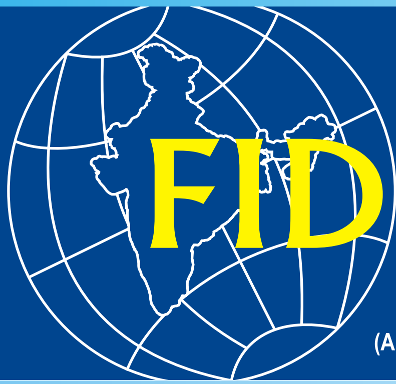


FIDC NEWS

Finance Industry Development Council

(A Self-Regulatory Organisation for Non-Banking Finance Companies (NBFCs) registered with RBI)

AUGUST-SEPTEMBER 2009 VOLUME - 1 • NO. - 2 FOR PRIVATE CIRCULATION

A KEY MILESTONE

It gives me great pleasure to inform all of you that the "FIDC Handbook on Repossession" was formally released by Dr. Justice A R Lakshmanan, chairman Law Commission and former judge of the Supreme Court at a well attended function in New Delhi, on September 3rd. The launch of this handbook is a key milestone for the NBFC sector and will serve as an authoritative reference on this subject not only for NBFC-AFCs but also for all other players in the finance sector. It should help remove the misconceptions surrounding the legitimate activity of repossession of assets, even while bringing about a certain level of transparency, uniformity and discipline in practices, across the NBFC sector.

As a responsible body, FIDC thought it fit to bring about uniformity in repossession practices amongst its members. A committee of legal experts from select member companies, under the leadership of Mr.Raman Agarwal, Co-Chairman FIDC, was tasked to bring out a detailed document on repossession. I commend the efforts of the committee for a job well done.

It is my earnest hope that every Asset Financing NBFC will follow the guidelines for repossession both in letter and in spirit. It is in our own interest to do so, since we run the risk of losing this important deterrent to default, if we do not.

Ultimately, we must continue to be identified as responsible, law abiding corporate citizens and play our designated role in the financial sector of the economy.

T. T. SRINIVASARAGHAVAN, Chairman

Reserve Bank Directions

RBI fiat on NBFCs

To enable RBI to verify that the 'fit and proper' character of the management of NBFCs is continuously maintained, RBI has decided that any take over / acquisition of shares of a deposit taking NBFC or merger/amalgamation of a deposit taking NBFC with another entity or any merger/amalgamation of an entity with a deposit taking NBFC that would give the acquirer / another entity control of the deposit taking NBFC, would require prior permission of RBI. [See RBI Notification No.DNBS (PD) 208 /CGM(ANR)/2009 dated September 17, 2009]

Chit funds prohibited from accepting deposits from public

The Reserve Bank of India on Aug.28 prohibited chit funds from accepting deposits from the public with immediate effect. These companies, however, can accept deposits from their shareholders. The central bank said any deposit, accepted and held by chit funds other than from its shareholders, as on date should be repaid on maturity and should not be renewed. According to the Ministry of Corporate Affairs, there are about 9,900 chit fund companies in India. [Business Line]

Introduction of Interest Rate Futures- NBFCs

The RBI, in terms of Notification No. FMD. 1 /ED(VKS) – 2009, dated August 28, 2009, covering the framework for trading of Interest Rate Futures (IRFs) in recognized exchanges in India, has now stated that NBFCs may participate in the designated interest rate futures exchanges recognized by SEBI, as clients, subject to RBI / SEBI guidelines in the matter, for the purpose of hedging their underlying exposures.

AT A GLANCE

A Key Milestone		1
Reserve Bank Directions		1
MAT changes will hit NBFCs		2
FIDC Handbook on repossession of assets released - A landmark event		3
Insight	Liquidity crisis - Implications for NBFCs	4
Policy	Determinants of Loss Given Default in Vehicle loans	6
Interview	We need an Indian Model of Financial Services	8
Periscope	NBFCs' Business Model	9
	Lenders join forces with Police to reclaim illegal cars in U K	9
	Financial firms rush into MF space	10
	Credit Bureau to help lenders track vanishing customers	10
	No plan yet to extend securitisation law to NBFCs	10
	MAT on gross assets- death knell for NBFCs	11
	Service Tax on hire purchase/ lease- appeal to Supreme Court	11
	FIDC News	11
FIDC in Action	FIDC Achievements & Activities F Y 2008-09	12
	Chairman and Co-chairman of FIDC	12
	FIDC welcomes Mr. A. Narayana Rao	12
	Direct Tax Code	12

EDITORIAL COMMITTEE

- MR. T. T. SRINIVASARAGHAVAN, Chairman
- MR. RAMAN AGGARWAL, Co-Chairman
- MR. MAHESH THAKKAR, Director General
- MR. SRINIVAS ACHARYA
- MR. MUKESH GANDHI
- MR. N M MUKHI, Editor

MAT changes will hit NBFCs

"To make matters worse, MAT will now represent a final tax and will not be allowed to be carried forward for claiming tax credit in subsequent years."

The Direct Taxes Code (DTC) is slowly being put to deeper scrutiny. As is always the case, some of the changes may be ushered in with good intention, but inept drafting leaves the door open for needless litigation.

The newly crafted Minimum Alternate Tax (MAT) is a case in point. Ever since Rajiv Gandhi unleashed the book profits tax on India Inc. in 1987, it has generated controversies galore and kept all the courts busy interpreting the intention and scope of the provision.

At present, MAT is applicable to corporates at 15 per cent on published profits. The nominal tax rate for the corporate sector is 33.99 per cent and the effective rate after all deductions/concessions stands at around 22.22 per cent.

Mat computation

MAT, despite the controversy surrounding its existence, has lived by the year for now 22 years and promises to open a new chapter from April 1, 2011.

The mechanics, as per the DTC, is simple. MAT will now be 2 per cent of the value of gross assets as against 15 per cent on profits. For this purpose the value of gross assets would be computed as shown in the Table.

It may be noted that even business assets such as sundry debtors, loans and advances will now form part of the computation of gross assets for the purpose of the levy.

