

REPORT OF THE EXPERT GROUP ON NIDHIS.

I. INTRODUCTION:

The Central Government by order No.37/61/96-CL.VI dated 13.02.2002, constituted an Expert Group (hereinafter referred to as "GROUP") to examine the various representations received, pursuant to the implementation of the recommendations of Sabanayagam Committee vide the two Notifications No.GSR.555(E) and 556(E) dated 26.07.2001. The said order is reproduced below:

“ The Central Government has decided to constitute an Expert Group consisting of the following members to examine the representations received from the Chamber of Nidhis and several existing Nidhi companies pursuant to the issue of Notifications Nos. GSR.555(E) and 556(E) dated 26.7.2001.

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| 1. Shri.A.R.Rao, Ex-Chairman,Income-Tax Settlement Commission | Chairman |
| 2. Shri.N.Sadasivan,Executive Director,RBI | Member |
| 3. Shri.T.S.Gokilan,President Chamber of Nidhis | Member |
| 4. Shri.S.Gopalakrishnan,Vice-President,Chamber Of Benefit Funds | Member |
| 5. Shri.V.S.Rao,Regional Director,Chennai,DCA | Member |
| 6. Shri.Rajesh Malhotra,Dy.Secretary,DCA | Member- |

Secretary

The Expert Group will examine and make recommendations with regard to:

The 18 issues against which the Chamber of Nidhis/Nidhi Companies have made representations and to suggest the modifications/relaxations by amendment of corresponding

provisions in the said Notifications. It will also examine the alternative of granting extension of time to individual Nidhi companies for complying with the provisions of existing Notifications.”

Brief details of the various representations received are contained in **Annexure.”A”**.

2) Although the task looked seemingly complex, the Group was pleasantly surprised to find that almost all the persons with whom they had interaction had no hesitation in accepting that there was a need for regulating the affairs of Nidhis or Mutual Benefit Societies, so that their activities are carried on in a professional manner. There was a consensus that any Nidhi or Mutual Benefit Society which will come into existence henceforth should adhere to the regulations already notified by the Government. There was however, a very strong apprehension that the existing Nidhis or Mutual Benefit Societies, which have been successfully running their affairs in a traditional manner for several decades, were not as yet mentally prepared for the changes prescribed in the recent Notifications. In particular, in the matter of following Prudential Norms and maintenance of Net Owned Funds as a percentage of deposits, there was a virtual scare amongst them. A forceful plea was made to the Group that it will be impossible for these Nidhis or Mutual Benefit Societies to switch over to the

new regime of regulations in such a short time. It was repeatedly pointed out to the Group that even for the NBFCs, the Reserve Bank of India had given a sufficiently long time to adhere to the prescribed regulations. After listening to their point of view, the Group was fully convinced that these Institutions do need a sufficiently long time to alter their style of functioning and reach a level capable of compliance. While making its recommendations on the various issues, the Group was guided mainly by the following assumptions:-

- a) The Nidhis or Mutual Benefit Societies do need more time not only to change their present mind-set but also to implement the various requirements contained in the Notifications already issued; and
- b) The Nidhis cater to the needs of middle class and lower middle class persons, who are all the members of the Nidhi generally operate in a small local area and the members are very often known to each other. Hence, certain norms prescribed for the NBFCs have to be necessarily diluted while applying to these Institutions.
- 3) As per the terms of reference, the Group has been asked “also to examine the alternative of granting extension of time to individual Nidhi companies for complying with the provisions of existing Notifications”. In the light of the points made out in the

preceding para, the Group has recommended general extension of time for complying with the requirements of the Notifications for all the Institutions, wherever necessary. The Group is of the view that extension of time in individual cases may not be desirable.

- 4) Another factor which the Group had taken into account while making its recommendation on the various issues was that in the running of the Nidhis or Mutual Benefit Societies, there were conflicting interests of the depositors, borrowers and shareholders. Although, these Institutions are essentially formed with the objective of cultivating the habit of thrift amongst its members and on the principle of mutual benefit, the ground reality is that there are a large number of depositors and borrowers who become members only to meet the procedural requirement. This results in conflicting interests amongst the depositors, borrowers and members. In all its recommendations, the Group has attempted to balance such conflicting interests.

II. DELIBERATIONS ON ISSUES:

The Group held five meetings apart from a general hearing in which the representatives of some of the Nidhis were given an opportunity to express their problems vis-à-vis the provisions of the Notifications. The hearing was intended to have a more interactive exchange of views so as to

grasp the real depth of the problems/limitations and difficulties faced in the implementation of Notifications GSR.555(E) and 556(E) dated 26.07.2001. In the various meetings held, the Group examined each of the issues keeping in view the difficulties expressed by the various individual Nidhi Companies, as well as Chamber of Nidhis and Chamber of Benefit Funds. Such deliberations and discussions form the basis of the recommendations of the Group.

