# FIDC NEWS

Finance Industry Development Council

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

JULY - SEPTEMBER 2010 VOLUME - 2 • NO. - 1 FOR PRIVATE CIRCULATION

## Complementarity is need of the hour

The two vital players in ensuring financial inclusion are the Banks and NBFC-AFCs. Each of them have their own strengths, most often complementary. The strength of the Commercial Banks lies in their capability to warehouse the assets, owing to their superior capital base and their ability to access low cost deposits, while the strengths of the NBFC-AFCs lie in their loan origination and servicing skills. Needless to mention, these entities have, over several decades, developed expertise in identifying the credit needs of the deserving, yet neglected, segments of the population. Their ability to efficiently assess the risks and deliver tailor made credit products to suit their requirements, has been widely acknowledged. Thus, this unique wholesaler/retailer collaboration model between the banks and NBFC-AFCs has ensured increased flow of credit to under-served, credit starved sections of society, which in turn has helped significantly in creation of Assets and Wealth in rural and semi urban parts of the country and ensure credit delivery to Millions of 'Non-Bankable' customers, across the country.

The Business Correspondence model for NBFCs will provide an ideal framework for NBFCs to work with banks, under the guidance of RBI, to further the financial inclusion goals in a sustainable manner.

*T. T. Srinivasaraghavan, Chairman*

## Regulatory Perimeter

### RBI Notifications:

**1. NBFCs- Know Your Customer (KYC) Norms/Anti-Money Laundering (AML) Standards/ Combating of Financing of Terrorism (CFT),** RBI circular dated Sept.22 2010, RBI/2010-11/212, DNBS(PD).CC. No 201/03.10.42 /2010-11 on a Statement issued by FATF dated June 25, 2010.

**2. NBFCs – Prevention of Money Laundering Amendment Rules**, 2010, RBI circular No. DNBS(PD)CC.No.198/03.10.42/2010-11, August 26 , 2010 regarding GoI Notification No.10/2010/E.S/FNo.6/8/2009-ES dated June 16, 2010

**3. Participation in Currency Futures:** RBI/2010-11 /164 dated August 9, 2010, No.DNBS (PD) CC No. 195 / 03.10.001/ 2010-11. NBFCs are allowed to participate in the designated currency futures exchanges recognised by the SEBI as clients, subject to RBI guidelines, only for the purpose of hedging their underlying forex exposures.

**4. NBFCs - KYC Norms/Anti-Money Laundering Standards: Countries which do not or insufficiently apply the FATF recommendations.** RBI/2010-11/161 dated August 09, 2010. No.DNBS. (PD) CC No. 194/03.10.42/2010-11.

## AT A GLANCE


- Complementarity is need of the hour .......... *T. T. Srinivasaraghavan* 1
- Regulatory Perimeter 1
- India Securitisation Market .......... *Ms. Shyamala Gopinath* 3
- We Wrote the Book on Financial Inclusion 60 Years Ago .......... *T. T. Srinivasaraghavan* 5
- Infrastructure Financing in India (Part-1) .........*Ms. Gunjeet Kaur, Shri L. Lakshmanan, Shri Raj Rajesh and Shri Naveen Kumar* 6
- Moves 9
- Legal Eagle 10
- Periscope 11
- FIDC In Action 12


## EDITORIAL COMMITTEE


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



*With Best wishes from :*

**MAS FINANCIAL SERVICES LTD.**

6, Ground Floor, Narayan Chambers, B/h. Patang Hotel, Ashram Road, Ahmedabad-09.
(Ph.) 079-30016500 • Fax : +91 079 30016597 • E-mail : mfsl@mas.co.in

CATALYST IN FINANCIAL INCLUSION
MICRO LOANS TO AFFORDABLE & RURAL HOUSING LOANS

**5. NBFCs - KYC Norms/Anti-Money Laundering Standards: Client accounts opened by professional intermediaries.** RBI/2010-11/163 dated Aug. 09, 2010. No.DNBS. (PD) CC No 193 /03.10.42/2010-11.

**6. NBFCs - KYC Norms/Anti-Money Laundering Standards:** Suspicion of money laundering/terrorist financing; Filing of Suspicious Transaction Report (STR); Politically Exposed Persons (PEPs); Principal Officer. RBI/20010-11/162 dated Aug. 09, 2010. No. DNBS. (PD) CC No 192 /03.10.42/2010-11.

**7. Loan facilities to the physically / visually challenged by NBFCs:** RBI/2010-11/143 dated July 27, 2010. No. DNBS.CC.PD.No. 191/03.10.01/2010-11

**8. NBFCs-ND-SI issuing guarantees - Applicability of exemption from Concentration norms:** RBI/2010-11/110 dated July 9, 2010 No.DNBS.PD/ CC.No.190 /03.02.002/2010-11. Amending Notification No. DNBS(PD)No. 214/CGM(US)-2010 dated July 09, 2010.

**9. Master Circulars- Miscellaneous Instructions to All Non-Banking Financial Companies**: RBI/2010-11/29 dated July 1, 2010. No.DNBS (PD) CC No. 189 / 03.02.001 / 2010-11

**10. Master Circular - Returns to be submitted by NBFCs:** RBI/2010-11/20 dated July 1, 2010 No.DNBS.PD.CC. No.180/03.10.042/2010-11

**11. Master Circulars- Miscellaneous Instructions to NBFC- ND-SI:** RBI/2010-11/28 dated July 1, 2010 No.DNBS (PD) CC No. /188 03.10.001/2010-11

**12. Notification as amended up to June 30, 2010** – “Non-Banking Financial Companies Auditor’s Report (Reserve Bank) Directions, 2008.”

**13. Notification as amended up to June 30, 2010** - Change in or Take Over of the Management of the Business of the Borrower by Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines, 2010.

**14. Master Circular – ‘Know Your Customer’ (KYC) Guidelines** – Anti Money Laundering Standards (AML) - ’Prevention of Money Laundering Act, 2002 - Obligations of NBFCs in terms of Rules notified thereunder.’

**15. Notification as amended up to June 30, 2010** – “Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1977.”

**16. Master Circular-Frauds** – Future approach towards monitoring of frauds in NBFCs.

**17. Notification as amended up to June 30, 2010**– “Non-Banking Financial (Non - Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.”

**18. Notification as amended up to June 30, 2010** – “Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.”

**19. Notification as amended up to June 30, 2010** – “Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998.”

**20. Master Circular** - Bank Finance to Non-Banking Financial Companies (NBFCs).

## Discussion papers/Reports placed by RBI for Comments/ feedback:

**1. On Engagement of ‘for-profit’ Companies as Business Correspondents (BCs)** placed on 02 Aug. 2010. Response by August 20, 2010 to GM, RBI, DBOD, Mumbai. [See www.rbi.org.in]

**2. The draft report of the Internal Group on Introduction of Credit Default Swaps (CDS) for Corporate Bonds** for Public Comments placed on August 04, 2010. Comments on the draft report may be forwarded to the Chief General Manager, Internal Debt Management Department, RBI, Mumbai by October 04, 2010. [See www.rbi.org.in]

**3. On Entry of New Banks in the Private Sector** placed on 11 Aug. 2010. Response by Sept. 30, 2010 to GM, RBI, DBOD, Mumbai. [See www.rbi.org.in]

## RBI issues draft proposals for credit protection on infra bonds

The RBI on Aug. 5 released a draft proposal for the operational framework in introducing corporate default swaps, a form of insurance in case a bond or loan goes into default. An internal group of RBI, in its recommendations, said CDS should be permitted on bonds issued by rated legal resident entities. The group hasn’t stipulated a rating for entities where a CDS can be had for their corporate bonds. The internal group has mooted that a system of non-guaranteed settlement of CDS transactions should be set up at the initial stage. Gradually, a central counterparty (an entity that is the buffer between the buyer and seller of a trade) for guaranteed settlement of CDS deals should set up. Those who can participate in CDS are sought to be divided in two categories, market makers and users. Market makers like banks, mutual funds and insurance companies could do both protection buying and protection selling. Users can only hedge their own underlying exposures. [Business Standard, August 5, 2010]

