FIDC NEWS

Finance Industry Development Council

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

OCTOBER - DECEMBER 2010 VOLUME - 2 • NO. - 3 FOR PRIVATE CIRCULATION

Let NBFC- AFCs be a part of the mainstream financial sector

FIDC has long been urging the authorities to bring into existence a policy framework that would recognise NBFC-AFCs as an integral part of the mainstream financial sector. This framework should be designed in a manner that all financial sector legislation such as SARFAESI Act, DRT Act, Income Tax Act and non applicability of the Money Lender's Act, among others, be extended to the NBFC–AFCs as much as it is presently applicable to all the other constituents in the financial sector. NBFC-AFCs are also seeking special status for road transport finance and infrastructure finance, similar to that of housing finance.

FIDC has also been seeking a revision of risk weightage for assets financed by the NBFC-AFCs. Under the present dispensation, all the assets financed by NBFCs, regardless of whether they are secured or unsecured and regardless of the risks associated with different assets, carry a uniform risk weightage of 100%. It is a well documented fact, based on the detailed analysis undertaken by credit rating agencies that commercial vehicles, cars and construction equipment have a much lower risk profile as compared to other categories of assets. By their very nature, they are easily saleable and realise significant residual values. In light of the above, risk weightage for assets financed by NBFC-AFCs should be revised as under:

- For Commercial Vehicles, Cars & multi utility vehicles- 50%
- For Construction & Material handling equipment &Tractors – 50%
- Loans against gold and silver jewellery up to Rs. 1 Lakh – 50%
- Three Wheelers -75%
- Two wheelers and industrial equipment -100%

This would duly reflect the appropriate levels of risk inherent in the respective asset classes and provide NBFC-AFCs a degree of capital relief. This is also in consonance with the Basel II requirement for Banks.

The FIDC has for long, been seeking long-term funding for NBFC—AFCs through a separate window set up by the RBI, as has already been done for housing finance by setting up National Housing Bank.

T. T. Srinivasaraghavan, Chairman

Regulatory Perimeter

Information to Credit Information Companies:

All registered Securitisation Companies/Reconstruction Companies vide Notification No. DNBS(PD-SC/RC).CC. No. 23 /26.03.001/2010-11 dated Nov.25, 2010 were advised for submission of information to Credit Information Companies.

Additional guidelines to Prepaid payment instrument Issuer:

Additional guidelines are issued in respect of issuance and operation of pre-paid payment instruments in India (Reserve Bank) Directions vide Notification No. RBI/2010-11/261 DPSS.CO.No. 1041/02.14.006/ 2010-2011 dated November 04, 2010.

Compliance with the AML / CFT standards:

All NBFCs and RNBCs are directed to consider information given in statement dated June 25, 2010 by Financial Action Task Force [FATF] in respect of Know Your Customer (KYC) Norms/ Anti- Money Laundering (AML) Standards/ Combating of Financing of Terrorism (CFT) vide Notification No. RBI/2010-11/226 DNBS(PD).CC. No 202 /03.10.42 /2010-11.

AT A GLANCE

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Infrastructure Finance Bonds issued by IFCs are not public deposit: RBI

RBI vide Notification No. DNBS.(PD) 216/ CGM(US)-2010 dated October 22 , 2010 has advised that amount raised by issue of infrastructure bonds by Infrastructure Finance Companies, as specified in the notification issued by the Central Government under Section 80CCF of the Income Tax Act, 1961, shall not be treated as 'public deposit' within the meaning of paragraph 2(1) (xii) of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998.

Statement of Interest Rate Sensitivity

NBFCs-ND-SI have been advised by the Reserve Bank to submit the return on Interest Rate Sensitivity (NBS-ALM3) within 20 days of the close of the half year to which it relates.

RBI Sub Committee to study Issues relating MFI Sector

The Sub-Committee of the Reserve Bank's Central Board of Directors chaired by Shri Y H Malegam to study issues and concerns in the micro finance sector will review the definition of 'microfinance' and MFIs for the purpose of regulation of NBFCs undertaking microfinance. It will examine the prevalent practices of MFIs in regard to interest rates, lending and recovery practices to identify trends that impinge on borrowers' interests and also delineate the objectives and scope of regulation of NBFCs undertaking microfinance by the Reserve Bank and the regulatory framework needed to achieve those objectives. It is asked to examine and make appropriate recommendations in regard to applicability of money lending legislation of the States and other relevant laws to NBFCs/MFIs. It will assess the role that associations and bodies of MFIs could play in enhancing transparency disclosure and best practices.