ISSUE NO.1: INCREASE IN FACE VALUE OF SHARES:-

Clause.1(a)(iv) of Notification No.GSR.555(E) (herein referred to as “Notification”) dated 26.07.2001 provides that no company declared as a Nidhi or Mutual Benefit Society under sec.620A of the Companies Act,1956, before or after the date of the Notification shall issue any equity shares of nominal value of less than Rs.10/-, provided that the existing Nidhis having face value of equity shares of less than Rs.10/- shall increase the face value to Rs.10/- within a period of one year from the date of the Notification. Large number of individual Nidhi companies either functioning as notified Nidhis under sec.620A of the Act or potential Nidhi companies which are awaiting declaration under sec.620A of the Act have expressed many practical difficulties, in the implementation of the said provision. In particular, it was pointed out that it would be impossible to convince small shareholders who do not have any current transactions with the company that they should contribute extra amounts to increase the face value of the shares. The expenditure involved would also be considerable.

. After deliberations, **the Group came to the conclusion that the existing Nidhi companies notified under Sec.620A of the Act, as well as the potential Nidhi companies awaiting declaration under Sec.620A of the Act, which are already functioning may be allowed to continue with the existing capital structure without any variation in the face value of the equity shares. In other words, the status-quo may be maintained so far as the existing Nidhi companies and the potential Nidhi companies are concerned. However, the group found that the new companies, which are to be incorporated after the Notification, may be insisted upon having equity shares of the face value of Rs.10/- each as contemplated therein. These new companies, which are to be incorporated after the issue of the Notification will not face any difficulties in having face value of equity shares of Rs.10/- each. While making the recommendations, the Group was mainly influenced by its recommendation on Issue.No.9.**

ISSUE NO.2: PREFERENTIAL ALLOTMENT OF SHARES:

Clause 1(a)(v) of the Notification provides that no company declared as a Nidhi or a Mutual Benefit Society under sec.620A of the Companies Act, shall make any preferential allotment of shares to any persons or group of persons, but shall make only rights issue and the unsubscribed portion can be apportioned by the Board of Directors in terms of Sec.81 of the Act. Against this provision, the various Nidhi companies have expressed some practical difficulties. **The Group considered the difficulties faced by these**

companies and came to the conclusion that the existing clause 1(a)(v) needs to be modified with a suitable proviso that the restriction shall not apply to allotment of share upto the face value of Rs.100/- to new deposit holders and borrowers, and in respect of qualifying shares to be held by Directors.

ISSUE NO.3: PREPAID INTEREST WARRANTS:

Clause 1(a)(xiv) of the Notification provides that no company declared as a Nidhi or Mutual Benefit Society under Sec.620A of the Act shall issue pre-paid interest warrants. Against this provision, the various Nidhi companies represented that they should be permitted to issue pre-paid interest warrants as long as they had sufficient fund. There were not many representations received on this issue. The representations of the Nidhi companies on the issue are not tenable for the reason that the RBI has restricted the issue of pre-paid interest warrants unless the entire amount covered by such issue is deposited with the bank. Also the Members of Nidhis are located within a small area and thus not call for issue of such warrants. After deliberations, **the Group concluded that the existing restriction relating to issue of pre-paid interest warrants may be retained.**

ISSUE NO.4: EXCLUSION OF PREFERENCE SHARE CAPITAL FROM NET

OWNED FUND:

In **Clause 1(b)(iii)** of the Notification, it is provided that the proceeds of Preference share capital will not be considered for arriving at Net Owned

Fund of the Nidhi or Mutual Benefit Societies. Against this, the representatives of Nidhis pointed out that in the year 1997 in the Notification vide GSR.No.603(E) the Government had permitted the issue of preference shares to increase the share capital position of the company to achieve the required Net Owned Fund. Now, all of a sudden if the same is withdrawn, it will affect the capital structure and put them to more difficulties in achieving the Net Owned Fund requirements of the company. Therefore, they requested that a via media should be provided to achieve the required Net Owned Fund. The Group heard representations of the various Nidhi managements and understood that preference share capital can be either redeemed by issuing fresh equity share capital or the preference share capital can be converted into equity share capital by following necessary legal procedures under the Companies Act,1956. By this, the difficulty expressed by the management will be eliminated. To comply with the process, the managements may have to be given some more time. Therefore, **the Group recommends that the Government may give time upto 31st December,2003, by which time these companies may either redeem or convert the preference share capital into equity share capital. The Group recommends that till 31st December,2003, preference share capital may be included in the computation of Net Owned Fund in terms of Clause.1(b)(iii) as well as Clause.1(d)(i).**

ISSUE NO.5 – RATIO OF NET OWNED FUND TO DEPOSITS:

In the Notification at **Clause 1(d)(i)**, the Norm is prescribed as follows:

“A Nidhi or Mutual Benefit Society may accept deposits not exceeding twenty times of its Net Owned Funds (NOF) as per last audited balance sheet:

Provided that in the case of existing Nidhis having deposits in excess of the aforesaid limits, the same shall be brought to the prescribed limit by increasing the Net Owned Fund position or alternatively by reducing the deposit within two years from the date of this Notification.