Further, while in the vertical form of the balance sheet the current assets are disclosed net of current liabilities, the proposed MAT computation mechanism does not envisage a reduction of current liabilities from current assets. This also leads to an anomalous situation where a company has to pay MAT on the amount of deferred tax asset, if it appears in the balance sheet of a company. The rate of MAT is proposed to be 0.25 per cent in the case of banking companies and 2 per cent in the case of all other companies, including foreign companies.

This is clearly a hardship for Non-Banking Financial Companies (NBFCs) where 70-75 per cent of the assets in the balance-sheet constitute loans and advances, stock on hire and business receivables. There does not appear to be any justification in levying 2 per cent MAT on business assets, which in any case yield income on monthly basis liable to corporate tax at 33.99 per cent (proposed to be reduced to 25 per cent by the DTC). In the case of several large NBFCs, 2 per cent MAT on gross assets would be far greater than 25 per cent on taxable income.

To make matters worse, MAT will now represent a final tax and will not be allowed to be carried forward for claiming tax credit in subsequent years. Not only this, certain companies, will receive an additional blow — for example, those in gestation period; having negative net worth because of huge accumulated losses; having book losses in the current year; having low asset-turnover ratio / low net profit ratio; and those earning mainly exempt income.

Change in concept

The justification for re-jigging MAT is that several countries have adopted a tax based on a percentage of assets. The concept of MAT when it first originated in 1987 was completely different from what is proposed in the DTC.

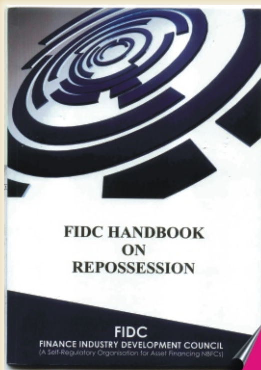
The economic rationale of "assets-based tax" is that it serves as an incentive for efficiency. If that be so then the normal tax itself should serve the purpose.

Any sort of tax that departs from the mainstream route of linkage with income/profits is bound to be litigious. Added to that is the discrimination between banking companies and other companies on the rate of tax. Some serious rethinking is required on the proposed MAT in the DTC.

R. Anand, Tax Partner, Ernst & Young, India

FIDC Handbook on repossession of assets

A function to release FIDC Handbook on Repossession on Sept. 3, 2009 at New Delhi. Seen in photo are [from R to L] Mr. Raman Aggarwal, Co-Chairman, FIDC; Mr. K V Eapen, Jt. Secretary, Deptt. of Financial Services, Ministry of Finanace, GoI, Guest of Honour; T T Srinivasaraghwan, Chairman, FIDC; Dr. Justice A R Lakshmanan, Chairman, Law Commission, Chief Guest and Mr. Mahesh Thakkar, Director General, FIDC.



FIDC Handbook on repossession released- a landmark event

Finance Industry Development Council (FIDC), the Self Regulatory Organisation (for Asset Financing NBFCs (NBFC-AFC). has come out with a Handbook on Repossession of assets. This is the first lime in the country that such a comprehensive document covering all aspects of repossession has been brought out. Justice Dr. A. R. Lakshmanan, Chairman. Law Commission of India and former judge of the Supreme Court released the Handbook at an event held in Delhi on 3rd September.

The idea behind this initiative is to bring about uniformity and discipline in repossession practices - a critical, and often, contentious issue for Asset financing NBFCs- and make it an integral part of the process framework for every NBFC-AFC in the country.

Dr. Justice A R Lakshmanan, stressing the need for having guidelines for repossession said, "There is an imperative need not only to codify existing guidelines for bankers for recovery of their defaulting loans from their clients but also enact new guidelines." Complementing the FIDC for its endeavour to come out with guidelines, he added, "This new book, which is based on practical experience of FIDC, will be an assisting tool in hands of banking industry for further conducting their business."

T.T. Srinivasaraghavan. Chairman FIDC and Managing Director of Sundaram Finance Ltd. said, "The time tested recovery process has comprised of gentle reminders, personal meetings, notices and persuasion through the guarantor. Repossession of the asset has traditionally been the remedy of last resort. However, with the entry of many new players and the practices adopted by them, the industry has witnessed several instances of cheating and fraud by wilful defaulting borrowers, on the one hand and several instances of unruly behaviour by repossession agents, on the other, resulting in a lot of negative publicity. It is our earnest hope that this comprehensive Handbook will remove the misconceptions surrounding the legitimate activity of repossession of assets, while simultaneously bringing about transparency and uniformity in practices across the NBFC sector. We would urge all Asset Financing NBFCs to follow the guidelines for repossession, both in letter and in spirit, for failure to do so, could result in our losing this important deterrent to default."

Key Features of the Hand Book: First of its kind for the NBFC Sector, Comprehensive in Content with minute detailing of the process, Put together by leading experts in the sector.

FIDC co-chairman Raman Aggarwal said repossession has been one of the most vexed issues plaguing the NBFC sector. Aggarwal said the new guidelines also lay down norms for hiring repossession agents. "The FIDC has issued guidelines for engaging repossession agents. A repossession agent will necessarily have to go for 100 hours of training on the subject. The FIDC is already in talks with both Indian Banks Association and Indian Institute of Banking and Finance to launch such training programmes."

The repossession agent will be required to have either a passport or a PAN card, before he/she can be roped in for the repossession process, FIDC says.

Meanwhile, the government in consultation with RBI is considering plugging the gaps in the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (Sarfaesi) which often hampers repossession of assets in case of a genuine default. "Some asset reconstruction companies. (ARCs) complain that the Sarfaesi Act creates problems while dealing with repossession of assets. RBI is talking to various ARCs to know the problems ARCs are facing and we would plug those gaps if needed," said KV Eapen, joint secretary ministry of finance.

Mr. Mahesh Thakkar, Director General, FIDC welcomed and introduced the guests at the function.

Insight

"Even though at some point it was widely perceived that the NBFCs were facing significant problems, in reality, only a small segment of the NBFCs had real liquidity constraints and the Reserve Bank's timely and adequate liquidity interventions could address the problems over a short timeframe."

