

**MINISTRY OF FINANCE
(DEPARTMENT OF FINANCIAL SERVICES)**

Regulatory Mechanism of Protection of Interests of the Depositors of Non-Banking Financial Companies (NBFC) - An Overview

[Action taken by Government on the recommendations contained in Fifth Report (Sixteenth Lok Sabha) of the Committee on Estimates]

**COMMITTEE ON ESTIMATES
(2015-16)**

FOURTEENTH REPORT

(SIXTEENTH LOK SABHA)



**LOK SABHA SECRETARIAT
NEW DELHI**

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COMMITTEE ON ESTIMATES
(2015-16)**

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**[Action taken by Government on the recommendations contained in Fifth Report
(Sixteenth Lok Sabha) of the Committee on Estimates]**

Presented to Lok Sabha on 24.02. 2016



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COMPOSITION OF THE COMMITTEE ON ESTIMATES
(2015-16)

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2. Shri Vipin Kumar - Director
3. Shri Srinivasulu Gunda - Additional Director
4. Ms. Savdha Kalia - Committee Officer

INTRODUCTION

I, the Chairman of the Committee on Estimates, having been authorized by the Committee to submit the Report on their behalf, do present this 14 Report on action taken by the Government on the observations/recommendations contained in the Fifth Report of Estimates Committee (Sixteenth Lok Sabha) on the subject 'Regulatory Mechanism of Protection of Interests of the Depositors of Non-Banking Financial Companies (NBFC) - An Overview' pertaining to the Ministry of Finance (Department of Financial Services).

2. The Fifth Report of the Committee was presented to Lok Sabha on 29, April 2015. Action Taken Notes on the Observations/Recommendations pertaining to the Ministry of Finance (Department of Financial Services) were received by 18 August, 2015. The Draft Report was considered and adopted by the Committee on Estimates (2015-16) at their sitting held on the 8th January, 2016.

3. An analysis of action taken by Government on the recommendations contained in the Fourteenth Report of the Committee on Estimates (Sixteenth Lok Sabha) is given in Appendix II.

NEW DELHI;
20 February, 2016
1 Phalguna, 1937 (saka)

DR. MURLI MANOHAR JOSHI
Chairperson,
Committee on Estimates.

CHAPTER I

REPORT

This Report of the Committee deals with the action taken by the Government on the recommendations contained in the Fifth Report (Sixteenth Lok Sabha) on the subject 'Regulatory Mechanism of Protection of Interests of the Depositors of Non-Banking Financial Companies (NBFCs) - An Overview' pertaining to the Ministry of Finance (Department of Financial Services).

1.2 The Fifth Report (Sixteenth Lok Sabha) was presented to Lok Sabha on 29.04.2015. It contained 12 observations/recommendations. Action Taken Notes on all these observations/recommendations were received from the Ministry of Ministry of Finance (Department of Financial Services) on 18.08.2015.

1.3 Replies to the observations and recommendations contained in the Report have broadly been categorized as under:-

(i) Recommendations/Observations which have been accepted by the Government:

Sl. Nos. 1, 2, 3, 9, 10, 11 and 12 (Total 7)
(Chapter-II)

(ii) Recommendations/Observations which the Committee do not desire to pursue in view of Government's reply:

Sl. Nos. Nil (Chapter-III)

(iii) Recommendations/Observations in respect of which Government's replies have not been accepted by the Committee:

Sl. Nos. 4, 5, 6, 7 & 8 (Total 05)
(Chapter IV)

(iv) Recommendations/Observations in respect of which final reply of Government is still awaited:

Sl. Nos. Nil (Total 05)
(Chapter V)

1.4. The Committee desire that response to the comments contained in Chapter I of this Report should be furnished to them expeditiously.

1.5 The Committee will now deal with the action taken by the Government on some of their recommendations.

A. Definition of 'Principle Business'

Observation/ Recommendation no. 1

1.6 With a view to ensuring that no entity engaged in the business of finance is left out of the regulations, the Committee recommended that the term 'Principal Business' be defined in RBI Act, 1934 itself giving much needed statutory clarity so as to remove ambivalence / misgivings.

1.7. The Ministry of Finance (Department of Financial Services), referring to the RBI's views stated as under :

“Reserve Bank of India (RBI) is agreeable to the proposed recommendation and has suggested suitable amendments in the RBI Act, 1934. RBI has indicated that all companies carry on some financial activities in the nature of lending / investment to determine the principle Business of the Company, RBI is applying the twin criteria of assets and income .If 50 % of the total assets is financial asset and 50 % of the total income is from financial assets, the company is regarded as a NBFC. This is proposed to be incorporated in the statute.”

B. Inclusion of Limited Liability Partnerships (LLPs) under the definition of NBFCs

Observation/ Recommendation No. 2

1.8 As LLPs are not included in section 45 I (e) which defines the term 'Non Banking Finance Company' since they are neither companies, nor corporations nor co-operative societies, and also not covered under Chapter III B of the RBI Act, 1934, dealing with prohibition of acceptance of deposits by Unincorporated Bodies i.e. individuals, firms or association of Individuals , the committee recommended that necessary amendment may be carried out at the earliest to include LLPs as "unincorporated bodies" for the purpose of prohibition from acceptance of deposits under Chapter III C of RBI Act, 1934.