Provided further that the ratio will apply to incremental deposits immediately.

Explanation: “Net Owned Funds” means the aggregate of the paid up equity capital and free reserves as reduced by accumulated losses and intangible assets appearing in the last audited balance sheet prior to issue of this Notification. A reserve shall be considered as “free reserve”, if it is available for distribution as dividend. Further, the amount representing the proceeds of issue of preference share shall not be included for calculating net owned funds”.

From the above, it will be seen that every Nidhi or Mutual Benefit Society can accept deposits not exceeding twenty times of its Net Owned Funds.. The representatives of various Nidhis have represented that many Nidhis and Mutual Benefit Societies had accepted deposits of more than 20 times of their Net Owned Funds and they were doing business very prudently for several decades. They have further represented that if the Norm is

implemented in a very short time, it will create hardships and also it will become difficult for them to meet their liquidity requirements.

The Chamber of Nidhis and Chamber of Benefit Fund Companies furnished to us statistical details in respect of seventy companies. It is found that as on 31.03.2001, there were 38 companies (out of the 70 companies) with Deposits in excess of 20 times, the Net Owned Funds, in the following manner:

Between 21 to 40 times of Net Owned Fund	:	19 companies
Between 41 to 60 times of Net Owned Fund	:	6 companies
Between 61 to 80 times of Net Owned Fund	:	7 companies
Between 81 to 100times of Net Owned Fund	:	3 companies
More than 100 times of Net Owned Fund	:	3 companies

In Para.I(2) of this Report, we have stated that there was an all round consensus that the Nidhis or Mutual Benefit Societies should be ultimately regulated by the prescribed norms and what is required for the present is that they should be given sufficient time to adhere to the norms. **The Group therefore, came to the conclusion that the Norm should be achieved by the companies within the extended period mentioned below:**

- a) **Companies with deposits below 25 times of Net Owned Funds as on 31.3.2001 : By 31.03.2004**
- b) **Companies with deposits between 26times and 40 times of Net Owned Funds as on 31.3.2001. : By 31.03.2005**
- c) **Companies with deposits between 41times**

and 80 times of Net Owned Funds

as on 31.3.2001

: By 31.03.2006

d) Companies with deposits exceeding

80 times of Net Owned Funds

: By 31.03.2007

as on 31.3.2001

The Group also noted that the **Explanation to Clause 1(d)(i)** defines Net Owned Funds with reference to the position as appearing in the last audited balance sheet prior to issue of the Notification. Once the Net Owned Funds are determined, they will be remaining static for future periods. Since this could not have been the intention, the words **“Prior to the issue of this Notification”** appearing in the Explanation may be removed.

ISSUE NO.6 : PERIOD OF FIXED DEPOSITS/RECURRING DEPOSITS.

Clause 1(d)(ii) (A) (B) provides that Recurring Deposits/Fixed Deposit accounts can be opened for a minimum period of 12 months and a maximum period of 60 months. Against this Clause, the Nidhi Companies including Chamber of Nidhis and Chamber of Benefit Funds have expressed various objections. **The Group did not find the representations tenable in respect of the Fixed Deposit accounts.** The Group felt that the existing restriction of having a minimum period of 12 months and a maximum period of 5 years for Fixed Deposits is reasonable. The lowering of the minimum period will affect the liquidity position of the company. Any increase in the maximum period will be detrimental to the health of the company due to sharp fluctuations in interest rates.

The representatives of the Nidhi managements however, explained that Recurring Deposit accounts are often opened at the time the Mortgage Loans are given by the company to facilitate the borrower to save periodically in the Recurring Deposit accounts so that repayment becomes convenient for the depositor. Therefore, they explained that life of the Recurring Deposits should be equal to the period of the Mortgage Loan. Accordingly, they requested the Group to recommend a concession in maintaining Recurring Deposit for more than 60 months to coincide with the life of the Mortgage Loan account.

The Group recommends a minor modification of the existing Clause to provide that in the case of Recurring Deposits related to Mortgage loans, the maximum period of Recurring Deposits may exceed 60 months, if it corresponds to the repayment period of the loan disbursed by the company

ISSUE NO.7 : SAVING DEPOSIT ACCOUNT

Clause 1(d)(ii) (C) of the existing Notification provides that the maximum balance at any given time qualifying for interest in Savings Deposit accounts shall not exceed Rs.20,000/- The rate of interest shall not be more than 2% of the rate of interest payable on savings bank accounts by Nationalised Banks. Against this provision, various Nidhi companies have made representations. The Group considered the representations of the Nidhi Companies, and after due deliberations came to the conclusion that there is no justification for enhancing the existing limit of Rs.20,000/-

qualifying for interest in Savings Deposit accounts. The Group found that there is no ceiling on the amount that can be retained in Savings Bank Account, but the restriction is only in relation to the amount qualifying for interest. The Savings Deposit account holder always has the freedom or choice of transferring the amount in excess of Rs.20,000/- to the Fixed Deposit account. Moreover, as the Nidhi Companies cater to the people in the lower strata of society, members with such huge balances may be very few. **The Group also found that the restriction on the rate of interest @ 2% above rate of interest offered by the Nationalised Banks is reasonable. The Group, therefore, recommends the retention of the existing provision with the Bench mark rate being reckoned on the rate on Savings Bank accounts offered by State Bank of India, if the rates offered by Nationalised Bank vary.**