The committee will recommend a grievance redressal machinery that could be put in place for ensuring adherence to the regulations recommended. Also, it will examine the conditions under which loans to MFIs can be classified as priority sector lending and make appropriate recommendations.

RBI refuses to give optionally convertible papers FDI status

The RBI has rejected a proposal of the Department of Industrial Policy and Promotion (DIPP) to allow optionally convertible debentures or preference share as part of foreign direct investment (FDI). Optionally convertible instruments, where pricing is decided on a future date (based on certain milestones), protect investors from upward or downward risk and, therefore, should be treated as debt rather than pure equity, the central bank said. In the consolidated FDI norms issued by DIPP , the nodal government agency that frames the guidelines for foreign investment and is under the ministry of commerce and industry, had suggested that the compulsorily convertible debentures (CCDs) and compulsorily convertible preference shares (CCPSs) with an option to fix the conversion price on future date based on certain milestone should be treated as FDI. The RBI's clarification will be a major deterrent for the companies that were planning to bring in foreign investors through structured deal under CCDs and CCPSs route, as ECB is not allowed in those sectors such as real estate. [Economic Times, 13 Oct.]

FIDC Press Briefing at Kolkata on 29 11 10

Government eases FDI norms for NBFCs

The government on Sept. 30 eased the foreign direct investment norms for sectors like wholesale cash-and-carry trading, NBFCs and certain other segments, besides bringing about procedural simplifications. In case of NBFCs, however, the government decided to ease the norms for downstream investment. It has said NBFCs with 100 per cent foreign investment and a minimum capitalisation of $50 million (around Rs 225 crore), can set up subsidiaries for specific NBFC activities, without bringing additional capital towards minimum capitalisation. On procedural aspects, the government has said downstream investments through internal accruals are permissible. "This clarity was necessary as the FDI policy says that for the purpose of downstream investment, the operating-cum-investing/investing companies would have to bring in requisite funds from abroad and not leverage funds from the domestic market for such investments. While this would not preclude companies from making downstream investments through 'internal accruals', it had been noticed that, in certain cases, some companies had started accessing the government approval route for downstream investments through internal accruals," an official statement said.

Draft norms on new bank licences by Jan: RBI

The Reserve Bank said it will issue by January draft guidelines on entry of new banks."Based on the comments and suggestions received from various parties and discussions held with major stakeholders in October 2010, it is proposed to put the draft guidelines in public domain by end of January 2011," RBI said in its second quarter policy review. [Financial Express, Nov.2] ■

PERFORMANCE OF NBFCS IN 2009-10

> *"There was a decline in the shares of all three NPA categories of sub-standard, doubtful and loss assets of asset finance companies in 2009-10 underlining the improvement in asset quality of these institutions."*

> *"The caps on bank lending to NBFCs may constrain their growth. The development of an active corporate bond market will help to address the funding requirement of NBFCs."*

PROFILE OF NBFCs

There are two broad categories of NBFCs based on whether they accept public deposits, namely, NBFC-Deposit taking (NBFC-D) and NBFCs-Non Deposit taking (NBFC-ND). Since 2006, NBFCs were reclassified based on whether they were involved in the creation of productive assets. Under the new classification, the NBFCs creating productive assets were divided into three major categories, namely, asset finance companies, loan companies and investment companies. Considering the growing importance of infrastructural finance, a fourth category of NBFCs involved in infrastructural finance was introduced in February 2010 namely infrastructure finance companies

The ownership pattern of NBFCs-ND-SI as well as deposit taking NBFCs companies suggest that these companies were predominantly non-government companies (mainly Public Ltd. Companies in nature- 60.3 and 94.2 percent respectively). The percentage of non-government companies was 96.6 per cent and 97.1 per cent respectively, in NBFCs-ND-SI[258 cos] and deposit taking NBFCs[302 cos] as against government companies having a share of only 3.4 per cent and 2.9 per cent respectively, at end-March 2010.

