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REPORT OF SABANAYAGAM COMMITTEE ON NIDHIS

I. Introduction

The Central Government vide Notification No.5/7/2000-CL.V dated 23rd March 2000

constituted a Committee to examine the various aspects of the functioning of Nidhi Companies. The said Notification is reproduced below:

“The Central Government hereby constitutes a Committee to examine various aspects of the functioning of Nidhi Companies and suggest an appropriate policy framework for overall improvement of the Nidhi Companies and to instill and restore the confidence of the investing public especially the small depositors and thereby facilitate the healthy functioning of the Nidhi Companies. Further, the Committee will examine alternative mechanism to regulate and facilitate Nidhi Companies to play key role in mobilising and gainfully investing small savings and examine in depth various aspects of the operation dynamics, existing deficiencies and

suggest appropriate policy prescription for further improving their viability resilience and performance. The Committee will consist of:

1. Shri P.Sabanayagam, Former Union Secretary,
Chief Secretary, Govt. of Tamil Nadu, Chennai. ... Chairman
2. Shri S.Radhakrishnan, Prof. of Economics ... Member
3. Shri N.R. Sridharan, C.A., Chennai ... Member
4. Shri T.S.V.Panduranga Sarma
Ex-Director General, M.R.T.P.C. ... Member
5. (i) Shri V.S.N.Murthy, Chief General Manager,
RBI, Mumbai (from 23.3.2000 to 30.6.2000) ... Member
- (ii) Shri R.Sadanandam, Chief General Manager
(Incharge), RBI, Mumbai
(with effect from 1.7.2000) ... Member
6. Shri H.Raja, C.A., Karaikudi ... Member
7. Shri Mathuradas H. Mehta, Mumbai ... Member
8. Shri R. Vadudevan, Director, Deptt. of Company Affairs ... Member
9. Shri V. Sreenivasa Rao, Regional Director,
Department of Company Affairs, Chennai ... Member-Secretary

The Committee will also examine and make recommendations with regard to:

- (i) Evaluate the present mechanism for monitoring the activities of Nidhi Companies and suggest improved mechanisms to sustain and strengthen the Nidhi Companies;
- (ii) Suggest prudential norms for deployment of funds of Nidhi on the Lines of NBFCs and develop guidelines for adoption;
- (iii) Suggest a supervisory framework to track non-compliance of such Norms and examine feasibility of bringing in Deposit Insurance Cover and some sort of rating that can be imposed on these Nidhi Companies;

- (iv) Develop a future long-term growth plan for Nidhi Companies for development and proper functioning of Nidhi Companies to play a role in the context of financial reforms, inter-alia, technological developments, emerging needs of stakeholders and national imperatives;

- (v) The Committee may consider such other matters incidental to as relevant..

The Committee may consult other experts in the field as and when necessary.

The Committee will submit its report within a period of three months from the date of issue of this notification/order. (The period has been extended for a further period of 3 months till 30th September, 2000, vide Department's letter No.5/7/2000-CL.V dated 30th June, 2000).

Department of Company Affairs will be the nodal Department.”

1. II. Methodology and Approach

To fulfill the task given to the Committee the Committee at its first meeting decided that all parties concerned with the functioning of Nidhis such as Association of Nidhis, Chambers of Commerce, Chartered Accountants, Company Secretaries, etc., should be given opportunity to make their representations. In order to focus their attention on issues rather than make general submissions a questionnaire (Appendix-I) was prepared and sent to all concerned. Meetings were held in Chennai, Delhi and Mumbai and intimations sent to all concerned (Appendix-II) to come and make their representations along with written statements. Frank discussions took place at these meetings so as to arrive at practical solutions.

2. III. History

- 1. The history of the Nidhis, their special features, their manner of functioning, their regulations, etc., have been described by the Committee mentioned below. Although these Committees covered financial institutions including Nidhis, the present Committee is the first to be appointed exclusively to study the functioning of Nidhis and make recommendations:

- (i) Viswanatha Shastri Committee in 1965
- (ii) Banking Commission in 1972
- (iii) James Raj Committee in 1975
- (iv) Chakravarthy Report in 1987
- (v) Dr.A.C.Shah Committee in 1992

2. All that needs to be emphasised is that for over a century Nidhis, with the objective of cultivating the habit of thrift, were promoted by public spirited men drawn from affluent local persons, lawyers and professionals like auditors, educationists, etc., including retired persons. The area of operation was local – within municipalities and panchayats. Some Nidhis on account of their financial and administrative strength opened branches within the respective revenue district and even outside. The principle of mutual benefit was fundamental – to get savings from members and lend only to members and never have dealing with Non-members.

3. The primary object of Nidhis has been to carry on the business of accepting deposits and lending money to member-borrowers only against jewels, etc., and mortgage of property. Nidhis were not expected to engage themselves in the business of Chit Fund, hire purchase, insurance or in any other business including investments in shares or debentures. As stated these Nidhis do their business only with Members. Such Members are only individuals. Bodies Corporate or Trusts are never to be admitted as Members.

4. A suggestion was made to the Committee that the benefit of share market capitalisation in the recent past benefitted a small group of affluent urban population and that it seemed that such benefits have not percolated to the rural people. In this context the Committee had to consider whether Nidhis could be allowed to involve in the equity investment by utilising the services of consultants. Since inception of regulations by DCA, Nidhis were prohibited from trading in shares. Moreover, the very object of Nidhis would be fractured if trading in shares is permitted. Hence the Committee does not recommend Nidhi being allowed to participate in equity investment.

5. In the history of Nidhis, there have been some failures but what hit the headlines recently is the failure of leading Nidhis involving crores of rupees and lakhs of depositors,

caused by imprudent lending and mismanagement by those in control. On account of these startling failures there is a tendency to condemn Nidhis as a whole. The facts, are that a large number of Nidhis, many of them 100 years old, have been functioning without giving room for any complaint and their financial resources mobilisation and service oriented practices have been commendable. The Committee appreciated that Nidhis play a very useful role in helping middle and lower middle classes by providing quick financial services with minimum formalities and should, therefore, be allowed to grow with supervision.

6. It must be admitted that the recent few failures referred to above are a salutary signal and there is an imperative need to regulate, supervise and exercise disciplinary control over the Nidhis, but without stifling them. In this regard the action of the Government to constitute the Committee is not a day too late and the terms of reference of the Committee has focussed on the important issues and the Committee seeks to give the following recommendations.

7. At this stage it must be made clear that while Nidhi is a company governed by the provisions of the Companies Act, the DCA has all along taken into consideration the objective of the Nidhi and has, therefore, sanctioned concessions by way of exempting the Nidhis from certain provisions of the Companies Act. Following this fundamental need for distinguishing Nidhis from a company under the Companies Act, this Committee while on the one hand recommended certain concessions to Nidhis, have also recommended certain regulations to govern the functioning of the Nidhis which may seem stricter, all because of the Committee's interest in depositors' security.

IV. Prevailing Regulatory Authorities

Nidhis are regulated by the provisions of the Companies Act in force. They also come under one class of NBFCs and hence RBI is empowered to issue directions to them in matters relating to their deposit acceptance activities. RBI has in recognition of the fact that these Nidhis deal with their shareholder-members only exempted the notified Nidhis from the core provisions of the RBI Act and other directions applicable to NBFCs. RBI has been reviewing the directions applicable to Nidhis from time to time. At present, the Nidhis are barred from

payment of brokerage on deposits and making advertisements in any manner. The only stipulation of RBI presently applicable to Nidhis pertains to the ceiling on interest rate payable on the deposits.

