Overview of FEMA provisions on NBFCs

CA Rajkumar S Adukia
B.Com (Hons), FCA, ACS, ACWA, LLB, DIPR, DLL &LP, IFRS(UK), MBA
email id: rajkumarradukia@caaa.in
Mob: 09820061049/09323061049

To receive regular updates kindly send test email to : rajkumarfca-subscribe@yahoogroups.com & rajkumarfca+subscribe@googlegroups.com

Fact & Figures

- The number of NBFCs has decreased from 13,014 in FY06 to 12,409 in FY11 however the sector has grown by 2.6 times between FY06 and FY11 at a CAGR of 21%.
- It accounted for 10.8% in terms of outstanding advances and 13% in terms of assets of the banking system in FY06.
- This share has risen to 13.2% and 13.78% respectively in FY11. In terms of deposits the share of public deposits held by NBFCs as compared to deposit base of banks has decreased from 1.05% in FY06 to 0.22% in FY11.

Source: Report of the Key Advisory Group on the Non-Banking Finance Companies (NBFCs) dated 31.01.2012

FEMA

- The Foreign Exchange Management Act 1999 came into force from 1st June 2000.
- It brought a fresh management regime of Foreign Exchange consistent with the emerging frame work of the World Trade Organization (WTO)
- Another enactment which FEMA brought with it was the Prevention of Money Laundering Act 2002 w.e.f 1sy July 2005
- The object of the act is to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly trade development and maintenance of foreign exchange market in India

Foreign Exchange under FEMA

Under Section 2 of the Foreign Exchange Management Act the definition is as follows

- (m) "foreign currency" means any currency other than Indian currency;
- (n) "foreign exchange" means foreign currency and includes,-
- (i) deposits, credits and balances payable in any foreign currency,
  (ii) drafts, travelers cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency,
  (iii) drafts, travelers cheques, letters of credit or bills of exchange drawn by banks, institutions or persons outside India, but payable in Indian currency;
- (o) "foreign security" means any security, in the form of shares, stocks, bonds, debentures or any other instrument denominated or expressed in foreign currency and includes securities expressed in foreign currency, but where redemption or any form of return such as interest or dividends is payable in Indian currency;

Activities covered under FEMA

The forex activities covered under FEMA can be divided into

- Capital Account Transactions
- Current Account Transactions

The golden rule

“ All Capital Account Transactions are prohibited unless specifically permitted and all the Current Account Transactions are permitted unless specifically prohibited

RBI Guidelines

Without the general or special permission of the Reserve Bank of India no person can

a) deal in or transfer any foreign exchange or foreign security to any person not being an authorized person;
b) make any payment to or for the credit of any person resident outside India in any manner;
c) receive otherwise through an authorized person, any payment by order or on behalf of any person resident outside India in any manner.
d) enter into any financial transaction in India as consideration for or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person

RBI Regulates

Capital Account Transactions

- a) transfer or issue of any foreign security by a person resident in India;
- b) transfer or issue of any security by a person resident outside India;
- c) transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India;
- d) any borrowing or lending in rupees in whatever form or by whatever name called;
- e) any borrowing or lending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India;

RBI Regulates

- f) deposits between persons resident in India and persons resident outside India;
- g) export, import or holding of currency or currency notes;
- h) transfer of immovable property outside India, other than a lease not exceeding five years, by a person resident in India;
- i) acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India;
  (j) giving of a guarantee or surety in respect of any debt, obligation or other liability incurred-
  (i) by a person resident in India and owed to a person resident outside India; or
  (ii) by a person resident outside India.

RBI Guidelines

Current Account Transactions:

Any person may sell or draw foreign exchange to or from an authorized person if such sale or drawal is a current account transaction: Provided that the Central Government may, in public interest and in consultation with the Reserve Bank, impose such reasonable restrictions for current account transactions as may be prescribed

FEMA Regulations

1. Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2010
2. Foreign Exchange Management (Foreign Currency Accounts by a person Resident in India) Regulations, 2010
3. Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2009
4. Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2009

FEMA Regulations

5. Foreign Exchange Management (Remittance of Assets) Regulations, 2009
6. Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2009
7. Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2009
8. Foreign Exchange Management (Export and Import of Currency) Regulations, 2009

FEMA Regulations

9. Foreign Exchange Management (Deposit) (Amendment) Regulations, 2009
10. Foreign Exchange Management (Guarantees) Regulations, 2009
11. Foreign Exchange Management (Borrowing and Lending in Rupees) (Amendment) Regulations, 2009
12. Foreign Exchange Management (Export of Goods and Services) (Amendment) Regulations, 2008

FEMA Regulations

13. Foreign Exchange Management (Establishment in India of Branch or Office or other place of business) (Amendment) Regulations, 2005
14. Foreign Exchange Management (Manner of receipt and payment) (Amendment) Regulations, 2005
15. Foreign Exchange Management (Permissible Capital Account Transactions) (Amendment) Regulations, 2004
16. Foreign Exchange Management (Withdrawal of General Permission to Overseas Corporate Bodies) Regulations, 2003
17. Foreign Exchange Management (Insurance) (Amendment) Regulations, 2003

