administration etc. will require prior approval of the Foreign Investment Promotion Board. Further, by implication, it could be assumed that the minimum capitalization norms will also be applicable to such activities falling outside the purview of the above 18 activities.

Minimum Capitalization Norm – FDI Policy		
% of FDI	Fund -Based	Non-Fund Based
	(USD in million)	
≥ 51%	0.50	0.50
51% < 75%	5.00	0.50
75% < 100%	50.00	0.50

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» NBFCS - OBVIATING DUAL REGULATION

In terms of Section 45-IA of the RBI Act, it is mandatory that every NBFC should be registered with RBI to

commence or carry on any business of non-banking financial institution. However, to obviate dual regulation, certain categories of NBFCs which are regulated by regulators other than RBI are exempted from the requirement of registration with RBI and consequently the prudential norms and directions laid down by the RBI. To name a few, such NBFC are:

Nature of NBFCs	Regulators
▪ Venture Capital Fund ▪ Merchant Banking ▪ Stock Broking ▪ Custodial Services ▪ Depository Participant	SEBI
▪ Nidhi Companies	Ministry of Corporate Affairs
▪ Insurance Companies	IRDA
▪ Housing Finance Companies	NHB

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» REPORTING REQUIREMENTS FOR RBI REGULATED NBFCS

NBFCs have always been considered to be sensitive entities by the Reserve Bank of India (*RBI*) since they can accept deposits from the public without the rigorous discipline applicable to banks. Many investment banks that failed in the US recently are comparable to the NBFCs in India despite certain conceptual, abstract and legal differences. Even these entities that used other people's money and lost them in trillions of dollars, however loss obviously was not restricted to those who gave monies to such entities but there were system wide global repercussions. In this context, NBFCs in India are obviously bound to face strict regulations and controlling regime by prescription of prudential norms akin to those applicable to banks.

RBI has instituted a strong and comprehensive supervisory mechanism for NBFCs. The focus of the RBI is on prudential supervision so as to ensure that NBFCs function on sound and healthy lines and avoid excessive risk taking. The RBI has put in place a four pronged supervisory framework based on: (i) On-site inspection; (ii) Off-site monitoring supported by state-of the art technology; (iii) Market intelligence; and (iv) Exception reports of statutory auditors of NBFCs.

The thrust of supervision is based on the asset size of the NBFC and whether it accepts/ holds deposits from the public. Broadly speaking, NBFCs are regulated by the RBI Act, the Non-Banking Financial Companies (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 (applicable to NBFCs that do not take deposits), Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 (applicable to NBFCs that do take deposits). RBI further issues circulars, guidance notes and policy papers from time to time in relation to the operations and functioning of NBFCs.

Several NBFCs have been lax in timely submission of the returns to the RBI. Action has been contemplated against such NBFCs – initially those with public deposits of Rs.50 crore and above for non-submission of returns. The action may include imposing penalties as provided in the RBI Act, 1934 as also launching court proceedings against the errant companies, besides considering rejection/ cancellation of the Certificate of Registration.

<u>Important Periodical reporting by NBFCs</u>

1. Deposit Taking NBFCs

Form	Applicability	Periodicity	Deadline	Disclosures

No.				
NBS 1	All	Annual	Latest by September 30	Provide position as on March 31. Shall include details of assets and liabilities including public deposits and other borrowings, net owned fund, outstanding loans and advances, investments etc.
NBS 2	All	Half-yearly (March and September)	Within 3 months	Capital funds, risk assets/exposures, risk asset ratio etc.
NBS 3	- do-	Quarterly	Within 15 days	Statutory liquid assets
NBS 4	NBFCs holding public deposits and whose application for Certificate of Registration for continuing business have been rejected	Monthly	-	Company profile, details of rejection, details of public deposits and other liabilities, liquid and other assets
NBS 5	Holding public deposits of Rs 200 million and above	Quarterly	Within 10 days	Company profile, Total Assets & Liabilities, Supervisory Data, Cash Flow Statement,
NBS 6	Total assets of Rs. 1000 million	Monthly	Within 7 days	Capital market exposure

2. Non-Deposit Taking NBFCs

Form No.	Applicability	Periodicity	Deadline	Disclosures
Not Specified	Asset size above Rs. 1000 million	Monthly	Within 7 days	Company profile, important financial parameters including sources and application of funds, asset classification, Bank/FIs exposure, foreign source of funds, capital market exposure etc.
NBS 7	Systemically Important NBFCs	Annually	Within 3 months	Capital funds, risk assets/exposures and risk asset ratio etc.