## RBI permits take-out financing via ECB for new infra projects

The RBI on July 22 further relaxed norms governing external commercial borrowings (ECBs) for infrastructure companies by allowing them to avail of take-out financing through such forex loans. This relaxation was applicable to companies involved in seaport, airport, road and power sectors, RBI said. “It has been decided to permit take-out financing arrangement through ECB, under the approval route, for refinancing of rupee loans availed of from domestic banks by eligible borrowers,” said RBI. The company developing the infrastructure project must have a tri-partite agreement with domestic banks and overseas lenders for take-out of the loan, RBI said. The loan must have a minimum tenure of seven years. Domestic banks involved in the transaction would be governed by norms related to take-out financing and would not be allowed to guarantee such financing, RBI said. After the take-out, the residual loan to be taken out by the overseas lender would be considered as an external commercial borrowing, the central bank said. [Business standard, July 23]

## Regulators allow currency options on bourses

Nearly two years after the introduction of currency futures, the joint regulators of exchange-traded currencies, RBI and SEBI, on July 30 allowed recognised stock exchanges to launch European style options in dollar-rupee based on the spot rate. As in exchange-traded currency futures, no underlying exposure is mandatory for trading in currency options. [Economic Times, 31 July 2010] ■

# INDIA SECURITISATION MARKET

Ms. Shyamala Gopinath

*"Globally, over the past two decades, banks have lost their traditional role as the dominant suppliers of credit in some countries, and securitisation has become a core component of the market - based supply of credit."*

**Ms. Shyamala Gopinath, Dy. Governor, Reserve Bank of India**

The growth in the Indian securitisation market has been largely fuelled by the repackaging of retail assets and residential mortgages and more recently by single loan sell-off of corporate loans of banks and other financial entities. This market which has been in existence since the early 1990s, has matured only post-2000 with an established narrow band of investor community and regular issuers. Asset backed securitisation (ABS) is the largest securitisation class driven by the growing retail loan portfolio of banks, investors' familiarity with the underlying assets and the short maturity of these loans.

Though securitisation of auto loans remained the mainstay throughout the 1990s, over time, the market has spread into several asset classes – housing loans, corporate loans, commercial mortgage receivables, project receivables, toll revenues, and more recently, even microfinance loans have been securitised. Within the auto loan segment, the car loan segment has been more successful than the commercial vehicle loan segment, mainly because of factors such as perceived credit risk, higher volumes and homogenous nature of receivables. Other types of receivables for which securitisation has been attempted in the past include property rental receivables, power receivables, telecom receivables, lease receivables and medical equipment loan receivables.

The mortgage backed securities (MBS) market has been relatively slow in taking off despite a growing housing finance market due to the long maturity periods, lack of secondary market liquidity and the risk arising from prepayment/re-pricing of the underlying loan. Unlike many international jurisdictions, though, MBS in India has not depended on direct or indirect government support/guarantee.

In the recent times, direct assignment of single loan or retail loan pools (as against securitisation involving a special purpose vehicle, or SPV) has been gaining importance in India. The broad structure of such transactions is similar to that of regular ABS or RMBS transactions, except for the absence of the issuance of any instruments like PTCs. The pool receivables in such cases are assigned directly to the "assignee" or "purchaser". Such deals typically involve a bank or a mutual fund acquiring the portfolio from other banks or NBFCs.

The choice of the route, "direct assignment" or "securitisation" depends largely on investor preference and such deals are customised to meet the requirements of investing entities. For instance, while MFs can invest only in "instruments", banks often prefer to acquire loan portfolios outright, as PTCs—by virtue of being investments— would need to be marked to market, and loans and advances do not have such requirement. Further, for the purchasing banks, the attraction is that many of such loans qualify for the Priority Sector Lending (PSL) requirements.

From a regulatory perspective, the real issue is that of regulatory arbitrage. While there is nothing wrong in direct sale of loans, banks should appreciate that if these transactions are being done to avoid restrictions on profit booking and higher capital requirements for credit enhancements, RBI would have concerns. As a prudent practice, banks should apply regulatory instructions according to the substance of transaction rather than form.

## Recent trends

Though the securitisation market in India is marked by relatively simple structures and stable ratings, concerns over asset quality have affected investor appetite for securitisation in the post-crisis scenario. Much of the securitisation activity is driven on the supply side by growth of retail loan portfolio in banks and NBFCs and the prevalent liquidity conditions. On the demand side, the key factors have been the requirements of mutual funds, particularly at the short end, insurance companies and banks to meet priority sector lending targets. Most of the securities are acquired with the intention to hold to maturity.

As per the data compiled by major rating agencies, the year 2009-10 has witnessed an overall moderation in the volumes in securitisation market. Total issuance volume saw a decline of 22% in 2009-10 over the previous fiscal. The dip in the overall securitisation volumes owed mainly to the 60% reduction in loan sell-off (LSO) issuances, which were mostly short-term in nature. In the case of retail loan-backed transactions, with the overall growth in retail loan portfolios being subdued and the liquidity position of most financiers being comfortable, the need to securitise—as a funding source—was limited. Nevertheless, securitisation of retail loans, both ABS and RMBS reported a 61 per cent increase in volume in 2009-10.

**Trends in Structured Finance Volumes (Rs. billion)**

| Type | 2001-02 | 2002-03 | 2003-04 | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 | 2009-10 |
|---|---|---|---|---|---|---|---|---|---|
| ABS | 12.9 | 36.4 | 80.9 | 222.9 | 178.5 | 234.2 | 313.2 | 135.8 | 209.7 |
| MBS | 0.8 | 14.8 | 29.6 | 33.4 | 50.1 | 16.1 | 5.9 | 32.9 | 62.5 |
| CDO/LSO/SLSD | 19.1 | 24.3 | 28.3 | 25.8 | 21.0 | 119.0 | 318.2 | 364.4 | 145.8 |
| OTHERS | 4 | 2.3 | 0.5 | 26 | - | - | 13 | 11.6 | 7.9 |
| TOTAL | 36.8 | 77.8 | 139.3 | 308.1 | 249.6 | 369.3 | 650.3 | 544.7 | 425.9 |

*(CDO : Corporate Debt Obligations, LSO : Loan Sell off, SLSO : Single Loan Sell - Down)*

*Source : Various Rating agencies like ICRA, CRISIL etc.*

*"Much of the securitisation activity is driven on the supply side by growth of retail loan portfolio in banks and NBFCs and the prevalent liquidity conditions."*

While the securitisation market has remained concentrated with a handful of originators and limited investors, the asset classes have continued to diversify, the latest additions being gold loans, microfinance loan receivables and loan against property.

RBI had issued comprehensive guidelines on securitization in February 2006 based on international best practices. The main focus of the guidelines was to encourage securitization in manner that ensures true sale -real risk transfer and banks do not retain risks in the transferred assets beyond a point. To this end, limit was placed on banks' exposure to PTCs and concentration of entire credit enhancement in the originating bank was discouraged by making second loss facilities more costly through higher capital adequacy. Banks are however permitted to invest outside the prescribed limit for non-listed investments in ABS and MBS which are rated at or above the minimum investment grade.

Another feature of the 2006 guidelines was the requirement that the gain on securitization of assets should not be recognized upfront and should be amortised over the life of the securities issued. This requirement was put as a conservative measure to avoid securitisation being used to inflate profits even while banks exposures in various capacities to the SPV remain.

After market showed some maturity, the capital adequacy treatment was aligned with that under Basel II in April 2007.

The recent draft guidelines issued in April 2010 stipulate a minimum holding period (MHP) and a minimum retention requirement (MRR) by the originators. The guidelines envisage MHP of 9 months and 12 months respectively for loans with maturity of less than 24 months and more than 24 months. Similarly, the MRR for loans with maturity of less than 24 months and more than 24 months has been proposed as 5% and 10% respectively. Banks will not be permitted to hedge the credit risk in the retained exposures counting towards the minimum retention requirements.

