



भारतीय रिज़र्व बैंक  
RESERVE BANK OF INDIA  
www.rbi.org.in

RBI/2012-13/33

DNBS(PD).CC.No.290/03.02.001/2012-13

July 2, 2012

To,

All Non-Banking Financial Companies (NBFCs)

Dear Sir,

**Master Circulars- Miscellaneous Instructions to All Non-Banking Financial Companies**

In order to have all current instructions in one place, the Reserve Bank of India has issued master circulars to NBFCs on various subjects. It is advised that Miscellaneous Directions / Instructions issued upto June 30, 2012, which do not find a place in such master circulars have been compiled herein. A consolidated list of all such instructions is enclosed for ready reference. The Master circular has also been placed on the RBI web-site (<http://www.rbi.org.in>).

Yours faithfully,

(C.R. Samyuktha)  
Chief General Manager

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## 1. Asset Liability Management (ALM) System for NBFCs - Guidelines

It was decided to introduce an ALM System for the Non-Banking Financial Companies (NBFCs), as part of their overall system for effective risk management in their various portfolios. The abovementioned guidelines would be applicable to all the NBFCs irrespective of whether they are accepting / holding public deposits or not. However to begin with, NBFCs (engaged in and classified as equipment leasing, hire purchase finance, loan, investment and residuary non-banking companies) meeting the criteria of asset base of Rs.100 crore (whether accepting / holding public deposits or not) or holding public deposits of Rs. 20 crore or more (irrespective of their asset size) as per their audited balance sheet as of 31 March 2001 would be required to put in place the ALM System.

A system of half yearly reporting was put in place in this regard and the first Asset Liability Management return as on 30 September 2002 was to be submitted to RBI by only those NBFCs which are holding public deposits within a month of close of the relevant half year i.e., before 31 October 2002 and continue thereafter in similar manner. The half yearly returns would comprise of three parts :

- (i) Statement of structural liquidity in format ALM
- (ii) Statement of short term dynamic liquidity in format ALM and
- (iii) Statement of Interest Rate Sensitivity in format ALM.

In the case of companies not holding public deposits, separate supervisory arrangements would be made and advised in due course of time.

## 2. Nomination rules under Section 45QB of RBI Act for NBFC Deposits

In terms of Section 45QB of the RBI Act, the depositor/s of NBFCs may nominate, in the manner prescribed under the rules made by the Central Government under Section 45ZA of the Banking Regulation Act, 1949 (B.R.Act). **one person** to whom, in the event of death of the depositor/s, the amount of deposit may be returned by the NBFC. It has been decided in consultation with the Government of India, that the Banking Companies (Nomination) Rules, 1985 are the relevant rules made under Section 45ZA of the B. R. Act. A copy of the rules is enclosed. Accordingly, NBFCs may accept nominations made by the depositors in the form similar to that specified under the said rules.

## 3. Safe Custody of Liquid Assets / Collection of Interest on SLR Securities

NBFCs including RNBCs are required to maintain liquid assets in the form of Government securities / guaranteed bonds as per the provisions of Section 45-IB of the RBI Act and lodge such securities in a Constituents' Subsidiary General Ledger (CSGL) Account with a scheduled commercial bank (SCB) / Stock Holding Corporation of India

Ltd., (SHCIL) or in a demat account with a depository through a depository participant (DP) registered with Securities & Exchange Board of India (SEBI) or with a branch of SCB to the extent such securities are yet to be dematerialised.

In order to protect the interest of depositors, an exclusive CSGL or demat account to hold Government securities shall be maintained for securities held for the purpose of compliance with Section 45-IB of the RBI Act. This account should be operated only for purchase or sale of securities due to increase or decrease in the quantum of public deposits or withdrawal of securities for encashment on maturity or for repayment to depositors in special circumstances, and not be used to undertake repo or other transactions.

In case an NBFC (including RNBC) deals in the government securities in a manner other than that permitted above, another CSGL account may be opened for this purpose.

It is also observed that some of the NBFCs have either not dematerialised the government securities or have dematerialized but failed to report the same to the RBI. For this purpose the quarterly liquid asset return in the reporting formats of NBS 3 and NBS 3A has been amended to include the information about the demat accounts, which will ensure that the information in this regard is not omitted by NBFCs.

It may be possible that there may be a few Government securities / Government guaranteed bonds that have not been dematerialized and are held in physical form which for the purpose of collection of interest are withdrawn from the safe custody with their designated bankers and re-deposited with the banks after collection of interest. To avoid the process of withdrawal and re-depositing the same it has now been decided that NBFCs / RNBCs shall authorize the designated banks as agents for collection of interest on due dates on these securities held in physical form and lodged for safe custody. NBFCs / RNBCs may approach their designated banker and exercise a Power of Attorney in favour of the designated bank to enable it to collect interest on the securities / guaranteed bonds held in physical form on the due date.

#### **4. Prudential Norms Directions - Preparation of Balance Sheet as on March 31 of every year**

In terms of paragraph 9B of Non Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998 NBFCs are to prepare the Balance Sheet and profit and loss account as on March 31 every year. Whenever an 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 ROC for this purpose. It may, however, be clarified that even in the cases where RBI and ROC grant extension of time, the company would be required to furnish to RBI a Proforma Balance Sheet (unaudited ) as on March 31 of the year and the statutory returns due on the above date.