CONCLUSION

The sub-prime crisis is too fresh in the mind to be even discussed here and the supervision of the RBI of non-deposit taking NBFCs ND can be only viewed in this context as good conservative measures. The problem though is that complex regulatory requirements are created at times of crisis but continue indefinitely even after the crisis passes by.

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News Articles

1) SEBI may relax rules to help companies raise funds for their arms ***(28th May, 2009 Economic Times)***

- The Securities and Exchange Board of India (SEBI) is considering a proposal to exempt infrastructure companies from the current rule that restrains parent companies from raising money through public issue of debentures for funding group companies.
- The move is aimed at boosting the corporate debt market by making it easier for companies to tap this mode of fund raising.
- Most infrastructure companies follow the holding company and Special Purpose Vehicle (SPV) structure because of the nature of the business.
- Since SPVs do not have a strong credit rating on their own, it becomes difficult for them to raise money by issuing bonds.
- Also, the debt requirement may not be large enough to justify a public issue of debt.
- Mainly NBFCs (Non-Banking Financial Companies) and infrastructure companies will tap the public issue of debt market; therefore the regulatory bottlenecks relating to these two sectors should be removed.

2) Company Law needs muscle ***(20th May 2009, Economic Times)***

- The Companies Bill, 2008 the formulation of which took five years of deliberations and which had been given cabinet approval late in 2008, has lapsed.
- The Bill was drafted at a time when the economy was booming and the government wanted to give greater flexibility to India Inc in decision making.
- The situation drastically changed with the failure of big western corporates, subsequent changes in the global economy and the financial scam in the Satyam case.
- These instances showed the need for greater regulation of corporate behaviour.
- The new company law will be a challenge for the Government as it will strive to guard against any further time lag.
- After the changes are made, a fresh Bill will be placed before the cabinet for approval.

3) Fairplay panel plans drive to 'educate' companies ***(1st June, 2009 Economic Times)***

- The Competition Commission of India (CCI), which got enforcement powers recently, has planned a campaign to educate companies about the practices that are illegal before it starts any action against errant firms.
- The CCI will reach out to corporate houses across the country in June to tell them what practices have to be stopped immediately.
- The CCI was empowered from May 20th this year to impose a penalty of 10% of the turnover of any company entering into an understanding with another in a way that stifles competition in the market.
- In the case of cartelisation, the penalty can be the higher of 10% of the turnover of each of the participants or three times the profits from the cartel.
- The proposed campaign against anti-competitive practices will include several international conferences in various cities, including one in the Capital from June 11TH and another in Cuttack later in the month.
- This would also create awareness among the consumers of their rights under the new law.
- CCI chairman Dhanendra Kumar has said that the regulator sees itself as a "preventive instrument" and wants to give companies adequate time to adapt themselves to a new law that has significantly

changed corporate behaviour the world over.

