



भारतीय रिज़र्व बैंक

RESERVE BANK OF INDIA

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July 1, 2014

Chairman and Managing Directors /

Chief Executives of

All Scheduled Commercial Banks (excluding RRBs)

Dear Sir,

**Master Circular - Bank Finance to Non-Banking Financial Companies
(NBFCs)**

Please refer to our [Master Circular DBOD.BP.BC.No.6/21.04.172/2013-14 dated July 1, 2013](#) on the captioned subject. The Master Circular has been suitably updated by incorporating instructions issued up to June 30, 2014 and has also been placed on the RBI web-site (<http://www.rbi.org.in>).

Yours faithfully,

(Rajesh Verma)
Chief General Manager-in-Charge

Master Circular on Bank Finance to Non-Banking Financial Companies
(NBFCs)

Purpose

To lay down the Reserve Bank of India's regulatory policy regarding financing of NBFCs by banks.

Classification

A statutory guideline issued under Section 35A of Banking Regulation Act, 1949

Previous guidelines superceded

Master circular DBOD.BP.BC.No.6/21.04.172/2013-2014 dated July 1, 2013 on 'Bank Finance to Non-Banking Financial Companies (NBFCs)'.

Application

To all Scheduled Commercial Banks (excluding Regional Rural Banks).

Structure

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1. Introduction

Reserve Bank of India has been regulating the financial activities of the Non-Banking Financial Companies under the provisions of Chapter III B of the Reserve Bank of India Act, 1934. With the amendment of the Reserve Bank of India Act, 1934 in January 1997, in terms of Section 45 IA of the said Act, all Non-Banking Financial Companies have to be mandatorily registered with the Reserve Bank of India.

1.1 Terminology

(a) 'NBFCs' means the Non-Banking Financial Companies registered with Department of Non-Banking Supervision of Reserve Bank of India.

(b) Residuary Non-Banking Companies (RNBCs) are the companies classified and registered with Department of Non-Banking Supervision of Reserve Bank of India as such.

(c) 'Current investments' means the investments classified in the balance sheet of the borrower as 'current assets' and are intended to be held for less than one year.

(d) 'Long term investments' means all types of investments other than that classified as 'current assets'.

(e) 'Unsecured loans' means the loans not secured by any tangible asset.

1.2 Background

The credit related matters of banks have been progressively deregulated by Reserve Bank of India. Consistent with the policy of bestowing greater operational freedom to banks in the matter of credit dispensation and in the context of mandatory registration of NBFCs with the Reserve Bank, most of the aspects relating to financing of NBFCs by banks have also been deregulated. However, in view of the sensitivities attached to financing of certain types of activities undertaken by NBFCs, restrictions on financing of such activities continue to be in force.

2. Bank Finance to NBFCs registered with RBI

2.1 The ceiling on bank credit linked to Net Owned Fund (NOF) of NBFCs has been withdrawn in respect of all NBFCs which are statutorily registered with RBI and are engaged in principal business of asset financing, loan, factoring and investment activities. Accordingly, banks may extend need based working capital facilities as well as term loans to all NBFCs registered with RBI and engaged in infrastructure financing, equipment leasing, hire-purchase, loan, factoring and investment activities.

2.2 In the light of the experience gained by NBFCs in financing second hand assets, banks may also extend finance to NBFCs against second hand assets financed by them.

2.3 Banks may formulate suitable loan policy with the approval of their Boards of Directors within the prudential guidelines and exposure norms prescribed by the Reserve Bank to extend various kinds of credit facilities to NBFCs subject to the condition that the activities indicated in paragraphs 5 and 6 are not financed by them.