1.9 The Ministry of Finance (Department of Financial Services) , referring to the reply of RBI, stated that Reserve Bank of India (RBI) is agreeable to the proposed recommendation and has suggested suitable amendments to the RBI Act, 1934. Accordingly, Definition of deposit is proposed to be modified to cover certain moneys collected in the name of advance for goods and services for without having wherewithal to provide the same. Further, only RBI regulated entities will be allowed to accept deposits. Deposits collected from members having no voting rights will be treated as public deposits.

C. Definition of Deposit

Observation/ Recommendation No. 3

1.10. Taking cognizance of rampant acceptance of deposits by unscrupulous entities from the gullible public in camouflaged manner as advance for goods or services, the Committee recommended that the RBI Act be amended expeditiously to cover such deposits within the ambit of "deposit"

1.11 The Ministry of Finance (Department of Financial Services) , referring to the reply of RBI , stated as under :

“Reserve Bank of India (RBI) is agreeable to the proposed recommendation and has suggested suitable amendments to the RBI Act, 1934. RBI has suggested that definition of deposit should be modified to cover certain money collected in the name of advance for goods and services without having wherewithal to provide the same. RBI regulated entities will be allowed to accept deposits. Deposits collected from members having no voting rights will be treated as public deposits. RBI has also suggested to provide for greater flexibility in defining what constitutes deposit which, may be provided in the legislation to take care of innovative ways in which deposit is collected.”

1.12. The Committee are pleased to note that RBI have accepted the three recommendations - incorporation of the definition of the term Principle Business in the RBI Act itself, inclusion of Limited Liability Partnerships (LLPs) as ‘unincorporated bodies’ for the purposes of prohibition from acceptance of deposits, change the definition of ‘Deposits’ to cover the Deposits taken as advance for goods or services and has suggested suitable amendments to RBI Act, 1934. The Committee hope that the Ministry of Finance would take necessary steps to bring in the required changes in the RBI Act, 1934 at the earliest so that the gaps in regulation of the NBFCs are addressed and the smooth functioning of the sector is ensured.

D. NEED FOR CONTINUANCE OF NBFCS-D

Observation/ Recommendation No. 4

1.13 In view of (i) high concentration of commercial banks in urban and semi Urban areas leaving substantial number of villages/ hamlets either uncovered or under covered by formal banking channels even after four decades of nationalization of the banks, compelling the people of these villages to approach NBFCs for their savings and credit needs, (ii) the ease at which NBFCs can be approached for availing credit and deposit facilities *vis-a vis* commercial banks, convenience of doorstep banking, customization of the product to suit the requirements of the customers, driving many savers to deposits their monies and avail credit facilities from NBFCs , (iii) reluctance of the banks to extend credit to the first time borrowers due to lack of credit history and low end borrowers for buying equipment, one or two vehicles, etc thereby forcing them to approach alternative channels of credit and deposits such as NBFCs (iv) the capacity

to reach the lowest common denominator (last mile connectivity in terms of financial services) , the Committee recommended that RBI in consultation with the Ministry of Finance, explore the possibility of allowing registrations of deposit taking NBFCs with stringent Regulations so that the needy persons in far flung areas across the country can avail safely the services of the NBFCs.

1.14 The Ministry of Finance (Department of Financial Services) in their Action Taken Replies submitted as under::

“The deposit taking should be a responsibility of the banking system because it has its own credentials and the regulatory mechanism to ensure the safety of public funds. To ensure that saving vehicles are provided to un served and underserved sections of the population, RBI will be granting licences to ‘Small Finance Banks’ which will be allowed to accept deposits. Existing NBFCs, MFIs have a choice of conversion into ‘Small Finance Banks’.

It is stated in Para 4 of the recommendations that “RBI categorically stated that default in repayment of deposits committed by NBFCs is due to lack of regulation”. RBI has clarified that this was stated in the context of defaults that had occurred in repayment of deposits in 1960s to 1990s and is not reflective of the current position. In fact, regulations were introduced for NBFCs and these are even more stringent for deposit accepting NBFCs. The cases of default in repayment of deposits pertain to only those legacy companies.

In addition banks are now also permitted to appoint Banking Correspondents (BCs) and majority of the villages are now covered by these BCs. Populace in far flung areas is being served by these entities which are under oversight from the banks as their principal.”

1.15 The Committee take a serious note of the casual reply furnished by RBI/ Ministry stating that the introduction of ‘Small Payment banks’ and Banking Correspondents with the objective of mobilizing small savings from people left out of the ambit of the formal banking channels obviates the need for fresh registration of NBFCs-D (NBFCs empowered to accept public deposits). However, the Committee find that the mandate of neither small payment banks, whose main objective is to provide payment and remittance services nor banking correspondents include lending / providing credit facilities to the individuals, tiny and small businesses / low end customers who are neglected by formal banking channels. It may, therefore, be seen that Small payment banks and banking correspondents may address concerns of mobilization of savings from the

targeted segments but the lending part is not addressed by either Small payment banks or banking correspondents. More over the Committee also believe that small payment banks may not compete with the NBFCs in terms of ease at which the NBFCs can be approached for availing deposit facilities, their reach in terms of providing financial services at the doorstep of the customers and also the facility of customization of the product. In fact the RBI had itself acknowledged the contribution of NBFCs in providing last mile connectivity for development of financial sector. The Committee, therefore, reiterate their recommendation that RBI in consultation with Ministry of Finance should explore the possibility of allowing registrations of deposit taking NBFCs with stringent regulations so that the needy persons in far flung areas across the country can avail safely the services of NBFCs.