4) Tricky FDI proposals set to get sole screen test *(May 22, 2009 Economic Times)*

- The Government is attempting to revive an old proposal for a comprehensive law to scan foreign investment in sectors such as telecommunications, defence, aviation and ports for potential security threats.
- The National Security Council (NSC) has argued that a comprehensive legislation is necessary in view of the open investment policy that India follows at present.
- An umbrella legislation, to be called National Security Exception Act (NSEA) which has been modelled on the lines of the Exon Florio Act of the US, would empower the Government to block mergers and acquisitions and takeovers of Indian companies in sensitive sectors if there is credible evidence of a threat to national security.
- The NSEA would subject foreign participation in sensitive sectors and locations and from countries of concern to special security screening, both at the times of approval and during the period of operation.
- The Ministry of Finance would be the nodal body for implementing and monitoring the security guidelines.
- The Reserve Bank of India (RBI) would be directed to follow a 'threshold criterion' and apprise the nodal body in cases where foreign investment is above a particular amount.
- Foreign investors would also be made to submit a commitment to the Government that they would not take any step that may harm India's security.
- Besides running security checks on foreign investments in sensitive sectors, the proposed legislation would also cover all ntracts of the government and public sector firms.
- The NSC's proposal was backed by the Defence and Home Ministries, but was vehemently opposed by the Department of Industrial Policy And Promotion (DIPP), as it was wary that the provisions would hamper foreign investment.

5) Kapil Sibal signals change in HRD outlook *(30th May, 2009 Economic Times)*

With Mr Sibal as the new HRD Minister, the following changes and developments can be expected:

- The introduction of Foreign Educational Institutions (Regulation of Entry and Operations, Maintenance of Quality and Prevention of Commercialization) Bill which received the Cabinet's nod in February 2007.
- The Right to Education Bill which is pending in the Rajya Sabha will also be pushed through.
- There may be second thoughts on the issues relating to regulation and extension of OBC reservation in private education institutes.
- Improvements will be made to the curriculum of schools and universities with more emphasis on skill development.
- In the backdrop of spiraling fees in private schools, a system would be put in place to ensure that no child is denied education on economic grounds.
- More importance to the role of the National Knowledge Commission, though every suggestion need not be adopted.
- Incorporation of modifications and improvements required to improve premium institutions like IIMs and IITs.
- The education sector under the leadership of Mr Sibal seems to be headed in a completely different direction as compared to the previous minister Mr Arjun Singh.

6) Dividend tax relief for group loans *(30th May, 2009 Economic Times)*

Closely-held group companies that frequently borrow money from each other should make a mental note of a recent ruling by the income tax appellate tribunal (ITAT), a quasi-judicial tax authority. The tribunal has said that "deemed dividend cannot be taxed in the hands of non-

shareholders." In order to avoid paying dividend distribution tax (DDT) of 17.5%, profit-making, closely-held (unlisted) companies, resort to granting loans to interested shareholders, those with over 10% shareholding in the companies, instead of paying them dividend after deducting DDT.

Alternatively, to avoid paying DDT, such companies resort to giving loans to any concern in which such a shareholder holds substantial interest, or in excess of 20%. However, in the latter case, since the shareholder is the ultimate recipient of such a payment, it is he and not the concern (which is a non-shareholder in the firm making the advance) that is liable to pay tax.

ITAT's ruling pertained to a privately-held company, Interventional Technologies, which is engaged in life-saving medical devices' trading. This company (assessee) is part of a group of five closely-held, profitable companies, which frequently borrowed from and lent funds to each other. Interventional Technologies received loans from group companies and was selected for scrutiny by an assessing officer (AO), who was of the opinion that the amounts received by it were to be treated as deemed dividend within the meaning of section 2 (22) (e) of the IT Act. AO therefore made an addition of Rs 1.01 crore to the total income of the assessee as deemed dividend under the relevant section for the assessment year 2005-06, thereby taxing it at a higher rate of 33.99%

The company approached ITAT after the Commissioner Income Tax (Appeals) confirmed the addition made by AO through an order dated September 16, 2008. Counsel for the company argued that since Interventional Technologies did not hold any shares of the group companies from which it received loans, the amounts received could not be treated as deemed dividend.

"It is argued that the dividend income can be received only by the shareholder and as the assessee company is not a shareholder of the other group companies, the advances received cannot be treated as deemed dividend," argued Bhupendra Shah, counsel for the assessee company. An ITAT Mumbai bench comprising J Sudhakar Reddy and RS Padvekar held that definition of dividend under section 2(22)(e) of the act is an inclusive definition that 'enlarges' the meaning of the term 'dividend' according to its ordinary and natural meaning to include even a loan or advance.