## **5. Certificate of Registration (CoR) issued under Section 45-IA of the RBI Act, 1934 - Continuation of business of NBFIs - Submission of Statutory Auditors Certificate - Clarification**

It has been observed that there are NBFCs which are no longer engaged in the business of NBFIs and hence are not required / eligible to hold the CoR granted by RBI, but still continue to do so. In order to ensure that CoRs are only held by NBFCs which are actually engaged in the business of NBFIs, all NBFCs 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.

It is clarified that the business of non-banking financial institution (NBFI) means a company engaged in the business of financial institution as contained in Section 45I(a) of the RBI Act, 1934. For this purpose, the definition of 'Principal Business' given, vide Press Release 1998-99/1269 dated April 8, 1999 may be followed.

### **Non- Reckoning Fixed Deposits with Banks as Financial Assets**

It was clarified, that the Reserve Bank issues a Certificate of Registration for the specific purpose of conducting NBFI activities. Investments in fixed deposits cannot be treated as financial assets and receipt of interest income on fixed deposits with banks cannot be treated as income from financial assets as these are not covered under the activities mentioned in the definition of "financial Institution" in Section 45I(c) of the RBI Act 1934. Besides, bank deposits constitute near money and can be used only for temporary parking of idle funds, and/or in the above cases, till commencement of NBFI business.

In addition, the NBFC which is in receipt of a CoR from the Bank must necessarily commence NBFC business within six months of obtaining CoR. If the business of NBFC is not commenced by the company within the period of six months from the date of issue of CoR, the CoR will stand withdrawn automatically. Further, there can be no change in ownership of the NBFC prior to commencement of business and regularization of its CoR

## **6. Operative instructions relating to relaxation / modification in Ready Forward Contracts, Settlement of Government Securities Transactions and Sale of securities allotted in Primary Issues**

All NBFCs / RNBCs are instructed to follow the guidelines on transactions in Government Securities as given in the [circular IDMD.PDRS.05/10.02.01/2003-04 dated March 29, 2004](#) meticulously, wherever applicable. The revised guidelines come into effect from April 2, 2004.

All NBFCs including RNBCs may refer to the [circular IDMD.PDRS.4777, 4779 & 4783/10.02.01/2004-05 all dated May 11, 2005](#) addressed to all RBI regulated entities.

All NBFCs / RNBCs are instructed to follow the guidelines on transactions in Government Securities as given in the circulars meticulously, wherever applicable. In cases of doubt they may refer to IDMD.

## **7. FIMMDA Reporting Platform for Corporate Bond Transactions**

SEBI has permitted FIMMDA to set up its reporting platform for corporate bonds. It has also been mandated to aggregate the trades reported on its platform as well as those reported on BSE and NSE with appropriate value addition.

All NBFCs would be required to report their secondary market transactions in corporate bonds done in OTC market, on FIMMDA's reporting platform with effect from September 1, 2007. Detailed operational guidelines in this regard would be issued by FIMMDA. In the meanwhile, the NBFCs may approach FIMMDA directly for participating in the mock reporting sessions.

## **8. Prior Public Notice about change in control / management**

### ***Need for public notice before (a) Closure of the Branch / Office by any NBFC (b) Sale / Transfer of Ownership by an NBFC***

(a) NBFC should give at least three months public notice prior to the date of closure of any of its branches / offices in, at least, one leading national news paper and a leading local (covering the place of branch / office) vernacular language newspaper indicating therein the purpose and arrangements being made to service the depositors etc.

(b) (i) A public notice of 30 days shall be given before effecting the sale of, or transfer of the ownership by sale of shares, or transfer of control, whether with or without sale of shares. Such public notice shall be given by the NBFC and also by the transferor, or the transferee or jointly by the parties concerned.

For this purpose, the term 'control' shall have the same meaning as defined in Regulation 2(1)(c) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

(ii) The public notice should indicate the intention to sell or transfer ownership / control, the particulars of transferee and the reasons for such sale or transfer of ownership / control. The notice should be published in one leading national and another in leading local (covering the place of registered office) vernacular language newspaper.

## **9. Change in Management and Mergers / Amalgamation**

It has been observed that the change in management also takes place by way of amalgamation / merger of an NBFC with another NBFC or a non-financial company and as such, these mergers / amalgamations would tantamount to the change in the management, as aforesaid.

It would be obligatory on the part of such an NBFC seeking change in management or merger or amalgamation with any other company to give an option to every depositor to decide whether to continue the deposits with the company under the new management or the transferee company or not. The company would also be obliged to make the payment to the depositors who seek the repayment of their deposits. The Bank would view the non-compliance of the above instructions very seriously and penal action would be initiated against the defaulter company on the merits of each case.

The following changes are effected in the above instructions in January 2006 :

(i) ***Merger and Amalgamation in terms of the High Court Order***

(a) Where merger and amalgamation takes place in terms of the High Court order in pursuance of Sections 391 and 394 of the Companies Act 1956, the company shall inform the Bank about merger or amalgamation along with Court's order approving the same within a period of one month from the date of the order. As the public notice is given by the companies under the Companies Act 1956 and Rules made thereunder, no further public notice is required to be given by the companies in terms of the Bank's Circular as mentioned above.