ISSUE NO.8: FORMAT OF APPLICATION FORM TO CONTAIN VARIOUS DETAILS ABOUT THE COMPANY:

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(i) **Clause 1(e)(A)(i) to (xii) and (B) (i) to (v)** of Notification prescribes various item of information to be incorporated in the application forms for accepting deposits from the members. The representatives of various Nidhis have represented that this provision may be implemented from 1st of April 2002 since the companies hold a large number of application forms in stock and would not like them to be wasted. The Group examined the request and concluded that the time requested by

the Management may be allowed. However, in addition to the particulars stated in Clause 1(e)(A)(ii) to (xii), **the Group is of the opinion that the Deposit application forms should also carry an abridged version of the latest Balance Sheet of the company as an additional disclosure.** This recommendation has to be considered in the light of our recommendations on Issue No.16.

SHARES

ISSUE NO.9: ISSUE OF MINIMUM Rs.100/- WORTH OF

TO EVERY MEMBER:

In Clause 1(f)(i)(A) of the Notification it is specified that:-

“every Nidhi or Mutual Benefit Society shall:-

allot to every deposit holder atleast a minimum of ten equity shares or shares equivalent to Rs.100/- whichever is higher:”

It has been represented by various Nidhi companies, that it will be very difficult to implement the above regulation because some of the existing shareholders have not left their contact addresses and in some cases, they may not be interested in continuing to deal with the company.

The Group discussed the issue with various Nidhi companies/managements and **came to the conclusion that the existing companies, should be permitted to continue with their present set-up in so far as present depositors are concerned subject to their allotting a minimum number of shares having a total face value of Rs.100/- to all newly opened deposits and renewed deposits.** The Group also felt that, it is necessary to **exempt Savings Bank account holders and Recurring Deposit Account**

holders from this provision since they would be mostly very poor depositors or borrowers who repay the loans in instalments.

ISSUE NO:10 FORECLOSURE OF DEPOSITS

Clause 1(f) C(ii) to (iv) of the Notification provides that every Nidhi or Mutual Benefit Society shall permit Fixed Deposit accounts to be foreclosed by the depositors only on the following conditions:

- i) A Nidhi or Mutual Benefit Society shall not repay any deposit within a period of 3 months from the date of its acceptance;
- ii) Where a Nidhi or Mutual Benefit Society at the request of the depositor repays any deposit after a period of 3 months, the depositor shall not be entitled to any interest upto 6 months from the date of deposit;
- iii) Where a Nidhi or Mutual Benefit Society at the request of the depositor makes repayment of deposit before the expiry of the period for which such deposit was accepted the rate of interest payable on such deposit shall be reduced by 2% from the rate which the Nidhi or Mutual Benefit Society would have ordinarily paid, had the deposit been accepted for the period for which such deposit had run.

However,. it has been provided that in the event of death of a depositor, the deposit may be repaid prematurely to the surviving depositor in the case of joint holding with survivor clause, or to the nominee or to legal heir, with interest at the rate which the company

would have ordinarily paid, had such deposit been accepted for the period for which such deposit had run, upto the date of repayment.

Against this provision, various Nidhi companies have represented that this clause is detrimental to the interest of the deposit holders. In times of exigencies, the depositor may have to fore- close their deposits on account of unforeseen circumstances . The Nidhi companies submitted that the Board of Directors should be given the discretion to decide such request for foreclosure taking into account the hardship faced by the depositor and the circumstances in which the foreclosure is requested.

The Group felt that any lenience in this regard, will encourage Nidhi companies to accept Fixed Deposits for shorter duration through back-door and thereby the restrictions provided in Para 1(d)(ii)(A) relating to minimum period of Fixed Deposits and Recurring Deposits would be defeated. **Therefore, the Group recommends continuation of the existing restrictions relating to foreclosure of deposits as these are reasonable restrictions and do not warrant any relaxation.**

Item.No.11: Investment of 10% of the Nidhis deposits with

Scheduled Bank:

Clause.1(g) of the Notification provides that

“ every Nidhi or Mutual Benefit Society shall invest and continue to invest, with effect from the 1st September, 2001, in unencumbered term Deposits with Scheduled Commercial Bank,

other than a co-operative bank or a regional rural bank, an amount which shall not be less than ten per cent of the deposits outstanding at the close of business on the last working day of the second preceding month;

Various representations have been received against maintenance of such unencumbered term deposit with a Scheduled Commercial Bank since this will reduce considerably the profits earned by the Nidhis or Mutual Benefit Societies. When it was explained that the requirement is only to enhance the liquidity position of the companies, a request was made that this provision for liquidity regime may enforced in in a phased manner. The Group discussed the request and felt that there is need to give some concession in the form of time so that they can comply with the liquidity requirements. For this purpose, **the Group recommends that all the Nidhis or Mutual Benefit Societies be asked to maintain as on 31.12.2002 unencumbered term deposits with a Scheduled Commercial Bank of 2% of the total liability deposits outstanding as on 31.10.2002 and the same may be increased to 5% by 31st December,2003 and then increased to 10% (as provided in the Notification) by 31.12.2004.**

The Group is of the view that there should be a provision for regulating the withdrawals from the deposit accounts in cases of unforeseen commitments in the matter of repayment of the deposits.