The ordinary and natural meaning of the term dividend would be a share in profits to an investor in the share capital of a limited company. If the definition of dividend is extended to a loan or advance to a non-shareholder, the ordinary and natural meaning of the word dividend is taken away. In the light of intentions behind the provisions of section 2(22)(e) and in the absence of indication in section 2(22)(e) to extend the legal fiction to a case of loan or advance to a non-shareholder also, we are of the view that a loan or advance to a non-shareholder cannot be taxed as deemed dividend in the hands of a non-shareholder."

7) Telecom Commission gives go-ahead to MVNOs *(30TH May, 2009 Economic Times)*

- The Telecom Commission (Commission) has cleared the proposal to allow Mobile Virtual Network Operators (MVNOs) to launch operations in India.
- MVNOs offer mobile services without owning cellular networks or airwaves (spectrum) on which telecom signals travel.
- Their business model involves buying airtime from existing operators that own telecom infrastructure and selling it to consumers under their own brand.
- The entry of MVNOs is set to further increase competition in the world's fastest growing mobile market.
- Following the Commission's approval, the Government will soon issue a formal notification along with guidelines for MVNOs to operate in India.
- So far, the Communications Ministry had been unable to release the guidelines for MNVOs, as the Department of Telecom (DoT) and regulator Telecommunications Regulatory Authority of India (TRAI) had not found consensus on key issues.

- The Commission, while clearing the proposal, has said MVNOs cannot go for multiple parenting in India.
- An MVNO can therefore tie-up with only one operator in an area for their services though an existing operator can tie-up with any number of MVNOs.
- The Commission also said that MVNOs would be given licenses for a 20-years period.
- The auctions of 3G spectrum and the launch of these high-end services is expected to serve as a catalyst and attract virtual operators to India, as many players that operate in this space globally specialize in high-end value-added services.

8) P-Notes in country's larger interest: Centre tells SC *(4th May, 2009 Economic Times)*

- In an affidavit filed before it the Centre told the Supreme Court, that investments through the issuance of Participatory Notes (P-Notes) are in the larger economic interest of the country.
- The affidavit is in response to a PIL filed by former Union law minister Ram Jethmalani and others contending that P-Notes were undesirable instruments since they did not disclose the true identity of investors.
- The government has stated that it does not subscribe to the position that SEBI possesses evidence to prove that P-Notes are being misusing by anonymous entities in the Indian market since:
- SEBI is empowered to obtain information about the final holder/beneficiary or of any holder at any point of time in case of an investigation or inquiry.
- The amended SEBI (FII) Regulations, 1995 provide that FIIs/sub-accounts/affiliates are also now obliged to provide all the requisite information regarding the P-Notes issued to SEBI as and when and in any form as may be required.
- The monthly reporting format for FIIs also requires them to provide details of outsourcing Offshore Derivative Instruments (ODIs).
- Foreign Institutional Investors (FIIs) in India are subject to Money Laundering and KYC requirements the nature of fund flow would be reflected in the accounts opened by FIIs with banks which in turn are under mandatory obligation to comply with these requirements.
- SEBI is therefore "adequately equipped" to call for any information regarding P-Notes both under provisions of the SEBI Act, 1992, and Regulation 20A of the SEBI (FII) Regulations, 1995.

9) SFIO seeks speedy trials, changes in Companies Act *(4th May, 2009 Economic Times)*

The Serious Fraud Investigation Office (SFIO), which functions under the Ministry of Corporate Affairs, in its report on the Satyam scandal has recommended that:

- Fast-track courts should be set up to try cases involving corporate fraud so that there is no delay in the administration of justice and
- Changes should be made to the Companies Act so that maximum punishment is handed out to those found guilty;
- Statutory auditors should be rotated every five years and their appointment as well as remuneration should be handled by an independent agency.
- Special emphasis be laid on extending the scope of peer review to include audit processes as well as audit plans.
- Disciplinary proceedings initiated against statutory auditors should be handled by an independent oversight board.
- The Reserve Bank of India (RBI) and banks should adopt steps to prevent companies faking bank documents to mislead auditors because in the absence of full details of credit transactions of clearance in the banks' computerized data, the investigation gets hampered.
- RBI should formulate guidelines for scheduled banks to develop such software.
- A uniform practice should be adopted by all commercial /foreign banks while issuing balance confirmation certificates to their customers.