- RBI

LIQUIDITY CRISIS – IMPLICATIONS FOR NBFCs

In view of the funding inter-linkages between NBFCs, mutual funds and commercial banks, when the contagion from the global financial crisis created selling pressures in the stock markets in India, the liquidity needs of the system as a whole had to be addressed by the Reserve Bank. The ripple effect of the US and European markets led to heavy redemption pressure on mutual funds, starting in September 2008, as several investors, especially institutional investors, started redeeming their investments in liquid funds/money market funds. Mutual funds are major subscribers to CPs and debentures issued by the NBFCs, besides CDs issued by banks. With the mutual funds facing redemption pressures and difficulties in rolling over the maturing investments, one of the prime sources of funds available to NBFCs dried up and, hence, there was no market for rollover of maturing short-term instruments floated by NBFCs for having regular access to market funding. Apart from this, there were reports that the liquidity crunch also made banks reluctant to lend to NBFCs. This heightened the perception that NBFCs were facing severe liquidity constraints. To ascertain the ground reality, a study involving discussions with a large number of NBFCs-ND-SI was initiated.

RBI STUDY OF GROUND REALITY:

The discussions centered on the immediate issue of liquidity constraints faced by the NBFCs and their experience with the measures taken by the Reserve Bank to ease the situation. The focus areas for discussions were: (i) the profile, composition and maturity pattern of assets and liabilities; (ii) liquidity issues/constraints faced by the companies; (iii) measures taken for mitigation of such constraints; (iv) feedback on the easing measures taken by the Reserve Bank; (v) business strategy/plans of the NBFCs in the immediate future, including substitution of short-term funds, possibility of downsizing the balance sheet and growth plans; and (vi) real estate/capital market exposures.

It emerged from the discussions that based on their liquidity sensitivity to the changing market conditions, NBFCs could be categorised into four groups. The first group of companies had financed assets with long-term liabilities and small amounts of CPs and had no asset-liability mismatches, as they mainly had short-term assets and also back-up lines of credit. They constituted the largest group and covered nearly three fourths of the total assets of companies under discussion. Another minority group had asset-liability mismatches but these companies had foreign parents from whom funds could be received. This group represented only 2.0 per cent of the total assets of the NBFCs. The third group of companies had financed assets with a mix of short-term CPs and bank funds and had a mismatch within tolerance limits. They had around 6.0 per cent of the total assets of the NBFCs. The last group of companies had long-term assets and short-term liabilities and was facing liquidity problems. These companies accounted for 17.0 per cent of the total assets of the NBFCs.

There was a general view among the companies that funds had become costlier and that raising funds outside bank borrowings had become extremely difficult in view of the then market conditions. Further, banks were also reluctant to extend additional credit or increase credit to NBFCs. Some of the NBFCs had put on hold incremental disbursements as they were utilising inflows to repay their short-term obligations and uncertainty of funds flow did not encourage them to expand their balance sheets.

Loan companies were expecting a slight increase in delinquency rates, as they had ventured into riskier segments, viz., unsecured loans and retail finance. The investment companies anticipated difficulty in subscriptions to their CPs/ debentures for which mostly

mutual funds and banks were their mainstay. A number of companies, particularly investment companies, that had significant exposure in the capital market also had not indicated any liquidity problems except in the first few weeks of October 2008 largely on account of the fact that the companies lent only up to 50.0 per cent of the market value and in some cases only up to 33.3 per cent, coupled with regular margin calls.

Thus, even though at some point it was widely perceived that the NBFCs were facing significant problems, in reality, only a small segment of the NBFCs had real liquidity constraints and the Reserve Bank's timely and adequate liquidity interventions could address the problems over a short timeframe.

RBI MEASURES :

On account of intensification of the global financial crisis in September 2008, some immediate impact was felt in the domestic capital markets, resulting in redemption pressure on mutual funds, which created liquidity constraints for NBFCs. In response, the Reserve Bank introduced special fixed rate Repo under LAF to banks exclusively for the purpose of meeting the funding requirements of mutual funds and NBFCs. The precautionary measures taken by the Reserve Bank since October 2008 to enhance the availability of liquidity to NBFCs are:

(i) Taking into consideration, the need for enhanced funds for increasing business and meeting regulatory requirements, it was decided that NBFCs-ND-SI could augment their capital funds by issue of Perpetual Debt Instruments (PDI) in accordance with the stipulated guidelines. Such PDI would be eligible for inclusion as Tier I capital to the extent of 15 per cent of total Tier I capital as on March 31 of the previous accounting year and the excess amount would qualify as Tier II capital within the eligible limits. The minimum investment in each such issue/tranche by a single investor would not be less than Rs.5 lakh. The amount of funds raised by NBFCs-ND-SI would not be treated as 'public deposit' within the meaning of Reserve Bank directives in this regard.

(ii) NBFCs-ND-SI which were facing problems of liquidity and ALM mismatch in the existent economic scenario were permitted, as a temporary measure, to raise short-term foreign currency borrowings under the approval route, subject to certain conditions.

(iii) To ease the flow of bank credit to the NBFCs, certain changes initiated were: (a) standard asset provisioning required to be made by banks on advances to NBFCs was reduced from 2.0 per cent to 0.4 per cent; (b) the risk weight on banks' exposure to NBFCs-ND-SI reduced to 100 per cent from 125 per cent earlier, irrespective of credit rating while exposure to AFCs which attracted risk weight of 150 per cent was also reduced to 100 per cent; and (c) banks were permitted, on a temporary basis, to avail liquidity support under the LAF window through relaxation in the maintenance of SLR to the extent of up to 1.5 per cent of their NDTL, exclusively for meeting the funding requirements of NBFCs and mutual funds.

(iv) A scheme for providing liquidity support to eligible NBFCs-ND-SI through an SPV for meeting the temporary liquidity mismatches in their operations was introduced. IDBI Stressed Asset Stabilisation Fund (SASF) Trust was notified as the SPV for undertaking this operation. The SPV would purchase short-term papers from eligible NBFCs-ND-SI to meet the temporary liquidity mismatches. The instruments would be CPs and CDs, with a residual maturity of not more than three months and rated as investment grade. The facility would not be available for any paper issued after September 30, 2009 and the SPV would cease to make fresh purchases after December 31, 2009 and would recover all dues by March 31, 2010. The rate of interest charged by the IDBI SASF Trust would be 12.0 per cent.