The guidelines further stipulate that the total exposure of banks to the SPV and/or securitised assets in the form of investments in equity/subordinate/senior tranches of securities issued by the SPV including through underwriting commitments; Credit enhancements including cash and other forms of collaterals including over-collateralisation and liquidity support should not exceed 20 percent. Complex securitisation structures viz. re-securitisation, synthetic securitisations and securitisation with revolving structures are specifically prohibited.

Similar guidelines have also been issued in respect of securitisation transactions undertaken by NBFCs.

**The feedback** received mainly briefly relates to the following:

a. Level playing field between banks and NBFCs as regards MRR and MHP – On the one hand, there is a view that given the intrinsic nature of loans given by the NBFCs, particularly in the microfinance sector, stringent requirements may hamper lending in these critical areas. On the other, there is the regulatory arbitrage issue which necessitates ensuring that the incentive structures do not again result in a shadow banking system.

b. Applicability of the guidelines to direct assignment transactions.

c. Category-specific relaxations for MHP

d. Relaxation of MRR requirement for retail loans

e. Treatment of 'time-tranched' issuances as against 'credit tranched' issuances

f. Relaxation in respect of the 'total exposure' norm

RBI is examining the responses and the final guidelines for banks as well as NBFCs will be issued after taking into account the feedback.

## Conclusion

Globally, over the past two decades, banks have lost their traditional role as the dominant suppliers of credit in some countries, and securitisation has become a core component of the market-based supply of credit. While corporate bonds served as the main dis-intermediated financing tool for non-financial corporations, securitisation acted as the main capital market instrument for household finance, and to a lesser degree SMEs. Post crisis, however, many of the pitfalls of the securitisation market have come to the fore. Securitisation *per se* has not been discredited totally though the new normal for securitisation markets is expected to be lower than its pre-crisis peak.

Covered bonds are considered an important part of this new normal particularly in Europe where it is permitted subject to safeguards. In this case the bonds are issued secured by high quality assets and both the liability and the assets remain on the balance sheet of the bank. The concentration of risks in the banking system remains which puts great strain on the health of the bank balance sheets. More importantly, it raises issues for the resolution regime given that the backing for depositors gets constrained.

The downside of securitisation that has come to the fore is the absence of alternative solutions available to borrowers to restructure their loans when there is a downturn with the originator since the banker-customer relationship is snapped when the loans are securitised. Any restructuring requires consent of the final investors and in the long chain of intermediaries it becomes difficult to restructure debt.

One of the reasons for the complexities of structures is that other derivatives such as currency and interest rate swaps are also embedded in some structures. This can be dealt with if these transactions are undertaken by the SPV and not embedded in the original structure.

In the Indian context, 'sustainable securitisation' can indeed play a positive role in financial intermediation provided there is genuine transfer of risk away from the banking system. The existing and proposed guidelines are in line with international practices and may appear stringent but in the long term, it is imperative that securitisation market develops for the right reasons. It is also necessary to promote standardisation to facilitate risk assessment and valuation and eventually enable the trading of these securities on the exchanges. There are a few challenges which need to be addressed.

- Bilateral assignments of a single loan or a portfolio that are in substance securitisation should be subject to the guidelines on securitisation.
- Though securitised paper issued by securitisation SPVs has been recognised as 'security' under SCRA, there are still some tax issues relating to recognition of pass-through structure of the SPV.
- Substitution of long term funding by banks by other market intermediaries through securitisation, particularly mortgage related securitisation, may require active participation by real money investors such as long term institutional investors such as insurance companies and pension/provident funds and the investment guidelines for these entities need to accommodate this aspect.
- However it is also important to ensure that such investors have better access to essential information and less reliance on rating agencies. This will require dissemination of loan pool composition and ongoing performance detail.
- The reliance on rating agencies may be the default option, in the absence of a viable alternative. Some of the methodological issues, though, need to be addressed by the regulators.
- There are serious data issues and as regulators of banks and NBFCs, it may become imperative for the RBI and the SEBI to put in place a robust reporting mechanism for primary issuances as well as secondary market data.

*(Excerpts from Inaugural Address by Ms. Shyamala Gopinath, at the India Securitisation Summit 2010 hosted by the National Institute of Securities Markets (NISM), August 10, 2010, Mumbai)* ■

## "We Wrote The Book On Financial Inclusion 60 Years Ago"

Mr. T T Srinivasaraghavan

*"One of the repeated pleas of the NBFC-AFCs over the last decade has been for the creation of a separate refinancing window for NBFCs, based on their track record and irrespective of their size."*

*"NBFCs are clearly an additional delivery channel not only for lending products but also for a whole range of savings and investment products like insurance and mutual funds. It is in the economy's interest to develop a robust NBFC sector."*

*[An interview by FinanceAsea, Hong Kong of Mr. T T Srinivasaraghavan, managing director of Sundaram Finance, one of India's oldest diversified financial services companies. A veteran of 30 years in the industry, he was president of the International Finance and Leasing Association, UK and is currently chairman of the Finance Industry Development Council [FIDC], a self regulatory organization for asset financing non-banking finance companies (NBFCs)].*

### What are the biggest constraints NBFCs face in expanding their business, is it the availability and/or cost of funds?

At the heart of the problem is a lack of appreciation of the role played by NBFCs in asset formation over the years. Notwithstanding the pioneering work that they have done, especially in financing commercial vehicles, they have been given short shrift. Banks should look at the long term funding needs of the asset financing NBFCs, especially given their track record. NBFCs have had a consistently better recovery experience than the banks in retail asset based lending.

Also, there is a need to cast the net wider and help credit reach the remotest corners of the country. For this, the needs of the smaller players should be understood and appreciated. To routinely insist on collateral security and credit ratings is often pointless, instead, banks can draw comfort from the fact that all NBFC-AFCs (asset financing companies) registered with the Reserve Bank of India, many of whom are deposit taking entities, are subject to stringent RBI regulation and supervision.

### What would you recommend by way of a solution?

One of the repeated pleas of the NBFC-AFCs over the last decade has been for the creation of a separate refinancing window for NBFCs, based on their track record and irrespective of their size (more than 90% of the NBFC-AFCs are small and medium companies). Another change we have been asking for is differential risk weights for different classes of assets, based on well established risk histories. This Is particularly relevant, given that nearly 70% of the assets funded by NBFC-AFCs qualify as priority sector lending, when they are refinanced by the banks.

I believe there is large unsatisfied demand in Tier 2 and 3 towns, which is where NBFCs can make a significant difference. If you really look at it, much before the Jargon came along, it is the NBFCs who took credit to the unbanked, unserved sections of the society, in many ways, we were the guys who wrote the book on Financial Inclusion - over 60 years ago.

You have the banks at one end and Micro Finance Institutions at the other, but there is a huge untenanted space in the middle, where the NBFCs can play a very meaningful role. NBFCs understand last mile credit delivery better than most, simply because they have done it for the longest time, especially the small regional NBFCs, whose operations are typically confined to tight geographical limits within a district and operate within a radius of 50-100 kms.

### In the long run, will NBFCs become banks?

What we need today are not more universal banks, but niche banks or specialised banks which can specifically target areas where financial inclusion is a crying need. For example, if we had banks which understood a particular territory very well (local area banks are a good example) or if somebody understood road transport financing very well or if someone understood the second-hand financing market, they would leverage their Intimate knowledge to deliver credit.

Truck financing, in particular, does require an in-depth knowledge of the market and customer behaviour, and constant personal touch with the customer. Size by Itself Is not a problem, but the mindset in dealing with customers has to be a personalised, small-company approach.

In the UK, there used to be entitles called licensed deposit taking companies. They were basically NBFCs but had limited cheque issuing authority. They were like banks. People who had deposited money there could write cheques against their deposits, in our view, these are the kinds of structures we need rather than large universal banks. We have enough of those.