(b) However there will be no change in other instructions contained in paragraph 5(iii) (b) of the Company Circular DNBS(PD).CC.No.12/02.01/99-2000 dated January 13, 2000.

**10. The Non-Banking Financial Companies (Deposit Accepting) (Approval of Acquisition or Transfer of Control) Directions, 2009.**

In exercise of the powers conferred by sections 45K and 45L of the Reserve Bank of India Act, 1934 (2 of 1934) and of all the powers enabling it in this behalf, Reserve Bank of India having considered it necessary in the public interest and being satisfied that for the purpose of enabling the Bank to regulate the credit system to the advantage of the country, it is necessary so to do, gives to every deposit taking NBFC the Directions hereinafter specified.

**Short title and commencement of the Directions**

1. (1) These Directions shall be known as the Non-Banking Financial Companies (Deposit Accepting) (Approval of Acquisition or Transfer of Control) Directions, 2009.

(2) These Directions shall come into force with immediate effect.

## Definitions

2. For the purpose of these Directions, unless the context otherwise requires, -

(a) "control" shall have the same meaning as is assigned to it under clause (c) of sub-regulation (1) of regulation 2 of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

(b) "NBFC" means non-banking financial company as defined in clause (xi) of sub-paragraph (1) of Paragraph 2 of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998.

### **Prior approval of RBI in cases of acquisition or transfer of control of deposit taking NBFCs**

Any takeover or acquisition of control of a deposit taking NBFC, whether by acquisition of shares or otherwise, or any merger / amalgamation of a deposit taking NBFC with another entity, or any merger / amalgamation of an entity with a deposit taking NBFC, shall require prior written approval of Reserve Bank of India.

### **Application of other laws not barred**

The provisions of these Directions shall be in addition to, and not in derogation of the provisions of any other law, rules, regulations or directions, for the time being in force.

### **Exemptions**

The Reserve Bank of India may, if it considers necessary for avoiding any hardship or for any other just and sufficient reason, exempt any NBFC or class of NBFCs, from all or any of the provisions of these Directions either generally or for any specified period, subject to such conditions as the Reserve Bank of India may impose.

#### **(ii) Other cases**

Where merger and amalgamation or change in the management of the company takes place upon sale / transfer otherwise than as stated in sub-paragraph (i) above, the NBFCs (including RNBCs) (deposit taking and non-deposit taking companies) should give prior public notice of 30 days.

### **11. Cover for public deposits - creation of floating charge on Liquid Assets by deposit taking NBFCs**



NBFCs raise funds for their operations from various sources like public deposits, bank borrowings, inter-corporate deposits, secured / unsecured debentures, etc.

In order to ensure protection of depositors interest, NBFCs should ensure that at all times there is full cover available for public deposits accepted by them. While calculating this cover the value of all debentures (secured and unsecured) and outside liabilities other than the aggregate liabilities to depositors may be deducted from the total assets. Further, the assets should be evaluated at their book value or realizable / market value whichever is lower for this purpose. It shall be incumbent upon the NBFC concerned to inform the Regional Office of the Reserve Bank in case the asset cover calculated as above falls short of the liability on account of public deposits. NBFCs accepting / holding public deposits were directed to create a floating charge on the statutory liquid assets invested in terms of Section 45-IB of the RBI Act, 1934, in favour of their depositors. Such charge should be duly registered in accordance with the requirements of the Companies Act, 1956.

In view of the practical difficulties expressed by the NBFCs in creating charge on the statutory liquid assets in favour of large number of depositors, it was subsequently decided that NBFCs accepting / holding public deposits may create the floating charge on the statutory liquid assets maintained in terms of Section 45-IB of the RBI Act, 1934 and notifications issued by the Bank from time to time, in favour of their depositors through the mechanism of 'Trust Deed'.

## **12. Unsolicited Commercial Communications - National Do Not Call Registry**

It is an emerging practice in India to engage agents / outsource business operations for the purpose of soliciting or promoting any commercial transactions using telecommunication mode. There is a need to protect the right to privacy of the members of public and to curb the complaints relating to unsolicited commercial communications being received by customers / non-customers, as part of best business practices.

Telecom Regulatory Authority of India (TRAI) has framed the Telecom Unsolicited Commercial Communications (UCC) Regulations for curbing UCC. Further, the Department of Telecommunications (DoT) has issued relevant guidelines for telemarketers alongwith the registration procedure on June 6, 2007. These guidelines have made it mandatory for telemarketers to register themselves with DoT or any other agency authorized by DoT and also specified that the telemarketers shall comply with the Guidelines and Orders / Directions issued by DoT and Orders / Directions / Regulations issued by Telecom Regulatory Authority of India (TRAI) on Unsolicited Commercial Communications(UCC). The detailed procedure in this regard is also available on TRAI's website ([www.trai.gov.in](http://www.trai.gov.in)).