V. Procedure for Incorporation of Nidhis

1. At the outset it would be pertinent to mention that there is no Government Notification defining the word 'Nidhi'. The companies doing Nidhi business, viz. borrowing from members and lending to members only against security, go under different names such as Nidhi, Permanent Fund, Benefit Funds, Mutual Benefit Funds and Mutual Benefit Company. In view of the above situation the Committee feels that it is imperative that a precise definition and meaning should be given to the word Nidhi. Taking into consideration the manner of functioning of Nidhis at present and the recommendations of the Committee in this report and also to prevent unscrupulous persons using the word 'Nidhi' in their name without being incorporated by Department of Company Affairs and yet doing Nidhi business, the Committee suggests the following definition:

“Nidhi is a company formed with the exclusive object of cultivating the habit of thrift, savings and functioning for the mutual benefit of members by receiving deposits only from individuals enrolled as members and by lending only to individuals, also enrolled as members, and which functions as per Notification and Guidelines prescribed by the DCA. The word Nidhi shall not form part of the name of any company, firm or individual engaged in borrowing and lending money without incorporation by DCA and such contravention will attract penal action.”

2. The Committee also recommends that any company desirous of doing Nidhi business as defined above should have the word 'Nidhi' added to the company's name. In so far as the existing companies functioning as Nidhis, they should be required to add the word 'Nidhi' after their name within a period of three months. By adopting this procedure the public and the authorities will have no confusion as to whether a company is a Nidhi or not.

3. The present procedure to incorporate a Nidhi company is as follows:

To get approval of the name by which the company will be known the promoters propose three names to ROC. After verification the ROC is able to either identify one name or else calls for a panel of fresh names. Following this exercise a name is finally allotted by ROC to the promoters which will be used as the name of the company. But the word 'Nidhi' cannot be used as a part of the name at this stage. Thereafter the promoters submit the Memorandum and Articles of Association to ROC who after examination registers the company and issues a Certificate of Incorporation. Thereafter the company submits to the ROC documents such as a Statement in lieu of Prospectus, declaration by the promoters etc., specified under Section 149 of the Companies Act. ROC registers these documents after corrections if any and issues a Certificate of Commencement of Business. At this stage there is no stipulation as to the membership strength of the company nor any restriction regarding capital for doing business. The company can receive deposits and lend without any restriction on rates of interest and for any period of time. Consequently, the functioning of such companies is not restricted or supervised by the authorities. During this period authorities are expected to know the functioning of this type of companies and place restrictions on receipt of deposits. Prior to amendments to RBI Act in January, 1997, the RBI held a view that grant of Nidhi status was under the purview of DCA and that the companies working on nidhi lines but awaiting notification by the Government should be under DCA's control and in fact, therefore, there being no clear understanding these companies had the opportunity to do what they liked.

4. It was only in January, 1998 when new regulatory framework for NBFCs was announced by RBI it was stipulated that all companies until they are notified as Nidhis under Section 620A of the Companies Act irrespective of their working on nidhi pattern would be treated as 'loan companies'. Incidentally it may be added that recently (on 1.11.1999) DCAvide a Notification restricted the companies by placing a limit on the acceptance of deposits as well as the quantum of incremental deposits. It is only such of those companies desirous of availing of the exemptions provided by the Government under Section 620A of the Companies Act that would have to apply to the DCA. For that purpose the information required by the Department is to be furnished. Having got the declaration the company gets the status of 'Nidhi' and would be exempted from many provisions of the Companies Act. However, such Nidhis are governed by the overall ceiling on the rate of interest prescribed by RBI under NBFC Directions.

5 Upto 1996, 192 companies have been declared as Nidhis,. Of these 136 are in Tamil Nadu. It so happens today in the Department the number of companies who have applied for registration under Section 620A of the Companies Act so as to be classified as Nidhis is said to be 93 and there are unspecified number of such companies claiming to be working on nidhi lines but have not applied for declaration as nidhis. In respect of those companies who have applied for classification as Nidhis, while declaration under Section 620A is pending, the RBI has in consultation with DCA issued instructions permitting such companies, subject to certain conditions similar to those applicable to companies declared as Nidhis, to accept deposits, treating them as mutual benefit companies. Hence on the one hand while earlier, only those companies registered as Nidhis under Section 620A were entitled to exemption from the restrictions of the RBI, subsequently the DCA identified such other companies on the ground that they were potential Nidhi companies by their activity, and the RBI in consultation with DCA permitted such other companies going by the name of Mutual Benefit companies, but not declared as Nidhis by DCA, also eligible for treatment similar to Nidhis, which seems anomalous.

6. Procedure recommended for incorporation of a company as 'Nidhi'

- (i) The Committee felt that the prevailing procedure for incorporation as Nidhi requires rationalisation in the following manner:

In view of the several recommendations of this Committee pertaining to the value of shares, raising of funds, deployment, interest charges, formation of Board of Directors, opening of branches, etc., mentioned later on, it is necessary that all such recommendations to the extent to which they are accepted by the Government and the guidelines issued by the Regulatory Authority from time to time, should form an integral part of the Memorandum and Articles of Association. A model of the Memorandum and Articles of Association and guidelines are annexed (Appendices III, IV & V).

- (ii) The company after getting ROC's approval of a name for the company which will necessarily have the word 'Nidhi', should submit its Memorandum and Articles of Association

along with necessary evidence to the ROC for incorporation. The ROC will after scrutiny issue Certificate of Incorporation.

(iii) For incorporation of a company as a 'Nidhi' the present stipulations vide Notification dated 1.11.1999 are 2000 members and capital of Rs.25 lakhs. The Association of Nidhis and others represented that Nidhis are promoted by local people, not too affluent, and for them to raise the capital and enroll membership as mentioned above will take unduly long time. In the past Nidhis were started with a few hundred members and a capital of say Rs.1 lakh. Considering the past and also the present value of the rupee and the semi-urbanisation which is taking place the Committee recommends that the membership required may be reduced to 500 members and the paid up capital to Rs.10 lakhs with an authorised capital of Rs.25 lakhs. To achieve this norm for enrolment of members and raising of capital three months' time may be given to companies in the municipal areas and six months for others. An extension upto a maximum of three months may be given for fulfilling the above requirements by the Regulatory Authority if adequate reasons are given by the company. If at the end of this period also the company is unable to fulfill the stipulations it shall be mandatory for the company to refund the amounts lying credited to Share Application money pending allotment.

(iv) On completion of this procedure, ROC himself, instead of the present practice of declaration by the DCA, New Delhi, after examination that all conditions have been fulfilled issue 'Certificate of Commencement of Business' and also notify the company under Section 620A as a Nidhi company. If the above procedure is adopted the following advantage will be ensured:

- (a) No company can borrow or lend without obtaining Certificate of Commencement of Business and without notification as Nidhi under Section 620A of the Companies Act.
- (b) There will be no extraordinary time lapse between incorporation and commencement of business;
- (c) Unscrupulous promoters cannot form a company as hitherto and carry on the business of borrowing and lending without being declared as a Nidhi.
- (d) Lastly by incorporating in the Memorandum and Articles of Association the recommendations made in this report, the Nidhi company would

automatically come under discipline and control of the Regulatory Authority to whom the company would have to provide periodical relevant information.

(v) It is understood that a number of applications made by the companies to the Department for declaration under Section 620A have been pending. This Committee would suggest that pending decision of the Government on the recommendations of this Committee such pending applications may be disposed of so long as they conform to the present guidelines but with a condition attached that declaration is subject to such changes as may be ordered by Government after consideration of the Committee's report. It may be stated that the applications received from the date of constitution of this Committee may be kept pending till the recommendations of the Committee are implemented by the Government.

