FIDC

Finance Industry Development Council

(A body incorporated as a Self Regulatory Organisation for Registered NBFCs – AFCs)

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August 05, 2016

Shri Sudarshan Sen
Executive Director
Reserve Bank of India
Shahid Bhagat Singh Road
Mumbai 400001

Respected Sir,

RE: **Meeting Held in Your Office on July 20, 2016 – Key Issues**

We once again convey our Heartiest Congratulations to you for taking charge as the Executive Director of RBI. We also convey our sincere thanks to you for sparing your valuable time and giving a patient hearing to some of the concerns raised by us during the meeting held in your office on July 20, 2016.

Finance Industry Development Council (FIDC) is a Self-Regulatory Organization (SRO) cum Representative Body of the NBFCs, registered with the Reserve Bank of India and engaged in Asset Financing. FIDC was formed 12 years ago, and is the recognized face of NBFCs, specially, those engaged in asset financing. We have been engaged in regular interactions both with Reserve Bank of India and Govt. of India, which include pre-budget meetings and also important policy related meetings with RBI. Almost all the leading NBFCs and a large number of small and medium sized NBFCs are our members.

NBFC Sector

1) As per the Financial Stability Report (FSR) dated June 2016:
   - Asset quality of NBFCs improved during the year 2015-16 and is better than the banks
   - The performance of the NBFC sector in terms of RoE and RoA is much better as compared to that of banks
   - NBFCs can support the drive towards promoting inclusive growth by catering to diverse financial needs, specially of MSMEs and individuals.
2) NBFCs have mastered the art of lending to the “unbanked” segment thereby furthering the Government’s agenda on financial inclusion for the last seventy years now.
3) NBFCs have been the pioneers in asset backed retail lending thereby playing an instrumental role in the development of important sectors like transport , infrastructure and SMEs/ MSMEs
4) Recent studies done by credit rating agencies show that few of the leading NBFCs have overtaken some of the scheduled commercial banks in terms of their balance sheet size
5) In spite of the fact that bank funding is one of the major sources of funds for NBFCs, none of the NBFCs have defaulted in meeting their liabilities towards the banks in the recent past

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6) NBFCs have a regulation history of more than 19 years and all the key parameters of our activities are well regulated, almost at par with banks
7) 100% FDI is permitted in the NBFC sector which has projected this as an important attraction for FDI investment
8) The report of the RBI Committee on Mid Term Path on Financial Inclusion has recommended building of strong linkages between banks and NBFCs

Key Issues

1. **Risk Weightage for Productive Assets**

Under the present dispensation, all the assets financed by NBFCs, regardless of whether they are secured or unsecured and regardless of the risks associated with different assets, carry a uniform risk weightage of 100%. It is a well documented fact, based on the detailed analysis undertaken by credit rating agencies that commercial vehicles, cars and construction equipment have a much lower risk profile, as compared to other categories of assets. By their very nature, they are easily saleable and realise significant residual values.

Suggestions

- *For Commercial vehicles, Cars & Multi Utility Vehicles = 50%*
- *For Construction & Material Handling Equipment & Tractors = 50%*
- *Loans against Gold and Silver Jewelry uptoRs. 1 Lakh = 50%*
- *Loans for plant & machinery/equipmentfor SMEs = 50%*
- *Three Wheelers, Two Wheelers and Industrial Equipment = 75%*

It is our submission that this would duly reflect the appropriate levels of risk inherent in the respective asset classes and provide NBFC-AFCs a degree of capital relief. This is also in consonance with the Base III requirement for Banks.

2. **Pending Notification on Coverage of NBFCs Under SARFAESI Act**

Union Budget 2015-16 announced coverage of NBFCs with asset base of Rs. 500 cr. and above under the SARFAESI Act. However, the notification to this effect has not been issued till date.

During our interaction with Ministry of Finance we were told that since coverage has been given to a class of NBFCs, as per Section 31A of the SARFAESI Act, the notification to this effect should be laid before both the houses of parliament for a minimum period of 30 days. It is been long since the minimum period of 30 days has passed, but still the notification is pending. It is perhaps a unique case where a budget announcement is pending implementation even after 15 months.

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Suggestions

We hereby seek RBI's support and recommendation to Ministry of Finance for early issuance of this pending notification.

3. Need to Promote Leasing

Sir, as you are very much aware that leasing is the most preferred tool for capital formation and lending to SMEs/MSMEs with low capital. However, leasing in India has suffered heavily on account of imprudent and multiple taxation. The key issues are

- Lease rentals are subject to the levy of both VAT and Service Tax (on the interest component)
- TDS on the entire lease rental which entails TDS on the capital(Principle) also
- Tax officers across the country perceive lease as a measure of tax evasion.
- This negative perception has resulted in denial of legitimate depreciation benefits to the lessor
- Operating lease is not considered as a financial activity

Suggestions

We request you to kindly take this matter with Government of India and remove the above said hurdles to promote leasing which can play a key role in the revival and growth of important sectors like Infrastructure and MSMEs.