NBFCs are therefore; advised

- (i) not to engage Telemarketers (DSAs / DMAs) who do not have any valid registration certificate from DoT, Govt of India, as telemarketers;
- (ii) to furnish the list of Telemarketers (DSAs/DMAs) engaged by them along with the registered telephone numbers being used by them for making telemarketing calls to TRAI; and
- (iii) to ensure that all agents presently engaged by them register themselves with DoT as telemarketers.

### **13. Requirement of minimum NOF of Rs. 200 lakh for all deposit taking NBFCs**

In accordance with the consultative approach adopted by the Bank in framing of guidelines, a draft circular on enhancement of minimum NOF level for deposit taking NBFCs was placed on web-site [www.rbi.org.in](http://www.rbi.org.in) on May 21, 2007.

The suggestions / comments received in this regard were considered. 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 upto a certain level, but have, for any reason, not accepted deposits upto that level will be permitted to accept public deposits upto the revised ceiling prescribed above.
- (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.

### **14. Reclassification of NBFCs**

In terms of Company [Circular DNBS.PD.CC No.85/03.02.089/2006-07 dated December 06, 2006](#) it was advised that NBFCs financing real / physical assets for productive / economic activity will be classified as Asset Finance Company (AFC) as per the criteria

given under paragraph 4 of that circular. Consequent upon re-classification of NBFCs, in the proposed structure the following categories of NBFCs will emerge :

- (i) Asset Finance Company
- (ii) Investment Company
- (iii) Loan Company
- <sup>1</sup>(iv) Infrastructure Finance Company
- <sup>2</sup>(v) Core Investment Companies-ND-SI

Accordingly, it was advised that the companies satisfying the conditions specified may approach the Regional Office in the jurisdiction of which their Registered Office is located, along with the original Certificate of Registration (CoR) issued by the Bank to recognize their classification as Asset Finance Companies. Their request must be supported by their Statutory Auditors' certificate indicating the asset / income pattern of the company as on March 31, 2006.

As substantial time has elapsed, since the issue of the circular, it has now been decided that erstwhile EL / HP NBFCs should, duly supported by Statutory Auditors' Certificate as on March 31, 2008, immediately approach the Regional Office concerned for appropriate classification latest by December 31, 2008 after which NBFCs which have not opted for the classification would be deemed to be loan companies.

#### **15. Monitoring Framework for non-deposit taking NBFCs with asset size of Rs 50 crore and above but less than Rs 100 crore**

It was decided to call for 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. The first such returns for the quarter ended September 2008 were to be submitted by first week of December 2008. The quarterly return as at the end of each quarter were to be filed online with the Regional Office of the Department of Non-Banking Supervision in whose jurisdiction the company was registered, within a period of one month from the close of the quarter, while the the procedure / system for online submission would be conveyed at a later date.

Applicable NBFCs were later advised to submit the above return 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 was registered, within a period

of one month from the close of the quarter, till the online procedure in this regard is advised.

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

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.

In this connection it is further clarified that

DTL created by debit to opening balance of Revenue Reserves or to Profit and Loss Account for the current year should be included under 'others' of "Other Liabilities and Provisions."

DTA created by credit to opening balance of Revenue Reserves or to Profit and Loss account for the current year should be included under item 'others' of "Other Assets."

Intangible assets and losses in the current period and those brought forward from previous periods should be deducted from Tier I capital.

DTA computed as under should be deducted from Tier I capital :

- (i) DTA associated with accumulated losses; and
- (ii) The DTA (excluding DTA associated with accumulated losses) net of DTL. Where the DTL is in excess of the DTA (excluding DTA associated with accumulated losses), the excess shall neither be adjusted against item (i) nor added to Tier I capital."

## **17. Introduction of Interest Rate Futures - NBFCs**

All NBFCs (excluding RNBCs) were advised to refer to the Directions issued by the Reserve Bank of India in terms of Notification No. FMD.1/ED(VKS)-2009 dated August 28, 2009, covering the framework for trading of Interest Rate Futures (IRFs) in recognized exchanges in India.

It has been decided that NBFCs may participate in the designated interest rate futures exchanges recognized by SEBI, as clients, subject to RBI / SEBI guidelines in the matter, for the purpose of hedging their underlying exposures.

NBFCs participating in IRF exchanges may submit the data in this regard half yearly, in the format enclosed, 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 half year.

#### **18. Compliance with FDI norms-Half yearly certificate from Statutory Auditors of NBFCs**

NBFCs having FDI whether under automatic route or under approval route have to comply with the stipulated minimum capitalisation norms and other relevant terms and conditions, as amended from time to time under which FDI is permitted.

As such these NBFCs are required to submit a certificate from their Statutory Auditors on half yearly basis (half year ending September and March) certifying compliance with the existing terms and conditions of FDI. Such certificate may be submitted not later than one month from the close of the half year to which the certificate pertains, to the Regional Office in whose jurisdiction the head office of the company is registered.

#### **19. Finance for Housing Projects - Incorporating clause in the terms and conditions to disclose in pamphlets / brochures / advertisements, information regarding mortgage of property to the NBFC**

In a case which came up before the Hon'ble High Court of Judicature at Bombay, the Hon'ble Court observed that the bank granting finance in housing, should insist on projects, disclosure of the charge or any other liability on the plot in question or development project being duly made in the Brochure or pamphlet etc. which may be published by developer / owner inviting public at large to purchase flats and properties. The Court also added that this obviously would be part of the terms and conditions on which the loan may be sanctioned by the bank.