(vi) In the case of companies, numbering about 1300, who are doing Nidhi business but who have not applied to the DCA for declaration as Nidhi they should be debarred from conducting Nidhi business. If any company's application for such declaration by DCA had been rejected with reference to the existing provisions, regulations and guidelines of DCA but is in confirmity with reference to the Committee's recommendations the company may seek appropriate redressal. In case they have made an applicationo to RBI for grant of Certificate of Registration, it is recommended that RBI may reject their applications if not found fit as per NBFC Regulations. In case of those who have not applied to RBI or any authority but yet doing Nidhi business it is for the State Police to take necessary action.

VI. Sources of Funds

1. Equity Shares

(i) The equity share value of many Nidhi companies is Re.1/-. In the present context considering the purchasing power of the rupee, the Committee recommends that for new companies to function as Nidhis the share value should be Rs.10/- with the proviso that the company shall not levy service charges. Whether a maximum should be fixed for the value of the share was also

considered but the Committee is of the opinion that in the context of the general feeling that as many people as possible should participate in the economic and financial development of the country, it is not necessary to fix higher share values. In so far as existing companies whose share value is Re.1/- they may be advised to raise it to Rs.10/- within a period of one year.

Nidhis can issue only rights shares and unsubscribed portion of rights issue can be apportioned by the Board of Directors as per the existing law.

- (ii) No member shall exercise voting rights in excess of 10% of the total voting rights of the equity shareholders.

2. Preference Shares

- (i) If Nidhis are permitted to issue preference shares there is always the danger of the Nidhi facing a liquidity crunch when the shares are due for redemption. Also in a manner of speaking, preference shareholder has no real stake in the functioning of a Nidhi.

- (ii) The issue of preference shares by a Nidhi would amount to creating another class of shareholders different from equity shareholders, which goes against the basic concept of mutuality and equality.

- (iii) Some Nidhis are said to have issued preference shares. In such cases once the preference shares are redeemed no fresh issue should be permitted. Also until then such shares should not be reckoned as part of Net Owned Fund.

The Committee, therefore, recommends that Nidhis should not be allowed to issue any new preference shares at any time.

3. Deposits

- (i) Nidhis may be permitted to privately circulate to their members their loan and deposit schemes and an abstract of the Balance Sheet. No advertisement shall be made for mobilisation of resources. No brokerage or incentives will be allowed to be paid for mobilising deposits or members or granting loans. Every Nidhi should make available to a prospective depositor a Deposit Application Form to be filled in by the depositor and

such form should contain the salient features of the Nidhi pertaining to its finance and administration as per NBFC Advertisement Rules.

(ii) All depositors, be they fixed or recurring, should hold atleast ten shares (Rs.100/-).

(iii) Fixed Deposits

Fixed Deposits should be for a minimum period of twelve months and a maximum period of 84 months.

(iv) **Recurring Deposits**

Nidhi company can operate Recurring Deposit Account with its members ranging for a period with a minimum of twelve months and a maximum period of 84 months.

(v) Since the Committee is proposing a maximum period of 60 months in respect of loans against property, a maximum of 84 months has been permitted in the case of Fixed Deposits and Recurring Deposits enabling the Nidhis to have sufficient liquidity.

(vi) Nidhi companies should not be permitted to issue Interest warrant prepaid. Such interest as may accrue could be credited to Savings Deposit Account of depositors if there be one.

4. Ceiling on mobilisation of Fixed Deposits

(i) At present there is no ceiling on the mobilisation of deposits which Nidhis can receive. Any financial institution must have capital of its own to face losses arising out of the exigencies of business, if any, so as to avoid the destabilising effect on the interest of the depositors. In the case of Nidhis the magnitude of credit risk faced by them is much lower than other financial institutions; they are not allowed to advertise for raising public deposits and they are dealing only with members. Hence the capital requirement could be lower than that applicable to banks and NBFCs and, therefore, the Committee recommends a ration of 1:20 (Net Owned Funds to Deposits). The date relevant for this purpose shall be the latest audited Balance Sheet date. By Net Owned Funds, we mean the aggregate of paid up equity and free reserves as reduced by accumulated losses and

intangible assets. In this, free reserves would mean and include the reserves distributable as dividend after apportioning the provision /amounts for various funds. In the case of Nidhis who have deposits in excess of the ratio of 1:20, viz. Net Owned Funds to Deposits, the receipt or renewal of deposits should be frozen but the Nidhi allowed to function. They may also be advised to raise the Net Owned Funds by issue of additional rights shares if it is possible within the authorised capital or else if need be increase the authorised capital and issue shares or as a last resort bring the deposits down to the ratio fixed now so that within a period of one year there is a match between Net Owned Funds and deposits in the ratio of 1:20.

(ii) In regard to deposits DCA has issued a Notification on 1.11.1999 and amended on 19.11.1999 and further amended on 25.04.2000. It has been stated therein that Nidhis shall not raise deposits beyond Rs.20 crores. At the same time in the amended notification Nidhis holding deposits of Rs.50 crores and above are allowed incremental deposits of 2%. There are other anomalies also which the Committee would not like to go into. The restrictions on raising deposits by Nidhis would be contrary to the unanimous view of the Committee that Nidhis are serving the lower and middle income groups and play an important role in the welfare of the country and therefore should be allowed to grow subject however to conditions. Therefore, the Committee recommends that Nidhis should be permitted to increase deposits subject however to the prudential norms which have been recommended above.

(iii) As per the Notification dated 25.04.2000 Nidhis having deposits of Rs.50 crores and above are allowed incremental deposits of only 2% of the deposits per annum for the next ten years. This seems to be very restrictive considering the rate of inflation and increased cost. Also Nidhis should be allowed to grow on their own and serve the community which is possible so long as they maintain the ratio of 1:20 between Net Owned Funds and Deposits. The restrictions on incremental deposit becomes redundant and may therefore be removed.

5. Foreclosure of Deposits

(i) Regarding foreclosure of deposits the opinion of public representatives is divided. Mass foreclosure of deposits would result in the crash of a Nidhi and hence there seems to be a case to prohibit foreclosure. At the same time depositors who genuinely require funds at a particular point of time should have the right to foreclose as otherwise they would be in distress. In the context of the regulatory and supervisory control which this Committee is proposing and in particular the insurance cover which the Committee is also proposing for the depositors the likelihood of mass withdrawals by depositors is not anticipated. Hence the Committee feels that foreclosure may be allowed subject to the condition that a week's time should be given and the encashment, only upto 70% of deposit.

(ii) Foreclosure of deposits should be governed by the following guidelines:

(a) No foreclosure shall be allowed within 3 months of deposit;

(b) No interest shall be allowed for foreclosure between three and six months of deposits. Only principal amount will be refunded.

(c) Interest shall be allowed at the Savings Bank rate payable by the Nidhis for foreclosure between six and twelve months.

(d) If foreclosure is opted for after twelve months of deposit the interest payable on such deposits would be reduced by 2% from the contracted rate of interest payable for such period for which the deposits have remained with the company.