NBFCs are clearly an additional delivery channel not only for lending products but also for a whole range of savings and investment products like insurance and mutual funds. It is in the economy's interest to develop a robust NBFC sector. Even during the recent financial crisis, the NBFC sector stood up very well. None of the NBFCs availed of the stimulus package and most of them managed the downturn very well.

Banks and NBFCs must be viewed as wholesalers and retailers respectively, so that the ends of efficient credit delivery are met. It is also vitally important to create a framework for long term funding, especially for the small and medium NBFCs, with appropriate safeguards in place, including for deposits. ■

# Infrastructure Financing in India (Part-1)

*"India has been, and will remain in the foreseeable future, a supply constrained economy. The biggest supply constraint is of infrastructure - physical, social and urban."*

*"Infrastructure financing in India has critical dimensions and contributes to increased investment and productivity, which is vital for an economy."*

Ms. Gunjeet Kaur, Shri L. Lakshmanan, Shri Raj Rajesh and Shri Naveen Kumar

## Introduction

A major area of concern for sustaining the real gross domestic product (GDP) growth in India has been lack of adequate infrastructure, which can support the growth process. The deplorably low levels of public investment have rendered India's physical infrastructure incompatible with large increases in the national product and clearly, without improving the rate of infrastructure investment, the overall growth rate at best would remain modest. Distinct from other large emerging market economies which are typically demand constrained, India has been, and will remain in the foreseeable future, a supply constrained economy. The biggest supply constraint is of infrastructure - physical, social and urban. It is widely recognised that poor and inadequate infrastructure is adding to production costs, denting productivity of capital and eroding competitiveness of our productive sectors (Subbarao, 2009).

The Global Competitiveness Report (GCR)1 2009-10 has stated that India ranks an outstanding 28th in the most complex areas measured by the business sophistication and innovation sub index, ahead of several advanced economies. The country also boasts of bustling financial markets (rank 16), a sound banking sector (rank 25) and fairly well functioning institutions (rank 54). On the other hand, the country underperforms on some of the basic determinants of competitiveness namely health and primary education (rank 101), macroeconomic stability (rank 96) and infrastructure (rank 76). In view of criticality of the issue of infrastructure availability, the Government of India has taken an affirmative stance and has highlighted relevance of Public Private Partnerships (PPPs) in this context.

## Infrastructure financing

Infrastructure financing in India has critical dimensions and contributes to increased investment and productivity, which is vital for an economy like India in order to sustain the uptrend in the cycle of growth. The Union Budget 2010-11 has provided resources amounting to Rs.1,73,552 crore for upgrading rural and urban infrastructure. Several initiatives have been taken to accelerate the pace of project implementation. The policy framework, especially for the PPPs, has been modified by streamlining PPP approvals in the central sector through Public Private Partnership Appraisal Committee (PPPAC), introducing viability gap funding facility, providing finance through India Infrastructure Finance Company Ltd. (IIFCL), standardising contracts to regulate terminologies related to risk, liabilities and performance standards, etc.

There are three principal forms of finance for infrastructure service delivery: 1) public finance; 2) corporate finance; and 3) project finance. In industrialised countries public finance consists of government providing equity financing (seed capital, in China's terms) through general budget reserves, earmarked reserves, self-raised funds (e.g. licensing fee, and sale, rental or leasing of government assets), and intergovernmental grants and fiscal transfers. Debt financing in the public finance system is through policy loans at concessional rates, supplier credits, and fixed income securities in the form of tax-secured bonds and revenue bonds secured by project-related revenue streams. In some cases, public debt financing is guaranteed by governments either explicitly or implicitly.

Corporate finance consists of corporations providing equity financing through retained earnings and shareholders' equity. Debt financing takes the form of commercial bank borrowing, subordinated debt (including convertible debentures and preferred stocks), privately-placed borrowing, and issuance of fixed income securities. These securities can be short-term in the form of commercial paper, or of longer durations in the form of corporate bonds. Debt is secured through collateralisation of corporate assets and assignments of receivables. Much of the infrastructure-related debt incurred in recent years by State Owned Corporations in China has been through commercial bank borrowings. However, unlike in industrialised countries, much of this debt is implicitly guaranteed by governments, and is not fully collateralised from corporations' own assets.

Project finance consists of government, corporations and PPP financing investments solely through the revenue stream of the infrastructure projects without taking recourse to government guarantees. Most project finance is made available by project-specific companies (often called the 'project company') with equity held by sponsors. Equity takes the form of sponsor investment in share capital of the project company. Debt is fully secured through the revenue stream of the infrastructure project; this stream is assigned to lenders through security agreements with trustees and does not appear on sponsor companies' balance sheets. Debt financing usually takes the form of a combination of bank loans (usually syndicated for large projects), sponsor loans, subordinated loans, suppliers' credits, and bonds of the project company. Corporate and project finance is clearly applicable only to private and club goods type of infrastructure for which there is sufficient revenue

stream that can be legally collateralised to lenders.

## Public and Private Sector share in infrastructure

The private sector has exhibited increasing interest in infrastructure investment in India. Resultantly, the relative shares of public and private investment in total infrastructure investment during the Eleventh Plan are projected to be about 70 per cent and 30 per cent, respectively as compared with 80 per cent and 20 per cent, respectively during the Tenth Plan. It is interesting to note that private sector is anticipated to take up projects in telecommunications, ports and airports and private investment is envisaged to constitute more than 60 per cent of total investment in these sectors during the Eleventh Plan. For the power sector, the investment is expected to rise to 28 per cent and for the road sector to 34 per cent.

The prominent role of private sector in infrastructure financing is based on the following considerations:

**I. Cost Efficiency :** Privately managed projects are likely to have a better delivery network for services, which are cheaper and of superior quality.

**ii. User Charges :** The infrastructure project benefits do not percolate uniformly among the masses in the country. It is, therefore, appropriate to impose user charges in order to recover the cost of providing these services directly from the users rather than from the country as a whole (the latter is the effect if the government builds the project from its own pool of resources). If users are charged a fair price, the project acquires a purely commercial character with the government playing the role only of a facilitator.

**iii. Allocative Efficiency :** Since users are likely to pay for the services that they need most, private participation and risk-return management has the added benefit since the scarce resources are automatically directed towards the areas where the need is greatest.

**iv. Fiscal Prudence :** Both at the centre and state levels, for a variety of reasons, there is a growing concern that the absolute and relative (to GDP and GSDP, respectively) levels of fiscal deficit are high and that incurring higher levels of deficit to finance infrastructure projects is not feasible.

On the strength of these arguments, the government has endeavoured to create a facilitating environment for large scale involvement of private sector in development of infrastructure. The private sector category includes PPP projects as well as pure private sector projects. While the former must be based on a Model Concession Agreement (MCA) with the government such as for toll roads, ports, and airports; the latter are market-based such as in telephony and merchant power stations.

## Public-Private Partnership in Infrastructure Development

In the face of budgetary and other constraints, government has recognised private sector as a means of meeting the financing requirements for infrastructure development.* The conditions for participation of private sector are, in most cases, different from those of the traditional financiers. PPPs offer significant advantages in terms of attracting private capital to create public infrastructure and enhance efficiency in the provision of services to users. The PPP course encompasses a range of alternatives such as BOT, BOOT, etc. They enable governments to transfer construction and commercial risks to the private sector, which is best equipped to manage the same. The success of such a route, however, rests on the ability of the public authorities to provide enabling arrangements to not only attract private investment but also to be able to ensure safeguarding public interest.

The recourse to the PPP model will go a long way to bridge the infrastructure gap in India. For projects which are financially viable, PPPs are increasingly becoming the preferred mode of project implementation, especially in sectors such as highways, airports, ports, railways and urban transit systems. So far, 65 central sector projects in road & transport, ports and civil aviation have been completed with a total investment of Rs.25,343 crore. Another 83 projects in the aforementioned categories and railways with an estimated project cost of Rs.75,914 crore are under implementation in the central sector. Further, 160 projects in these segments are in the pipeline with an estimated project cost of Rs.1,84,807 crore.