Keeping in view the above, it is felt desirable that while granting finance to housing / development projects, NBFCs also should stipulate as a part of the terms and conditions that :

(i) the builder / developer / owner / company would disclose in the Pamphlets / Brochures / advertisements etc., the name(s) of the entity to which the property is mortgaged.

(ii) the builder / developer / owner / company should indicate in the pamphlets / brochures, that they would provide No Objection Certificate (NOC) / permission of the mortgagee entity for sale of flats / property, if required.

NBFCs were advised to ensure compliance with the above stipulations and funds should not be released unless the builder / developer / owner / company fulfils the above requirements.

## **20. Loan facilities to the physically / visually challenged by NBFCs**

It was brought to the notice of RBI that a NBFC has discriminated against physically / visually challenged persons in the matter of offering loans.

NBFCs were therefore advised that there shall be no discrimination in extending products and facilities including loan facilities to the physically / visually challenged applicants on grounds of disability. NBFCs were also instructed to advise their branches to render all possible assistance to such persons for availing of the various business facilities.

## **21. Participation in Currency Futures**

Reserve Bank had issued guidelines to banks on trading in currency futures in recognised stock/new exchanges on August 6, 2008. It was decided that all NBFCs excluding RNBCs may participate in the designated currency futures exchanges recognized by SEBI as clients, subject to RBI (Foreign Exchange Department) guidelines in the matter, only for the purpose of hedging their underlying forex exposures. NBFCs were advised to make appropriate regarding transactions undertaken in the Balance sheet.

## **22. Services to persons with Disability - Training Programme for Employees**

In terms of [DNBS.CC.PD.No.191/03.10.01/2010-11 dated July 27, 2010](#) NBFCs were advised that there shall be no discrimination in extending products and facilities including loan facilities to the physically / visually challenged applicants on grounds of disability and that they may also advise their branches to render all possible assistance to such persons for availing of the various business facilities.

In continuation to the above, NBFCs are advised that they may include a suitable module containing the rights of persons with disabilities guaranteed to them by the law and international conventions, in all the training programmes conducted for their

employees at all levels. Further, NBFCs may ensure redressal of grievances of persons with disabilities under the Grievance Redressal Mechanism already set up by them.

### **23. Submission of data to Credit Information Companies - Format of data to be submitted by Credit Institutions**

In terms of Section 2(f)(ii) of the Credit Information Companies (Regulation) Act, 2005, a non-banking financial company as defined under clause (f) of Section 45-I of the Reserve Bank of India Act, 1934 has also been included as "credit institution". Further, the Credit Information Companies (Regulation) Act provides that every credit institution in existence shall become a member of at least one credit information company. Thus all NBFCs being credit institutions are required to become a member of at least one credit information company as per the statute.

In this regard, in terms of sub-sections (1) and (2) of Section 17 of the Credit Information Companies (Regulation) Act, 2005, a credit information company may require its members to furnish credit information as it may deem necessary in accordance with the provisions of the Act and every such credit institution has to provide the required information to that credit information company. Further, in terms of Regulation 10(a)(ii) of the Credit Information Companies Regulations, 2006, every credit institution shall :

- (a) keep the credit information maintained by it, updated regularly on a monthly basis or at such shorter intervals as may be mutually agreed upon between the credit institution and the credit information company; and
- (b) take all such steps which may be necessary to ensure that the credit information furnished by it, is update, accurate and complete.

It is therefore, advised that NBFCs which have become member / members of any new credit information company / companies may provide them the current data in the existing format. Such NBFCs may also provide historical data in order to enable the new credit information companies to validate their software and develop a robust database. Care should be taken to ensure that no wrong data / history regarding borrowers is given to Credit Information Companies.

### **24. Implementation of Green Initiative of the Government**

As part of the 'Green Initiative' of the Government, the Government of India has suggested that steps be taken by entities in financial sector, including NBFCs to help better utilisation of their resources and also better delivery of services.

NBFCs were therefore, requested to take proactive steps in this regard by increasing the use of electronic payment systems, elimination of post-dated cheques and gradual phase-out of cheques in their day to day business transactions which would result in more cost-effective transactions and faster and accurate settlements.

## **25. Attempt to defraud using fake bank guarantee-modus operandi**

In view of reports of instances of frauds involving fake Bank Guarantee with forged signature etc in certain bank branches, NBFCs were advised to take notice of the names of the beneficiaries /representative of beneficiaries and applicants of BGs in order to exercise due caution while handling cases involving the firms/individuals cited in the circular.

## **26. Credit Default Swaps – NBFCs as Users**

NBFCs shall only participate in CDS market as users. As users, they would be permitted to buy credit protection only to hedge their credit risk on corporate bonds they hold. They are not permitted to sell protection and hence not permitted to enter into short positions in the CDS contracts. However, they are permitted to exit their bought CDS positions by unwinding them with the original counterparty or by assigning them in favour of buyer of the underlying bond.

Apart from complying with all the provisions above, NBFCs were advised that, as users, they shall also be required to ensure that the guidelines enclosed including operational requirements for CDS are fulfilled by them.