IMPACT :

These steps indirectly also helped in dealing with the market pressure which had been building up on the liquid and fixed maturity plan portfolios of mutual funds. In this context, a review of the impact of these measures/relaxations on release of credit by banks to mutual funds/NBFCs was carried out in mid-November 2008. The review revealed that during the period from October 14 to November 20, 2008, many banks availed liquidity support under the 14-day special fixed rate repo of the Reserve Bank funding to mutual funds against the collateral of CDs. Some banks also availed liquidity support under 14-day special fixed rate repo of the Reserve Bank against their funding to NBFCs against the collateral of receivables of their regular NBFC clients. Overall, the policy announcement had a salutary effect on the mutual funds that faced liquidity problems

[Source: The Annual Report of RBI for the year ended June 2009]

[Rearranged the presentation and sub-headings were supplied]

Policy

> "The study shows that loans with tenures of over four years have significantly higher losses on default than loans with shorter tenures."

DETERMINANTS OF LOSS GIVEN DEFAULT IN VEHICLE LOANS

Executive Summary

CRISIL's analysis1 of vehicle loan pools indicates that the loan-to-value (LTV) ratio, tenure, early performance, and the geography of a delinquent loan are key indicators of future recovery of the loan. The analysis, based on a large sample of data, reveals that the loss given default (LGD) on delinquent loans with LTVs greater than 80 per cent is likely to be three times that of loans with LTVs less than 60 per cent. Similarly, the LGD on a delinquent loan with original tenure of more than four years is likely to be two times that of loans with original tenures of less than three years. Further, contracts that have shown delinquency in the early months of their tenure have exhibited lower recoveries than others. The geography of the loan is another important factor: south-eastern states exhibit higher recoveries than others.

Background

In asset-backed loans, recoveries from delinquent contracts can arise through two routes. Firstly, the delinquency could be cured and regular payments restarted. In many cases, however, this will not happen; instead, the contract will be terminated, either through a settlement with the borrower, or through repossession and eventual sale of the asset. In many of the cases, the originator may incur a loss on a part of the receivables.

Seasoning of the loan and the delinquency bucket are some of the key determinants of credit losses in vehicle loan pools. CRISIL has published separate commentaries analysing these aspects2. But, as would be intuitively appealing, the magnitude of the loss on asset-backed loans is also driven by fundamental loan parameters such as borrower characteristics and asset characteristics. This study explores some of these factors, and the effect that they have on the magnitude of the losses from a delinquent contract.

1 For data and methodology details refer box

2 Refer 'CV Pools-Seasoning & Early delinquency as predictors of collection shortfalls' and 'Seasoning & Delinquency profile-Key indicators of future credit performance of car loan pools'

Key Findings

CRISIL's analysis reveals the following key factors that influence the loss on a delinquent contract:

- LTV ratio: The LTV ratio is a key characteristic of asset-backed loans. As higher LTVs imply lower borrower's equity in the asset, the LGD should be higher for such loans. The study not only validates this but also indicates that car and light commercial vehicle (LCV) contracts with higher LTV ratio (more than 80 per cent) suffer LGD which can be up to thee times as much as that for lower LTV (less than 60 per cent) contracts (see Chart 1). However, for medium and heavy commercial vehicle (MHCV) contracts, the LTV was not observed to be a significant driver of LGD. This may be due to the fact that for MHCVs, the LTV is computed primarily with reference to the chassis value where the financier funds a substantial part, and the borrower is required to bring in equity contribution towards body building of the vehicle. CRISIL believes that the effective LTV for MHCVs would be more relevant for determining LGD.

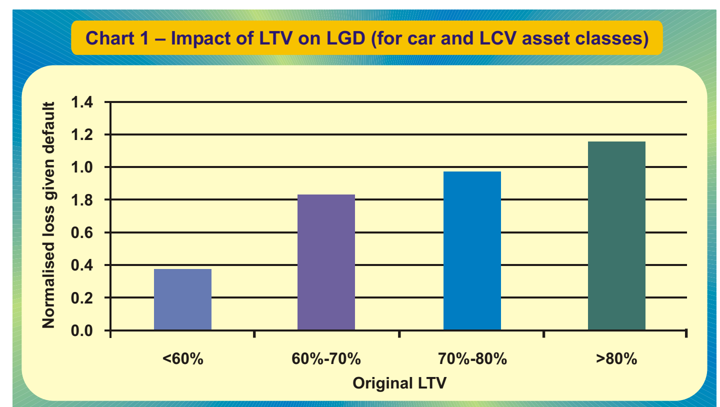


Chart 1 – Impact of LTV on LGD (for car and LCV asset classes)

Data and Methodology

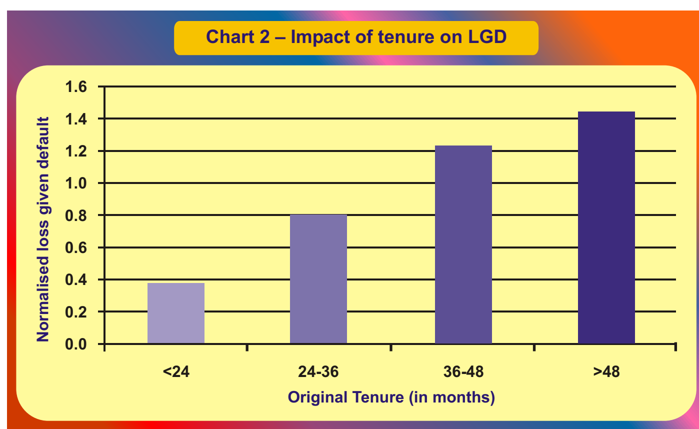
Loss given default (LGD) is the expectation of loss incurred on a delinquent exposure as a

percentage of the exposure amount at the time of default. As recoveries from delinquent contracts contribute to the credit support, the LGD plays an important part in the loss estimation for a retail pool.