In the state sector (including the Union Territories) primarily in the roads, urban infrastructure and ports (in the coastal states) segment, 176 projects have been completed with the total investment of Rs.41,284 crore; 209 projects at an estimated project cost of Rs.1,65,197 crore are under implementation and 252 projects with an estimated investment of Rs.1,91,754 crore are in the pipeline.

The success of PPP arrangements has been distinctly noteworthy in recent years in the cellular segment of telecommunications sector and to some extent in the power and road sectors. This could be credited to a host of factors such as sector specific policies, government commitment, increased private interest in these sectors, evolving competitive market processes, greater availability of information, size of the projects, acceptable price and encouraging developer returns, etc. In this context, in terms of policy support, development of credible regulatory mechanisms and presence of effective regulatory bodies would go a long way in enhancing the public confidence.

## Sources of Funds

The states governments are likely to depend mainly upon budgetary support (66.3 per cent) to fund their infrastructure projects during the Eleventh FYP, while the central government and private sector would fund 51.7 per cent and 70.0 per cent, respectively, through borrowings from the market. The central government is likely to generate 22.2 per cent of resources through internal means, while for the state governments this would constitute only 10.1 per cent of total resources. Overall, the debt and non-debt components of the total resources likely to be raised would almost be equal.

### (i) Budgetary Support

Financing of the proposed investment of Rs. 20,56,150 crore over the Eleventh FYP relies only to the extent of Rs. 6,44,671 crore (31 per cent) on budgetary support. In the case of states, about Rs. 4,44,671 crore is expected from budgetary resources. The budgetary support is limited because of large financing requirements of other sectors such as agriculture, health and education. Of the available resources for infrastructure, large sums are likely to be directed towards rural infrastructure and development in the North- East.

*Infrastructure projects differ in significant ways from manufacturing projects and expansion and modernisation projects undertaken by companies. Essentially, infrastructure financing has characteristics: 1.Longer Maturity, 2. Large Investments, 3. Higher Risk, 4. Fixed and Low (but positive) Real Returns.

## (ii) Internal Generation

The internal resources which would constitute 20.6 per cent of the total investment during the Eleventh Plan comprise internal accruals and equity of the private sector. In the public sector, it is essential to bring in efficiency improvements for economising on costs and enforce rational user charges for improving the revenue streams. Inadequate attention to these aspects would seriously restrict the ability of public sector to raise resources for such investments, thereby adversely affecting infrastructure investment with its consequential negative impact on GDP growth.

## (iii) Viability gap funding for Infrastructure

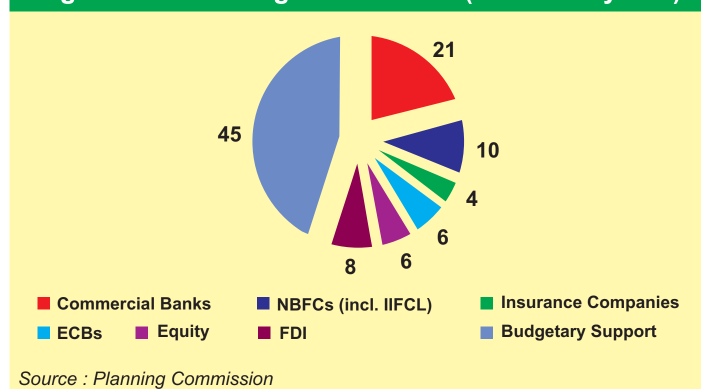
Infrastructure projects have a long gestation period and, in most cases, have valuable social but unacceptable commercial rate of return. In order to overcome the resource constraints and promote techno-managerial efficiencies, the government is encouraging PPPs in infrastructure development through a special facility i.e. 'viability gap funding'. This facility, announced in 2004 and operationalised in 2005, is meant to reduce the capital cost of the projects by credit enhancement, and to make them viable and attractive for private investors through supplementary grants. Budgetary provisions for this facility are made on a year to year basis. Department of Economic Affairs in the Ministry of Finance examines the project 'eligibility for consideration'. The lead financial institution monitors and evaluates project compliance.

Viability gap funding can take various forms, including but not limited to capital grant (one time or deferred), subordinated loans, operations and management support grants or interest subsidy. A mix of capital and revenue support may also be considered. The funding is disbursed contingent on agreed milestones, preferably physical, and performance levels being achieved, as detailed in funding agreements. The funding is provided in installments, preferably in the form of annuities, and with at least 15 per cent of the funding disbursed only after the project is fully functional.

## (iv) Debt/Borrowings

The debt component of the total investment during the Eleventh Plan period would be around Rs. 9,88,035 crore (48.1 per cent). The private sector would need to fund almost 70.0 per cent of their resource requirements through borrowings, while for central government and state government; such requirements would be 52.0 per cent and 23.6 per cent, respectively. The main sources for raising the debt would be commercial banks, non-banking financial companies, pension/insurance companies and external commercial borrowings (see figure-1).

**Figure 1 : Financing the 11th FYP (first three years)**




*Source : Planning Commission*

As may be seen, with all sources of debt taken together, the total availability of funds for financing infrastructure in the Eleventh Plan is estimated at Rs.8,25,539 crore. The funding gap for the debt component is accordingly, Rs.1,62,496 crore (or US$ 40.6 billion). To bridge this gap, it may be necessary to enhance availability of bank credit; relaxation in norms for raising external commercial borrowings; and tap pension, insurance and other funds to finance infrastructure projects.

## (v) Specialised Institutions

Providing long-term finance to infrastructure projects from the banking sector has become a challenge with the extinction of Development Finance Institutions (DFIs). The extant banks find it difficult to bridge the gap created due to asset-liability mismatches on account of such financing. In recent years, initiatives have been taken by the government to provide for long-term infrastructure finance through creation of Infrastructure Development Finance Corporation (IDFC) and India Infrastructure Finance Company Limited (IIFCL). The IIFCL was incorporated on January 5, 2006 with an authorised capital of Rs.2,000 crore and paid-up capital of Rs.1000 crore. The IIFCL would lend funds, especially debt of longer-term maturity, both directly to the eligible projects and by extending refinance to banks and financial institutions to supplement their resources for infrastructure financing. The IDFC is an infrastructure arm to provide long-term finance for this sector. The IDFC in partnership with Feedback Ventures has created India Infrastructure Initiative* that would identify infrastructure development projects across the country and promote PPP for building infrastructure. Though the IDFC and the IIFCL provide long-term and viability gap funding for the infrastructure development, they are not deemed sufficient to meet the growing financing needs of the sector. The data on bank credit to infrastructure substantiate that commercial banks have proactively freed resources to meet the credit needs of infrastructure sector. The deployment of gross bank credit to infrastructure has steadily gone up from 13 percent in the year 2000 to over 33 per cent in 2009

## (vi) Other Sources

The data on bank credit to infrastructure substantiate that commercial banks have proactively freed resources to meet the credit needs of infrastructure sector. The deployment of gross bank credit to infrastructure has steadily gone up from 13 per cent in the year 2000 to over 33 per cent in 2009.

---

*The India infrastructure initiative (III) is jointly promoted by IDFC and Feedback Ventures. The IDFC, established by the Government of India in 1997 specialises in providing capital to commercially viable infrastructure projects, promotes public-private partnerships, and provides policy advice to encourage private financing in infrastructure. Feedback ventures is India's leading infrastructure development company with a 16-year-old track record of putting together infrastructure projects in core, social, and urban infrastructure. Feedback works with the leading Indian states to manage the process of creating PPP projects. The III starts with the corpus jointly contributed by IDFC and Feedback Ventures. III seeks to provide critical project structuring solutions that address all these intricate issues and be a neutral facilitator. III looks to work with the central, the state, the municipal governments and panchayati raj institutions and their related entities like urban development authorities, road development corporations, water boards, etc. wherever there is scope for rational PPP initiatives. The III enables the concerned authorities and players in conceptualising, detailing, i.e. assessing the technical and engineering viability, costing revenue and profitability, etc; feasibility, do-ability, i.e., checking for clearances, regulatory issues, concessions etc.; acceptability and implementability of the projects.