3. Bank Finance to NBFCs not requiring Registration¹

In respect of NBFCs which do not require to be registered with RBI, viz. i) Insurance Companies registered under Section 3 of the Insurance Act, 1938; ii) Nidhi Companies notified under Section 620A of the Companies Act, 1956; iii) Chit Fund Companies carrying on Chit Fund business as their principal business as per Explanation to Clause (vii) of Section 45-I(bb) of the Reserve Bank of India Act, 1934; iv) Stock Broking Companies / Merchant Banking Companies registered under Section 12 of the Securities & Exchange Board of India Act; and v) Housing Finance Companies being regulated by the National Housing Bank (NHB) which have been exempted from the requirement of registration by RBI, banks may take their credit decisions on the basis of usual

¹ While financing NBFCs, which do not require registration with RBI, banks should also refer to the guidelines / notifications issued in this regard from time to time by the Ministry of Corporate Affairs, Government of India.

factors like the purpose of credit, nature and quality of underlying assets, repayment capacity of borrowers as also risk perception, etc.

4. Bank Finance to Residuary Non-Banking Companies (RNBCs)

4.1 Residuary Non-Banking Companies (RNBCs) are also required to be mandatorily registered with Reserve Bank of India. In respect of such companies registered with RBI, bank finance would be restricted to the extent of their Net Owned Fund (NOF).

4.2 Net Owned Fund (NOF)

4.2.1. Banks should follow the definition of NOF as given in the explanation to Section 45-IA of the Reserve Bank of India Act, 1934, i.e.,

I. Net Owned Fund means

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

- (i) accumulated balance of loss;
- (ii) deferred revenue expenditure; and
- (iii) other intangible assets; and

(b) further reduced by the amounts representing

(1) investment of such company in shares of

- (i) its subsidiaries;
- (ii) companies in the same group;
- (iii) all other Non-Banking Financial Companies; and

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

- (i) subsidiaries of such company; and
- (ii) companies in the same group,

to the extent such amount exceeds ten percent of (a) above.

II. "Subsidiaries" and "Companies in the same group" shall have the same meanings assigned to them in the Companies Act, 1956 (1 of 1956).

5. Activities not Eligible for Bank Credit

5.1 The following activities undertaken by NBFCs, are not eligible for bank credit:

(i) Bills discounted / rediscounted by NBFCs, except for rediscounting of bills discounted by NBFCs arising from sale of -

(a) commercial vehicles (including light commercial vehicles), and

(b) two wheeler and three wheeler vehicles, subject to the following conditions :

- the bills should have been drawn by the manufacturer on dealers only;
- the bills should represent genuine sale transactions as may be ascertained from the chassis / engine number; and
- before rediscounting the bills, banks should satisfy themselves about the bona fides and track record of NBFCs which have discounted the bills.

(ii) Investments of NBFCs both of current and long-term nature, in any company / entity by way of shares, debentures, etc. However, Stock Broking Companies may be provided need-based credit against shares and debentures held by them as stock-in-trade.

(iii) Unsecured loans / inter-corporate deposits by NBFCs to / in any company.

(iv) All types of loans and advances by NBFCs to their subsidiaries, group companies / entities.

(v) Finance to NBFCs for further lending to individuals for subscribing to Initial Public Offerings (IPOs) and for purchase of shares from secondary market.

5.2 Leased and Sub-Leased Assets

As banks can extend financial assistance to equipment leasing companies, they should not enter into lease agreements departmentally with such companies as well as other Non-Banking Financial Companies engaged in equipment leasing.

6. Bank Finance to Factoring Companies

6.1 In terms of the Factoring Regulation Act, 2011, which regulates factoring companies and, inter-alia, defines the terms 'factor, factoring business, principal business, assignment', etc., the Reserve Bank has been given powers to stipulate conditions for 'principal business' in terms of assets and gross income as also powers to give directions and collect information from factors.

6.2 Accordingly, the Reserve Bank has introduced a new category of NBFCs viz.; 'Non-Banking Financial Company – Factors' and has issued a Notification DNBS.PD.No.247/CGM(US)-2012 dated July 23, 2012 in this regard. Paragraph 6 (i) of the above Notification has prescribed 'Principal Business' of such an NBFC and it states that "An NBFC-Factor shall ensure that its financial assets in the factoring business constitute at least 75 percent of its total assets and its income derived from factoring business is not less than 75 percent of its gross income."