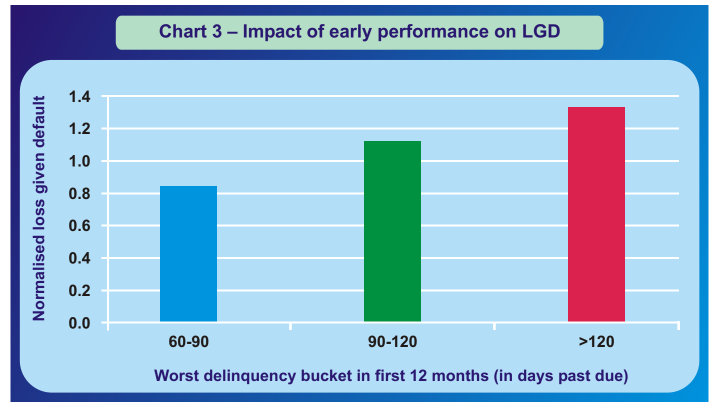
For the purpose of the study, default is defined as a loan entering into a 90 days past due delinquency bucket; in other words, payments on the loan have been due for more than three months. The loans covered in the study were between 90 and 180 days delinquent, and the delinquency status of the loan has been considered at 12-15 months after origination (This was done to ensure homogeneity of the pool in terms of the seasoning profile). The recoveries on the loans were analysed for the next 36 months, and any amounts due and not recovered in this period were classified as loss. As a majority of the securitised retail pools have door-to-door tenure of approximately 48 months, recoveries beyond the 48 months will not be relevant from a securitisation perspective. Also, even though there is a potential for future recovery after 36 months, the results from the study are still relevant as the analysis is on relative LGDs. CRISIL has analysed loan-level information for about 8000 delinquent contracts for commercial vehicle (CV) and car financing across three originators, spanning the period between 2002-03 (refers to financial year, April 1 to March 31) and 2006-07.

To adjust for the impact of originator/asset class-specific variations, the data for each originator and each asset class has been normalised by dividing each value by the average for the sample. The normalised LGD rate has been considered for the study.

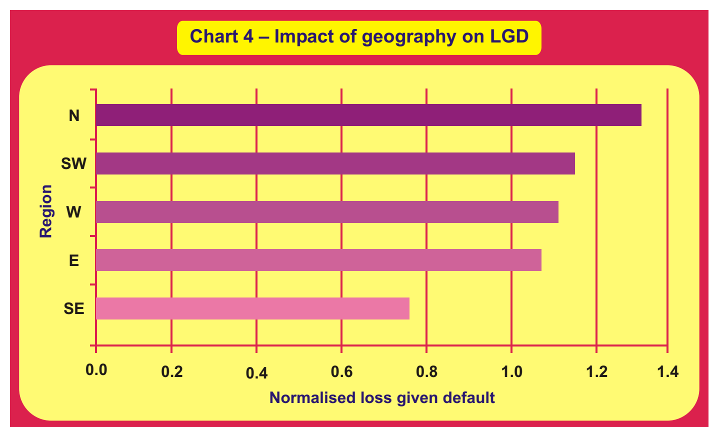
• Tenure : The tenure of a loan determines the pace of the loan's amortisation. CRISIL's analysis shows that loans with longer tenures tend to have higher LGD. This is only to be expected: if a loan becomes delinquent at a given point in its life, the longer the remaining tenure, the higher will be the proportion of the loan principal that is outstanding at that time. Over the past couple of years, the proportion of vehicle loans with longer tenure has been increasing. The study shows that loans with tenures of over four years have significantly higher losses on default than loans with shorter tenures. (See Chart 2.)



• Early performance: The early performance of the contract (as measured by the worst delinquency bucket experienced prior in the first year post origination) is an important indicator of future recoveries from it. (See Chart 3.)



• Geography : The study also indicates that northern (Delhi, Uttar Pradesh, Rajasthan, Punjab) and south-western (Karnataka, Kerala) states have much lower recoveries from delinquent contracts than the south-eastern states (Andhra Pradesh, Tamil Nadu). This could possibly reflect weaker collection infrastructure or originator-specific issues in these states. (See Chart 4.)



Relevance of the Study

The study has certain limitations. The analysis is based on univariate analysis which does not capture the interplay between the factors. However, a multivariate analysis was not feasible due to lack of adequate data. Also, the data largely correspond to a period with benign economic environment; economic environment tends to have significant impact on asset prices, and therefore, on LGDs.

However, CRISIL believes that the results are broad indicators that will be useful in understanding LGD. In CRISIL's opinion, the results of the study provide significant insights for market participants. The indicators of the magnitude of losses on delinquent contracts could help focus greater attention on the contracts with such characteristics. This might help in reducing the overall losses in a pool of contracts. The results of the study are also relevant to underwriting decisions and pricing of the loans. For investors in the structured finance market, this data can be useful for monitoring the performance of the investments. The study is also relevant to the securitisation of non-performing assets (NPAs) by asset reconstruction companies.

[Courtessy : CRISIL]

Interview

“NBFC as a channel to deliver these products to the un-served sections of society is very much on and is part of our agenda.”

WE NEED AN INDIAN MODEL OF FINANCIAL SERVICES

Given our diversity, the challenges here are very different from anywhere else in the world. We must, therefore, seek Indian solutions to our problems.

An Interview by D Murali, Business Line with
T. T. Srinivasaraghavan, MD, Sundaram Finance Ltd, and Chairman, FIDC

T T Srinivasaraghvan
MD, Sundaram FinancLtd.
& Chairman - FIDC

Direct Tax Code:

Are the DTC proposals threatening to adversely impact the NBFCs?

At a broader level, the implications of the Direct Taxes Code (DTC) Bill are evolving every day because more you read the Code, more new things pop up. But specifically on the issue of ‘tax on gross assets’ and its implications for the NBFC sector, clearly our view is that if the banks are going to be taxed at 0.25 per cent, then the same rule has to be applied to all other institutions in similar business of lending, including NBFCs and HFCs (housing finance companies). More importantly, though, the right approach would be to levy the tax on net assets, for banks and financial services companies.

It is our earnest plea to the Finance Minister to take a re-look at this because with this kind of a tax, no one other than banks can exist

Financial Inclusion:

Your views on financial inclusion as a need, and also on the appropriateness of the approach we have been adopting to achieve the same.

It has become fashionable in this country to believe that anything to do with financial services has to be made in America. We fail to realise that what we need here in the financial services sector is an Indian model, given our diversity and the fact that our challenges are very different from anywhere else in the world. With the turn of events over the last 12-18 months, I am hoping that we will finally realise that we must seek Indian solutions to our challenges.