E. DEPOSIT INSURANCE

Observation/ Recommendation No. 5

1.16 While taking note of the RBIs' view that deposit acceptance should be in the realm of banks alone as they are more stringently regulated who can also avail deposit insurance to repay the depositors and the deposit insurance should not be extended to NBFCs due to moral hazard and regulators discomfort, the Committee felt that the risk involved in extending the deposit insurance can be addressed by instituting stringent regulations by the regulators and accordingly recommended that insurance cover may be extended to the deposits of NBFCs either within the DICGC framework by amending the relevant legislation or through creation of separate entity as favoured by RBI for offering deposit insurance

1.17 In their Action Taken Replies the Ministry have stated that RBI is not in favour of bringing deposits of NBFCs under the ambit of DICGC on account of inherent weakness of the sector, lack of market discipline and dichotomy observed in case of premium paid by commercial banks and benefits availed by Urban cooperative banks and Rural cooperative banks for DICGC claims. There is no need for deposit insurance for NBFCs as they accept only term deposits.

1.18 The Committee note that due to inherent weaknesses of the sector, lack of market discipline and dichotomy observed in case of premium paid by the commercial banks, RBI is not in favour of extending insurance cover to the deposits of NBFCs. Further, the reply of RBI/Ministry also states that deposit insurance was not required for deposits of NBFCs as they accept only term deposits. However, in the considered view of the Committee, these concerns of the RBI in respect of NBFCs can be addressed by instituting effective and stringent regulations. Notably, the RBI proposes to do so by empowering themselves with punitive powers and also by suitably amending the RBI Act 1934 for plugging the gaps hampering the development of the sector. The Committee, therefore, believe that once these proposed changes are put in place, insurance cover for deposits of NBFCs either within the DICGC framework or outside of it, as favoured by RBI initially, can be introduced. The Committee are quite sanguine that these proposed amendments and changes aimed at strengthening the NBFC sector will go a long way in attracting serious players and discouraging fly-by-night operators. The representative of RBI appearing before the Committee on 25 March, 2015 stated that RBI is recommending separate insurance guarantee corporation for the NBFC category. In their latest reply RBI / Ministry, however, have stated that there is no need for deposit insurance as they accept only term deposits. It is, therefore, apparent, that RBI itself does not have clarity on the issue. The Committee reiterate their recommendation that insurance cover may be extended to the deposits of NBFCs.

F. Unclaimed Deposits

Recommendation / Observation No. 6

1.19 Taking note of the data furnished by RBI, the Committee observed that an amount of ₹ 556 crore is lying unclaimed with 24 deposit taking NBFCs (NBFCs-D) and the same has not been transferred to Investor Education and Protection Fund (IEPF) as required

under section 205 of the Companies Act, 2013 and recommended that Govt./ RBI specify in unambiguous terms whether the huge amount of ₹ 556 crore deposits lying unclaimed with 24 NBFCs has actually been transferred to IEPF and the details thereof , and; if not the reasons there for.

1.20 The Ministry of Finance (Department of Financial Services) referring to the action taken reply furnished as under:

“RBI has informed that as on March 31, 2015, 22 companies did not have any deposits eligible to be transferred to the IEPF (a deposit is due for transfer to IEPF if it remains unclaimed for 7 years).

One company is under court ordered liquidation. In respect of a PSU, i.e. Tamil Nadu Transport Development Finance Corporation Ltd, only an amount of ₹ 5,22,375 has not been transferred to IEPF due to some legal disputes. The company has transferred all other unclaimed deposits held for more than 7 years.”

1.21 The Committee note that the reply furnished by RBI/ Ministry does not specify whether unclaimed deposits of ₹ 556 crore lying with 24 deposit taking NBFCs (NBFCs-D), as furnished by them and as mentioned at Appendix - IX of the original report, have been transferred to Investor Education and Protection Fund (IEPF) as required under section 205 of the Companies Act, 2013. They therefore, reiterate their recommendation that RBI specify in unambiguous terms whether ₹ 556 crore of deposits lying unclaimed till 2014 have actually been transferred to IEPF and if not, the reasons therefor.

F. EXCEPTION REPORT FROM AUDITORS

Observation/ Recommendation No. 7

1.22 As Reserve Bank of India could not take up the issue of non submission of exception reports by the auditors of 50 NBFCs, operating without registration or violating relevant provisions of the RBI Act, 1934, under NBFCs Auditors' Report (Reserve Bank of India Directions, 2008), either with defaulter auditor or in the

Coordination mechanism with the Institute of Chartered Accountants of India (ICAI), the Committee sought the reasons for the same from RBI. The Committee also recommended that a proper code of ethics and conduct be formulated for the statutory auditors of NBFCs about the requirement of submitting Exception Reports to RBI for defaulting entities. Further, the committee also urged the Ministry of Finance (Department of Financial Services) to amend the RBI Act to empower RBI to remove or replace auditors in cases where they fail to inform the RBI of any violations committed by the NBFCs detected during the course of their audit under the said directions. In the event of such occurrences, the Committee recommended that the matter pertaining to Statutory Auditors be discussed with ICAI to ensure that suitable action is taken against them.

1.23 The Ministry of Finance (Department of Financial Services) in their Action Taken Replies submitted as under:

“RBI had deliberated on the issue of violations by statutory auditors at the Board level and recommended action by way of penalising them for violating the guidelines laid down by the Bank such as not submitting exception reports.