4. Refinancing By MUDRA as a Substitute to Public Deposits held by Small & Medium NBFCs

MUDRA was setup with the prime objective of refinancing banks, NBFCs and MFIs for on-lending to non corporate small businesses. For this purpose three categories of loans have been prescribed – Shishu (upto Rs.10. lakh), Tarun (Rs.1.0-5.0 lakhs) and Kishore (Rs. 5.0-10.0 lakhs). While the "Shishu" category is primarily the forte of MFIs, it is the "Tarun" and "Kishore" categories which are a perfect fit for NBFCs. However, till date MUDRA's exposure to NBFC sector has been negligible. This has been primarily due to the fact that the eligibility norms for NBFCs adopted by MUDRA, are not favorable, specially, for small and medium NBFCs.

It has been a stated policy of RBI that acceptance of deposits shall be the forte of banks in the long run. As such regulations for acceptance of deposits by NBFCs have been made more stringent over the years.

In terms of numbers, more than 80% of the NBFCs registered with RBI are small and medium sized. They have been doing an excellent job of furthering the Govt's agenda on financial inclusion by providing need based credit to the "unbanked" segment of the society. It is a well

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known that NBFCs take the first credit call on an "unbanked" borrower and thus make him part of the mainstream financial system. On the other hand, these small and medium sized NBFCs have been complying to the prescribed RBI norms, thereby posing a low risk to the system (a fact that was recognized by the Usha Thorat Committee).

One of the biggest challenges before these companies is to raise funds at competitive costs. These are family run companies who have built a strong niche for themselves in their limited area of operation. There are about 200 small and medium sized NBFCs authorized by RBI to accept deposits. Over the years these companies have also built a strong trust among their close friends and relatives, which enables them to readily raise funds through public deposits at competitive rates. However, obtaining a minimum investment grade credit rating for these companies is a big challenge, simply because of their size. As a result, these companies are being forced to move out of the deposit acceptance arena.

In such a scenario, there is a crying need to provide these companies with an alternative source of funding. Creating a refinance mechanism for NBFCs has been a long standing demand of the sector which was also recommended by the Parliamentary Standing Committee on Finance on the 45th report on dated June 2003.

Suggestions

Under these circumstances we feel that the eligibility norms for NBFCs for availing refinance from MUDRA should be made favorable. This shall enable small and medium sized NBFCs to shift from acceptance of public deposits and instead avail refinance from MUDRA.

This shall be a win win situation for all the stakeholders:

- *NBFCs would move out of deposit acceptance, which is in line with RBIs policy.*
- *These companies shall not only survive but also grow and continue the excellent work being done in catering to the unbanked segment, including small non corporate businesses*
- *The objectives for which MUDRA was setup will also be achieved*

5. Small and Medium Deposit Taking NBFCs – Challenges in Obtaining Credit Rating

Asset Financing NBFCs (NBFC – AFCs) were earlier allowed to accept deposits upto 1.0 times their NoF without credit rating, based on their clean track record and the fact that they are into asset backed lending which is considered as a low risk business, as compared to other types of retail lending. However, the revised regulatory framework issued in 2014 has made it mandatory for all NBFCs to obtain minimum investment grade credit rating for acceptance of deposits.

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All the credit rating agencies follow a rating model, which does not distinguish companies on the basis of the size of their balance sheet and operations. As such, a small NBFC with an asset base of 5 crores is treated at par with a large NBFC with asset base of 500 crores. Naturally, under these circumstances, obtaining the minimum credit rating is a tough ask for small and medium NBFCs.

Suggestions

Based on our discussion held during the meeting, and the facts stated above , we suggest that small and medium sized NBFC-AFCs may be allowed to accept public deposit with a minimum ticket size of Rs.50,000/-(Fifty Thousand only) without obtaining an investment grade credit rating.

6.Formalised Arrangement for Engagement with FIDC

Considering the fact that NBFCs play a very significant role in the overall financial system, there is a need to have a formalised arrangement for regular interaction between the NBFC sector and the regulator i.e. RBI. Moreover the agenda set out for 2015-16 as per the Annual Report of RBI, also states that "the Consultative approach followed by the department (Department of Non-Banking Regulation) is proposed to be formalised to having periodical interactions with the industry in 2015-16".

In the late 1990s and early 2000, RBI had setup an Informal Advisory Group (IAG) on NBFCs comprising of the industry bodies , key players and also independent professional bodies like ICAI. IAG meetings were held on a quarterly basis which provided an ideal platform for a two way exchange of ideas, concerns and suggestions for the healthy growth of the sector.

Suggestions

We therefore request you to have an arrangement where FIDC as the representative body may meet the Governor/ Deputy Governor at least twice a year. Further meetings at the Department level may be held once every quarter. The idea is to have "proactive " engagement rather than the current practice of "reactive" engagement.

We hope that the above said issues and our suggestions thereon shall be considered favorably. Assuring you of our full co-operation always and thanking you in anticipation

Warm Regards

Raman Aggarwal
Chairman
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