FIDC

Finance Industry Development Council

(A body incorporated as a Self Regulatory Organisation for Registered NBFCs – AFCs)
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May 08, 2015

Shri Hasmukh Adhia,
Secretary,
Department of Financial Services,
Ministry of Finance,
Jeevan Deep Building, Parliament Street
New Delhi 110001

Respected Sir,

RE: Financing of Non Corporate Small Businessea by MUDRA - Role of NBFCs

We thank you for inviting us to the Stakeholders' Consultation Meeting on Developing Business Model for MUDRA held at RBI Regional office in New Delhi on April 22, 2015.

Finance Industry Development Council (FIDC) is a Self-Regulatory Organization (SRO) cum Representative Body of all the Asset Financing NBFCs, (NBFC-AFCs) registered with the Reserve Bank of India. FIDC is the recognized face of NBFC-AFCs and has been engaged in regular interactions both with Reserve Bank of India and Ministry of Finance. We have been regularly invited for pre-budget meetings by the Honourable Finance Minister and also important policy related meetings with Governor and Deputy Governor of RBI.

Based on the discussion held in the above said meeting we would like to state the following in context to the 3 key discussion points: Partners, Products and Pricing

PARTNERS

NBFCs 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. They specialize in financing to productive assets in the Transportation, Agricultural, infrastructure and SME segments and their customer segments include , First time buyers, SRTOs, Agricultural and Weaker sections of the society, involving people who normally either cannot approach banks for their credit requirements or are unable to provide appropriate documentary proofs of their

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creditworthiness to the banks. Considering that such are the customers being catered to by the NBFC-AFCs, it is acknowledged time and again that they are thus playing a vital role in enabling the informal segment customers, who are "unbanked", to move away from the Money lenders to an Organised financier and over a period of time move them into the formal segment which enables these customers to be recognised and serviced by the Banking segment as well and thus become "bankable"

NBFCs are Best Suited for Funding The Unfunded

The whole concept of funding the unfunded is based on the definition of financial inclusion as given by RBI :

"Financial Inclusion is the process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular at an affordable cost in a fair and transparent manner by mainstream institutional players"

As such there are 4 key parameters which can form the basis for identifying a suitable partner to MUDRA. They are – Reliability, Affordability, Accessibility and Flexibility.

Parameter	NBFCs
Reliability	NBFCS have 18 years of regulation history almost at par with banks covering all key areas of financial regulation.
Affordability	NBFCs are highly affordable as the interest charges are quite low as compared to MFIs and money lenders.
Accessibility	Maintaining a personal touch with the customers to understand his needs has been the key to the survival and growth of NBFCs. Significant presence in rural and semi-urban areas for more than 60 years
Flexibility	Providing personalized services by way of flexible operations arising out of the changing customer needs and market scenario has been the hall mark of NBFCs

Credit Appraisal Without Any Available Track Record/Credit History

Almost 90% of the total number of NBFCs registered with RBI are small and medium in size. These NBFCs have developed niche market in the respective regions of their presence. Even the large NBFCs have a pan India presence through their branch/field offices employing the local workforce. This enables NBFCs to be rooted to the soil of the land and keep themselves updated on the credit needs and the issues faced by the potential borrowers. They also have a thorough understanding of the prevailing business environment in their region. All this

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knowledge and understanding manifests itself in appraising the credit worthiness of borrowers who do not have any previous track record/credit history. This is done by gauging the earning capacity of the borrowers business coupled with his willingness to repay.

Use of Modern Technology to Increase Efficiency

In addition to relying on the traditional ways of sourcing business, credit appraisal and collection, NBFCs have effectively adopted and used modern technology to increase efficiency and maintain better asset quality as compared to banks. This is proven by the data on stressed assets.

Products / Offering of MUDRA Match Those of the NBFCs

A big majority of lending portfolio of all the NBFCs, specially those engaged in asset financing, comprise of loans of ticket size less than Rs. 10 lakhs. This is a perfect match to the initial products (categorized as Shishu, Kishore and Tarun) of MUDRA.

Further the target sector/activities identified for MUDRA include land transport which involves purchase of transport vehicles for goods and passengers like light commercial vehicles (LCVs), Auto Rickshaw, three wheelers, taxi etc. Also included are equipment finance scheme for micro units which involves purchase of machinery / equipment.

The pioneering role being played by NBFCs in financing to the above said sectors has been widely acknowledged and appreciated by all the expert committees / task force setup by Govt. of India and RBI.

Based on the facts explained above NBFCs registered with RBI are best suited to act as partners to MUDRA and avail refinancing for onlending to the small business.

While all NBFCs may be considered as direct partners (one level intermediation) to MUDRA, large NBFCs classified as Systematically Important by RBI (with asset base of Rs. 500 cr. and above) may play the role of Regional Aggregators which in turn may engage small financiers (two levels of intermediation).

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PRODUCTS

Catering To The Demand of The NBFC Sector

The biggest issue being faced by the NBFCs sector today is limited sources for raising funds. NBFCs heavily rely on banks for raising funds which is an area of concern to the RBI. Therefore, it has been a long standing demand of the NBFC sector to have a refinancing window especially for asset backed lending. This demand was accepted and recommended by the Parliamentary Standing Committee on Finance vide their 45th Report dated June 2003.

Under these circumstances raising funds from MUDRA would be a win-win situation for all the stake holders.

Mode of Funding NBFCs for On lending To Small Businesses

Direct refinancing by way of term loans/cash credit limits as well as securitization by way of bilateral assignments shall be the most preferred mode of funding NBFCs. Further in case of small NBFCs providing equity support on an assured return basis, similar to the private equity model may also be considered.

Portfolio Credit Guarantee

Traditionally NBFCs have been engaged in lending against the prime security of moveable assets like vehicles, equipment etc. which are easy to repossess and sell in case of default. However, financing to the SME/MSME sector by NBFCs have been largely hampered by the lack of coverage under any credit guarantee schemes which are available to banks only.

As such providing portfolio credit guarantee upto 75% specially in case of non-asset backed lending (unsecured) shall give the much desired impetus to financing of SMEs/MSMEs by NBFCs.

PRICING

RBI has categorically ruled against regulating/capping of lending rates charged by all financial sector entities under its supervision. However, considering the sensitivity involved in operationalizing MUDRA and keeping in mind the vulnerability of target customers, *we hereby suggest that a spread of 5-10% may be prescribed between the MUDRA lending rate to NBFCs and the ultimate cost to the borrower. This variation in spread is required to be*

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commensurate to the risks involved depending on the borrower profile, geographical condition and the product offered.

We hereby request you to kindly give us an appointment at an early date so as to enable us to present our views that need urgent consideration, in detail and in person.

We look forward to an **immediate positive response** and are confident that we are in the process of a long and beneficial relationship.

Thanking you,

Yours sincerely,

FOR FINANCE INDUSTRY DEVELOPMENT COUNCIL

MAHESH THAKKAR
Director General