Further, RBI is also conducting seminar/events specifically related to NBFC Audit in collaboration with the local chapter of ICAI detailing various Rules and Regulations relating to NBFCs. This platform is being used to highlight commonly observed deficiencies in audit report and sensitizing the auditors about impending penal action in case of non-submission of exception reports. It is also being used to request Auditors to report inadequacies beyond the strict contours of the NBFCs Auditor’s Report (Reserve Bank) Directions, 2008.

RBI is shortly inviting national level office bearers of ICAI to apprise them of the concerns relating to Audit reports for NBFCs.

Further, RBI has suggested suitable amendments to the RBI Act to empower RBI to impose penalties without approaching a court on auditors of NBFCs. Non Payment of Penalty imposed by RBI will be an offence. To recover penalty, RBI may issue garnishee orders”

1.24 The Committee observe that the reply furnished by the Ministry of Finance (Department of Financial Services) is conspicuously silent as to why the non submission of exception reports by the auditors of 50 NBFCs, operating without registration or violating relevant provisions of the RBI Act, 1934, under NBFCs Auditors’s Report (Reserve Bank of India Directions, 2008), could not be taken up

by RBI either with defaulter auditors or in the Coordination mechanism with the Institute of Chartered Accountants of India (ICAI). Further, it appears that RBI deliberated the issue at the Board level only after the issue was raised by the Estimates Committee and sought the reasons for not taking the required action against the said auditors. The Committee, would therefore like to be apprised of the action taken against such auditors.

The Committee are pleased to note that the RBI, in pursuance of the Committee's recommendation, has taken steps for conducting seminars/ events to bring efficiency in the working of auditors by highlighting their deficiencies and sensitizing them about penal actions to be taken against them in case of non submission of exception reports and also decided to invite national level office bearers of ICAI to apprise them of the concerns of the Committee in the matter. The Committee desire that the proposed meet be expedited and appropriate steps be taken to bring further efficiency in the working of statutory Auditors and the Committee apprised in due course of the tangible outcome of the steps initiated by the RBI.

The Committee also note that RBI has suggested suitable amendments to the RBI Act to empower them to impose penalties without approaching court of law, on auditors of NBFCs making an offence. Also non Payment of Penalty imposed by RBI would be an offence and allow RBI to issue garnishee orders for recovery of penalty. The Committee would like to be apprised of the action taken to effect necessary amendments in the RBI Act.

G. MASS AWARENESS CAMPAIGN

Observation/ Recommendation No. 8

1.25 The Committee while noting that many investors, especially in small towns and villages, lured by high interest rates offered, deposit their hard earned savings in the schemes floated by unscrupulous and fly-by-night operators / firms, mostly unregistered NBFCs and unincorporated bodies, without assessing the risk involved therein. The Committee, therefore, strongly recommended:

- (i) Mass awareness campaigns be conducted not only in electronic media but also in print media especially in vernacular languages at regular intervals to create the desired impact;
- (ii) The other channels of mass communication such as radio jingles, banners in public places and on public transport should be used to curb and eliminate such unscrupulous entities from the money market;
- (iii) A part of the amount lying in unclaimed deposits with NBFCs which are required to be transferred to Investor Education and Protection Fund (IEPF) may be used for educating the investors and creating awareness among them about the risks involved in investing in fly-by-night firms.
- (iv) The Investors' awareness and education programmes may be included as an activity eligible for spending money under 'Corporate Social Responsibility';
- (v) Lists of the type of firms eligible and ineligible for acceptance of deposits from the public and also of firms banned from accepting deposits from public may be published in English , Hindi and vernacular Dailies to ensure that people make informed investment decisions; and
- (vi) Every entity advertising/representing/soliciting customers, must indicate their PAN/Registration number so that the activities of fake/fly-by-night operators are checked and the gullible public are not duped.

1.26 In their Action Taken Replies the Ministry while submitting on each of the above stated:

- (i)&(ii) RBI will soon be commencing a Nationwide Investor Awareness Programme to make the public aware of the perils and pitfalls of investing their money in unregulated entities, and fraudulent/ dubious schemes. It will be using print media, televisions, radio, banners etc for this campaign.
- (iii)&(iv) The points relate to Ministry of Corporate Affairs.
- (v) The list of NBFCs allowed by RBI to accept public deposits, and the list of NBFCs prohibited from accepting public deposits is given on the RBI website. The advertisements published by the RBI will provide a link to the list of such NBFCs.

(vi) Registered NBFCs are required to comply with prescribed Advertisement Rules while issuing any advertisement.

The non-NBFCs will fall under the jurisdiction of Ministry of Corporate Affairs (MCA), who may consider the recommendations of the Estimates Committee to prescribe such norms, and penalties for violation thereof.

1.27 The Committee note that pursuant to their recommendation, the Ministry of Finance and the RBI will soon be initiating Nationwide Investor Awareness Programme using various channels of mass media for educating the public. Further, a link to list of NBFCs prohibited from accepting deposits is also being published in advertisements. However, the reply of the Ministry is silent on use of Hindi and other vernacular languages for better reach of such awareness campaigns. Regrettably, the Ministry of Finance did not coordinate with the Ministry of Corporate Affairs regarding the recommendation of the Committee for using part of unclaimed deposits lying with NBFCs and are required to be transferred to IEPF to be used for educating investors and creating awareness about the risks involved in investing through the fly-by-night operators and also allowing such awareness campaigns to be covered as an activity eligible under 'corporate social responsibility.' While deploring the lack of initiative on part of the Ministry of Finance to coordinate with the Ministry of Corporate Affairs, the Committee reiterate that matter be taken up with the Ministry of Corporate Affairs in right earnest so that necessary steps can be taken and the Committee apprised of the same.