6. Savings Account

(i) DCA vide Notification dated 1.11.1999 restricted the operation of Savings Bank Accounts. There has been a demand from Nidhis for continuing the maintenance of Savings Bank Account. The facts are that the members of a Nidhi belong to lower and middle class and they find it easier to deposit in a Nidhi and withdraw as compared to the formalities in commercial banks. Hence all are agreed that Savings Deposit Account may be permitted for Nidhi. There is, however, the question whether any limit should be placed. Although some Nidhis do not want any limit to be fixed, considering the fact that

Nidhis are not supposed to do the normal banking functions it is necessary that while Savings Deposit Account may be permitted restrictions on the amount should be fixed. The Committee, therefore, recommends a limit of Rs.20,000/- and rate of interest shall be not more than 2% above the Savings Bank interest rate of Nationalised Banks. No interest will be paid by the Nidhi if the limit of Rs.20,000/- is exceeded.

(ii) When loans are sanctioned loanees may be permitted to deposit the amount or part thereof in Savings Account without restrictions so that the loanee can draw such sums of money he may require from time to time and not be under the compulsion to draw the entire loan amount.

(iii) While some Nidhis have recommended that cheque facility in respect of Savings Account should be provided the Committee is of the opinion that such proposition would amount to going against the very grain of permitting the opening of Savings Deposit Account by Nidhis who function with least formalities.

7. Current Accounts

While the Committee has as a special case permitted the Nidhis to maintain Savings Bank Account for its members, there is no case for permitting them to maintain Current Accounts as this would amount to normal banking business.

VII. Deployment of Funds

1. General

(i) To ensure the safety, liquidity and profitability of a Nidhi, conditions need to be imposed on the deployment and utilisation of funds. Therefore, the Committee recommends that not less than 10% of the funds deposited in the Nidhi should be deposited in a Nationalised Bank in the form of unencumbered Fixed Deposit Receipts and only 90% should be used for business. The date of reckoning shall be the last day of the second preceding month. The compulsory deposits in Nationalised Bank may be varied by the Department depending on exigencies. Withdrawal from

Fixed Deposit Receipts will be permitted temporarily by the Regulatory Authority only for repayment of depositors when exigency demands and in due course restored to the prescribed limit.

(ii) The Nidhi should earmark ½% of the deposit amount received towards Contingency Fund. The purpose of setting up this Fund is to have sufficient resources to help Nidhis who may face financial crunch at some point of time on account of unexpected withdrawal of deposits or delayed recovery/realisation of dues from loanees. The Fund will be maintained and administered in accordance with the rules to be framed by the Regulatory Authority.

(iii) At present loanees are not required to take equity shares. In order to strengthen the Nidhi and to give the loanee a sense of participation the Committee recommends that all loanees should be required to hold equity shares of the value of at least 5% of loan amount in respect of loans upto Rs.1 lakh and 3% in respect of loans exceeding Rs.1 lakh but less than Rs.5 lakhs and 2% in respect of loans above Rs.5 lakhs all of which would automatically strengthen the financial position of the company. After the loan taken is repaid the shares held by the loanee should be transferred only to another loanee so as to ensure that there is no reduction in the capital.

2. Loans

(i) The undermentioned recommendations of the Committee is with the objective of ensuring that the power given to the Nidhis to sanction loans is for the benefit of a large number of individuals in the middle and lower income groups and not cornered by a favoured group and also to minimise the rush of withdrawals on accounts of loss faced by a Nidhi. The Committee has noticed the tendency on the part of some Nidhis to give as much as 80% of the loans against property and some Nidhis a similar high percentage against jewellery which is not advisable as there should be a fair mix of the two.

(ii) Apart from the traditional two kinds of security, namely jewels and property, the Committee is of the view that by virtue of the objectives of the Nidhi they could also

be permitted to advance loans to individuals holding KVP/NSC/NSS/Insurance Policy and Government securities. Certain conditions are being prescribed by the Committee in respect of these kinds of loans. Apart from the limit on the loans, Nidhis should before sanctioning loans appraise the repaying capacity of the borrowers and work out repayment schedule for the loan amount.

(iii) Loans shall be given only to individuals against the following securities:

- (a) Jewellery, gold and silver;
- (b) Immovable property;
- (c) ©KVP/NSC/NSS/Insurance Policies and other Government securities;
- (d) Fixed Deposit Receipts.

(iv) Nidhi shall not pledge any of the securities lodged by its members for obtaining loans.

3. Quantum of loan against security, period and mode of recovery

(i) Loans against jewellery, gold, etc.

(a) In the case of loans against security of jewellery, gold, etc., loan amount shall not exceed 60% of the estimated value of the security offered. The period of loan should be not more than 12 months.

(b) A month before expiry period of loan, loanee should be informed to clear the loan. If the loan is not repaid in full even after the notice, a second notice should be sent to the effect that the jewellery, gold, etc. offered as security will be sold in public auction. If no repayment is made within 15 days of the issue of notice, the auction should be held and loan amount recovered.

(c) If at auction the sales value is less than 75% of the estimated value then the auditors should report the fact to the Regulatory Authority who may suitably advise the Nidhi.

(d) Appointment of Government valuers for valuation of gold,jewellery etc. and Punitive action

It was decided that it may not be feasible to appoint Government valuers for valuation of gold, jewellery and ornaments as the number involved is very large. No gold or jewel loan should be allowed to continue beyond 12 months. In case the loan is not cleared within one year, even if part payment is made the gold or jewel should be auctioned.

(ii) Loans against immovable property

Since loans against property will be long term loans the following ceiling on loans is proposed. The loan amount will be no more than 33 1/3% of the value of the property offered as security.

(a) Not more than Rs.2 lakhs per individual where the total amount of deposits held by the Nidhi is Rs.2 crores or less; and the sum total of all individual loans of Rs.50,000/- and above should not exceed 15% of the total deposits.

(b) Not more than Rs.7,50,000/- per individual where the deposits held by the Nidhi is more than Rs.2 crores but not exceeding Rs.20 crores; and the sum total of all individual loans of Rs.2 lakhs and above should not exceed 15% of the total deposits.

(c) Not more than Rs.12 lakhs per individual where the deposits held by the Nidhi is more than Rs.20 crores but not exceeding Rs.50 crores; and the sum total of all individual loans of Rs.3 lakhs and above should not exceed 15% of the total deposits.

(d) Not more than Rs.15 lakhs per individual where the deposits held by the Nidhi company exceed Rs.50 crores; and the sum total of all

individual loans of Rs.4 lakhs and above should not exceed 15% of the total deposits.

(e) The sum total of such mortgage loans should not exceed 40% of the amount of overall loans outstanding on the date of approval by the Board of Directors. Two years time may be given to Nidhis who have given loans in excess to come to the norm of 40% . Until such stage is reached no mortgage loans should be given.

The reason for giving this conservative percentage is because property values have been fluctuating sharply in recent years and recovery of such loans takes considerable time.

1. (iii) Mode of Recovery

(a) When sanctioning loans against property offered as security the Nidhis generally get an equitable mortgage, registered or unregistered, or merely a letter from the loanee depositing the title deeds with the Nidhi. When the loan is not repaid the Nidhi resorts to legal action incurring heavy expenditure and it takes years before they can bring the property for sale. Consequently the liquidity of the Nidhi is affected, sometimes seriously. The Committee examined the problem to see if there can be a better method of recovery. Since this is a legal matter discussions were held with the Legal Adviser of DCA and the Legal Adviser of the Association of Nidhis and the facts are as follows:

(b) There are six kinds of mortgages:

- (i) Simple Mortgage
- (ii) Mortgage of conditional sale
- (iii) Usufructuary Mortgage
- (iv) English Mortgage
- (v) Equitable Mortgage or Mortgage of property by depositing the title deeds and
- (vi) Anomalous Mortgage

Of the above six kinds of mortgages, as stated earlier the general practice prevailing in the Nidhis is to get either a mortgage, registered or unregistered, or merely a letter from the loanee depositing the title deeds. Hence the Committee would like to confine to these two kinds of mortgages.