Banks should look at their relationship with NBFCs as a wholesaler-retailer relationship and not as competitors. While NBFCs are only a small number, if this business model of a wholesaler-retailer evolves, it will certainly help in expanding the reach of credit delivery to the far corners of the country, especially to the under-served markets.

The success of the last mile delivery depends on the various players working as a continuum.

Is microfinance being seen as an alternative to the NBFC model? Are there synergies, instead, that can be explored?

When something becomes the flavour of the times, everyone jumps on and wants a piece of the action. Later, depending on whether it succeeds or fails, it charts a very different course. I have nothing against micro-financing. There is enough anecdotal evidence that it has served certain very vulnerable sections of society. It is certainly something we should support but the problem is in over-hyping it, which is what we typically tend to do.

While the MFIs (microfinance institutions) definitely have a very important and useful role to play in serving rural India, they should not become a privileged class that excludes everyone else.

We should find the right balance and recognise that there are several channels in providing last mile credit delivery — there are the nationalised banks, RRBs (regional rural banks), MFIs and the NBFCs. It is important to involve all those who understand the dynamics of rural India, especially the un-served parts of the country.

Innovative products & potential for technology:

Despite the blame that financial innovation has been heaped with, post economic meltdown, do you see scope for innovative products in the field of finance, especially at the grassroots level? And also, what is your view on the potential of technology to reduce costs of finance delivery?

From relying only on fund-based activities, most NBFCs today have moved on to expand their presence in the financial services space and have become distributors of several financial products in insurance, mutual fund, home finance, etc. NBFC as a channel to deliver these products to the un-served sections of society is very much on and is part of our agenda. I do believe that NBFCs will continue to provide this varied range of financial products to the rural market and will actually expand the market for these products.

Technology will certainly reduce transaction costs, though the initial costs of creating the technology platform and infrastructure can be significant.

Periscope

> "NBFCs, especially asset-financing NBFCs which are expected to grow at comparatively higher rate during 2009-10 and 2010-11, will benefit the most from the deferment [of CAR]."
>
> \- CRISIL

NBFCs' BUSINESS MODEL

NBFCs are facing an increasingly challenging operating environment. Their ability to compete with banks, which have a superior reach and resource base, is limited. NBFCs' disbursement levels, which were severely affected by the liquidity crunch and demand slowdown in the second half of 2008-09, are yet to rebound to earlier levels. The economic slowdown is also expected to adversely affect NBFCs' asset quality in the near term. The sector has, nonetheless, received a reprieve in the form of deferment of the revised CAR norms for systemically important, non-deposit taking NBFCs (NBFCs-ND-SI).

The liquidity crisis in September and October 2008 brought to light the inherent funding constraints faced by NBFCs. Most NBFCs rely heavily on institutional funds to support growth, with mutual funds being the major source of funding. Deposit-taking NBFCs were able to better manage the liquidity crisis, thanks to their greater reliance on longer-term public deposits. While bank lending to NBFCs has partially resumed, post the liquidity crunch, credit concerns remain, and there is uncertainty regarding uninterrupted availability of long-term funds at competitive costs. As a result, the asset-liability management (ALM) profile of NBFCs is expected to remain under pressure.

NBFCs have suffered from a rise in delinquency levels across segments since 2007, with unsecured loans and commercial vehicle segments being the worst affected. The slowdown in the economy, along with the impact of dilution in underwriting standards in the past few years, and the seasoning of the loan portfolio, are expected to result in higher credit costs for NBFCs in 2009-10. The recent shift towards secured lending, and exit from unsecured segments by most NBFCs, as well as tightened underwriting norms, could, to some extent, prevent deterioration in asset quality over the medium term.

The Reserve Bank of India (RBI) has deferred the implementation of its revised CAR norms for NBFCs-ND-SI by a year. Although a majority of the large NBFCs are adequately capitalised, pressures on profitability and limited options to raise capital in the current weak environment could constrain their overall growth in the medium term. The deferment in implementation of RBI's revised CAR norms has now given them time to capitalise further. NBFCs, especially asset-financing NBFCs which are expected to grow at comparatively higher rate during 2009-10 and 2010-11, will benefit the most from the deferment. The deferment will also benefit NBFCs with global parents: even parents that are facing significant pressures on credit can now postpone fresh infusion of capital.

CRISIL believes that, over the medium term, the NBFCs' business model will remain under pressure. Only NBFCs that have a niche geographical or product presence will be able to compete with banks. Other NBFCs will have to transform their role into one of innovation and partnership, from the current role of pure asset financing.

The key rating sensitivity factors for NBFCs are changes in asset quality and profitability, and extent of mismatch in asset-liability profile.

[CRISIL has outstanding ratings on 149 financial sector entities1 across various businesses; banks and non-banking financial companies (NBFCs) constitute the largest segment (refer chart 1). Of the financial sector entities rated by CRISIL, 98 per cent have investment grade ratings. Nearly two-thirds of these are in the 'AAA' or 'AA' rating categories (refer chart 2). The main driver of high ratings for a large proportion of financial sector entities is the expectation of support from parent or group entities in the event of distress; more than 60 per cent of the CRISIL-rated financial sector entities benefit from parent or group support with median notch-up of four notches. The other important factor driving high ratings is the healthy capitalisation of these entities.]

Lenders join forces with Police to reclaim illegal cars in U K

A new Vehicle Recovery Scheme launched in U K aims to tackle illegal driving. The scheme is a partnership between the Finance & Leasing Association (FLA), which represents the motor finance industry and regional police authorities of U K. It is designed to enable motor finance companies to reclaim vehicles they own which have been driven illegally by their

customers and ultimately seized by the police.

According to the Association of Chief Police Officers (ACPO), the number of illegal vehicles on Britain's roads is increasing. Last year police seized a record 170,000 uninsured vehicles. Driving without insurance is also a growing concern with an estimated two million uninsured motorists on the road. Uninsured driving nullifies a car financing contract. As a result of this illegal behaviour, motor finance providers may be forced to increase their premiums to other drivers to cover the higher risks. The vehicle recovery scheme could help to reduce the cost of finance for consumers and help companies protect their valuable assets – benefits worth striving for in current economic conditions.