The total number of NBFCs registered with the Reserve Bank declined to 12,630 as at end-June 2010 from 12,740 at end-June 2009. There was also a decline in the number of deposit taking NBFCs (NBFCs-D) in 2009-10. This decline was mainly on account of cancellation of Certification of Registration of NBFCs, exit of NBFCs from deposit taking activities and conversion of deposit taking companies into non-deposit taking companies.

Despite the decline in the number of NBFCs, their total assets as well as net owned funds registered an increase during 2009-10 from Rs.13,617 crore to Rs.16,178 crore, while deposits recorded a decline from Rs.21,566 crore to Rs.17,247 crore. Similarly, the share of Residuary Non-Banking Companies (RNBCs) in total assets as well public deposits of NBFCs witnessed a decline in 2009-10, while share of the RNBCs in net owned funds registered an increase.

The ratio of deposits of NBFCs to aggregate deposits of Scheduled Commercial Banks (SCBs) in 2009-10 indicated a decline. The ratio of deposits of NBFCs to the broad liquidity aggregate of L3 also declined during the year 2009-10 to 0.4 percent from about 1.2 percent in 2002-03.

[A] Operations of NBFCs-D (excluding RNBCs)

The balance sheet size of NBFCs-D expanded at the rate of 21.5 per cent in 2009- 10 as compared with 3.4 per cent in the previous year, largely due to increase in borrowings of NBFCs-D [Table- 1). It may be noted that borrowings constituted around three-fourth of the total liabilities of NBFCs-D. Further, growth of deposits of NBFCs-D sector showed a substantial increase in 2009-10 compared to a decline in the previous year due to increase in public deposits of three NBFCs-D. On the assets side, hire purchase assets remained the most important asset category for NBFCs-D constituting over two-fifth of their total assets. Loans and advances constitute the second-most important asset category which witnessed large expansion during 2009-10. Total investments of NBFCs-D also recorded a sharp rise during 2009-10 primarily on account of rise in non-SLR investments.

Table -1 : Consolidated Balance Sheet of NBFCs-D

(Amount in crore)

Item	As at End-March		Variation			
			2008-09		2009-10	
	2008-09	2009-10 P	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6	7
Liabilities						
1. Paid up capital	3,817 (4.9)	3,361 (3.6)	551	16.9	-456	-11.9
2. Reserves & Surplus	9,412 (12.2)	12,237 (13.1)	717	8.2	2,825	30.0
3. Public Deposits	1,971 (2.6)	2,727 (2.9)	-71	-3.5	756	38.4
4. Borrowings	55,897 (72.5)	69,070 (73.7)	5,320	10.5	13,173	23.6
5. Other Liabilities	6,031 (7.8)	6,314 (6.7)	-3,951	-39.6	283	4.7
LIABILITIES/ASSETS	**77,128**	**93,709**	**2,566**	**3.4**	**16,581**	**21.5**
Assets						
1. Investments	15,686 (20.3)	19,335 (20.6)	4,476	39.9	3,649	23.3
i) SLR Securities @	9,412 (12.2)	10,773 (11.5)	2,266	31.7	1,361	14.5
ii) Other Investments	6,274 (8.1)	8,562 (9.1)	2,210	54.4	2,288	36.5
2. Loan & Advances	21,583 (28.0)	30,802 (32.9)	2,760	14.7	9,219	42.7
3. Hire Purchase Assets	35,815 (46.4)	38,549 (41.1)	2,290	6.8	2,734	7.6
4. Equipment Leasing Assets	613 (0.8)	241 (0.3)	-435	-41.5	-372	-60.7
5. Bill business	24 (0.0)	44 (0.0)	12	98.2	20	83.3
6. Other Assets	3,407 (4.4)	4,739 (5.1)	-6,537	-65.7	1,332	39.1

P : Provisional @ : SLR Asset comprises 'approved securities' and 'unencumbered term deposits' in Scheduled Commercial Banks.

Note: Figures in parentheses are percentage shares in respective total.

Source: Annual Returns.

Asset Finance Companies (AFCs) held the largest share[74.5 %] followed by loan

companies in the total assets of NBFCs-D at end-March 2010.