(c) The mere depositing of the title deeds does not confer any right to the Nidhi to possession and sale. Besides, there is no knowing if the said property is free from encumbrance. In the case of a mortgage if it is not registered with the State Department of Registration then again it is not known if it is free from encumbrance. If, however, a mortgage, with power given to mortgagee to sell, is registered with State Department of Registration who will do so only if there is no encumbrance, then the Nidhi is safe and assured.

(d) For recovery Nidhi would have to file a suit involving substantial court fee, viz. 7.5% of value of the suit claimed plus legal fees, etc. At the present rate of disposal of suits by Courts, the Nidhis from experience say that it will take long years, before a

(e) decree can be obtained. During this period the Nidhis will face a liquidity crunch, sometimes unmanageable.

(e) In the case of Co-operative Banks loans are given only to individuals against mortgage of properties and the State Government exempts such mortgages from the payment of stamp duty. Only registration charge of 1% is collected by the Registration Department. Since the Nidhis also give loans only to individual members belonging to the low income groups the case of Nidhis stands on all fours with Co-operative Banks and hence a petition to the State Government to grant similar exemption as for the Co-operative Banks stands to reason. It may be argued that the State Government would be losing the 4% stamp duty. It would be pertinent to point out that very few of the large number of mortgages filed with Nidhis are registered and hence the revenue received by the State Government is very little. If, however, the State Government were to accept the Committee's petition, viz. to exempt the mortgages with the Nidhis from the payment of stamp duty then atleast the State Government would get the 1% registration charge in

respect of the thousands of mortgages with the Nidhis, thereby adding to the revenues of the Registration Department.

(f) The Committee's recommendation is that the Nidhis who advance loans against property shall do so only against registered mortgages with power given to mortgagee to sell. All loanees would automatically be required to register the mortgages.

(g) Under Section 69© of the Transfer of Property Act, 1882, intervention of the Court is not necessary to sell the property if the property mortgage is executed in the towns of Calcutta, Chennai and Mumbai, and in the mortgage deed there is a provision whereby the mortgagee has the power to sell etc. without intervention of the Court. Hence while Nidhis in the specified towns mentioned under Section 69© can avail of the provision and take action to sell without going to Court, the Nidhis situated elsewhere cannot do so. In view of the special character and objectives of the Nidhis there is a strong case for extending this provision to enable all the Nidhis to take action to sell without intervention of the Court. All that need be done is for the State Government to duly notify in the Gazette as provided in Section 69©. This action by State Government will justifiably benefit all Nidhis greatly. Incidentally it may reduce the volume of work in the Courts also.

(h) The Committee, therefore, recommends the following for recovery in respect of property loans:

Nidhis are permitted to grant loans against property only if the loanee executes a mortgage with power to the mortgagee to sell without intervention of the Court and is properly registered with the Department of Registration. This recommendation can be effectively implemented only if the DCA takes up the matter with the State Governments to exempt the payment of stamp duty and to take action under Section 69© of the Transfer of Property Act, 1882, as proposed above.

(iv) Loans in respect of KVP, NSC, etc. and Fixed Deposits

Nidhis while giving advances for a period of one year on security of KVP/NSC/NSS/Insurance Policy and other Government securities would have to take note that these are not transferable to other than investors. These instruments generally have a lock in period of three years, during which period they are not encashable and hence, will not qualify as liquid assets. Beyond the lock in period, they are encashable at a discount of the maturity value. While granting loans against such instruments, Nidhis would have to take adequate precautions by having the certificates discharged by the holders and an undertaking from the holders that on maturity, the loan would be repaid by them to the Nidhi or earlier by premature encashment. The Nidhi needs to verify if the Post Office would pay the maturity amount to the holders only or to any person or institution authorised by them and take appropriate action.

4. Micro Financial Groups

- (i) Individuals in the lower income group of the community engage themselves in a variety of operations – basket making, handicraft, rope making, toys, food products such as appalams, garlands, etc. There are some agencies who help them either by supplying raw material or by giving small loan. This category of individuals who are mostly women deserve to be helped and encouraged. Wherever these individuals form themselves into Self Help Groups, the Committee recommends that Nidhis may advance credit to them under the following conditions.
- (ii) A group should have a minimum of ten members. Each member may be entitled to a loan of Rs.500/- and no one Self Help Group can be given more than Rs.10,000/-

. These loans will be secured by the guarantee of all the members of the group. There shall, however, be a ceiling, viz. the sum total of all such loans shall not exceed 5% of the value of all loans.

(iii) The Committee recommends that the sum total of all loans given against the security of property shall not be more than 40% and in respect of loans against jewels, etc., not more than 50% and in respect of Micro Financial Groups the ceiling shall be 5% . The balance of loans may be spread over to loans against KVP, etc.

3. VIII. Ceiling on Interest and Dividend

1. The cost of services and overheads of Nidhis is relatively low as compared to banks and NBFCs, who invite deposits. Hence the Nidhis can afford to give depositors a higher rate of interest than other credit institutions. At the same time such increase should be reasonable as otherwise the Nidhis would be compelled to charge a corresponding higher rate of interest on loans. The Committee, therefore, recommends the following:

(i) The rate of interest on fixed deposits should not exceed the rate prescribed by the Regulatory Authority.

(ii) The rate of interest on loans shall not exceed 5% of the highest rate of interest offered on deposits by the Nidhis based on Reducing Balance method.

(iii) As regards dividends some Nidhis are known to declare very high rates – as much as 100% and more. This is against the very concept of Nidhis. At the same time Nidhis who manage their business efficiently should have recognition and publicity whereby not only the shareholders are satisfied but the public also become aware and confidence instilled leading to flow of more deposits.

2. Therefore, the Committee recommends that the ceiling on dividend be pegged at 25% subject to the condition that an equal amount is transferred to General Reserves and there has been no default in repayment of matured deposits and interest thereon.

4. IX. Organisation and Policy guidelines

1. General

A Nidhi can conduct business only if they have deposits with whose money loans are granted. Hence the interest of depositors should be kept in mind and legitimately they should have a say in the management of the Nidhi. The promoters who establishes a Nidhi and on account of whose reputation and effort deposits are mobilised should also have a say in the management of the Nidhi. There is a consensus in the country that women who have so far been sidelined in spheres of development should be given adequate representation. It is also necessary to ensure that vested interests are not allowed to dominate. A person convicted by a Court of Law for a criminal offence shall remain disqualified to be a director. Keeping all these in mind the Committee recommends the following.

2. Board of Directors

- (i) Nidhis to be managed by a Board of directors with due representation for depositors for depositors and promoter/directors and adequate representation for women, atleast one to begin with. No director to continue beyond 10 continuous years except with the approval of the Regulatory Authority. Meetings are to be held every month and proper registers to be maintained which should be inspected quarterly by the auditor before sending the quarterly report to the Regulatory Authority. A person can be a director in only one Nidhi company.
- (ii) No loan should be given in future to a director. A person who has a loan subsisting with a Nidhi should be debarred from becoming a director of that Nidhi.