Paul Harrison, Head of Motor Finance at the FLA, said, "We estimate that our partnership with the police could lead to over 20,000 illegal vehicles being taken off the road. This scheme will make the roads safer for law-abiding drivers and send a clear message to motorists breaking the law that their behaviour will not be tolerated by the police or finance providers. The FLA has been delighted with the positive response to the scheme received from ACPO and regional police authorities." [Source: FLA]

Financial firms rush into MFspace

Nine players in various stages of launch as stock markets show signs of revival. With the capital market showing signs of revival, banks and financial companies that had put their mutual fund plans on hold are gearing up to enter the segment. The list includes Bank of India, IDBI Bank, Axis Bank, Mahindra and Mahindra Financial Services (M&M Finance), SREI Infrastructure Finance, Bajaj Allianz, Indiabulls Fiancial Services, L&T Finance and Motilal Oswal. While Axis Bank and Indiabulls are ready for product launches, companies like Srei have received the regulatory go-ahead. Bank of India and IDBI Bank are in the process of setting up asset management companies and are scouting for partners. Though the market is crowded with 36 players, some of whom are looking to exit, the newcomers say there is a lot of potential. Besides, a mutual fund subsidiary will help these companies cross-sell. They would also be able to use their existing networks, said bankers.

The proportion of mutual fund investment to household savings is 4-5 per cent in India while the share of bank fixed deposits is around 20 per cent. In addition, over the last 10 years, while a number of new players have come in, we have also seen a number of players exit. Among non-banking finance companies, SREI Infrastructure has received Sebi's approval to enter the asset management business. Mahindra & Mahindra Finance has sought regulatory nod for an AMC. "We have appointed a consultant to look into the worthwhileness of the mutual fund business. The consultant's report is expected in three months. We have also applied to Sebi for its in-principal approval," said M&M Finance Chief Financial Officer V Ravi. [Business Standard, September 16]

Credit Bureau to help lenders track vanishing customers

The Credit Information Bureau (India) Ltd (CIBIL) has launched 'Locate Plus', a product which can help lenders locate customers even if their contact details have changed. This product can help banks and financial institutions strengthen their relationship with their customers and also in risk management, as it improves efficiencies and processes for collection, said Mr Arun Thukral, Managing Director, CIBIL.

HOW IT WORKS

If a customer has changed his/her residence or telephone number but not informed the bank, CIBIL Locate Plus will scan all the addresses and telephone numbers of that particular customer that exist in CIBIL's repository. The final report will show the latest address and telephone numbers. The tool locates the customer by his name, PAN card number or voter ID, or any other personal identification that will continue to remain the same. For instance, a bank can track down a customer who has disappeared through CIBIL's database that may list his another address and recover any payments that maybe overdue.

VALUE ADDITION

As a next step, CIBIL is looking to offer 'triggers', which will be a value addition to Locate Plus. Using this service, banks can keep a watch on select customers to see if there is any change in data. For instance, if the bank gives CIBIL a portfolio of about 100 people it wants tracked, CIBIL can proactively inform the bank about any change in the addresses or telephone numbers. As of date CIBIL has 175 customers or members, 140 million individual records and 4 million business records. [Business Line, Sept. 17]

No plan yet to extend securitisation law to NBFCs

The Government is not looking to bring non banking finance companies (NBFCs) within the ambit of the Sarfaesi (Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests) law, a senior Finance Ministry official said. "There is no plan to bring NBFCs within Sarfaesi. But we are certainly looking to fill certain gaps in that law. For that, we are in touch with the Reserve Bank of India. The discussions are preliminary," the official said.

So far, the Government and RBI have not allowed NBFCs to use Sarfaesi provisions to move against defaulting borrowers. The asset financing NBFCs are keen that the law be extended to cover their sector. "We are the only segment of the financial sector who do not get to use SARFAESI. There is a good case to do that," Mr T.T.Srinivasaraghavan, Chairman, Finance Industry Development Council, told Business Line.

The Sarfaesi Act 2002 was enacted to enable banks and financial institutions to realise long-term assets and improve recovery by exercising powers to take possession of securities, sell them and reduce NPAs by adopting measures for recovery. [Business Line, Sept.4]

MAT on gross assets- death knell for NBFCs

As per the proposed Direct Taxes Code (DTC), all companies would be liable to pay minimum alternate tax at the rate of 2% on the value of the gross assets as at the close of the financial year, if such amount is higher than the corporate tax payable on taxable income. Thus, the base for computing minimum alternate tax is sought to be shifted from 'book profits' to 'value of gross assets'. While this has far reaching consequences for all companies, it would effectively shut down all financial institutions other than banks - notably Non Banking Finance Companies (NBFCs) and Housing Finance Companies (HFCs), said FIDC.

The minimum alternate tax rate of 2% of gross assets assumes a return of at least 8% on its assets to ensure that one is not subject to MAT but to normal corporate income tax. This assumption is clearly untenable. It is a well documented fact that NBFCs, like their banking counterparts, work with a Return on Assets (ROA) of between 1.5 and 2%. Thus, the 2% tax on gross assets would have a disastrous impact on the post tax profits of NBFCs. *(Refer accompanying table)*

No deduction is allowed in respect of the matching liabilities relating to the specific assets. NBFCs asset portfolios are funded predominantly by leveraging; under the new provisions, NBFCs will have to pay tax on assets acquired through borrowed funds as well. This would result in a cascading impact – The NBFC would pay tax on the loan assets and the borrower company would again pay tax on the same assets acquired through the NBFC.

NBFCs supplement the banking industry, insofar as their activities are concerned. A differential tax treatment whereby banks are required to pay MAT @ 0.25% of their gross assets, while NBFCs are taxed @ 2% of their gross assets, would be the death knell for NBFCs.

FIDC, therefore, strongly advocates that MAT should continue to be linked to book profits, as at present and should not be linked to assets, as proposed. Even if the concept is retained, a deduction in respect of all liabilities must be available against gross assets and only the net assets so computed should be subject to such minimum alternate tax. FIDC strongly urges that at the very least, the MAT rate of 0.25% should be uniformly applicable to all Permitted Financial Institutions, including NBFCs and HFCs and MAT credit should be reinstated.