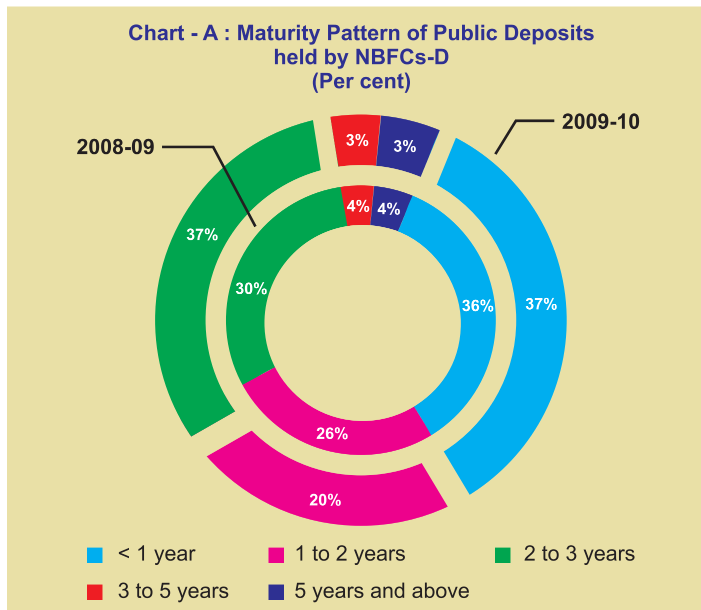
Deposits of NBFCs-D

A steep increase was discernible in 2009- 10 in the share of NBFCs-D located at the upper end having deposit size of more than Rs.50 crore, accounting for 86.7 per cent of the total deposits at end-March 2010. However, there were only eight NBFCs-D belonging to this class constituting about 3.5 per cent of the total number of NBFCs-D. Thus, only relatively bigger NBFCs-D were able to raise resources through deposits.

There was a concentration of NBFCs-D in the northern region of the country, which accounted for 63.5 per cent of companies in the total number of NBFCs-D at end-March 2010. However, the deposit size of NBFCs-D in the northern region was fairly smaller in comparison with the NBFCs-D located in the southern region, which accounted for 67.5 per cent of deposits at end-March 2010. There was, however, a decline in the share of deposits held by NBFCs-D in the southern region in 2009-10. Among the metropolitan cities, New Delhi accounted for the largest number of NBFCs-D, while Chennai from the southern region held the largest share in total deposits of NBFCs-D.

The largest amount of public deposits of NBFCs-D were raised at interest rates in the range of up to 10 per cent with the share accounting more than half as at end-March 2010.

The largest proportion of public deposits raised by NBFCs-D belonged to the short- to medium-term end of the maturity spectrum. At end-March 2010, the largest percentage of deposits had a maturity of less than one year closely followed by deposits having a maturity of more than two years and up to three years. In 2009-10, there was an increase in the shares of deposits belonging to these two maturity categories, while the shares of deposits belonging to the long-term maturity categories of more than 5 years showed a decline [Chart-A].



Sources of Borrowings

Banks and financial institutions were the dominant source of borrowings for NBFCs-D with a share of over 45 per cent at end-March 2010. The share of borrowings from the Government (extended only to Government Companies) witnessed a steep rise, while there was a noticeable decline in the share of external sources. Others (which include, inter alia, money borrowed from other companies, commercial paper, borrowings from mutual funds and any other type of funds, which were not treated as public deposits) registered a significant growth in 2009-10 resulting in a rise in its share in total borrowings of NBFCs-D (Table-2).

Table -2 : Sources of Borrowings by NBFCs-D by Classification of NBFCs

(Amount in crore)

Classification	As at end-March									
	Government		External Sources @		Banks and Financial Institutions		Debentures		Others	
	2008-09	2009-10 P	2008-09	2009-10 P	2008-09	2009-10 P	2008-09	2009-10 P	2008-09	2009-10 P
1	2	3	4	5	6	7	8	9	10	11
Asset Finance	3 (0.0)	– (0.0)	832 (56.9)	757 (100.0)	21,974 (88.4)	25,488 (80.9)	11,627 (88.3)	13,267 (92.6)	6,253 (42.9)	14,690 (82.5)
Investment	– (0.0)	– (0.0)	– (0.0)	– (0.0)	– (0.0)	– (0.0)	– (0.0)	– (0.0)	– (0.0)	– (0.0)
Loan	1,824 (99.8)	4,673 (100.0)	631 (43.1)	– (0.0)	2,872 (11.6)	6,018 (19.1)	1,546 (11.6)	1,057 (7.4)	8,335 (57.1)	3,121 (17.5)
Total	1,827	4,673	1,464	757	24,846	31,505	13,173	14,324	14,588	17,811

P : Provisional. @ : Comprises (i) Foreign Government, (ii) Foreign Authority, and (iii) Foreign Citizen or Person.
Note : Figures in parentheses are percentage to respective total.
Source: Annual Returns.