10) Stamp duty waiver likely for conversion into LLPs *(28th April, 2009 Economic Times)*

- The Government may exempt partnership firms and limited companies from paying stamp duty while converting into Limited Liability Partnerships (LLPs).
- The Government will amend the Income Tax Act later this year to provide a tax regime for LLPs, which are being incorporated from the beginning of this month.
- The idea is to adopt a provision similar to Section 394 of the Companies Act, which allows High Courts to waive off stamp duty while approving amalgamations and restructuring of companies involving transfer of assets.
- The proposed move will effectively address the difficulties in getting stamp duty exemptions from State Governments.
- The Finance Ministry, however, may insist that the shareholding pattern of the company/ partnership firm from which assets are transferred to an LLP, and the shareholding of the receiving LLP be the same in order to prevent any stamp duty evasion on asset sale or transfer under the garb of conversion to LLPs.

11) Government to now count banks as 'our own' ***(28th April, 2009 Economic Times)***

- The government plans to bring out yet another clarification to exclude banks from the purview of its revised foreign investment norms, in order to prevent a clutch of Indian private banks from being categorized as foreign-owned.
- The RBI had recently pointed out to DIPP that under its revised FDI norms, banks including ICICI Bank, HDFC Bank, Development Credit Bank and ING Vysya, would cease to be counted as Indian-owned banks.
- Hence DIPP may issue clarifications on certain key issues that may be raised instead of reversing the guidelines.
- These issues are related to the treatment of
- FDI in the banking sector
- Shielding FDI-prohibitive sectors from foreign capital and
- Treatment of investments made prior to introduction of the new FDI calculation norms.
- The government's other concern is that even if foreign holding in a company is as much as 49%, its investment in another downstream subsidiary company, which could be in a FDI restricted sector, will be termed as fully domestic investment.
- The DIPP will also address apprehensions relating to foreign money entering FDI-restricted sectors such as multi-brand retail, agriculture and gambling under the garb of new FDI rules.
- The status of investments made prior to the introduction of the new norms in February this year via Press Notes 2, 3 and 4 could also be subjected to further clarification.

12) Fixed maturity plans (FMPs) affected by SEBI's stringent regulations ***(4th May 2009, Economic Times*****)**

- FMPs are a popular class of closed ended funds, the investment term of which should ideally match the tenure of the paper being invested into to ward off asset-liability mismatch, as per the product structure.
- However, as institutional money started pouring into these schemes, fund managers started to invest short-term investments in long-dated securities with a view to increasing their profits.
- They also started investing in papers issued by real estate and NBFCs in order to boost returns.
- FMPs were thus being used by cash-rich institutions as a 'money-multiplying' instrument.
- When liquidity dried out of the market towards the end of 2008, almost all mutual funds were trapped with illiquid papers and no buyers in sight, and there were widespread apprehensions of investment defaults.
- Post the October '08 redemption fiasco SEBI felt the need to regulate FMPs, mandating funds to only invest in term papers that correspond to the tenure of scheme, barring fund managers from giving indicative yields to investors and putting an end to fund managers including more than 30% of debt papers of a single issuer in one debt scheme.

- These regulations have been perceived as unnecessarily stringent, and it has been opined that the structure of FMP as a product was not faulty, but it just got into a severe liquidity crisis.