H. NEED FOR SEPARATE REGULATOR/ LEGISLATION

Observation/ Recommendation no.12

1.28 Expressing serious concern at the lack of willingness of RBI to empower themselves so as to punish defaulting NBFCs and ensuring repayment of the deposits expeditiously and also to address the shortage of skills required for the effective regulation of NBFCs, the Committee recommended that the RBI Act should be amended to empower RBI with punitive powers such as imposition of penalties and /or direct refund of deposits in case of non repayment on the due date, attach and sell the movable and immovable assets of the defaulting NBFCs to recover penalties and

secure payments of deposits, freeze the Assets/bank accounts of such defaulters as well as to take action against Directors and key management personnel ,etc.

Further, in the light of RBI's reluctance to empower themselves to effectively regulate NBFCs, the Committee recommended that Government may also consider enacting a separate legislation for regulating all deposit accepting entities (other than commercial banks).

1.29 The Ministry in their Action Taken Replies stated as under :

“In this connection, RBI has submitted that it has been progressively tightening up its regulatory and supervisory ambit over NBFCs. In the recent past, certain entities may have exploited certain regulatory gaps, which largely arise on a narrow definition of the term “deposits”. However, RBI has taken initiatives in plugging these gaps on two fronts, through an expanded role for the State Level Coordination Committee and strengthening Market Intelligence. Detailed information on these aspects have been submitted to the Committee.

The RBI is further agreeable to the proposed recommendations of the Committee to grant it enforcement powers for search and seizure etc, as has been granted to SEBI.

The provisions of Chapters IIIB, IIIC and V are quite elaborate. With the amendments proposed above, certain existing gaps would be removed and the RBI Act would be comprehensive with a wide range of powers to the RBI to effectively regulate and supervise the sector, obviating the need of a separate legislation.

There is no reluctance on the part of RBI to regulate the NBFC Sector. There is certainly a need to fill in the gaps as detailed above and bring in some enabling provisions as detailed hereinabove to make such Regulation and Supervision more effective.”

1.30 The Committee note that the RBI and the Ministry of Finance, with a view to bridge the regulatory gaps, is agreeable to the proposed recommendation of the Committee to grant enforcement powers for search and seizure to the RBI as has been granted to SEBI. The Committee are also given to understand that these steps shall tighten the regulatory and supervisory ambit of RBI over NBFCs thereby obviating the need of a separate legislation. Despite the reply of the Ministry stating that there is no reluctance on the part of RBI to empower itself effectively, the Committee are constrained to note that no tangible initiative has been taken by the RBI in this direction all these years. Further, deprecating this casual approach of the Ministry, the Committee note that the matter of absence of

enforcement powers with RBI, the regulator for NBFCs, should have been effectively taken up long ago. The Committee, therefore, reiterate their recommendations and urge the Ministry to empower the RBI on lines of SEBI by amending the RBI Act suitably without any further delay. The Committee should like to be apprised of the Action Taken in the matter within one month of the presentation of this Report to Lok Sabha.

CHAPTER II

RECOMMENDATIONS/OBSERVATIONS WHICH HAVE BEEN ACCEPTED BY THE GOVERNMENT

Observation/Recommendation no. 1

With a view to ensuring that no entity engaged in the business of finance is left out of the regulations, the Committee recommended that the term 'Principal Business' be defined in RBI Act, 1934 itself giving much needed statutory clarity so as to remove ambivalence / misgivings.

Reply of the Government

The Ministry of Finance (Department of Financial Services), referring to the RBI's views stated as under :

“Reserve Bank of India (RBI) is agreeable to the proposed recommendation and has suggested suitable amendments in the RBI Act, 1934. RBI has indicated that all companies carry on some financial activities in the nature of lending / investment to determine the principle Business of the Company , RBI is applying the twin criteria of assets and income .If 50 % of the total assets is financial asset and 50 % of the total income is from financial assets, the company is regarded as a NBFC. This is proposed to be incorporated in the statute.”

Comments of the Committee

(Please see Para No. 1.12 of Chapter-I)

Observation/Recommendation No. 2

Necessary amendment may be carried out at the earliest to include LLPs as "unincorporated bodies" for the purpose of the prohibition from acceptance of deposits under Chapter III C of RBI Act, 1934 and the Committee be apprised.

Reply of the Government

Reserve Bank of India (RBI) is agreeable to the proposed recommendation and has suggested suitable amendments to the RBI Act, 1934. Definition of deposit is

proposed to be modified to cover certain moneys collected in the name of advance for goods and services for without having where withal to provide the same only RBI regulated entities will be allowed to accept deposits. Deposits collected from members having no voting rides will be treated as public deposits.

Comments of the Committee

(Please see Para No. 1.12 of Chapter-I)

Observation/ Recommendation No. 3

Taking cognizance of rampant acceptance of deposits by unscrupulous entities from the gullible public in camouflaged manner as advance for goods or services, the Committee recommend that the RBI Act be amended expeditiously to cover such deposits within the ambit of "deposit".