***Excerpts from a RBI staff study paper on "Infrastructure Financing Global Pattern and The Indian Experience" by Smt. Gunjeet Kaur [Director in Department of Economic Analysis and Policy], Shri L. Lakshmanan Assistant Adviser in Internal Debt Management Department] and Shri Raj Rajesh and Shri Naveen Kumar[Research Officers in Department of Economic Analysis and Policy, Reserve Bank of India]***

**[To be continued in Part-2 in next issue]** ■

### Credit default swaps may be allowed in corporate bonds soon

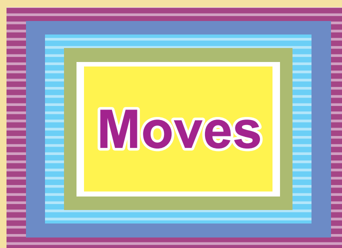
Credit default swaps (CDS) may soon become a reality in India. Plans are afoot to allow plain vanilla CDS on corporate bonds in the over-the-counter (OTC) market, according to Ms Shyamala Gopinath, RBI Deputy Governor. [Hindu Business Line, Aug. 1]

### Holding companies face stiff RBI norms

The RBI introduced minimum capital adequacy norms and limits to the amount that can be borrowed by core investment companies (CIC), which operate as holding companies. Such companies will have to register with RBI within six months. Only those which meet capital adequacy and leverage ratios will be exempted from complying with the norms for maintaining minimum net owned funds as well as rules relating to exposures, RBI said. RBI has described such companies as 'systemically important core investment companies' that are involved in the business of acquiring shares and other securities and hold at least 90 per cent of their investment in shares or loans in group companies. [Business Standard, August 14]

### New tax code to bring clarity on financial lease taxation

The Direct Taxes Code (DTC) proposes to do the necessary for bringing some certainty on tax treatment of a financial lease, but this is not sufficient to make it a preferred mode of finance, say industry and tax experts. The levy of multiple taxes on a financial lease continued to hamper their widespread usage, they said. "The DTC proposal to specify that the lessee will be allowed to claim depreciation under a financial lease is a welcome step. It provides certainty on taxation front. But financial lease as a mode of finance will take off only when the issue of multiple taxation is addressed. The biggest issue is that of service tax on lease rentals. There is also the issue of VAT as leasing is considered as deemed sale by State Governments," Mr Raman Agarwal, Co-Chairman, FIDC told Business Line.




### 'Many NBFCs have invested abroad without RBI nod'

Several NBFCs, registered with the SEBI, have made investments in overseas joint ventures/ wholly owned subsidiaries without the RBI's approval during the last three years, the Minister of State for Finance, Mr S.S. Palanimanickam, said in a written reply in Lok Sabha on Aug.13, adding that action has been taken against them. The admitted contraventions are compounded by the RBI only after the NBFC obtains post-facto approval from the regulator. [Hindu Business Line, Aug. 13]

### NBFCs to banks

The RBI on 11 Aug. released a discussion paper on 'Entry of new banks in the private sector'. The discussion paper touches upon various topics such as the minimum capital requirement, foreign ownership, conversion of NBFCs into bank, business houses setting up a bank and promoter shareholding. [Hindu Business Line, 12 Aug.]

### New commercial paper guidelines in the works

RBI Deputy Governor Shyamala Gopinath said: "We are in the process of reviewing the guidelines in consultation with market participants." According to her, CP issuances are going to rise in the future, mainly because of the base rate regime. The norms needed to be reviewed as the existing ones were issued at least a couple of years ago. However, she said RBI was not averse to more CP issuances. [Business Standard, August 25]

### SEBI may make whistleblower mechanism mandatory for cos

The SEBI is considering a proposal to make it mandatory for companies to have a whistleblower mechanism, according to a member of one of the committees constituted by the regulator. At present, under clause 49 of the listing agreement, it is optional for a company to have such a mechanism, which also has safeguards against victimisation of the whistleblower. [Economic Times, 13 Aug. 2010]

### SEBI mulls common defaulter database for market players

SEBI is considering setting up a common defaulter database in order to provide a one-stop reference point for all types of market players such as brokerages, mutual funds, merchant banks, portfolio managers and rating agencies. The move would make it easy for any market intermediary to beforehand identify a client, person or institution, that has defaulted in the past. [Economic times, 8 Aug. 2010]

### Vehicle & licence details will just be a click away

The government will soon create an online database of all registered vehicles and driving licences, a move that will benefit banks, insurance companies and police departments. An integrated platform, being developed by the ministry of roads and transport, will allow authorised agencies to verify the details of a vehicle or driver by sending an SMS. The ministry will set up state registers, which would compile the data online, in a few days. The database will help banks to check the hypothecation information of vehicles. Police departments require such data to check fraud and track stolen vehicles. Forged documents produced by drivers can now be verified easily. National registers, which will act as a backup for all such data and help customers access information from anywhere within the country, will also happen within the end of the year. The applicants will be able to visit the website of the transport department and avail the services by filling online forms and paying through payment gateways. [ET Bureau, 20 July 2010]

### Careless markings on cheques may cost you a tidy sum

While RBI had released a circular to banks to dishonour cheques with alterations even if the same is authenticated, the implementation of the same has been deferred till December 1, 2010, and shall be applicable only in New Delhi as it is a CTS (Cheque Truncation System) enabled location. [ET Bureau, 14 July 2010]

### IIFCL may guarantee infra bonds from next month

India Infrastructure Finance Company [IIFCL] is likely to start guaranteeing all infrastructure bonds from next month, helping generate long-term funds for the sector. Mr. SK Goel, CMD of IIFCL, said the proposal is likely to get the government's nod by end-September. "We will enhance the ratings of the project developers by giving our unconditional guarantees for the repayment of their bonds and their interests," he said. [Reuters, 26 Aug. '10]

### RBI warns on surge in non-bank lending

RBI Deputy Governor Usha Thorat on Sept. 8 said, "When we had looked at the recent data on the flow of funds to the commercial sector we find that the source of funding from non-banks has been equal to if not more than from banks." She cautioned against a sharp rise in lending activity by NBFCs to companies, which she said can lead to asset bubbles. She is also not in favour of further relaxation of infrastructure lending norms after the RBI eased its single borrower and group borrower exposure limits earlier this year. Those rules limit a bank's lending to a single borrower or group of borrowers. [Business Standard, 8 Sept.] ■

## 'Borrowers are duty bound to repay debt' -SC

Expressing concern over the misuse of legal processes to frustrate the recovery proceedings of banks and financial institutions, the Supreme Court has said that the borrowers are duty bound to repay the due debt and any lapse in this regard will invite serious action. The court, allowing the plea of appellant Indian Bank, directed the defaulter borrower to deposit Rs 3 crore with the lender, noting that the present case is "illustrative of how a defaulting borrower can use the court process for frustrating the action initiated by a bank under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, for recovery of its dues".

A bench comprising justice GS Singhvi and justice AK Ganguly said: "The court cannot lose sight of the fact that the bank is a trustee of public funds. It cannot compromise public interest for benefiting private individuals. Those who take loan and avail financial facilities from the bank are duty bound to repay the amount strictly in accordance with the terms of the contract. Any lapse in such matters has to be viewed seriously and the bank is not only entitled, but also duty bound to recover the amount by adopting all legally-permissible methods." The court said: "The parliament enacted the Act (Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002) because it was found that legal mechanism available till then was wholly insufficient for the recovery of the outstanding dues of banks and financial institutions."