13) Government may do away with FBT in budget *(27th May 2009, Economic Times)*

- The Government is considering a proposal to do away with Fringe Benefit Tax (FBT) — the tax on all benefits and perks that companies provide to their employees introduced in the 2005-06 Finance Bill.
- FBT, at Rs 8,000 crore last year, accounted for just over 2% of the total direct tax collection of Rs 3.4 lakh.
- There is a view that collections from this unpopular tax is too minuscule and not worth all the paperwork involved.
- Corporates opposed FBT not just on account of adding to the tax burden, but because of the huge additional paperwork and accounting complications involved.
- FBT is levied on perquisites provided by the employer to the employee in addition to the regular salary.
- This is a tax paid by the employer on the benefits or perks that the employee receives.
- It includes components like the employee's accommodation, entertainment, travel expenses and phone calls and later Employee Stock Option Plans (ESOPs) too were brought under the FBT umbrella.
- FBT has faced criticism in all countries where it is levied like in the United States, New Zealand, Japan, Australia and the United Kingdom.

RBI UPDATES

Prudential Norms on Unsecured Advances (RBI/2008-09/434 dated April 17, 2009)

This notification provided that for determining the amount of unsecured advances, the rights, licenses, authorizations, etc., charged to the banks as collateral in respect of projects (including infrastructure projects) financed by them, should not be reckoned as tangible security but as unsecured. This was done in order to enhance transparency and ensure correct reflection of the unsecured advances in Schedule 9 of the banks' balance sheet. Moreover, banks should also disclose the total amount of advances for which intangible securities such as charge over the rights, licenses, authority, etc. has been taken in addition to the estimated value of such intangible collateral. Such disclosure may be made under a separate head in "Notes to Accounts". This would differentiate such loans from other entirely unsecured loans.

Prudential guidelines on restructuring of advances (RBI/2008-09/435 dated April 17, 2009)

This notification puts to rest the issue of whether on a mere receipt of an application for restructuring of an advance, a bank is entitled to classify it as standard asset, if the account though standard as on September 1, 2008 has turned a Non Performing Asset (NPA) subsequently. It states that during the pendency of the application for restructuring of the advance, the process of reclassification of an asset would not stop and the usual asset classification norms will continue to apply. However, as an incentive for quick implementation of the package, if the approved package is implemented by the bank as per the following time schedule, the asset classification status may be restored to the position which existed when the reference was made to the Corporate Debt Recovery Cell (CDR Cell) in respect of cases covered under the CDR Mechanism or when the restructuring application was received by the bank in non-CDR cases:

(i) Within 120 days from the date of approval under the CDR Mechanism.
(ii) Within 90 days from the date of receipt of application by the bank in cases other than those restructured under the CDR Mechanism.

It is further clarified that the cases where the accounts were standard as on September 1, 2008 but slipped to NPA category before 31st March 2009, these can be reported as standard as on March 31, 2009 only if the restructuring package is implemented before 31st March 2009 and all conditions prescribed in para 6.2.2 of

the circular dated August 27, 2008 (as amended till date) are also complied with and otherwise not. However, in any regulatory reporting made by the bank after the date of implementation of the package within the prescribed period, these accounts can be reported as standard assets with retrospective effect from the date when the reference was made to the CDR Cell in respect of cases covered under the CDR Mechanism or when the restructuring application was received by the bank in non-CDR cases. In this regard, it is clarified that reporting with retrospective effect does not mean reopening the balance sheet which is already finalized but that in all subsequent reporting, the account will be reported as standard and any provisions made because of its interim slippage to NPA can be reversed.

Two Tier checking in RTGS Transactions (RBI/2008-09/437 dated Apr 20, 2009)

This notification provided that all banks participating in RTGS should put in place adequate checks and balances to prevent any slackening of the two tier security system inherent in the architecture of RTGS and suggested various measures such as staff accountability, foolproof IT security and strong internal control systems to counter frauds / attempted frauds. It also stated that any breach in the internal control system resulting in fraud /attempted fraud may lead to termination or suspension of RTGS membership as prescribed in Section 14 of RTGS (Membership) Regulations, 2004. In addition, RBI may also impose fines under Section 30 of the Payment and Settlement Systems Act, 2007 (51 of 2007).