6.3 In view of the above, the criteria regarding asset and income of factoring companies eligible for bank finance have been reviewed. Accordingly, notwithstanding the restrictions mentioned at Paragraph 5.1(i) and 5.1 (iv) above, banks can henceforth extend financial assistance to support the factoring business of Factoring Companies, which comply with the following criteria:

- (a) The companies qualify as factoring companies and carry out their business under the provisions of the Factoring Regulation Act, 2011 and Notifications issued by the Reserve Bank in this regard from time to time.

(b) They derive at least 75 per cent of their income from factoring activity.

(c) The receivables purchased / financed, irrespective of whether on 'with recourse' or 'without recourse' basis, form at least 75 per cent of the assets of the Factoring Company.

(d) The assets / income referred to above would not include the assets / income relating to any bill discounting facility extended by the Factoring Company.

(e) The financial assistance extended by the Factoring Companies is secured by hypothecation or assignment of receivables in their favour.

7. Other Prohibitions on Bank Finance to NBFCs

7.1 Bridge loans / interim finance

Banks should not grant bridge loans of any nature, or interim finance against capital / debenture issues and / or in the form of loans of a bridging nature pending raising of long-term funds from the market by way of capital, deposits, etc. to all categories of Non-Banking Financial Companies and also Residuary Non- Banking Companies (RNBCs). Banks should strictly follow these instructions and ensure that these are not circumvented in any manner whatsoever by purport and / or intent by sanction of credit under a different nomenclature like unsecured negotiable notes, floating rate interest bonds, etc., as also short-term loans, the repayment of which is proposed / expected to be made out of funds to be or likely to be mobilised from external / other sources and not out of the surplus generated by the use of the asset(s).

7.2 Advances against collateral security of shares to NBFCs

Shares and debentures cannot be accepted as collateral securities for secured loans granted to NBFCs borrowers for any purpose.

7.3 Restriction on guarantees for placement of funds with NBFCs

Banks should not execute guarantees covering inter-company deposits / loans thereby guaranteeing refund of deposits / loans accepted by NBFCs / firms from other NBFCs / firms. The restriction would cover all types of deposits / loans irrespective of their source, including deposits / loans received by

NBFCs from trusts and other institutions. Guarantees should not be issued for the purpose of indirectly enabling the placement of deposits with NBFCs.

8. Prudential ceilings for exposure of banks to NBFCs

8.1 The exposure (both lending and investment, including off balance sheet exposures) of a bank to a single NBFC / NBFC-AFC (Asset Financing Companies), which is not predominantly engaged in lending against collateral of gold jewellery, should not exceed 10% / 15% respectively, of the bank's capital funds as per its last audited balance sheet. Banks may, however, assume exposures on such a single NBFC / NBFC-AFC up to 15% / 20% respectively, of their capital funds provided the exposure in excess of 10% / 15% respectively, is on account of funds on-lent by the NBFC / NBFC-AFC to the infrastructure sector. Further, exposure of a bank to the NBFCs-IFCs (Infrastructure Finance Companies) should not exceed 15 per cent of its capital funds as per its last audited balance sheet, with a provision to increase it to 20 per cent if the same is on account of funds on-lent by the IFCs to the infrastructure sector.

8.2 Banks may also consider fixing internal limits for their aggregate exposure to all NBFCs put together.

8.3 The exposure (both lending and investment, including off balance sheet exposures) of a bank to a single NBFC which is predominantly engaged in lending against collateral of gold jewellery (i.e. such loans comprising 50 per cent or more of their financial assets), should not exceed 7.5 per cent of banks' capital funds. However, this exposure ceiling may go up by 5 per cent, *i.e.*, up to 12.5 per cent of banks' capital funds if the additional exposure is on account of funds on-lent by such NBFCs to the infrastructure sector. Banks which were having exposure to such NBFCs in excess of the above regulatory ceiling as on May 18, 2012 were required to reduce their exposure within the prescribed limit at the earliest, but not later than November 17, 2012.

8.4 Banks should have an internal sub-limit on their aggregate exposures to all NBFCs, having gold loans to the extent of 50 per cent or more of their total financial assets, taken together. This sub-limit should be within the internal limit fixed by the banks for their aggregate exposure to all NBFCs put together as prescribed in paragraph 8.2 above.