In this case, the Indian Bank had sanctioned loan to M/s NS Investments, a Chennai-based partnership firm in 1989 and again in 1991. After some time, the account of the borrower was declared as non-performing asset. In 1995, M/s Blue Jaggers Estate took over the assets and liabilities of the firm. Since it failed to clear the outstanding dues, the bank filed an application before Debts Recovery Tribunal for recovery of Rs 2,15,38,158 with interest, which is pending. During its pendency, the parties signed joint memo of compromise on June 23, 2004. The bank agreed to accept an amount of Rs 153.50 lakh towards full and final settlement of its claim against the outstanding due of Rs 661.30 lakh. Borrower, instead of making payment continued litigation at various forums which at last came to the Supreme Court. [Economic Times, 11 aug.2010]

## 'Stays not advisable on dues of banks, creditors'-SC

The Supreme Court (SC) ruled that the courts should not normally pass stay orders in cases relating to recovery of dues of banks, financial institutions and secured creditors as they would have serious adverse impact on the financial health of such institutions which ultimately prove detrimental to the economy of the nation. "The high courts should be extremely careful and circumspect in exercising its discretion to grant stay in such matters," the court stated in the judgment, United Bank of India vs Satyawati. In this case, the bank initiated against the guarantor of a debt when the borrower, Pawan Colour Lab, defaulted in repayment of the loan. This action of the bank under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act was challenged by the guarantor in the Allahabad high court. It stayed the recovery proceedings. On appeal by the bank, the SC set aside the high court order. [BS Reporter, August 09, 2010]

## SEBI issues arbitration guidelines for stock exchanges

The SEBI issued guidelines on Aug. 12 aimed at strengthening the arbitration process at stock exchanges as well as speed up the resolution of disputes. The arbitration committees on the BSE and the NSE help settle disputes between a client and broker, or disputes among brokers. Under the new rules, the stock exchanges have to maintain a panel of arbitrators and the number of arbitrators in the panel will have to be commensurate to the number of disputes so that each person handles a limited number of cases. This will help in speedy disposal of cases.

"An arbitration reference for a claim up to Rs 25 lake shall be dealt with by a sole arbitrator while that above Rs 25 lake shall be dealt with by a panel of three arbitrators," said the SEBI circular, which comes into effect from September 1, 2010. The arbitration reference will have to be concluded by way of issue of an arbitration award within four months from the date of arbitrator appointment. However, at the discretion of the managing director or executive director of an stock exchange for sufficient cause, they could extend the time for issue of the arbitration award by two months on a case-to-case basis. If the aggrieved party is unhappy with the arbitration award, he can appeal against it to the appellate panel of arbitrators of the stock exchange. However, the appeal must be filed within one month from the date of receipt of the arbitration award. [Economic Times,13 Aug 2010]

## Order of consumer commission against financial corp quashed

The Supreme Court has quashed the order of the National Consumer Commission against the Maharashtra State Financial Corporation charging it with deficiency in service in dispersing loan amounts to an industrialist, Sanjay Shankarsa. The corporation sanctioned the loan for a hotel project in Amravati on certain conditions. However, one cheque issued by the debtor was dishonoured and he did not furnish the progress report on the project. So the corporation did not release the balance of the amount. When he moved the national commission, it asked the corporation to pay compensation. The corporation appealed to the Supreme Court. It allowed the appeal stating that the industrialist was a "defaulter right from inception of his dealing with the corporation and fairness cannot be a one-way street. Where the borrower has no genuine intention to repay and adopts pretexts and ploys to avoid payment, he cannot make a grievance that the corporation was not acting fairly."

## Arbitration Act applies to non-commercial disputes also

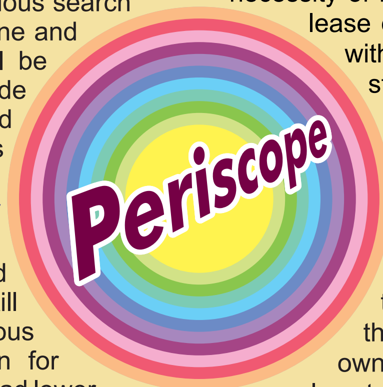
The Supreme Court has stated that the Arbitration and Conciliation Act would apply to all civil disputes, and not merely to commercial disputes. It set aside the view of the Karnataka high court in the case, H Srinivas Pai vs H V Pai, in which the high court remarked that the law will apply only to "commercial agreement matters and international commercial matters." In that case, the dispute was over partition of property, a civil dispute. Contradicting the high court view, the Supreme Court ruled that the "applicability of the Act does not depend upon the dispute being a commercial dispute. Reference to arbitration and arbitrability depends upon the existence of an arbitration agreement, and not upon the question whether it is a civil dispute or commercial dispute. There can be arbitration agreements in non-commercial civil disputes also." [BS Reporter, July 26, 2010] ■

## Action needed against illegal non-banking firms: RBI

"The state governments, under the prevailing laws, can take action against the unauthorised NBFCs collecting money from people," PN Murthi, AGM,DNBS, RBI said in Aizawl. The RBI officials said NBFCs not recognised by the RBI, the Insurance Regulatory Development Authority (IRDA) or the Securities and Exchange Board of India (SEBI) cannot do any monetary business or take deposit from people. Regarding the functioning of illegal NBFCs in Mizoram, Van Hela Pachuau, chief secretary said: "The problem has been persisting since the early 1980s. [Economic Times, 15 July]

## Cibil launches fraudulent and suspected activities database

Credit Information Bureau (India) Ltd (Cibil) on July 7 launched a centralised database of reported fraudulent and suspected activities. Cibil Detect is the first repository in India which will tell banks whether a person or an organisation was a victim of a fraud or was involved in such an act in the past. The database will give data on confirmed frauds or cases of misuse which are being investigated in banks and financial institutions. It will also contain information on high-risk vendors and agents. It will keep a track of the modus operandi of individuals who have committed banking related frauds in the past. Banks will be able to check for cases of fraud by using various search parameters such as name, address, telephone and fax number of the customer. The data will be available to 200 members of Cibil, which include banks, financial institutions, NBFCs and housing finance companies. [Business Standard, July 8]




## Construction tool loans show lower delinquency levels: Icra

An Icra analysis of various Asset Backed Securitisation (ABS) transactions rated by it till June 2010 has revealed that pools across various originators and asset classes, loans given for acquiring construction equipment (CE) have had lower delinquency levels when compared to that for car and commercial vehicles (CV) loan pools. The pre-payment rate has also been very low in case of CE pools compared with car and CV pools. The peak cumulative cash collateral utilisation in highly amortised or matured CV, car and CE pools rated by Icra has been around 30% on an average. For a few pools, where the delinquency build-up was higher than expected, the peak cash collateral utilisation has been more than 60%. Among CV pools, those of recent vintages have shown a relatively better performance than that of loan pools assigned in calendar year 2006 and 2005. The performance of Icra-rated microfinance pools, a relatively new product when compared to the traditional asset classes (car, CV, CE, personal loans (PL) and soon), has also been very good. [F E Bureau, Aug 19]

## Govt exempts infra bonds from credit ratings

In a major fillip to the success of infrastructure bonds, the government has decided to exempt them from getting the credit ratings — which are mandatory for all the other kinds of bond issuances. Taking forward the issue, the government has begun the process of allowing the issuance of tax-free infrastructure bonds by selected NBFCs. [PTI, 16 Aug.]

## NBFCs float long-tenure bonds to borrow cheap

NBFCs are testing the markets with long-term bonds to borrow at attractive rates. Indian Railways Finance Corporation (IRFC) hit the market in May this year with a 25-year issue of Rs 1,100 crore at a semi-annualised coupon rate of 8.83%. Now IL&FS, the infrastructure lender is looking to raise Rs 150 crore by way of secured redeemable non-convertible debentures (NCDs) for a 25-year period, carrying a coupon rate of 9.35%, payable annually. Potential investors could be provident fund trustees and insurance companies, much like it was in the case of IRFC. "This is the first time, the IL&FS is testing the market. It may look at raising a higher amount of capital from a similar kind of issues in the future," an industry source said. He also pointed out that more and more private companies will tap the market for long-term resources. In February 2010, Magma Finance Corporation raised Rs 40 crore by way of long-term perpetual bonds with a green-shoe option of Rs 20 crore. SREI Infrastructure CMD Hemant Kanoria said,"The company plans to raise funds through longer-term bonds with a maturity of 10 years." [Fin. Express, 8 Sept.]