Assets of NBFCs

The total assets of deposit-taking NBFCs- D sector registered a significant growth during 2009-10 mainly on account of increase [from Rs.56,496 crore to Rs.69,801 crore] in the assets of asset finance companies [AFCs]. As at end-March 2010, around three-fourths of the total assets of the NBFCs-D sector were held by assets finance companies. Components-wise, advances accounted for the predominant share of total assets followed by investment.

Based on their deposit taking capacity only bigger NBFCs-D had larger asset base. At end-March 2010, only 7 per cent of NBFCs-D had an asset size of more than Rs.500 crore, which had share of 97.5 per cent in total assets of all NBFCs-D. Smaller companies with asset size upto Rs. 10 crore, which

Table-3 : Assets of NBFCs - D by Activity

(Amount in crore)

Item	As at end-March		Percentage Variation
	2008-09	2009-10	2010
1	2	3	4
Loans and Inter corporate deposits	21,583 (28.0)	30,802 (32.9)	42.7
Investments	15,686 (20.3)	19,335 (20.6)	23.3
Hire Purchase	35,815 (46.4)	38,549 (41.1)	7.6
Equipment and Leasing	613 (0.8)	241 (0.3)	-60.7
Bills	24 (0.0)	44 (0.0)	85.0
Other assets	3,407 (4.4)	4,739 (5.1)	39.1
Total	**77,128**	**93,710**	**21.5**

P: Provisional.
Note: Figures in parentheses are percentages to respective total.
Source: Annual Returns.

accounted for 72 percent in number in this category had assets of only 0.4 percent.

During 2009-10, assets held in the form of loans and inter corporate deposits and investments of NBFCs-D witnessed a robust growth. Notwithstanding a decline in the share of assets held by hire purchase companies in 2009-10, this activity continued to have the largest share in total assets of the NBFCs-D sector (Table-3).

Financial Performance of NBFCs-D

During 2009-10 funds based income rose from Rs.11,572 crore to Rs. 13,489 crore but there was a decline in fee-based income. The financial performance of NBFCs-D witnessed moderate deterioration as reflected in the decline in their operating profits during 2009-10. This decline was mainly on account of a higher growth in expenditure (especially financial expenditure) than income of these institutions. The decline in operating profit along with a marginal increase in tax provision resulted in a decline in net profits in 2009-10.

Expenditure as a percentage to average total assets witnessed a significant increase during 2009-10, while income as a percentage to average total assets increased at a slower pace resulting in a decline in net profit to total average assets (Return on Assets) ratio of NBFCs-D.

Soundness Indicators: Asset Quality of NBFCs-D

There was a decline in the gross NPAs to credit exposure ratio [which stood at 1.3 percent] of NBFCs-D in 2009-10 in continuation with the trend observed in the recent past. Net NPAs remained negative with provisions exceeding NPAs for three consecutive years extending upto end-March 2010.

There was an improvement in the asset quality of asset finance and loan companies in 2009-10 as evident from a decline in the gross NPAs to gross advances ratio for these companies.

There was a decline in the shares of all three NPA categories of sub-standard, doubtful and loss assets of asset finance companies in 2009-10 underlining the improvement in asset quality of these institutions. However, in case of loan companies, there was improvement in share of standard assets at end-March 2010 to 97.3 per cent notwithstanding a marginal increase in share of loss assets.

Capital Adequacy Ratio of NBFCs-D

At end-March 2010, 212 out of 216 NBFCs had CRAR of more than 12 per cent or more as against 221 out of 225 NBFCs at end- March 2009. It may be highlighted that the NBFC sector is witnessing a consolidation process in the last few years, wherein the weaker NBFCs are gradually exiting, paving the way for a stronger NBFC sector.

The ratio of public deposits to Net Owned Funds (NOF) for all categories of NBFCs taken together remained unchanged at 0.2 per cent at end-March 2010.