ISSUE NO.12: LOAN AGAINST IMMOVABLE PROPERTIES.

Clause 1(h) of the Notification deals with various loans that can be advanced by Nidhi and Mutual Benefit Societies to its Members. In **sub-Clause(i) (B)**, it is provided as follows:

“Provided that the loan against immovable property shall not exceed fifty per cent of the over all loan outstanding on the date of approval by the Board and the individual loan shall not exceed fifty per cent of the value of property offered as security. The period of such loan shall not exceed five years.

Explanation: Existing Nidhi companies shall bring down the ratio of loan against immovable property to fifty per cent of the over all loan outstanding within two years from the date of this Notification”.

It will be seen from the above that Mortgage loans should not be more than 50% of the total loan portfolio of a Nidhi company or Mutual Benefit Society. Against this, various managements have represented that the Nidhis or Mutual Benefit Societies situated in urban areas are invariably dependent only on loans against immovable properties and the scope for giving other loans like gold and jewellery loans etc., are minimal. This is mainly because the property values in urban areas are very high and borrowers prefer to use these assets for securing their loans. The managements have given various working papers and statistical details to prove that most of the Nidhis or Mutual Benefit Fund

Companies are dependent only on immovable property loans in urban areas, whereas in the other areas, they are mainly dependent on gold jewellery loans

The Group examined and found that the representations made by the various Nidhi and Mutual Benefit Fund companies have a lot of merit. The requirement that mortgage loans should not exceed 50% is very restrictive, especially when it is seen that many of these companies can lend only on immovable properties and not jewellery . It was represented to the Group that these companies lend only on registered mortgage of properties and as per the provisions of Sec.69 of the Transfer of Property Act, it is possible for the companies to sell the mortgaged property without the intervention of the Court in the specified towns like Chennai, Mumbai and Kolkatta. It is because of this, the experience of these companies has been that the borrowers invariably settle their dues, when they are threatened with the auction of the mortgaged property with resort to recovery action through Courts being exceptional. Therefore, the Group is of the view that the immovable property loans are good assets from the angle of recovery. Considering the practical experience of these companies, **the Group recommends that registered mortgage loans may be exempted from the ceiling limit of 50%. Loans on immovable properties by any other type of mortgage will alone be considered for the purposes of Clause 1(h)(i)(B) of the Notification. While making this recommendation,**

the Group took due note of the fact that the liquidity problems that may arise on account of mortgage loans are minimised by the liquidity regime mentioned in our recommendation on Issue.No.11.

By this, the difficulty of deployment of funds by urban Nidhi Companies is taken care of. At the same time, the funds of the depositors are also protected by legally registered mortgage of the properties.

Further the Group was informed that most of the mortgage loans are for a 7 year period and reducing the loan period to 5 years will result in practical problems. If the borrower wants to pay monthly instalments towards the loan, the amount of EMI (Equated Monthly Instalments) will be very high for a 5 year period loan when compared to a 7 year period loan. It was further pointed out that the rate of interest charged is higher for longer period loans which benefits the company. It was therefore, argued that the limit of 5 years placed on mortgage loans may be increased to 7 years. The request was considered by the Group. It is in the interest of the borrowers as well as the company to have higher ceiling of 7 year period for mortgage loans and **the Group recommends the extension of the time limit of the immovable property loans to 7 years.** The Group took note of the fact that these loans are generally given to persons in the lower income bracket for fulfilling social obligations and the limit of 5 years, for repayment will be unrealistic.

ISSUE NO.13: LOANS ON OWN FD,KVP,NSC ETC:

Clause 1(h) (i) (C) of the Notification provides that every Nidhi or Mutual Benefit Society may give loans to its shareholders or members against the following securities, viz. the Fixed Deposits, Kisan Vikas Patras, National Saving Schemes, Insurance policies and other Government Securities provided that such securities are pledged to the company duly discharged and the lock-in-period of such securities does not fall beyond the loan period or one year whichever is earlier.

Against this provision, the Nidhi companies have represented that these restrictions are reasonable except the one relating to loan, against Fixed Deposits. They have submitted that in the case of loans against Fixed Deposits, the maximum tenure can be allowed to be as long as the remainder of the deposit period. It has been clarified that in the case of loans given against pledge of Fixed Deposits, the margin is about 25% and there will be no risk if the loan period is allowed to correspond to the remainder period of Fixed Deposits.