3. Remuneration of Directors

It did not occur to the Committee that it would have to regulate the number of Board meetings of Nidhi or the sitting fees payable to the members until it came to the Committee's notice that some Nidhis are inclined to hold unduly large number of Board meetings, sometimes as many as two a week, and more so paying sitting fees as much as Rs.2000/- per member. Considering the concept of the Nidhi that it is formed by public spirited men, one could have even expected that such public spirited men may do voluntary service and not even receive sitting fees but that would be expecting too much. Hence in the above context, the Committee feels that a Nidhi should hold a Board meeting once a month and not more than 15 in a year. Nidhis also do have sub-committees to evaluate property loans, etc., but it will not be possible to regulate the number of such sub-committee meetings. Having said this the Committee recommends that the maximum amount that may be paid to directors for attending board meetings should not be more than Rs.10,000/- a year and a similar amount for those attending the sub-committee meetings. This will ofcourse be in addition to such remuneration as entitled under Section 309/198 of the Companies Act.

4. Opening of Branches

- (i) Since the very concept and rationale for the existence of Nidhis is to promote thrift among the local people and the business conducted should be only with the local people, the desire and demand of representatives of Nidhi that there should be no restriction on opening of branches, be they within or outside the State, seems to be unjustified. In any particular area adjacent to an existing Nidhi if no effort has been made by local people to form a Nidhi there would be a case for opening of a branch in such area. It is in this context the Committee makes the following recommendations:
- (ii) Any Nidhi company can open branches only if it has earned operating profits for atleast three continuous years and its projection reveals that it would be able to recover the capital expenditure within a period of three years. Subject to this,

- (a) A Nidhi can open upto three branches without requiring any approval so long as they are within the Revenue District as delimited territorially on 26th January, 1950, the Republic Day.
- (b) If however, a Nidhi wants to open a branch outside the district but within close proximity they should obtain the approval of the Regulatory Authority.
- (c) ©Any increase beyond three branches within the district or elsewhere in the State will require the approval of the Regulatory Authority.
- (d) Nidhis which are already having three branches within or outside the district and desirous of opening of new branches should apply to Regulatory Authority.
- (e) Nidhis will not be permitted to open any branch outside the State.
- (f) No Nidhi can open a branch in the disguise of Collection Centre or Deposit Centre and the like.
- (g) In so far as Nidhis having branches outside the State such branch or branches in one State should be separately constituted as a separate company and allowed to function thereafter. A year's time may be given for that purpose including compliance with applicable norms for a Nidhi.

5. Guidelines for opening branches

The Regulatory Authority while approving opening of branches shall adhere to the following criteria:

- (i) For every five years of completed service, one branch can be allowed to be opened in the district where the company is registered or outside the district, but not outside the State;
- (ii) If one hundred citizens or more of a town or village represent to a company to open branch in their locality, the Regulatory Authority may consider the case;
- (iii) The Regulatory Authority shall satisfy that the company has maintained the prescribed norm of Net Owned funds and deposits;

- (iv) The audit reports of the company do not contain any qualifications;
- (v) The company has not defaulted in payment of deposits to its members;
- (vi) The company has not defaulted in submitting its returns to the Regulatory Authority

in

compliance with regulations;

6. Administrative Efficiency

In the Banking and Financial Sector Nidhis are no doubt small but they deal with large number of clients, depositors and loanees and have to maintain necessary records for the conduct of the business. The present developments in office equipments conducive to efficiency such as computers, peripherals, etc., have to be noted and the Nidhis would do well to embark on a scheme of computerising their operations so that information can be stored conveniently and retrieved quickly. Atleast Nidhis having deposits of over Rs.20 crores should consider computerisation of their records and accounts.

7. Acquiring control of another Nidhi either by purchase of shares or by nominating persons on the Board

No Nidhi should be allowed to acquire another company by purchase of shares. In the Memorandum and Articles of Association there shall be no provision for nominating any person on the Board of Directors of another company as this may lead to control of that company. However, Nidhis in the same state could amalgamate or merge under existing provisions of the Companies Act subject to the norms of forming of a Nidhi.

8. Nidhis shall not allow use of its name by any other sister body corporate whose objectives are similar to that of a Nidhi.

9. Transaction with Body Corporates

The Committee agrees with the present guideline that a Nidhi should not be allowed to borrow or lend money from any body corporate or make investment in any body corporate. As already stated Nidhis' dealings should be only with members.

10. Limit on circulation of Notices

A company having 10,000 members or Rs.2 crores by way of deposits shall publish their audited Balance Sheets in two dailies, one in English and the other in the local vernacular language. Others need only publish the abstract of the Balance Sheet by way of pasting on the Notice Board of the Nidhi and sending such abstract to members holding ten shares or more.

11. Nidhis should continue to file with ROC the full list of shareholders quinquennially as per the existing provisions.

12. Dividend declared should be published in the Notice Board. No individual intimation is at present sent to the shareholders and sometimes this dividend amount is rather small and, therefore, shareholders do not come to claim them. After a period of 7 years as per Section 205C of the Companies Act the unclaimed dividend amount should be transferred to the fund created by the Central Government under Section 205C of the Companies Act.

13. Penalties

(i) No regulation and supervision can be effective without commensurate penalties for defaults/violations of guidelines/regulations. Nidhis being incorporated with the sole object of serving lower and middle strata of society, it is imperative that penalties should be provided for defaults/violations/non-compliance committed by people in charge of management of such companies. Certain violations which defeat the very object of such companies should be visited with punishment including imprisonment. Keeping this in view a table containing the kind of violations/offences with corresponding penalties is furnished in Appendix-IX.

(ii) By virtue of the powers under clause (b) of sub-section (2) of Section 620A of the Act read with Section 642 of the Act, the Central Government may by Notification provide for the penalties detailed in Appendix-IX.

5. X. Rating

1. According to the terms of reference the Committee has to consider whether Credit Rating Agencies could also play a role in assessing the various deposit schemes of Nidhis.
2. The relevance and validity of the existence of Credit Rating Agencies is not in doubt and the Committee had discussions with a few such Agencies. Nidhis should know the state of their health, whether good, bad or indifferent and if such rating is possible by Credit Rating Agency not only the public would become aware of the functioning of Nidhi but the rating will also be of use to the Regulatory Authority. Hence this Committee considered this issue in depth. Nidhis are formed by public spirited local people and functioning within a small area and deal with local people. Nidhis do not deal with anybody other than individual members. In short, Nidhis cannot have business dealings with non-members or corporate entities. Hence Nidhis stand as a class apart from all other business concerns engaged in the business of borrowing and lending. The formalities, system of maintaining accounts, etc., by the Nidhis are comparatively simple as opposed to other business and banking institutions. Above all, taking into consideration the recommendations in this report, in particular the prudential norms, limits on loans, system of auditing and the supervisory framework, etc., to ensure public confidence and depositors' interest, and the timely corrective action that the Regulatory Authority can take, the Committee is of the opinion that it would not be necessary to have Credit Rating of all Nidhis. However, considering the growth of Nidhis, perhaps such Nidhis whose deposits are in excess of Rs.50 crores, who can afford to pay the fees for rating, may be advised to requisition the services of a Credit Rating Agency to get themselves classified. The Regulatory Authority also may have the authority to direct

such Nidhis to avail the services of Credit Rating Agency. Further extension of this procedure may be considered in due course.