## Guidelines for Credit Default Swaps - NBFCs as users

### Definitions

The following definitions are used in these guidelines:

- (i) **Credit event payment** – the amount which is payable by the credit protection seller to the credit protection buyer under the terms of the credit derivative contract following the occurrence of a credit event. The payment can be only in the form of **physical settlement** (payment of par in exchange for physical delivery of a deliverable obligation).
- (ii) **Underlying asset / obligation** – The asset<sup>1</sup> which a protection buyer is seeking to hedge.
- (iii) **Deliverable asset / obligation** – any obligation<sup>2</sup> of the reference entity which can be delivered, under the terms of the contract, if a credit event occurs. (Assets under (iii) above, will rank at least *pari-passu* or junior to the underlying obligation).
- (iv) **Reference obligation** - the obligation<sup>3</sup> used to calculate the amount payable when a credit event occurs under the terms of a credit derivative contract. [A reference obligation is relevant for obligations that are to be cash settled (on a par-less-recovery basis).]

### 2. Operational requirements for CDS

- a) A CDS contract should represent a direct claim on the protection seller and should be explicitly referenced to specific exposure, so that the extent of the cover is clearly defined and incontrovertible.
- b) Other than non-payment by a protection buyer of premium in respect of the credit protection contract, it should be irrevocable.
- c) There should be no clause in the contract that would allow the protection seller unilaterally to cancel the credit cover or that would increase the effective cost of cover as a result of deteriorating credit quality in the hedged exposure.
- d) The CDS contract should be unconditional; there should be no clause in the protection contract outside the direct control of the NBFC that could prevent the protection seller from being obliged to pay out in a timely manner in the event that the original counterparty fails to make the payment(s) due.
- e) The credit events specified by the contracting parties should at a minimum cover:

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<sup>1</sup> Please refer to paragraph 2.4 of the circular IDMD.PCD.No. 5053 /14.03.04/2010-11 dated May 23, 2011

<sup>2</sup> For the present, only deliverable obligation permitted in terms of guidelines on CDS vide circular IDMD.PCD.No. 5053 /14.03.04/2010-11 dated May 23, 2011.

<sup>3</sup> Please refer to paragraph 2.4 of the circular IDMD.PCD.No. 5053 /14.03.04/2010-11 dated May 23, 2011

- (i) failure to pay the amounts due under terms of the underlying obligation that are in effect at the time of such failure (with a grace period that is closely in line with the grace period in the underlying obligation);
  - (ii) bankruptcy, insolvency or inability of the obligor to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and analogous events; and
  - (iii) restructuring of the underlying obligation (as contemplated in the guidelines on CDS issued vide [Circular No. IDMD.PCD.No.5053/14.03.04/2010-11 dated May 23, 2011](#)) involving forgiveness or postponement of principal, interest or fees that results in a credit loss event;
  - (iv) when the restructuring of the underlying obligation is not covered by the CDS, but the other requirements in paragraph 2 are met, partial recognition of the CDS will be allowed. If the amount of the CDS is less than or equal to the amount of the underlying obligation, 60% of the amount of the hedge can be recognised as covered. If the amount of the CDS is larger than that of the underlying obligation, then the amount of eligible hedge is capped at 60% of the amount of the underlying obligation.
- f) If the CDS specifies deliverable obligations that are different from the underlying obligation, the resultant asset mismatch will be governed under paragraph (j).
- g) The CDS shall not terminate prior to expiration of any grace period required for a default on the underlying obligation to occur as a result of a failure to pay<sup>4</sup>.
- h) If the protection buyer's right/ability to transfer the underlying obligation to the protection seller is required for settlement, the terms of the underlying obligation should provide that any required consent to such transfer may not be unreasonably withheld.
- i) The identity of the parties responsible for determining whether a credit event has occurred should be clearly defined. This determination should not be the sole responsibility of the protection seller. The protection buyer should have the right/ability to inform the protection seller of the occurrence of a credit event.
- j) A mismatch between the underlying obligation and the reference obligation or deliverable obligation is permissible if (1) the reference obligation or deliverable obligation ranks *pari passu* with or is junior to the underlying obligation, and (2) the underlying obligation and reference obligation or deliverable obligation share the same obligor (i.e. the same legal entity) and legally enforceable cross-default or cross-acceleration clauses are in place.

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<sup>4</sup> Definition of maturity – the maturity of the underlying exposure and the maturity of the hedge should both be defined conservatively. The effective maturity of the underlying should be gauged as the longest possible remaining time before the counterparty is scheduled to fulfill its obligation, taking into account any applicable grace period.

(k) A mismatch between the underlying obligation and the obligation used for purposes of determining whether a credit event has occurred is permissible if (1) the latter obligation ranks *pari passu* with or is junior to the underlying obligation, and (2) the underlying obligation and reference obligation share the same obligor (i.e. the same legal entity) and legally enforceable cross-default or cross acceleration clauses are in place.

### **3. Treatment of exposures below materiality thresholds**

Materiality thresholds on payments below which no payment is made in the event of loss as per the CDS contract, are equivalent to retained first loss positions and should be assigned risk weight of 667% ( $1/0.15 \times 100$  as minimum CRAR requirement for NBFCs is 15%) for capital adequacy purpose by the protection buyer.