The Group considered the representations and found that the reasons adduced for relaxation of this provision are valid. After deliberations, **the Group came to the conclusion that the existing clause may be relaxed as far as the loan against Fixed Deposits are concerned and the tenure restriction need not apply to loans against Fixed Deposits. Accordingly, the Group recommends that the**

tenure of loan against Fixed Deposits may correspond to the remainder period of Fixed Deposits.

Item.No.14: MARGIN OF INTEREST CHARGED ON LOANS:

In **Clause.1(h)(ii)** of the Notification, it is provided that the rate of interest charged on loans given by a Nidhi company shall not exceed 5% of the highest rate of interest offered on deposits accepted by them and shall be based on reducing balance method. The claim of the Nidhis is that the spread of 5% provided is too low and their present working spread is more than this figure. Various Nidhi companies filed their working of the spread and it is seen that almost all of them are having a spread between 7 & 8% and a few more than 9%.

The Group examined the representations as well as the need to control the spread so that the borrowers are not squeezed heavily. After a long deliberation the Group concluded that the spread of interest rates should not exceed 7.5%. Accordingly, **it is recommended that the spread may be increased from 5 to 7.5% in Clause.1(h)(ii).**

ISSUE NO.15 :TENURE OF DIRECTORS:

Clause 1(h)(second h)(i) (A) provides that no company declared as Nidhi or Mutual Benefit Society after the publication of the Notification, shall have any person as director for continuous period of more than 10 years except with the approval of the Regulatory Authority Against this restriction, various Nidhi companies have represented that unlike others, these companies are closely identified with the promoter directors/directors. When a director leaves the company, or discontinues his directorship, it will be taken as a sign of failure of the company and this can result in a run on the company. In view of this, the Nidhi companies demanded that this restriction should be relaxed so that the existing directors can continue beyond the period of 10 years through

election in the General Body by a special resolution. The Group considered the representations and found that the grounds adduced for relaxation of this restriction were not very convincing. The Group took note of the causes for the failure of leading Nidhi companies such as Royapettah Benefit Fund, Alwarpet Benefit Fund etc. which accepted dominance of management by a few directors who functioned with vested interest. The Group is of the view that the existing restriction is reasonable particularly so, in view of the provision for continuation in office beyond 10 years with the approval of Regulatory Authority. Therefore, **the Group recommends continuation of the existing restriction without any alteration.**

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ISSUE NO.16: PRESS PUBLICATION OF ANNUAL ACCOUNTS:

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Clause 1(h)(second h)(ii) of the Notification provides that every Nidhi or Mutual Benefit Society having membership of 10,000 and above, or deposits of Rs.2 crores or above as at the end of each financial year shall publish the audited accounts in two dailies, one in English and one in vernacular language within 6 months from the closure of the financial year.

The various Nidhi companies, Chamber of Nidhis and Chamber of Benefit Funds have represented that the publication of annual accounts in two Dailies, should not be insisted upon for the following reasons:

- a) many Nidhi companies operate on low capital and small margin of profit, and therefore, expenditure on advertisements for publication of annual accounts can unduly drain its meagre resources;.
- b) The annual accounts are meant only for the members/shareholders of the company and where they are sent by post to the various

shareholders, no useful purpose is served by publishing the annual accounts in two dailies; and

- c) The publication of annual accounts in Newspapers is not insisted upon even in the case of NBFCs .

The Group considered the representations of the Nidhi companies and found that the grounds adduced for removal of this requirement are convincing and reasonable. The Group took note of the fact that this aspect was considered in detail, by the Expert Groups constituted earlier for reviewing the functioning of the Nidhi companies and on the basis of their recommendations, the Dept.of Company Affairs vide GSR.978 dated 28.5.1963, read with various other Notifications dated 11.10.1963, 4.6.1964, 12.2.65, 30.8.65, 14.1.1966 and finally 1.10.1966 relaxed the requirements of sec.219 of the Act, vis-à-vis the Nidhi companies by stating that it would be sufficient if the annual accounts are pasted on the notice board at the registered office of the Nidhi company and the publication in the local Dailies of the annual accounts is not necessary if the account copies are sent through post or otherwise, to all the individual members or the shareholders of the company.

Accepting these arguments, **the Group, recommends that Clause 1(h)(second (h)(ii) may be deleted.** To protect the interest of potential depositors of Nidhis and Mutual Benefit Societies, the Group has recommended the inclusion of an abridged version of the latest Balance Sheet of the company in the application form (Vide.Issue.No.8).

ISSUE NO.17: UNDISBURSED DIVIDEND:

Clause 1(h)(second(h)(v) of the Notification provides that any dividend remaining unclaimed for a period beyond seven years shall be

transferred to the Central Govt. account in terms of section. 205C of the Companies Act 1956.

Against this provision, various Nidhi companies have represented that this clause does not benefit either the Nidhis or their members. They have submitted that the Nidhi companies can be treated on a special footing and allowed to retain unclaimed dividends by transferring the amounts to the Reserve Fund, for the benefit of the its members. The Nidhi companies have also pointed out that they are exempt from the provisions of Sec.205A and 205B of the Companies Act 1956 vide Notification issued by the Department of Company Affairs and they are permitted to credit the dividend payment to the concerned savings accounts of the Members.

