FIDC

Finance Industry Development Council

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

October 27, 2008

Mr. Amitabh Verma
Joint Secretary
Banking Operations & Administration
Ministry of Finance
Jeevandeep Building
Parliament Street,
New Delhi

NOTE ON IMMEDIATE STEPS NEEDED FOR ASSET FINANCING NBFCs (NBFC-AFCs)

A. Measures to Improve Funding Position

We thank you very much for providing us the opportunity to put forward our views on liquidity position of NBFCs before the learned Committee members. Briefly, we have to state as under:

Problems faced by us:

- Banks are reportedly restricting the use of sanctioned bank limits, even where drawing power is available.
- Similarly, banks are asking for re-pricing or pre-payment of existing term loans.
- Mutual Funds too are seeking pre-payments of FMPs.

These create issues of liquidity, ALM and growth.

Solutions:

- Banks must not withhold sanctioned limits since this puts a serious strain on liquidity.
- Recently, SIDBI has started entertaining proposals from Asset Financing NBFCs (NBFC-AFC). This needs to be stepped up significantly and there is a good case for the creation of a specific fund under the aegis of SIDBI, to refinance NBFC-AFCs, along the lines of the funding support that housing finance companies enjoy from NHB.
- Also, given the fact that a reasonable proportion of our advances go directly or indirectly to the agricultural sector, it would be a great support if NABARD could also extend medium to long term funding to NBFC-AFCs.
- Given the limitations of medium and long term funding in the domestic market, there is a strong case to allow NBFC-AFCs to access ECBs.

222, Ashoka Shopping Centre, 2nd Floor, L. T. Road, Near G. T. Hospital, Mumbai – 400 001 (India).
Tel: 022 2267 5500 / 98200 35553 ? Fax: 022 2267 5600 ? E-mail: maheshthakkar@vsnl.com ? website : fidcindia.com

Freeing of capital for NBFC-AFCs:

- 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 classes of assets, carry a uniform risk weight of 100%.
- It is a well documented fact, based on detailed analysis undertaken by credit rating agencies that commercial vehicles, cars and construction equipments have a much lower risk profile, as compared to other categories of assets.
- These assets, by their very nature, are easily saleable and realise significant residual values and therefore deserve to be treated on a different footing from other assets.
- Having said that, we also feel that unsecured loans fall in an entirely different category altogether and the risk weights for these loans need to significantly higher.
- In light of the above, the *risk weights for assets* financed by NBFCs should be suitably revised to reflect the varying risk profiles, as follows:
    - *Commercial vehicles, cars and multi-utility vehicles -50%*
    - *Construction & Material handling equipment, tractors -50%*
    - *Loans against Gold & silver ornaments upto Rs. 1lakh -50%*
    - *Three Wheelers -75%*
    - *Two wheelers and Industrial equipments -100%*
    - *Unsecured loans -150%*

  It is our submission that this would duly reflect the appropriate levels of risk inherent in the respective asset classes and free up capital for Asset financing NBFCs. This is also in consonance with the Basel II framework for Banks.

B. Recovery Mechanisms

1. *SARFAESI Act*

Banks and Financial institutions have been notified under the Act, giving them the ability to move against defaulting borrowers and secure their assets. Subsequently, specified housing finance companies (HFCs), have also been notified under the Act. NBFC-AFCs are the only segment of the financial sector that have not been notified under the Act.

It is submitted that in order that the interests of investors be protected, NBFC-AFCs may also be brought within the purview of the SARFAESI Act.

2. *Debt Recovery Tribunals (DRTs) :*

We request you to grant access to NBFC-AFCs to DRTs. We also request you to increase the number of DRTs if the existing set-up is found inadequate. This would fulfill a long felt need of the NBFC-AFCs and lead to speedier realization of their dues.

3. *Guidelines on Repossession Agents*

Recent pronouncements of various courts have come down heavily on the rights of the banks and finance companies to repossess the assets in case of default. Courts have suggested the SARFAESI route to which NBFCs have no access. The restriction on NBFC's right of repossession would only encourage defaults, which will seriously affect the financial discipline in country.

RBI had issued guidelines on Recovery Agents engaged by Banks on April 24, 2008. We understand that RBI is currently in process of drafting guidelines for NBFCs. In this context we would like to state the following:

a. Foremost there is a need to distinguish between "Recovery Agents" engaged by banks to recover unsecured loans like personal loans, credit cards etc. and "Repossession Agents" engaged by NBFC-AFCs and banks to repossess assets like vehicles, equipments etc. financed by them.

b. Recovery Agents Vs Repossession Agents

Sno.	Recovery Agents	Repossession Agents
1	Engaged to "recover" unsecured loans like personal loans, credit cards etc	Engaged to "repossess" assets financed in case of default
2	Adopt pressure tactics on the customer since there is no underlying security	Focused on taking possession of the asset which is the prime security
3	Often cause harassment to the borrower by calling at odd hours and use of unethical methods	May not contact the borrower and simply take back the asset as soon as it is traced, as per the terms of the agreement
4	Start approaching the borrower at the first instance of default	Repossession is the last recourse resorted to only after other options fail and there is a default of at least 3 EMIs
5	The borrower may not be aware/ informed of the default	The borrower is an "informed defaulter" to whom reminders, notices etc. have been sent

c. NBFC-AFCs have been doing this business for the last many decades without facing any major problems. All problems relating to unethical behavior of Recovery Agents are recent.

d. Repossession is more a deterrent to default and is an important tool for recovery for NBFC-AFCs in the absence of coverage under SARFAESI Act and DRTs.

e. Only two percent of the total number of cases land up in repossession and that too are often settled amicably with the borrower and the borrower is able to retake possession of the asset by updating the account.

f. Stopping repossession is having a cascading effect and even regularly paying borrowers are now defaulting. This is a highly disturbing trend that needs to be immediately curbed. Otherwise, it can have serious consequences for the entire financial system.

g. FIDC has intervened in one of the legal cases on this issue before the Hon'ble Supreme Court, where the judges have expressed their "no objection" to the issuance of guidelines by RBI.

We therefore request for issue of separate guidelines for Repossession of Assets in case of default based on the above stated facts.

C. Need to Constitute a Permanent Working Group

There is a crying need to constitute a Permanent Working Group comprising of all constituents of financial sector in the economy under the aegis of RBI to regularly monitor the financial position of all financial players, so that pre-emptive steps like inter-institutional funding can be taken well in advance to arrest the crisis situation in the market.

Thanking you,
Yours faithfully,
For **FINANCE INDUSRY DEVELOPMENT COUNCIL**