### **4. Prudential treatment post-credit event**

In case the credit event payment is not received within the period as stipulated in the CDS contract, the NBFC shall ignore the credit protection of the CDS and reckon the credit exposure on the underlying asset and maintain appropriate level of capital and provisions as warranted for the exposure. On receipt of the credit event payment, (a) the underlying asset shall be removed from the books if it has been delivered to the protection seller; or (b) the book value of the underlying asset shall be reduced to the extent of credit event payment received if the credit event payment does not fully cover the book value of the underlying asset and appropriate provisions shall be maintained for the reduced value.

### **5. Capital Adequacy**

In terms of NBFC Prudential Norms Directions, 2007, risk weights for credit risk for corporate bonds held by NBFCs is 100%. A CDS contract creates a counterparty exposure on the protection seller on account of the credit event payment. In case of hedging of the cash position by CDS, the exposure will be reckoned on the protection seller subject to the conditions mentioned in para 6 below. NBFCs shall calculate the counterparty credit risk charge for all bought CDS positions as the sum of the current mark-to-market value, (if positive and zero, if MTM is negative) and the potential future exposure.

### **6. Treatment of exposure to the protection seller**

6.1 Exposure to the underlying asset in respect of the hedged exposure shall be deemed to have been substituted by exposure to the protection seller, if the following conditions are satisfied:

- a. Operational requirements mentioned in para 2 are satisfied
- b. There is no maturity mis-match between the underlying asset and the deliverable obligation. If this condition is not satisfied, then the amount of credit protection to be recognised should be computed as indicated in paragraph 6.2 below.

In all other cases the exposure will be deemed to be on the underlying asset.

6.2 Risk weights as applicable to the underlying assets shall be applied for the unprotected portion of the exposure. The amount of credit protection shall be adjusted if there are any mismatches between the underlying asset/ obligation and the deliverable asset / obligation with regard to *asset* or *maturity*. These are dealt with in detail in the following paragraphs.

### 6.3 Mismatches

The amount of credit protection shall be adjusted if there are any mismatches between the underlying asset/ obligation and the deliverable asset / obligation with regard to *asset* or *maturity*.

#### (i) Asset mismatches

Asset mismatch will arise if the underlying asset is different from the deliverable obligation. Protection will be reckoned as available to the NBFC only if the mismatched assets meet the requirements specified in paragraph 2 (j) above.

#### (ii) Maturity mismatches

The NBFC would be eligible to reckon the amount of protection if the maturity of the credit derivative contract were to be equal to the maturity of the underlying asset. If, however, the maturity of the CDS contract is less than the maturity of the underlying asset, then it would be construed as a maturity mismatch. In case of maturity mismatch the amount of protection will be determined in the following manner:

- a. If the residual maturity of the credit derivative product is less than **three months** no protection will be recognized.
- b. If the residual maturity of the credit derivative contract is **three months** or more protection proportional to the period for which it is available will be recognised. When there is a maturity mismatch the following adjustment will be applied.

$$Pa = P \times (t - .25) \div (T - .25)$$

Where:

Pa = value of the credit protection adjusted for maturity mismatch

P = credit protection

t = min (T, residual maturity of the credit protection arrangement) expressed in years

T = min (5, residual maturity of the underlying exposure) expressed in years

**Example:** Suppose the underlying asset is a corporate bond of Face Value of Rs. 100 where the residual maturity is of 5 years and the residual maturity of the CDS is 4 years. The amount of credit protection is computed as under:

$$100 * \{(4-.25) \div (5-.25)\} = 100*(3.75 \div 4.75) = 78.95$$

- c. Once the residual maturity of the CDS contract reaches **three months**, protection ceases to be recognised.

6.4 NBFCs as users need to adhere to all the criteria required for transferring the exposures fully to the protection seller in terms of paragraph 7.1 above on an on-going basis so as to qualify for exposure relief on the underlying asset. In case any of these criteria are not met subsequently, the NBFC will have to reckon the exposure on the underlying asset. Therefore, NBFCs should restrict the total exposure to an obligor including that covered by way of CDS within an internal exposure ceiling considered appropriate by the Board of the NBFC in such a way that it does not breach the single / group borrower exposure limit prescribed by RBI. In case of the event of any breach in the single / group borrower exposure limit, the entire exposure in excess of the limit will be risk weighted at 667%. In order to ensure that consequent upon such a treatment, the NBFC does not breach the minimum capital requirement prescribed by RBI, it should keep sufficient cushion in capital in case it assumes exposures in excess of normal exposure limit.

6.5 No netting of positive and negative marked-to-market values of the contracts with the same counterparty will be allowed for the purpose of complying with the exposure norms.

## **7. General Provisions Requirements**

For the CDS positions of NBFCs, they should hold general provisions for gross positive marked-to-market values of the CDS contracts.

## **8. Reporting Requirement:**

On a quarterly basis, NBFCs should report “total exposure” in all cases where they have assumed exposures against borrowers in excess of the normal single / group exposure limits due to the credit protections obtained by them through CDS, guarantees or any other permitted instruments of credit risk transfer, to the Regional Office of Department of Non-Banking Supervision where they are registered.