## Uniformity in laws: lease of movable properties

Mr. M. R. Umarji, Advisor, Indian Banks Association and retired Executive Director, RBI, attended as a special invitee at the FIDC meeting and spoke about financial inclusion, role of NBFCs, level-playing field etc. He also advocated the necessity of bringing about uniformity of laws pertaining to lease of movable properties which can be taken up with Central Government for adopting UNIDROIT standard code, as the Government of India is a signatory to UNIDROIT. He has offered his services to draft the paper on this.

## Some 'poor Indians' live it up with 2-wheelers, TVs, fridges

A significant proportion of the country's official below poverty line (BPL) population cannot be termed 'poor'. Fathom this: around a fourth of the 14 million odd BPL households in urban India own a two-wheeler, a third of them a colour TV and almost two-third a pressure cooker. Almost one in five urban BPL households has at least one well-educated, graduate or above, member. The 56 million-strong rural BPL population too exhibits varying degrees of consumption. Whilst every one in ten here have a two-wheeler, every fifth BPL village kitchen has a pressure cooker, and around 6% a CTV, according to a recent study done exclusively for FE by the National Council of Applied Economic Research's Centre for Macro Consumer Research (NCAER-CMCR). The research reveals that over 13% of urban BPL households are led by a salaried chief wage earner (CWE) with a stable monthly income and under a tenth of rural BPL households have an illiterate CWE. [Financial Express, Jun 29, 2010]

## Police hail Vehicle Recovery Scheme success in UK

The Vehicle Recovery Scheme of Finance & Leasing Association, UK has now been in operation for six months. On 13 April, finance companies in UK and police forces met to review the scheme. In its first six months, FLA members were sent over 1,300 vehicle seizure alerts and recovered over 200 vehicles worth in excess of £2.3 million. On 21 April, we presented the results to the annual police vehicle recovery conference. The regional forces represented at the conference confirmed that the scheme had helped build positive relationships with finance companies. ■

## A case for NBFCs to be empanelled as business correspondents to banks

Presenting a strong case for empanelling Non-banking Finance Companies [NBFCs] as business correspondents [BC] to the banks in response to a discussion paper placed by the Reserve Bank of India, FIDC said in its representation to RBI, "We believe that NBFCs can contribute significantly in achieving RBI's goal of financial inclusion." FIDC chairman T. T. Srinivasaraghavan added that "over their long history, NBFCs have been providing financial services precisely to these segments of people that are not covered by banks". FIDC, an industry body representing Asset Management Companies elaborated on the "inherent strengths of NBFCs which match the requirements of BC model, thus making NBFCs an ideal collaborator for banks as BCs".

NBFCs have local market knowledge and provision of excellent service levels to the customer, well trained field staff, low cost and flexibility in the operations, technology leverage, financial strength and have adherence to the governance structure and compliance norms set by RBI.

In respect of potential conflict of interest between the NBFC and bank's operations the FIDC represented to RBI that "the solution lies in evolving appropriate monitoring and control mechanisms that will mitigate such risks." Such a regulatory mechanism could involve development of a operational guidebook for use by the NBFC staff acting as BCs, to separate the bank and NBFC interests, non-compete agreement, mandatory disclosures for all NBFCs and banks on BC activities, creating setup in the NBFCs and bank for monitoring and internal audit of BC activities, arrangement for peer audit by banks and NBFCs and setup of a banking ombudsman for monitoring all BC activities of NBFC etc.

FIDC chairman said that the BC model provides the ideal framework for both deposit taking and non-deposit taking NBFCs to work with banks under the guidance of RBI to further the financial inclusion goals in a sustainable manner.

**FIDC In Action**

### Meeting of Managing Committee of FIDC

The meeting of Managing Committee of FIDC was held on August 25, 2010 at Mumbai. Next meeting is proposed to be held at Kolkata on 29th November, which would be hosted by SREI Equipment Finance Pvt. Ltd.

### Representation on amendment to MV Act

Mr. Raman Aggarwal, co-Chairman, FIDC, had earlier on November 27, 2009 made quite effective presentation to the Sundar Committee, an Expert Committee set up by Ministry of Road Transport and Highways, regarding proposed amendments in various provisions of Motor Vehicles Act affecting NBFC-AFCs' interest as financiers of motor vehicles [see for details page 10 of FIDC News Oct.-Nov 2009 issue]. FIDC took up the matter in right earnestness and made out a cogent case in this regard. As a result of FIDC's strong representation before the Sundar Committee, Section 51 of M V Act which allows endorsement of financiers' interest in the R C Book and issue of Fresh RC in favour of financiers for repossessed vehicles is being retained. Further, the other changes which are likely to be proposed in the M V Act are expected to reduce hardships, especially in matters relating to issuance of fresh RC - in case of repossessed vehicles - in the name of financiers. It is, however, perceived that all these reliefs are likely to entail significant increase in costs to the financiers. FIDC proposes to take up this issue, when draft proposals are finalised. FIDC will also explore possibility of taking up this issue jointly with other interested organisations in a structured manner.

### RBI draft Guidelines on Securitisation

FIDC had submitted a representation on 21st June in respect of proposed draft guidelines issued by Reserve Bank of India on securitization especially in respect of minimum holding period [see for details page-12 of FIDC News Feb.-June 2010 issue]. FIDC office bearers had several personal meetings with CGM-in-charge and other officials at DNBS to follow up the matter and explain the genesis of the representation. FIDC expects some of the concerns of industry to be fairly addressed in the final guidelines.

### FIDC to take up the issues at highest level

FIDC has been quite concerned about long term funding for the NBFC-AFCs in view of likelihood of imbalance in ALM and had, therefore, taken up the need for arrangement of long-term funding at the previous meeting with RBI Governor on April 6 once again. FIDC proposes to take up, apart from other issues, the following issues at the time of the ensuing FIDC meeting with RBI Governor on October 18, 2010:

[1]The removal of cap of Rs. 10 crores on acceptance of Public Deposits by unrated NBFC-AFCs and to allow them to raise public deposits up to 1.5 times their NOF. [2] Draft Securitisation Guidelines.[3] Discussion Paper on Business Correspondents.

### Repossession of Assets-adherence to discipline

'FIDC Handbook on Repossession of Assets' is well received and appreciated by all, including officials of regulatory authority, bankers etc. It is mooted that the copies of the Handbook be given to regional associations for them to take up the matter with respective police authorities in their states to educate and inform them about NBFC's rights and remedies in respect of repossession, as has been done by GFCA for Gujarat. Pro-active manner in which Punjab Police has issued a circular on 10th June at the behest and in response to a representation of the Punjab & Haryana Finance Companies Association [PHFCA] which was followed up by Mr. Alok Sondhi and co-chairman Mr. Raman Aggarwal from FIDC is worth emulating by other states.

The handbook is proposed to be placed at the next hearing of the case [wherein FIDC has intervened] before the bench of Supreme Court. It is mandatory on the part of all members to strictly adhere to the guidelines stipulated therein. Any member found to be grossly violating the law of the land and bringing disrepute to the industry would actually be violating the fair practices code of FIDC. A Disciplinary Committee may be formed to deal with such matters, which can lay down rules for blacklisting such errant members and informing the matter to the authorities.

### Strengthening of Managing Committee

Mr. V.P. Nandakumar, chairman FCA and Mr. D K Jindal, Meerut H P Association were appointed as additional members of the Managing Committee of FIDC to hold office till next Annual General Meeting.

### Value Added Tax on repossessed vehicles

FIDC proposes to take up the issue of Value Added Tax on repossessed vehicles, as this is now being demanded by many states. The Representation Committee and the Legal committee of FIDC will deliberate on the issue and are expected to come up with action plan for further consideration by the Managing Committee. ■

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
E-mail : FIDC : info@fidcindia.com
Director General : maheshthakkar45@yahoo.in
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**

*If it is a phone from the Bank, tell them that we are doing excellent business... if it is some creditor tell him that we are in the process of restructuring...*

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