8.5 Infusion of capital funds after the published balance sheet date may also be taken into account for the purpose of computing exposure ceiling. Banks should obtain an external auditor's certificate on completion of the augmentation of capital and submit the same to the Reserve Bank of India (Department of Banking Supervision) before reckoning the additions to capital funds.

9. Restrictions regarding investments made by banks in securities / instruments issued by NBFCs

9.1 Banks should not invest in Zero Coupon Bonds (ZCBs) issued by NBFCs unless the issuer NBFC builds up sinking fund for all accrued interest and keeps it invested in liquid investments / securities (Government bonds).

9.2 Banks are permitted to invest in Non-Convertible Debentures (NCDs) with original or initial maturity up to one year issued by NBFCs. However, while investing in such instruments banks should be guided by the extant prudential guidelines in force, ensure that the issuer has disclosed the purpose for which the NCDs are being issued in the disclosure document and such purposes are eligible for bank finance in terms of instructions given in the preceding paragraphs.

Appendix

List of Circulars Consolidated in the Master Circular

Sl. No.	Circular No	Date	Subject
1	DBOD.No.FSC.BC.71/C.469/91-92	22.01.92	Restriction on credit to certain sectors
2	IECD.No. 14/08.12.01/94-95	28.09.94	Lending to Non-Banking Financial Companies
3	IECD.No.42/08.12.01/94-95	21.04.95	Lending to Non-Banking Financial Companies
4	DBOD.No.FSC.BC.101/24.01.001/95-96	20.09.95	Equipment Leasing, Hire Purchase and Factoring etc. Activities
5	IECD.No. 17/03.27.026/96-97	06.12.96	Bank Finance for Purchase/Lease of Existing Assets
6	IECD.No.1 5/08.12.01/97-98	04.11.97	Guidelines for Lending by Banks - Assessment of Working Capital
7	IECD.No.29/08. 12.01/98-99	25.05.99	Lending to Non-Banking Financial Companies (NBFCs)
8	RBI/273/2004-05 DBOD.IECS.BC.No.57/08.12.01 (N)/2004-05	19.11.04	Mid-Term Review of the Annual Policy Statement for the year 2004-05 - Bank Finance to NBFCs
9	RBI/2007-08/235 DBOD.BP.BC.No.60/08.12.01/2007-08	12.02.08	Bank Finance to Factoring Companies
10	RBI/2009-10/317 DBOD.No.BP.BC.74/21.04.172/2009-10	12.02.10	Risk Weights and Exposure Norms in respect of Bank Exposure to NBFCs categorised as 'Infrastructure Finance Companies'
11	RBI/2010-11/219 DBOD.No.BP.BC.44/21.04.141/2010-11-11	29.09.10	Prudential Norms on Investment in Zero Coupon Bonds
12	RBI/2010-11/349 DBOD.BP.BC.No.72/21.04.141/2010-11	31.12.10	Investment in Non-SLR Securities - Non-Convertible Debentures (NCDs) of maturity up to one year

13	DBOD.No.Dir.BC.90/13.07.05/98-99	28.08.98	Bank Finance against Shares & Debentures
14	DBOD.No.Dir.BC.107/13.07.05/98-99	11.11.98	Rediscounting of Bills by Banks
15	DBOD.No.Dir.BC.173/13.07.05/99-2000	12.05.2000	Rediscounting of Bills by Banks
16	DBOD.No.BP.BC.51/21.04.137/2000-01	10.11.2000	Bank Financing of Equities and Investment in Shares
17	RBI/2004-05/68 DBOD.No.Dir.BC.18/13.03.00/2004-05	23.07.2004	Master Circular – Guarantees and Co-acceptances
18	RBI/2006-07/205 DBOD.No.FSD.BC.46/24.01.028/2006-07	12.12.2006	Financial Regulation of Systematically Important NBFCs and Bank's Relationship with them - Final Guidelines
19	RBI/2011-12/568 DBOD.BP.BC.No.106/21.04.172/2011-12	18.05.2012	Bank Finance to NBFCs Predominantly Engaged in lending against Gold
20	RBI/2012-13/199 DBOD.BP.BC.No.40/21.04.172/2012-13	11.09.2012	Bank Finance to Factoring Companies