External Commercial Borrowings Policy – Liberalization (Issue of Guarantee for Operating Lease) (RBI/2008-09/438 dated April 20, 2009)

In accordance with this notification, the AD Category – I banks are now allowed to convey 'no objection' from the Foreign Exchange Management Act (FEMA), 1999 angle for issue of corporate guarantee in favour of the overseas lessor for operating lease in respect of import of aircraft/aircraft engine/helicopter. The 'no objection' to the Indian importer for issue of corporate guarantee under FEMA, 1999 may be conveyed after obtaining –

(i.) Board Resolution for issue of corporate guarantee from the company issuing such guarantees, specifying names of the officials authorised to execute such guarantees on behalf of the company.

(ii.) Ensuring that the period of such corporate guarantee is co-terminus with the lease period. It should be specified by the banks that the 'no objection' is issued only from the foreign exchange angle under the provisions of FEMA, 1999 and should not be construed as an approval by any other statutory authority or Government or any other laws / regulations. Furthermore, the 'no objection' should not be construed as regularizing or validating any irregularities, contravention or other lapses, if any, under the provisions of FEMA or any other laws or regulations.

Amendment to Prudential Guidelines on Restructuring of Advances by UCBs (RBI/2008-09/436 dated April 20, 2009)

The Reserve Bank of India (the RBI), vide its notification dated March 6, 2009 had issued Prudential Guidelines on Restructuring of Advances by UCBs (the Guidelines). Paragraph 5.2 (i) of this notification, which deals with provision for diminution in the fair value of restructured advances, has been amended by the latest circular issued by RBI.

The earlier notification provided that the erosion in the fair value of the advance should be computed as the difference between the "the present value of future cash flows (principal and interest) reckoned based on the current BPLR as on the date of restructuring plus the appropriate term premium and credit risk premium for the borrower category on the date of restructuring", and "the present value of future cash flows' (principal and interest) based on rate charged as per the restructuring package". The latest notification seeks to clear out the ambiguity pertaining to interest rate calculation while ascertaining the present value of cash flows.

As per the latest notification, erosion in the fair value of the advance should be computed as the difference between the fair value of the loan ***before*** and ***after*** restructuring. In arriving at the fair value before restructuring, the interest component of the present value of cash flows will be the existing rate charged on

the advance before restructuring. Similarly, in arriving at *fair value of the loan after restructuring* the interest component of the present value of cash flows will be the rate charged on the advance on restructuring.

It has also been clarified that these provisions are **distinct** from the provisions which are linked to the asset classification of the account classified as NPA and reflect the impairment due to deterioration in the credit quality of the loan. The RBI has further noted that the above formula moderates the swing in the diminution of present value of loans with the interest rate cycle and will have to be followed consistently in future and that the modifications effected to the guidelines are aimed at facilitating banks and borrowers to preserve the economic value of the units and not as a means to evergreen the advances. Finally, the notification provides that banks, in addition to the disclosures provided under paragraph 9 of the Guidelines, must disclose the amount and number of accounts in respect of which applications for restructuring are under process, but for whom the restructuring packages have not yet been approved.

The Bankers' Books Evidence Act, 1891 - Submission of Certified Copies of Entries / Print out to Courts (RBI/2008-09/457 dated April 24, 2009)

Recently, a Court of Civil Judge, Maharashtra advised the Reserve Bank of India (the RBI) to instruct all banks that any data stored in their computer systems as evidence under Bankers' Books Evidence Act, 1891 (the Act) to a court of law must be accompanied by a certificate prescribed under Section 2A (a) and (b) of the Act. The above-mentioned provisions deals with the requirements to be adhered to by the banks while furnishing print outs of 'certified copies' (defined in S. 2(8) of the Act). Whenever data is furnished in print out form, S. 2 A(a) requires it to be accompanied by a certificate giving out details of its entries, whereas S. 2A(b) requires it to be accompanied by a certificate providing details of the computer system, safeguard taken to prevent corruption of data in the computer system etc. Hence, RBI has advised that all State and Central Co-operative banks should comply with the Section 2A (a) and (b) of the Act while furnishing certified copies and computer printouts to courts. In the absence of such statutory certificate, the court would not be obliged to admit the document in evidence without any further proof.