Reply of the Government

Reserve Bank of India (RBI) is agreeable to the proposed recommendation and has suggested suitable amendments to the RBI Act, 1934. RBI has suggested that definition of deposit should be modified to cover certain money collected in the name of advance for goods and services without having wherewithal to provide the same. RBI regulated entities will be allowed to accept deposits. Deposits collected from members having no voting rights will be treated as public deposits. RBI has also suggested to provide for greater flexibility in defining what constitutes deposit which, may be provided in the legislation to take care of innovative ways in which deposit is collected.

Comments of the Committee

(Please see Para No. 1.12 of Chapter-I)

Observation/ Recommendation No. 9

Considering the vital importance of robust market intelligence in maintaining vigil over the financial market and the uncanny modus operandi used for collection of deposits, the Committee, recommend that urgent and effective steps should be taken to improve the intelligence gathering apparatus of the Regulator to check effectively illegal collection of deposits. The Committee should like to be apprised of the action taken in this regard in due course.

Reply of the Government

Market Intelligence (MI) structure in RBI is revitalized through instructions issued to the RBI's Regional Offices (ROs) on October 08, 2014. MI Cells in 16 ROs of RBI were constituted with officers assigned these duties. These MI officers were also given training with specialized agencies like the IB, CEIB, SEBI, EOW, etc. besides in-house experts of RBI. Unlike the traditional MI work of collecting of news items from the dailies, the source of MI has now widened. Inputs are now also taken from RIA queries, communication from other regulators and agencies (both within the State Level Consultative Committee (SLCC) and outside the SLCC framework) including Intelligence Bureau, SEBI, and Ministry of Finance etc. RBI has also revamped the State Level Consultative Committee (SLCC) by bringing it under the Chairmanship of Chief Secretaries of the States/ UTs. This forum consisting of relevant regulators and agencies not only facilitates sharing of information but also deliberate on actions to be taken especially on illegal collection of deposits. It is further suggested that when RBI provides such inputs to Law Enforcement Authorities, it may be given suitable legislative mandate for prompt registration of the complaint, so that further necessary action can be done by Law Enforcement Authorities.

Observation/ Recommendation No. 10

- (i) A grievance redressal mechanism on the lines of the Securities and Exchange Board of India (SEBI) Complaints Redressal System (SCORES), should be set up and suitable IT platforms be developed to enable lodging of e-complaints as well.
- (ii) An all India toll free call centre in major and regional languages be set up for convenience of the depositors;
- (iii) A dedicated web portal may be created for lodging of complaints and answering web queries on the RBI site, which should also be translated and made available in various regional languages; and
- (iv) The Department of Financial Services need to look into the feasibility of creating an ombudsman on the lines of banking ombudsman for NBFC sector as well for effective reach to the last mile depositor and for redressal of his grievance.

Reply of the Government

RBI has constituted an Internal Committee to study the entire gamut of complaints received by it and suggest appropriate redress. Suggestions of the

Estimates Committee have been noted and shall be factored into in the report of the Internal Committee as well as the decisions arising from it. RBI is in an advanced stage of setting up a website for the SLCC members. This website will also have a provision for accepting complaints pertaining to any consumer of financial services which shall be forwarded/ addressed by the appropriate regulator/agency since the complainant may not be aware of jurisdiction of each agency. The envisaged system will also support report of complaints over telephone. RBI will examine the feasibility of setting an ombudsman for NBFC sector.

Observation/ Recommendation No. 11

- (i) The Frequency of the meetings of the SLCCs be suitably fixed to facilitate effective periodic coordination so that necessary corrective / remedial action is taken on time; and
- (ii) Income Tax Authorities and Enforcement Directorate be also associated with the SLCC so as to facilitate sharing of vital information and timely action against unauthorized financial entities.

Reply of the Government

- (i) At the behest of Financial Stability and Development Council– Sub–Committee (FSDC- SC), the frequency of the SLCC meetings has been increased to quarterly as against half yearly earlier and it is now being chaired by the Chief Secretary/Administrator of the concerned States / UTs. Further, Sub-Committees of SLCCs have also been formed in various States which meet at regular intervals to discuss the operational matters, Market Intelligence, share information on specific cases.
- (ii) The SLCCs are being asked to invite Income Tax (IT) authorities as participants to the SLCC.

Observation/ Recommendation No. 12

In the considered view of the Committee, the RBI Act should be amended to empower RBI to impose penalties and /or direct refund of deposits in case of non repayment on the due date. In order to recover the penalties and secure repayment of deposits, RBI should be able to attach and sell the movable and immovable assets of

the defaulters. RBI should also be allowed to conduct searches, both within and outside the country, in respect of defaulting entities, freeze the assets/bank accounts of such defaulters as well as to take action against Directors and key management personnel. Further, in the light of RBI's reluctance to empower themselves to effectively regulate NBFCs is reflected in their lack of action on one pretext or the other all these years. The Committee recommend that Government may also consider enacting a separate legislation for regulating all deposit accepting entities (other than commercial banks).