6. XI. Insurance

1. In the terms of reference the Committee has been asked to consider the feasibility of having an Insurance Scheme for Nidhi deposits. It is a fact that there have been fervent appeals from aggrieved depositors of Nidhis that there should be a Deposit Insurance Scheme for the Nidhi depositors. The Committee had discussions with Oriental Insurance Company Limited, General Insurance Corporation of India and Insurance Regulatory and Development Authority. The Insurance companies seem to be of the view that an insurance scheme for Nidhis' deposits could not be comparable to the Deposit Insurance Scheme for banks administered by the Deposit Insurance and Credit Guarantee Corporation of India because such scheme would be classified as a financial guarantee. Therefore, they would have to look into the quality of assets of Nidhis. It was also pointed out that an account of inadequacies in the regulatory framework in the past there have been proliferation of Nidhis and that the supervisory mechanism will have to be toned up so as to minimise the erosion in the value of the assets and the size of the capital should be commensurate with risk profile of the assets. During the course of discussion the Committee members explained that our recommendations would cover minimum capital requirements, linkage of liabilities to Net Owned Fund, exposure ceilings, periodical audits and reporting to Regulatory Authority thereby ensuring supervisory framework and control. Hence these recommendations would go a long way to strengthen the financial position of Nidhis and the wrong selection of assets would be curbed if not eliminated. Recommendations are also made for certain changes in the Transfer of Property Act, so as to expedite the realisability of securities of mortgage loans. Hence there would be an overall improvement in the functioning of Nidhis thereby inspiring confidence among the depositors-shareholders.

2. The Insurance Authorities referred to above welcomed the recommendations proposed by the Committee and stated that once these are implemented a scheme could be

considered for insuring the deposits of Nidhis. Hence further action by DCA would have to be taken up in due course. It may, however, be made clear that any scheme of insurance formulated should cover all Nidhis and not selectively. Also there should be no separate evaluation of the properties mortgaged as not only the numbers would be very large but also because adequate safeguards have been prescribed in the recommendations by the Committee.

7. XII. Prudential Norms

1. The present guidelines issued by the DCA do not provide for any norms for Nidhi Companies in the matter of income recognition and classification of assets. As a result, it was left to the subjective wisdom of the Boards of the respective Nidhis to decide on the issue but unfortunately the Nidhis have not adopted prudential methods of Income Recognition.
2. The Committee feels in the absence of such prudential norms for income recognition and classification of assets, many Nidhis have window-dressed their Balance Sheets and intentionally misled the members of the public about the actual financial health of the company with the objective to paint a rosy picture and induce the public at large to make huge deposits with the company. Further, in the absence of any guidelines on these two important issues, the statutory auditors went by the views of the Board or in hazy areas disclaimed opinions about the correctness of the stand taken by the Board. Therefore, the Committee feels that there is a need for prescribing certain minimum prudential norms for income recognition and classification of assets.
3. The Committee also sought the views of the Institute of Chartered Accountants of India on the issues of Income Recognition and classification of assets for Nidhis. The Institute has suggested that norms applicable to banking companies could be extended to Nidhis.
4. The Committee has also been guided by the factors taken into account by RBI who have laid down norms which must be mandatorily complied with by NBFCs and banking companies in the matter of income recognition and classification of assets.

5. On the lines of what is relevant for banks and NBFCs the prudential standards on the income recognition norms based on records of recovery irrespective of nature and value of primary or collateral security and asset classification, the Committee endorses the three principles mentioned below:

- (i) stoppage of income recognition on accrual basis after a specified period;
- (ii) de-recognition of unrealised income taken to Profit and Loss Account before stoppage of its recognition; and
- (iii) additional provisions against total outstandings, would hold good in each non-performing account.

6. Further, all credits (except loans against own Fixed Deposit Receipts) should be classified into four categories, i.e. standard, sub-standard, doubtful debts and loss assets on the lines of what is relevant for banking companies and NBFCs.

7. The Committee has already taken a view that secured loans could be granted against jewellery, Fixed Deposit Receipts, KVPs, NSCs, NSS, insurance policies and against group guarantee to Micro Financial Groups or Self Help Groups and the period for these loans should not exceed one year. The Committee has also recommended that House mortgage loans should not be granted for a period more than five years. As regards recovery of principal and interest, it is observed that most of the loans granted by Nidhis are for consumption and their repayment is traditionally correlated to the harvesting seasons in the rural and semi-urban areas. It would, therefore, be necessary to suitably modify the prudential income recognition norms and provisioning norms in favour of Nidhis to suit their business practices.

8. Income Recognition Norms

Income should not be taken to Profit and Loss Account on accrual basis on any borrowal account if it is a non-performing asset. Part receipt of interest income, during or after the

account becomes non-performing, would not be reckoned as complete discharge of the liability by the borrower and hence the aforementioned principle would be applicable. Further the income taken to Profit and Loss Account but remaining unrealised after the account becomes non-performing asset, would be reversed out of the current year's profits. Such reversal of income should be specifically disclosed in the Profit and Loss Account and should not be netted against gross income or against the provisions if already held by the company for bad and doubtful debts off the Balance Sheet. Excess provisions could be written back to the Profit and Loss Account.

Note: Non-performing assets would be those borrowal accounts where interest income and/or instalment of loan towards repayment of principal amount have remained unrealised fully for 12 months.

9. Provisioning for bad and doubtful debts

As already recognised, the Nidhis are permitted and would be permitted to grant only secured loans, a major portion of which would be backed by such securities which can be converted into cash with minimum formalities, the provisioning norms would also have to be altered making them less stringent in respect of Nidhis vis-a-vis norms for banking companies and NBFCs. Accordingly, the following provisioning norms are suggested:

(a) Housing Mortgage Loans

- (i) Standard Assets : No provision
- (ii) Sub-standard Assets : 10% of the aggregate outstandings

(Sub-standard Assets will be those borrowals accounts which are non-performing assets. Reschedulement of the loan instalment of interest repayments would not change the classification of asset unless the borrowal

account has satisfactorily performed for atleast 12 months after such reschedulement.)

(iii) **Doubtful Assets** : 50% of the aggregate outstanding (The estimated realisable value of the collateral security may be reduced from the total outstanding amount if the proceedings for sale of property have been initiated within the previous two years of the interest income or instalment remaining unrealised. In no case the value of security would be more than the value assessed at the time of grant of loan).

(Doubtful assets will be those borrowal accounts which remained non-performing for more than one year but upto two years).

(iv) **Loss Assets** : 100% of the outstandings
(irrespective of value of collateral security)

(Loss Assets will be those borrowal accounts which remained non-performing asset for more than 2 years or where the documents executed may become invalid if subjected to legal processes.)

Note: An asset can become loss asset without passing through the previous two categories, namely sub-standard or doubtful assets depending upon the probabilities of enforcement of claim against borrower or realisability of the collateral security or availability of the collateral security as the case may be.

10. Loans on security of gold, jewellery and other securities

Since the above loans are required to be cleared off after 12 months from the date of grant of such loans together with interest accrued thereon either by repayment by the borrowers or by auction/enforcement by the Nidhi of its claim against the collateral security, provisioning norms are not being suggested. Efforts should be made by the Nidhi to adjust its dues against the realisable value of collateral security within next three months. In case the amount is not recovered in the above manner, the uncovered portion after taking into consideration the realisable value of securities would be fully provided for immediately and the deficit on the date of realisation of the collateral security remaining if any would be further provided for on the date of realisation of the proceeds.

8. XIII. Audit of Nidhis' Accounts

1. For the purpose of statutory audit of Nidhis Regulatory Authority would suggest the names of three auditors and the Nidhi will select one. Such auditor selected will perform his duties continuously for three years unless situation demands a change. At the end of the three years period a new auditor will be appointed as per the above procedure. Apart from the annual audit, the auditor should send to the Regulatory Authority financial quarterly reports as per format (Appendices VI, VII & VIII) which will include important prudential norms. If there are serious complaints about the functioning of the Nidhi or the quarterly reports of auditor reveals information requiring further probing the Regulatory Authority will have the power to order a departmental inspection and also to order special audit.