Clarification regarding repossession of vehicles financed by NBFCs (RBI/2008-09/454 dated April 24, 2009)

RBI vide its notification dated Sept 28, 2006 had issued guidelines on Fair Practices Code for Non-Banking Financial Companies (NBFCs). As a clarification to queries raised regarding repossession of vehicles, RBI vide the current notification has provided that NBFCs must have a built in re-possession clause in the contract/loan agreement with the borrower which must be legally enforceable. In order to promote transparency, such an agreement is required to have: (a) notice period before taking possession; (b) circumstances under which the notice period can be waived; (c) the procedure for taking possession of the security; (d) a provision regarding final chance to be given to the borrower for repayment of loan before the sale / auction of the property; (e) the procedure for giving repossession to the borrower and (f) the procedure for sale / auction of the property. The NBFCs are also required to furnish a copy of the loan agreement along with a copy each of all enclosures quoted in the loan agreement to all the borrowers at the time of sanction / disbursement of loans, which may form a key component of such contracts/loan agreements.

SEBI Updates

PAN is now a mandatory requirement for transfer of shares of listed company in physical form

SEBI vide circular dated April 27, 2007 had made PAN as the mandatory sole identification number for all participants transacting in the securities market, irrespective of the amount of such transaction. In continuation of the aforesaid circular, SEBI has now clarified that for securities market transactions and off-market/ private transactions involving transfer of shares in physical form of listed companies, it shall be mandatory for the transferee(s) to furnish copy of PAN card to the Company / Registrar to issue and Transfer Agents (RTAs) for registration of such transfer of shares. All Stock Exchanges and RTAs are advised to implement the above by making dissemination of this information on the website and necessary amendments to the bye-laws and Listing Agreement as applicable.

SEBI (Investor Protection and Education Fund) Regulations, 2009

SEBI has notified the SEBI (Investor Protection and Education Fund) Regulations, 2009 with a view to strengthening its activities for investor protection. The salient features of these regulations are – (1.) The Fund shall be used for the protection of investors and promotion of investor education and awareness, in

ways like (a) educational activities including seminars, training, research and publications, aimed at investors; (b) awareness programmes through media - print, electronic, aimed at investors; (c) funding investor education and awareness activities of investors' associations recognized by the Board; (d) aiding investors' associations recognized by the Board to undertake legal proceedings in the interest of investors in securities that are listed or proposed to be listed. (2.) The Board shall constitute a seven-member advisory committee for recommending investor education and protection activities as mentioned above, to the Board. This Committee would comprise of both SEBI officials and outside experts. (3.) These regulations also provide for suitable amendment to the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997, to provide for one of the sources of income for the IPEF.

DIPP Updates

Press Note No. 5 (2009)

Press Note 2 (2008) dated 12th March 2008 stipulated a composite ceiling for foreign investment in Commodity Exchanges of 49% with prior Government approval, subject to the condition that investment under the Portfolio Investment Scheme will be limited to 23% and that under the FDI Scheme will be limited to 26%. As some of the existing Commodity Exchanges had foreign investment above the permitted level, as on the date of issue of the said Press Note they were permitted to avail of transition/complying/correction time for this purpose, up to 30.6.2009, vide Press Note 8 of 2008 dated 19 August, 2008. Due to the various difficulties faced by the exchanges this time perimeter has been increased by 3 months, vide the present Press Note, till 30.9.2009, by which time all Commodity Exchanges are mandated to furnish a compliance report informing the foreign investment in the Commodity Exchange as on 30.9.2009, along with details of equity structure, to the Department of Industrial Policy & Promotion, Department of Consumer Affairs, Foreign Investment Promotion Board, the Forward Market Commission and SEBI.

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