Reply of the Government

In this connection, RBI has submitted that it has been progressively tightening up its regulatory and supervisory ambit over NBFCs. In the recent past, certain entities may have exploited certain regulatory gaps, which largely arise on a narrow definition of the term “deposits”. However, RBI has taken initiatives in plugging these gaps on two fronts, through an expanded role for the State Level Coordination Committee and strengthening Market Intelligence. Detailed information on these aspects have been submitted to the Committee. The RBI is further agreeable to the proposed recommendations of the Committee to grant it enforcement powers for search and seizure etc, as has been granted to SEBI. The provisions of Chapters IIIB, IIIC and V are quite elaborate. With the amendments proposed above, certain existing gaps would be removed and the RBI Act would be comprehensive with a wide range of powers to the RBI to effectively regulate and supervise the sector, obviating the need of a separate legislation. There is no reluctance on the part of RBI to regulate the NBFC Sector. There is certainly a need to fill in the gaps as detailed above and bring in some enabling provisions as detailed hereinabove to make such Regulation and Supervision more effective.

Comments of the Committee

(Please see Para No. 1.30 of Chapter-I)

CHAPTER III

OBSERVATIONS/RECOMMENDATIONS WHICH THE COMMITTEE DO NOT DESIRE
TO PURSUE IN VIEW OF GOVERNMENT'S REPLY

-Nil-

CHAPTER IV

OBSERVATIONS/RECOMMENDATIONS IN RESPECT OF WHICH GOVERNMENT'S REPLIES HAVE NOT BEEN ACCEPTED BY THE COMMITTEE

Observation/ Recommendation No. 4

RBI in consultation with the Ministry of Finance, should explore the possibility of allowing registrations of deposit taking NBFCs with stringent Regulations so that the needy persons in far flung areas across the country can avail safely the services of the NBFCs.

Reply of the Government

The deposit taking should be a responsibility of the banking system because it has its own credentials and the regulatory mechanism to ensure the safety of public funds. To ensure that saving vehicles are provided to un served and underserved sections of the population, RBI will be granting licences to 'Small Finance Banks' which will be allowed to accept deposits. Existing NBFCs, MFIs have a choice of conversion in to 'Small Finance Banks'. It is stated in Para 4 of the recommendations that "RBI categorically stated that default in repayment of deposits committed by NBFCs is due to lack of regulation". RBI has clarified that this was stated in the context of defaults that had occurred in repayment of deposits in 1960s to 1990s and is not reflective of the current position. In fact, regulations were introduced for NBFCs and these are even more stringent for deposit accepting NBFCs. The cases of default in repayment of deposits pertain to only those legacy companies. In addition banks are now also permitted to appoint Banking Correspondents (BCs) and majority of the villages are now covered by these BCs. Populace in far flung areas is being served by these entities which are under oversight from the banks as their principal.

Comments of the Committee

(Please see Para No. 1.15 of Chapter-I)

Observation/ Recommendation No. 5

The insurance cover may be extended to the deposits of NBFCs either within the DICGC framework by amending the relevant legislation or through creation of separate entity as favoured by the RBI for offering deposit insurance.

Reply of the Government

RBI is not in favour of bringing deposits of NBFCs under the ambit of DICGC on account of inherent weakness of the sector, lack of market discipline and dichotomy observed in case of premium paid by commercial banks and benefits availed by Urban cooperative banks and Rural cooperative banks for DICGC claims. There is no need for deposit insurance for NBFCs as they accept only term deposits.

Comments of the Committee

(Please see Para No. 1.18 of Chapter-I)

Observation/ Recommendation No. 6

Government / RBI specify in unambiguous terms whether the huge amount of unclaimed deposits lying with 24 NBFCs have actually been transferred to IEPF and if so, the details thereof (NBFC wise) and if not the reasons thereof be submitted to the Committee within three months of presentation of this report.

Reply of the Government

RBI has informed that as on March 31, 2015, 22 companies did not have any deposits eligible to be transferred to the IEPF (a deposit is due for transfer to IEPF if it remains unclaimed for 7 years). One company is under court ordered liquidation. In respect of a PSU, i.e. Tamil Nadu Transport Development Finance Corporation Ltd, only an amount of Rs. 5,22,375 has not been transferred to IEPF due to some legal disputes. The company has transferred all other unclaimed deposits held for more than 7 years.

Comments of the Committee

(Please see Para No. 1.21 of Chapter-I)

Observation/ Recommendation No. 7

In terms of NBFCs auditor's report (Reserve Bank directions, 2008, statutory auditor are require to submit to the RBI directly exception reports in the event of Non Compliance by NBFC to the provision of the chapter III B of the RBI Act, 1934 and

direction issued by RBI regarding deposit acceptance and prudential norms. The RBI furnish 50 cases of NBFCs-D operating without registration or violating relevant provisions of the RBI Act, 1934 or the directions issued there under, to refund the deposits collected from the public. Surprisingly, Non of the auditors of these NBFCs furnish exceptions reports to the RBI. The Committee are perturbed to note that the RBI has neither cared to take up the issue with the defaulter auditor nor they seem to have discussed in the co-ordination mechanism with the institute of Charter Accountants of India (ICAI) the regulatory body for auditors. The Committee seek reasons for not taking up the matter of non submission of exception reports with RBI with the NBFCs or ICAI and also the action taken or proposed to be taken against the firms for failing to send the exception reports in the said cases. The Committee also recommend that a proper code of ethics and conduct be formulated for the statutory auditors of NBFCs about the requirement of submitting Exception Reports to RBI for defaulting entities. It also urge the Ministry of Finance (Department of Financial Services) to amend the RBI Act to empower RBI to remove or replace auditors in cases where they fail to inform the RBI of any violations committed by the NBFCs detected during the course of their audit under the said directions. Further, in the event of such occurrences, the matter pertaining to Statutory Auditors be discussed with ICAI to ensure that suitable action is taken against them.