The Group considered the representations of the Nidhi companies and found that the grounds for relaxation of this provision are not tenable and any modification in this regard would require amendment of the Companies Act, which may not be warranted. **Therefore, the Group recommends that the existing restriction may continue** and the Nidhi companies may be treated at par with other companies in the matter of transfer of unclaimed dividend to the Investors' Protection Fund as contemplated in Sec.205C of the Act.

ISSUE NO.18: PRUDENTIAL NORMS:

GSR.556(E) dated 26.07.2001(hereafter referred to as Second Notification) deals with Prudential Norms for income recognition and asset classification and has come into force from the date of Notification. Separate norms have been prescribed for mortgage loans and other loans like loans against jewellery, Government securities and own deposits. The most contentious issue considered during the deliberations of the Group was regarding the norms fixed for mortgage loans. The issue was therefore, discussed at great length.

2) In respect of mortgage loans, the Second Notification lists them under two broad categories viz. Standard Assets and Non-Performing Assets. Standard asset is a mortgage loan in respect of which, there is no default in repayment of instalment towards principal or interest. The other categories of loans are non-performing assets, which are loans where interest or instalments of loan remain unpaid for 12 months or more. The Non-Performing Assets, themselves consist of Substandard assets, Doubtful Assets and Loss Assets. Substandard assets are simple non-performing assets i.e. where there are unpaid interest or repayment of instalment outstanding for 12 months or more. Doubtful assets are those loans which remained non-performing for more than two years but less than 3 years. Loss Assets are those which remained non-performing for more than 3 years.

3) The provision that is required to be made in the accounts is as follows:-

Substandard asset	- 10% of outstanding amounts
Doubtful asset	- 50% of outstanding amounts
Loss asset	- 100% of outstanding amounts

The main argument raised against the above requirement is that the Nidhis or Mutual Benefit Societies cannot be equated with Banks or NBFCs. While the Banks and NBFCs give loans mainly for productive purposes and on the basis of additional income likely to be generated by utilizing the loans, the Nidhis or Mutual

Benefit Societies lend to non-business individual borrowers for discharging social needs or other commitments. These loans are given solely on the basis of the security available and generally, they are not repaid with any regular periodicity but in lumpsums at irregular intervals. Repayments are made by the members depending upon the availability of funds with them. In such cases, instalments for repayments are fixed more for the convenience of the borrowers than any expectation of regular repayments in instalments. It was forcefully argued before the Group that there are very few instances of bad debts in the history of Nidhis or Mutual Benefit Societies. This is because, the loans are given only upto 50% of the market value. Moreover, the loans are given on Registered mortgage of the properties barring some exceptions.

4) The representatives of the Nidhis or Mutual Benefit Societies referred to the failure of a few big Nidhi companies in the recent past. It was stated that in all those cases, the fall of the companies was due to the fraudulent manner in which the affairs of the Nidhis were conducted by the management which had developed vested interest. If those Nidhis had properly observed the regulations contained in their Articles of Association, there would not have been defaults in the repayment of deposits. Attention of the Group was drawn to the fact that after the Govt. notified certain regulations vide GSR.No.603(E) dated 20.10.97 fixing the maximum amount of loan that can be given to a borrower, there has not been even a single instance of failure of any Nidhi or Mutual Benefit Society. The representatives of the Nidhis or Mutual Benefit Societies argued that the regulations governing the affairs of these companies that existed prior to the issue of the two Notifications dated 26.7.2001 were sufficient to safeguard the interests of the depositors. It was further pointed out that these companies have a small area of operation and the members are usually known to each other. In cases of default by borrowers, a mere threat to bring the property to auction would ensure that the borrower settles his dues. Occasions to approach the Court are exceptional.

5) The Group had no hesitation in accepting that there was a lot of force

in the points made out by the management of these companies. However, noting the recent trend of falling property prices and the practical difficulties involved in selling even properties under Registered mortgages, there was a need to keep the members of these companies informed of the actual state of affairs in respect of the mortgage loans given to the borrowers. The ideal solution would be to recognize the Non-Performing Assets status and the propensity for losses by making a provision in the accounts of a sum calculated on the basis of certain norms. However, in view of the past history of the Nidhis or Mutual Benefit Societies and the careful manner in which mortgage loans are granted at only 50% of the market value and that too, on registered mortgage of the property, the Group is of the view that the Prudential Norms could be enforced in the present form only after a sufficient lead time. It was quite obvious from the details submitted to the Group in respect of 24 companies that if the Prudential norms in the present form are implemented to the full extent, many of the Nidhis or Mutual Benefit Societies would disclose losses and in some cases the net worth of the companies may show a negative figure. The consequences could be undesirable. Moreover, the Government is insisting on these companies restricting their deposits in relation to the Net Owned Funds. Against Issue.No.5, the Group has recommended that by 31.03.2007, all these companies should ensure that their deposits do not exceed 20 times of Net Owned Funds. If these companies have to make in addition, provision in the accounts as per the Prudential Norms, it would be an impossible task for them.