9. NBFCs shall also disclose in their notes to accounts of balance sheet the details given in annex- 2.

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**Format of disclosure to be made in the Annual Financial Statements**

(Rs. crore)

1. No. of transactions during the year
  
2. Amount of protection bought during the year
  
3. No. of transactions where credit event payment was received during the year
  - a) pertaining to current year's transactions
  - b) pertaining to previous year(s)' transactions
4. Outstanding transactions as on March 31:
  - a) No. of Transactions
  - b) Amount of protection
  
5. Net income/ profit (expenditure/ loss) in respect of CDS transactions during year-to-date:
  - a) premium paid
  - b) Credit event payments received (net of value of deliverable obligation).

List of Circulars

Sl. No.	Circular No.	Date
1.	DNBS.(PD).CC.No.11/02.01/99-2000	November 15, 1999
2.	DNBS.(PD).CC.No.12/02.01/99-2000	January 13, 2000
3.	DNBS.(PD).CC.No.15/02.01/2000-2001	June 27, 2001
4.	DNBS.(PD).C.C.No.27/02.05/2003-04	July 28, 2003
5.	DNBS.(PD).C.C.No.28/02.02/2002-03	July 31, 2003
6.	<a href="#">DNBS.(PD).CC.No.37/02.02/2003-04</a>	May 17, 2004
7.	<a href="#">DNBS.(PD).CC.No.38/02.02/2003-04</a>	June 11, 2004
8.	<a href="#">DNBS.(PD).C.C.No.42/02.59/2004-05</a>	July 24, 2004
9.	<a href="#">DNBS.(PD).C.C.No.43/05.02/2004-05</a>	August 10, 2004
10.	<a href="#">DNBS.(PD).C.C.No.47/02.01/2004-05</a>	February 07, 2005
11.	<a href="#">DNBS.(PD).CC.No.49/02.02/2004-05</a>	June 9, 2005
12.	<a href="#">DNBS.(PD).CC.No.63/02.02/2005-06</a>	January 24, 2006
13.	<a href="#">DNBS.(PD).C.C.No.79/03.05.002/2006-07</a>	September 21, 2006
14.	<a href="#">DNBS.(PD).C.C.No.81/03.05.002/2006-07</a>	October 19, 2006
15.	<a href="#">DNBS.(PD).CC.No.82/03.02.02/2006-07</a>	October 27, 2006
16.	<a href="#">DNBS.PD.CC. No.85/03.02.089/2006-07</a>	December 06, 2006
17.	<a href="#">DNBS.(PD)C.C No.87/03.02.004/2006-07</a>	January 4, 2007
18.	DNBS.PD/C.C.No.105/03.10.001/2007-08@ @ Actual Circular Number should be DNBS.PD/C.C.No.96/03.10.001/2007-08	July 31, 2007
19.	<a href="#">DNBS.PD/C.C No.109/03.10.001/2007-08</a>	November 26, 2007
20.	<a href="#">DNBS. (PD).C.C.No.114/03. 02.059/2007-08</a>	June 17, 2008
21.	<a href="#">DNBS.(PD).C.C.No.124/03.05.002/2008-09</a>	July 31, 2008
22.	<a href="#">DNBS.PD.CC No.128/03.02.059/2008-09</a>	September 15, 2008
23.	DNBS.PD. Notification No.208	September 17, 2008* * Actual date should be 17-09-09
24.	<a href="#">DNBS.PD.CC.No.130/03.05.002/2008-09</a>	September 24, 2008
25.	<a href="#">DNBS.PD.CC.No.137/03.05.002/2008-09</a>	March 02, 2009
26.	<a href="#">DNBS.PD/CC.No.142/03.05.002/2008-09</a>	June 9, 2009

27.	<a href="#">DNBS.(PD).CC.No.167/03.10.01/2009-10</a>	February 04, 2010
28.	<a href="#">DNBS.PD.CC.No.168/03.02.089/2009-10</a>	February 12 , 2010
29.	<a href="#">DNBS.(PD).CC.No.173/03.10.01/2009-10</a>	May 03, 2010
30.	<a href="#">DNBS.(PD).C.C.No.174/03.10.001/2009-10</a>	May 6, 2010
31.	<a href="#">DNBS.CC.PD.No.191/03.10.01/2010-11</a>	July 27, 2010
32	<a href="#">DNBS (PD) CC No. 195 / 03.10.001/ 2010-11</a>	August 9, 2010
33)	<a href="#">DNBS.(PD).CC.No.200/03.10.001/2010-11</a>	September 17, 2010
34	<a href="#">DNBS(PD).CC.No.206/03.10.001/2010-11</a>	January 5, 2011
35)	<a href="#">DNBS.CC.PD.No.208/03.10.01/2010-11</a>	January 27, 2011
36	<a href="#">DNBS(PD).CC. No.245 /03.10.42 /2011-12</a>	September 27 , 2011
37)	<a href="#">DNBS(PD).CC. No 248 /03.10.01 /2011-12</a>	October 28, 2011
38)	<a href="#">DNBS (PD)CC.No.259 /03.02.59/2011-12</a>	March 15, 2012
39	<a href="#">DNBS.CC.PD.No.253/03.10.01/2011-12</a>	December 26, 2011