2. Additional items of reporting by Auditors of Nidhis

The Committee has recommended a wider role for auditors in monitoring the activities of the Nidhis which includes quarterly certification of the returns to be submitted by the Nidhis to the Regulatory Authorities and annual audit of its accounts encompassing of true and fair financial health of the company. While the need for onsite examination of any Nidhi by the Regulatory Authority at periodical interval cannot be underestimated, it is the considered

view that the auditors could be given additional responsibility of reporting, by exception, to the Regulatory Authority, the contraventions of regulations by the Nidhis, so as to trigger correcting/effective steps for the welfare of the depositors. The Exception Report could include atleast the following non-compliance by the Nidhis:

- (i) Whether the Nidhi has commenced its operations only after obtaining a Certificate of Commencement of Business from the ROC.
9. (ii) Whether the minimum capital is more than Rs.10 lacs as on the date of Balance Sheet.
10. Sheet.
11. (iii) Whether the Net-owned Funds to Deposit liability ratio is more than 1:20 as on the date of Balance Sheet.
12. Balance Sheet.
- 13.
14. (iv) Whether the company has issued fresh preference shares have been excluded from the Net Owned Funds and whether the preference shares due for redemption have not been redeemed.
15. Net Owned Funds and whether the preference shares due for redemption have not been redeemed.
16. redeemed.
17. (v) Whether the company is mobilising the deposits as per the regulations in relation to contents of the application form, period of deposits, rate of interest payable on deposits, foreclosure of deposits, maximum balance outstanding in savings deposit accounts,etc.
18. contents of the application form, period of deposits, rate of interest payable on deposits,
19. foreclosure of deposits, maximum balance outstanding in savings deposit accounts,etc.
20. (vi) Whether the company has opened any branch as per the regulations.
21. (vii) Whether the ban on entering into any transactions with any corporate party, has been honoured.
22. honoured.

23. (viii) Whether the company has maintained liquid assets.
24. (ix) Whether the liquid assets securities have been lodged with the designatory schedule
25. commercial banks.
26. (x) Whether the company has complied with the prudential norms on income recognition
27. and provisioning against sub-standard/default/loss assets.
28. (xi) Whether the company has adequate procedures for appraisal of credit proposals/requests,
29. assesment of credit needs and repayment capacity of the borrowers.
30. (xii)Whether the repayment schedule of various loans granted by the Nidhi is based on the
31. repayment capacity of the borrower and would be conducive to recovery of the loan
32. account.
33. (xiii)Whether the value of securities against which the loans is above the outstanding amount
34. has deteriorated in each borrowal account (as per a sample check).
35. (xiv)Whether the company has granted loans against eligible securities within the ceiling for
36. loan accounts against a particular asset.
37. (xv)Whether the aggregate of loans against house mortgage and other securities is within the
38. prescribed sectoral exposure limits.
39. (xvi)Whether the documents obtained by the Nidhi including the original securities are in
40. order.
41. (xvii)Whether the ban on loans to directors has been honoured.
42. (xviii)Whether loans given, if any, to the directors are being repaid in accordance with the

43. repayment schedule.
44. (xix)Whether the company has furnished to the Regulatory Authorities the relevant returns
45. at prescribed periodicity and within the stipulated time.
46. (xx)Whether the returns have been properly complied and the information/data reported
47. therein has been taken from the actual books of accounts.
48. (xxi)Whether the management affairs of the company are being run in accordance with the
49. provisions of the Companies Act and Nidhi Regulations.
50. (xxii)Whether the conduct of business by the Board of Directors, the composition of the
51. board of directors, the compliance with the regulatory framework covering the board
52. of directors has been found in order.
53. (xxiii)Wherever in the auditors report, the statement regarding any of the item referred to any
54. of the paragraph is unfavourable or qualified, the auditors shall also state the reasons
55. for such unfavourable or qualified statement as the case may be. Where the auditor is
56. unable to express the opinion on any of the items referred to in the above paragraphs,
57. his report shall indicate such facts together with the reasons therefor.
58. (xxiv)A copy of his report on the non-compliance would be submitted to the board of
59. directors of the Nidhi, would be included in the auditors report under Section 227 of
60. the Companies Act to the shareholders of the company and would also be sent

61. through a separate communication, to the Regulatory Authority.

3. After incorporation the Nidhis are to function according to the provisions of the Memorandum and Articles of Association and according to such notification of the DCA and such guidelines as issued by the Regulatory Authority, if the Nidhis contravene any of these aforesaid provisions, notification and guidelines then they will be liable for administrative and penal action being taken by the Regulatory Authority also and if need be for appointment of Special Officer to take over the management of Nidhi. Special Officer shall function as per the guidelines stipulated by the Regulatory Authority.

62. XIV. Regulatory and Supervisory Authority

1. Nidhi being a company registered under the Companies Act, it automatically comes under the supervision of the DCA. Being a finance company, borrowing and lending money, the Nidhi performs a quasi-banking function and hence comes under the supervision of RBI. On account of this position there is dual control over the Nidhi by the DCA and RBI. The unanimous view of the Nidhis was that it would be advisable to have a single authority to supervise and control. This is understandable and the Committee accepts this request of the Nidhis.

2. The RBI is the monetary authority established by the Government to govern the functioning of all financial institutions, be they banks, finance companies, etc. Therefore, their coverage and responsibility is vast, onerous and critical. In terms of numbers the Nidhis are said to be about 1200 who have been incorporated and awaiting declaration as Nidhi under the Companies Act. Majority of these are in the Southern Region. Considering that these Nidhis are primarily located in small towns in rural areas, serving the lower and middle class people, to ask the RBI to take on the responsibility of supervision and control of these Nidhis would seem unreasonable; at the same time in regard to the capital adequacy ratio, the interest charges, etc., that the Nidhi should

strictly follow, the RBI is indeed the right authority to issue instructions. In so far as constitution, membership, election of directors, administrative practices, etc., of Nidhis they are within the ambit of DCA. The RBI from time to time can advise the DCA in matters concerning their scope of responsibility as mentioned earlier and the DCA could implement. Therefore, the sole responsibility for supervising and regulating of Nidhis could be under the DCA.

3. For Nidhis, which are small companies, primarily in rural areas, it would be convenient if the immediate supervisory and controlling authority is located nearby and not far away in Delhi. While it would not be possible or necessary to have such authority in each State, the purpose can be well served by designating the Regional Director of the DCA, who is in charge of about three/four states as the Regulatory Authority and for the DCA to delegate sufficient powers to him. In the case of the Southern Region where the largest number of Nidhis are functioning it would be necessary to have an Officer exclusively earmarked to assist the Regional Director/Regulatory Authority. The overall supervision and powers of appeal etc., may be retained by the DCA in Delhi.

4. Continuing this approach of delegation of responsibility and powers, the DCA may consider opening of sub-regional offices where there are concentration of Nidhis. The existing regional offices may for the present attend to this work also.

5. For the reasons mentioned above the RBI would always have to play an important role in the functioning of Nidhis in regard to matters such as capital adequacy ratio, interest charges, etc. Hence there should be timely exchange of information between the Regulatory Authority and the RBI and also direct responsible interaction between them. The Committee, therefore, recommends that a Standing Review Committee of representative of RBI, the Regulatory Authority and the DCA be constituted. The Review Committee should meet in the Regulatory Authority's headquarter every month succeeding every financial quarter. Proceedings of the Review Committee should be sent

to the DCA and RBI. The Regulatory Authority will also take action in regard to matters falling within his competence.