6) The Group feels that certain relaxations in the norms for classification of Assets and also extension of adequate lead time are required. **The Group recommends that the explanation for classification of the Assets given in the Paragraph 1(ii) a be re-stated as follows:-**

1)“**Standard asset**” means the asset in respect of which no default in repayment of principal or payment of interest is perceived and which

does not disclose any problem nor carry more than normal risk attached to the business;

2)“**Sub-standard asset**” will be that borrowal account which is a non performing asset.

3)“**Doubtful Asset**” will be that borrowal account which remained non-performing for more than two years but upto three years.

4)“**Loss Asset**” will be that borrowal account which remained non-performing for more than three years or where as per the opinion of the Nidhi or its internal auditor or by the inspecting authority during the course of its inspection a shortfall in the recovery of the loan account is expected because the documents executed may become invalid if subjected to legal processes or for any other reason,

5)“**Non-Performing asset**” will be that borrowal account where interest income and /or installment of loan towards repayment of principal amount remained unrealized for 12 months.

7) **The Group also recommends that the provision required against the assets classified be changed as follows:-**

NATURE OF ASSET	PROVISION REQUIRED
Standard Asset	No provision
Sub-standard Asset	10% of the aggregate outstanding amount
Doubtful Asset	25% of the aggregate outstanding amount
Loss Asset	100% of the aggregate outstanding amount.

8) **The Group recommends that as Nidhis or Mutual Benefit Societies will not be able to comply as on 31.03.2002 with the requirement of Income recognition, classification of assets and provisioning for mortgage loans outstanding,, adequate time be provided for compliance as follows:-**

Mortgage loans given upto and outstanding as on	Compliance date i.e. date of the Balance Sheet
a) 31.03.2000	31.03.2005
b) 31.03.2001	31.03.2006
c) 31.03.2002	31.03.2007

9) While compliance with classification of assets and income recognition/provisioning for existing mortgage, loans will be as above, **the Norms prescribed in the second Notification modified as recommended on paragraphs 6 and 7 above will be applicable to all the mortgage loans sanctioned from 01.04.2002 onwards.**

10) **As regards loans against jewellery** etc, the representatives of the Nidhis and Mutual Benefit Societies did not have any serious reservation in the enforcement of Prudential norms. However, it was pointed out that very often, such loans are continued without any formal renewal.. The representatives desired that it should be made clear that Prudential norms will not apply in such cases if the loans are renewed within a year. **Keeping in view, the Group recommends that the Clause 1(b) of the second Notification be substituted by the following:**

“The aggregate outstanding amount of loan granted against the security of gold jewellery etc, should be either recovered or renewed within next three months after the due date of repayment specified at the time of grant of such loans. If not recovered or not sold should make 100% provision against current year’s Profit and Loss Account to the extent of unrealized

amount or aggregate outstanding amount of loan as applicable. No income shall be recognized on such loans outstanding after the expiry of 3 months period or sale of jewellery, whichever is earlier.”

APPLICABILITY

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Para 2 of the two Notifications provide that the directions contained therein would apply to all Nidhi companies notified under Sec.620A of the Companies Act, before or after the publication of the Notifications and to all Potential Nidhi companies deserving to get Nidhi status under the Act. In view of this, the recommendations contained in this Report will apply to such companies also.

Considering the fact that the Nidhi companies will have to close their accounts for the financial year 2001-2002 on 31.03.2002, it is very necessary that a decision is taken on the various recommendations immediately and notified before 31.03.2002.

III.CONCLUSION:

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The Group has endeavoured to make an objective assessment of the implications of the Notifications GSR.555(E) & 556(E) dated 26.07.2001 on the existing Nidhi or the Mutual Benefit Societies and Potential Nidhi companies.. Sufficient opportunities were given to various individual Nidhi companies, and Chambers to personally appear before the Group for explaining the difficulties and

hardships faced in the process of implementation of the said Notifications. The various representations received by the Group were examined in detail in its various deliberations and the recommendations have been made taking into account the positive role played by the existing Nidhi/Benefit Fund companies in the society by meeting the financial requirements of the poorer sections of society in an affordable manner. At the same time, it has been ensured while making the recommendations that the loopholes sought to be plugged through the recommendations of the Sabanayagam Committee are recognized and the objectives aimed to be achieved are not diluted. While the interest of the depositors are duly recognized, the practical difficulties and the need for proper developments of the Nidhis have also been taken into account. The approach has been to ensure that the Nidhis in the long run will be run professionally by following a set of norms so that they can serve the society better.

(A.R. RAO)
CHAIRMAN

(N. SADASIVAN)
MEMBER

**(T.S.
GOKILAN)**
MEMBER

(S.GOPALAKRISHNAN)
MEMBER

(V.S.RAO)
MEMBER

(RAJESH MALHOTRA)
MEMBER
