October 25, 2012

To
Mr. Alok Nigam,
Joint Secretary (B O) & Chairman
Key Advisory Group on NBFCs
Ministry of Finance,
NEW DELHI.

Dear Sir,

Sub: Recommendations of the Smt. Usha Thorat Committee on NBFCs

This has reference to the recent meeting of Key Advisory Group on NBFCs our **Chairman R Sridhar** attended as a member of the Committee and also as Chairman of Finance Industry Development Council (FIDC).

As you are aware, the Asset Financing NBFCs, (NBFC-AFC) registered with Reserve Bank of India, have joined hands and formed a Self Regulatory Organization (SRO) under the name of Finance Industry Development Council (FIDC).

NBFC AFCs have been recognized for their role in credit delivery in remote corners of India and have carved a niche for themselves in the semi-rural and rural segments of the country. NBFC-AFCs are also playing a vital role in furthering the cause of Financial Inclusion and in credit dispensation to the poor states/credit starved areas for over 5 decades. Based on the discussions at the above referred meeting, FIDC had interaction with its members on the various proposals and based on the feedback received, would like to place before you certain areas of concern that will have adverse impact on the NBFC sector. These are enumerated below for your kind consideration.

1. **Norms for Capital Adequacy**

The Reserve Bank of India has increased the CAR by 50% during the last three years from 10% to 12% and then to 15% w. e. f. March 31, 2012. This is now applicable for both deposit accepting and non-deposit accepting NBFCs. It is erroneously recommended that the 15% CAR can be maintained by following the existing regulation of having Tier I capital of minium10% and balance by way of Tier II capital of 5%. Whereas as per the existing norms, NBFCs are permitted to have the minimum Tier I capital of 7.5% and balance 7.5% by way of Tier II capital.

Suggestion:

Since RBI is agreeable to implement the recommendations of KAG of maintaining status quo, it should continue with the existing norms on capital adequacy i.e. minimum Tier I capital of 7.5% should be maintained and it should not be raised to

10%. Further, in the current market conditions, it will not be feasible to raise equity capital so easily and hence, we would request you to continue with existing Tier I capital limit of 7.5% and not to raise it.

2. Asset Classification & Provisioning Norms

The committee has recommended that the NPL provisioning guidelines for NBFCs should be in line with those of banks.

Likely Difficulties:

a. The customers funded by NBFCs generally belong to the informal/unorganised segment and the average loan sizes of the NBFCs are between Rs 3 lacs and Rs10 lacs. Almost all assets funded are productive assets and are impacted by various causes like accident, increase in fuel and insurance costs without any corresponding increase in freight rates etc. It may hence not be appropriate to equate the provisioning norms for banks which are largely into wholesale lending with the NBFCs which are completely into retail lending.

b. The cash flows for NBFC customers are more often than not seasonal in nature and thus slippages do occur, which however does not tantamount to default. Such delays are a function of the fact that the AFCs cater to retail rural & semi-rural market where borrowers' repayment capacity is often impacted by the environmental conditions, which is an unlikely situation for Banks, as Banks' portfolio mostly comprises of large ticket size, organized & urban borrowers.

c. As per various reports published by rating agencies, as also by experience, the recovery efficiencies of NBFCs are superior to that of Banks and more so it is reflected in the percentage recoveries made by NBFCs from the bad debts written off subsequently.

d. There will be an adverse impact driven by increased provisioning as it will substantially affect the profitability and the subsequent return on asset of NBFCs (this read with the increased tier 1 requirement will compound the concern, as, if NBFCs do not produce returns, capital is not going to be easy to come by)

Suggestion:

As against the calibrated approach suggested by the committee, we feel, the existing provisioning norms are sufficient, considering the fact the assets are productive in nature and the repayments are self liquidating.

3. Mandatory Rating & reduce the deposit acceptance limit to 2.5 times of NOF for rated AFCs (from 4 times at present)

Likely Difficulties:

a) Recommendation of Working Group to make rating mandatory & reduce the deposit acceptance limit to 2.5 times of NOF for rated AFCs (from 4 times at present) is not desirable as CRAR regulates the total borrowings.

b) Many small sized NBFCs depend on public deposits as a main source of funding. Even for large sized NBFCs, public deposit is one of the sources of funding which can be tapped in case of sudden liquidity crunch faced from banks and financial institutions.

c) It has been brought to the notice of RBI many a times earlier also that rating is not viable for the SME sector due to high fees charged by the credit rating agencies which is unaffordable for the small AFCs, besides lack of understanding by them of the ground realities in which SME sector operates.

d) Vide notification no. DNBS (PD) CC No.47/02.01/2004-05 dt Feb 7, 2005, the RBI has mandated NBFCs accepting public deposits that such NBFCs should ensure that all times, there is full asset cover available for Public deposit accepted by them.

e) NBFCs have been in full compliance with this requirement of RBI & hence, currently deposits raised by NBFCs are fully secured by means of Assets of the NBFCs.

Suggestions:

Since the overall borrowings of NBFCs are regulated by the capital adequacy requirements and public deposits have full asset cover, there need not be a cap on category wise borrowing and status-quo should be maintained.

Prayer:

Further, on 16th October, 2012 during the interaction with R B I Governor, prior to the announcement of mid-term credit policy, the above issues were raised by FIDC. The Hon'ble Governor has instructed the D. G. and CGM (in charge) of DNBS to call a meeting of industry representatives and associations to discuss the issues governing NBFC sector. In view of this, we would request you to keep in abeyance the implementation of the recommendations of Smt. Usha Thorat Committee on NBFCs.

We have set out above our views on the issues and concerns of the NBFC sector. Considering the important role played by the NBFC sector over the years in the Indian economy in all areas, especially in promoting financial inclusion, it is important that the NBFC sector be strengthened by appropriate regulations.

We kindly request you to give us opportunity to present our case before finalizing the regulations.

Thanking you,

Yours faithfully,

For **Finance Industry Development Council**

MAHESH THAKKAR
Director General