Service Tax on hire purchase/ lease- appeal to Supreme Court

Equipment Leasing Association [India] [ELAI] has filed an appeal in the Supreme Court of India against the judgment of Madras High Court on the levying of Service Tax on leasing/hire purchase transactions on a batch of writ petitions/applications.

FIDC News

The 1st edition of FIDC's full-fledged colourful informative bi-monthly Newsletter "FIDC News" was released earlier at the 5th Annual General Meeting of members of FIDC on August 21, 2009 at Mumbai at the hands of the Chairman Shri T T Srinivasaraghavan.

Impact of proposed MAT on various categories of companies and banks **(Rs. in lakhs)**

Name of the Company	Gross Assets as at 31.3.2009	PBT for the year ended 31.3.2009	IT @ 25% of PBT	Gross Assets Tax [2% of Gross Assets for companies & 0.25% for banks]	GAT Payable as a % of PBT
Category : Bank					
Bank - A	96443208.07	912122.65	228030.66	241108.02	26.43
Bank - B	18327077.32	224493.92	56123.48	45817.69	20.41
Category : NBFC					
NBFC - A	2498973.23	92063.11	23015.78	49979.46	54.29
NBFC - B	800725.99	21971.03	5492.76	16014.52	72.89
Category : Housing Finance Companies (HFC)					
HFC - A	10165691.59	321904.28	80476.07	203313.83	63.16
HFC - B	2938230.16	72641.97	18160.49	58764.60	80.90
HFC - C	200413.06	3926.31	981.58	4008.26	102.09
Category : Manufacturing Companies					
Manufacturing Company - A	3726115.00	101376.00	25344.00	74522.30	73.51
Manufacturing Company - B	783626.67	22193.50	5548.38	15672.53	70.62
Category : Insurance Companies					
Insurance Company - A	316703.05	14977.05	3744.26	6334.06	42.29
Insurance Company - B	159525.70	691.94	172.99	3190.51	461.10
Insurance Company - C	100454.16	973.05	243.26	2009.08	206.47

Source : Annexure for Representation under Direct Taxes Code Bill, 2009

FIDC
In Action

FIDC Achievements & Activities F Y 2008-09

Playing the role of a responsible SRO and the representative body of the NBFC sector, FIDC continued to represent to the various statutory bodies on different issues faced by the NBFCs. The year 2008-09 saw hectic discussions, representations and meetings between FIDC office bearers and various arms of the Government of India in order to overcome the economic slowdown. This is implicit recognition of the role of FIDC as the credible voice of NBFCs-AFCs similar to that of other financial sector representative bodies like IBA, AMFI etc. Following is the summary of the same:

Interaction with Government of India

The year 2008-09 was one of great turmoil in the global economy resulting in an unprecedented financial meltdown. The effects of this were also felt in India, as a result of which, Government of India announced some growth boosting stimulus packages.

1. The Special Committee constituted by Government of India under the chairmanship of Finance Secretary to tackle the liquidity crisis, invited FIDC to present the liquidity position and requirements of the NBFC sector. • 2. It was due to the compelling representation made by FIDC that Government of India in their stimulus package announced in January 2009, made a provision to setup a special line of credit from public sector banks for NBFCs engaged in financing of commercial vehicles. • 3. Following the announcement made in stimulus packages, Ministry of Finance engaged FIDC in active dialogue and discussion along with Indian Banks Association to implement the proposal. • 4. Economic Advisory Council (EAC) to the Prime Minister of India invited FIDC for discussion on steps to be taken to boost credit off take in the area of retail asset backed lending. • 5. In order to address the issues relating to Repossession of assets in case of default, Ministry of Finance engaged FIDC in regular interaction and discussion along with Indian Banks Association (IBA) and Society of Indian Automobile Manufacturers (SIAM). • 6. FIDC was invited to attend the Meeting convened by Finance Secretary to initiate short term and long term measures in order to address structural issues of NBFCs.

Interaction with Reserve Bank of India

1. In response to representation made by FIDC, RBI extended the deadline set for NBFC-ND-SI to increase their CRAR to 12% and 15% by a year • 2. RBI accepted the request made by FIDC and allowed NBFCs to invest in fixed deposits/ bonds issued by SIDBI and NABARD towards maintaining the prescribed SLR.

Chairman and Co-chairman of FIDC

T T Srinivasaraghvan
Chairman

Mr. T T Srinivasaraghavan and Shri Raman Aggarwal are reappointed as Chairman and Co-chairman of FIDC respectively for a further period of 2 years i.e. till the conclusion of 7th Annual General Meeting of FIDC in view of the good work and the untiring efforts put in by both of them in all endeavours of FIDC as also to ensure continuity and consistency.

Raman Aggarwal
Co-Chairman

FIDC welcomes Mr. A. Narayana Rao

Mr A. Narayana Rao has taken over as new Chief General Manager-in-charge, Department of Non-Banking Supervision, Reserve Bank of India, Mumbai. A warm welcome to Mr. Rao from FIDC.

Direct Tax Code

FIDC has decided to form a small sub-committee for representing on the proposed Union Government's Direct Tax Code and represent in the matter to Ministry of Finance, Government of India after taking members' views on various provisions in the Code affecting the sector.

Views expressed herein are not necessarily the views of FIDC.

Published by :

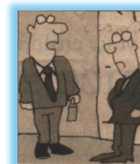
T T SRINIVASARAGHAVAN
for and on behalf of
Finance Indusry Development Council,
222, Ashoka Shopping Centre, 2nd Floor, L T Road,
Near G T Hospital, Mumbai-400001, INDIA.
Phone : 91-222267 5500 / 91 98200 35553
Fax : 91-222267 5600,
E-mail : FIDC : info@fidcindia.com
Director General : maheshthakkar@vsnl.com
Website : www.fidcindia.com

Suggestions and feed-back

We would appreciate your views, suggestions and feed-back to make the **'FIDC News'** more useful and illuminating. Your inputs and contributions too are welcome on : fidcnews@gmail.com

- Editorial Committee

... now that the upturn is round the corner we have to change the way we work...!



[Courtessy : Economic Times]

Printed by : Aditya Print Shop (Ph.) 079-26579959