FEMA Regulations

18. Foreign Exchange Management (Investment in Firms or Proprietary concern in India) (Amendment) Regulations, 2002
19. Foreign Exchange Management (Issue of Security in India by a branch, office or agency of a person resident outside India) Regulations, 2000

Infrastructure Finance Companies (IFCs)

RBI has, on 11 February 2010, amended the **Non-Banking Financial (Non- Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 [NBFC Directions]** to introduce a

- 4th category of Non Banking Financial Company [NBFC] viz. “Infrastructure Finance Company” [IFC].
- This is in addition to the existing 3 categories of NBFCs viz. Asset Finance Company (AFC), Loan Company (LC) and Investment Company (IC)

Infrastructure Finance Companies (IFCs)

In view of the thrust given to the development of the infrastructure sector, a separate category of NBFCs viz. Infrastructure Finance Companies (IFCs) has been introduced in terms of the guidelines contained in DNBS Notification. In view of the new category of NBFCs being in place, the dispensation provided in "**Old Position**" below is not considered necessary.

External Commercial Borrowings

Old Position

As per the extant ECB policy, Non-Banking Finance Companies (NBFCs), which are exclusively engaged in financing of infrastructure sector, are permitted to avail of ECB from the recognized lender category including international banks, under the **approval route**, for on- lending to the infrastructure sector, as defined in the extant ECB policy

External Commercial Borrowings

New Position

- Accordingly, proposals for External Commercial Borrowings (ECBs) by the IFCs, which have been classified as such by the Reserve Bank, for on-lending to the infrastructure sector, as defined in the extant ECB policy may be considered under the **approval route**, subject to their complying with the following conditions:
- i) **compliance** with the norms prescribed in the aforesaid DNBS Circular dated February 12, 2010;
  ii) **hedging** of the currency risk in full; and
  iii) the total outstanding ECBs including the proposed ECB **not exceeding 50 %** of the Owned Funds.

FDI in NBFC

- Foreign direct investment in NBFCs is permitted under the automatic route in specified activities subject to compliance with the minimum capitalization norms.
- Once an NBFC is established with the requisite capital under FEMA, subsequent diversification either through the existing company or through downstream NBFCs is undertaken without any further authorization.
- This could give scope for undertaking those activities which do not qualify for FDI through the automatic route

FDI in NBFC

- FDI/NRI investments allowed in the following NBFC activities indicated below:
  - Merchant banking
  - Underwriting
  - Portfolio Management Services
  - Investment Advisory Services
  - Financial Consultancy
  - Stock Broking
  - Asset Management
  - Venture Capital

FDI in NBFC

- Custodial Services
- Factoring
- Credit rating Agencies
- Leasing & Finance
- Housing Finance
- Forex Broking
- Credit card business
- Money Changing Business
- Micro Credit
- Rural Credit

FDI in NBFC

- Minimum Capitalisation Norms for fund based NBFCs:
  - For FDI up to 51% - US$ 0.5 million to be brought upfront
  - For FDI above 51% and up to 75% - US $ 5 million to be brought upfront
  - For FDI above 75% and up to 100% - US $ 50 million out of which US $ 7.5 million to be brought upfront and the balance in 24 months
- Minimum capitalisation norms for non-fund based activities: Minimum capitalisation norm of US $ 0.5 million is applicable in respect of all permitted non-fund based NBFCs with foreign investment

FDI in NBFC

- Foreign investors can set up 100% operating subsidiaries without the condition to disinvest a minimum of 25% of its equity to Indian entities, subject to bringing in US$ 50 million as at (b) (iii) above (without any restriction on number of operating subsidiaries without bringing in additional capital)
- Joint Venture operating NBFC's that have 75% or less than 75% foreign investment will also be allowed to set up subsidiaries for undertaking other NBFC activities, subject to the subsidiaries also complying with the applicable minimum capital inflow i.e. (b)(i) and (b)(ii) above
- FDI in the NBFC sector is put on automatic route subject to compliance with guidelines of the Reserve Bank of India. RBI would issue appropriate guidelines in this regard

About the Author

- *CA. Rajkumar S Adukia is an eminent business consultant, academician, writer, and speaker. He is the senior partner of Adukia & Associates.*
- *In addition to being a Chartered Accountant, Company Secretary, Cost Accountant, MBA, Dip IFR (UK), Mr. Adukia also holds a Degree in Law and Diploma in Labor Laws and IPR.*
- *Mr. Adukia, a rank holder from Bombay University completed the Chartered Accountancy examination with 1st Rank in Inter CA & 6th Rank in Final CA, and 3rd Rank in Final Cost Accountancy Course in 1983.*
- *He started his practice as a Chartered Accountant on 1st July 1983, in the three decades following which he left no stone unturned, be it academic expertise or professional development.*

About the Author

- *He has been coordinating with various Professional Institutions, Associations, Universities, University Grants Commission and other Educational Institutions.*

- *Authored more than 50 books on a vast range of topics including Internal Audit, Bank Audit, SEZ, CARO, PMLA, Anti-dumping, Income Tax Search, Survey and Seizure, IFRS, LLP, Labour Laws, Real estate, ERM, Inbound and Outbound Investments, Green Audit etc.*

- *The author can be reached at* ***rajkumarradukia@caaa.in***
  Mob – 09820061049 / 09323061049

- *For more details log on to www.caaa.in*

Thank You