Reply of the Government

RBI had deliberated on the issue of violations by statutory auditors at the Board level and recommended action by way of penalising them for violating the guidelines laid down by the Bank such as not submitting exception reports. Further, RBI is also conducting seminar/events specifically related to NBFC Audit in collaboration with the local chapter of ICAI detailing various Rules and Regulations relating to NBFCs. This platform is being used to highlight commonly observed deficiencies in audit report and sensitizing the auditors about impending penal action in case of non-submission of exception reports. It is also being used to request Auditors to report inadequacies beyond the strict contours of the NBFCs Auditor's Report (Reserve Bank) Directions, 2008. RBI is shortly inviting national level officer bearers of ICAI to apprise them of the concerns relating to Audit reports for NBFCs. Further, RBI has suggested suitable

amendments to the RBI Act to empower RBI to impose penalties without approaching a court on auditors of NBFCs. Non Payment of Penalty imposed by RBI will be an offence. To recover penalty, RBI may issue garnishee orders.

Comments of the Committee

(Please see Para No. 1.24 of Chapter-I)

Observation/ Recommendation No. 8

- (i) Mass awareness campaigns be conducted not only in electronic media but also in print media especially in vernacular languages at regular intervals to create the desired impact;
- (ii) The other channels of mass communication such as radio jingles, banners in public places and on public transport should be used to curb and eliminate such unscrupulous entities from the money market;
- (iii) A part of the amount lying in unclaimed deposits with NBFCs which are required to be transferred to Investor Education and Protection Fund (IEPF) may be used for educating the investors and creating awareness among them about the risks involved in investing in fly-by-night firms.
- (iv) The Investors' awareness and education programmes may be included as an activity eligible for spending money under 'Corporate Social Responsibility';
- (v) Lists of the type of firms eligible and ineligible for acceptance of deposits from the public and also of firms banned from accepting deposits from public may be published in English, Hindi and vernacular Dailies to ensure that people make informed investment decisions; and
- (vi) Every entity advertising / representing / soliciting customers, must indicate their PAN / Registration number so that the activities of fake / fly- by-night operators are checked and the gullible public are not duped.

Reply of the Government

- (i)&(ii) RBI will soon be commencing a Nationwide Investor Awareness Programme to make the public aware of the perils and pitfalls of investing their money in unregulated entities, and fraudulent/ dubious schemes. It will be using print media, televisions, radio, banners etc for this campaign.
- (iii)&(iv) The points relate to Ministry of Corporate Affairs.

- (v) The list of NBFCs allowed by RBI to accept public deposits, and the list of NBFCs prohibited from accepting public deposits is given on the RBI website. The advertisements published by the RBI will provide a link to the list of such NBFCs.
- (vi) Registered NBFCs are required to comply with prescribed Advertisement Rules while issuing any advertisement.

The non-NBFCs will fall under the jurisdiction of Ministry of Corporate Affairs (MCA), who may consider the recommendations of the Estimates Committee to prescribe such norms, and penalties for violation thereof.

Comments of the Committee

(Please see Para No. 1.27 of Chapter-I)

CHAPTER V

OBSERVATIONS/RECOMMENDATIONS IN RESPECT OF WHICH FINAL REPLY OF GOVERNMENT IS STILL AWAITED

-Nil-

NEW DELHI;

**2016
1937 (saka)**

**DR. MURLI MANOHAR JOSHI
Chairperson,
Committee on Estimates.**

MINUTES OF TENTH SITTING OF THE COMMITTEE ON ESTIMATES (2015-16)

The Committee sat on Friday, the 8th January, 2016 from 1200 hrs. to 1300 hrs. in Room No. '53', Parliament House, New Delhi.

PRESENT

Dr. Murli Manohar Joshi – Chairperson

Members

2. Shri Anil Shirole
3. Shri Ashwini Kumar Choubey
4. Col. Sonaram Choudhary
5. Shri Sanjay Dhotre
6. Shri P.C.Gaddigoudar
7. Shri Sudheer Gupta
8. Dr. Sanjay Jaiswal
9. Shri P. Kumar
10. Shri J.C. Divakar Reddy

SECRETARIAT

- | | | | |
|----|---------------------|---|----------------------|
| 1. | Shri Devender Singh | - | Additional Secretary |
| 2. | Shri Vipin Kumar | - | Director |

3. Shri Srinivasulu Gunda - Additional Director

2. At the outset, the Chairperson welcomed the Members to the Sitting of the Committee.

3. The Committee then took up for consideration the following Reports:-

(i) *****

(ii) Draft Report on the Action Taken by the Government on the Observations/Recommendations contained in the 5th Report of the Committee on Estimates (2014-15) (Sixteenth Lok Sabha) on the subject 'Regulatory Mechanism of Protection of Interests of the Depositors of Non-Banking Financial Companies (NBFCs) - An Overview' pertaining to the Ministry of Finance (Department of Financial Services).

4. The Committee after consideration adopted the above Reports without any modifications. The Committee then authorized the Chairperson to finalise them and present the same to Lok Sabha.

5. *****

6. *****

The Committee then adjourned with vote of thanks to the Chair.

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