There was an increase in NOF and public deposits of NBFCs-D in 2009-10. This increase was mainly concentrated in the NOF size category of Rs.500 crore and above.

[B] Performance of NBFCs-ND-SI

Information based on the returns received from non-deposit taking systemically important NBFCs (with asset size of `100 crore and above) for the year ended March 2010 showed an increase of 16.7 per cent in their liabilities/assets over the year ended March 2009. Total borrowings (secured and unsecured) by NBFCs-ND-SI increased by 19.6 per cent during the year ended March 2010, constituting around two-thirds of the total liabilities (Table-6). Unsecured loans continued to constitute the largest source of funds for NBFCs-ND-SI, followed by secured loans, and reserves and surplus.

ND-SI sector is growing rapidly and unsecured borrowings comprise their largest source of funds, mostly sourced from banks/FIs. Thus, they have a systemic linkage and need to be monitored closely to ensure that they do not pose any risk to the system. To the extent that they rely on bank financing, there is an indirect exposure for depositors. While the concentration of funding has risks, the caps on bank lending to NBFCs may constrain their growth. The development of an active corporate bond market will help to address the funding requirement of NBFCs. The leverage ratio of the entire ND-SI sector rose during 2009-10. ND-SI sector's exposure towards the sensitive sector that is prone to potential boom-bust cycles such as capital market also shows an increase.

The region-wise analysis of the total borrowing of the NBFCs-ND-SI reveals that the northern region along with the western region continued to account for more than three fourths of the total borrowings during March 2010 and March 2009; this trend continued during the quarter ended June 2010 also. All regions registered significant growth during March 2010 as compared with March 2009. During the quarter ended June 2010 all regions registered an increase in the borrowing except eastern region.

Financial Performance of ND-SI

The financial performance of the NBFCs- ND-SI sector improved marginally as reflected in the increase in net profit during 2009-10 over the previous year. However, their net profit as a ratio to total assets declined during the same period.

Gross and net NPAs as a ratio to total asset of the entire NBFCs-ND-SI sector deteriorated marginally during the year ended March 2010. Latest information available relating to the quarter June 2010 shows some improvements.

As on March 2010, seventy-eight companies out of 188 ND-SI companies relied on owned fund to fund their assets. However, few companies showed their dependence on ICDs/commercial paper/banks to fund the significant portion of their assets. As on March 2010, ND-SI companies were largely dependent on the nationalised banks for their term loans, working capital loans, and debentures/CPs. New private banks have emerged as a second major bank group for the ND-SI companies to raise term loans and working capital loans. However in case of debentures, foreign banks contribution was significant for the ND-SI.

It may be noted that there still exist a large number of NBFCs which do not come under the direct purview of regulation and supervision of the Reserve Bank. For promoting the growth of the NBFC sector, the development of alternative sources of funding in the form of an active corporate bond market, would be desirable.

[Edited version of excerpts from Reserve Bank of India's Report on Trend and Progress of Banking in India 2009-10, Nov 08, 2010] ■

Infrastructure Financing in India [Part-2)

"Major issues in debt finance relate to asset-liability mismatch... Development of efficient and liquid corporate bond market, in this context, can provide a viable alternative in meeting the financing requirements of infrastructure."

"Indian lenders to infrastructure projects would like to have some of their loans refinanced in order to enhance their assets portfolio, and at times, to limit their risks."

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

[Continued from previous issue of FIDC News, 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]

Major issues in debt finance relate to asset-liability mismatch of banks and this constrains the ability of banks to extend finance to long-gestation infra projects. Development of efficient and liquid corporate bond market, in this context, can provide a viable alternative in meeting the financing requirements of infrastructure.

The other than budgetary support resources are estimated to be at 55 per cent during the first three years of the Eleventh FYP. The total debt would account for approximately 41 per cent of the resources and equity (including FDI) is estimated to contribute 14 per cent of the funds.

Regulatory Issues in Borrowing from Banks and Financial Institutions

Financing of infrastructure by banks and financial institutions poses three different kinds of regulatory issues. First, many infrastructure projects require long-term financing. When banks provide such funding, they are exposed to a maturity mismatch, as most of their funding is through short-term deposits. The maturity mismatch poses in part liquidity risk and partly an interest rate risk. Lending on a floating rate basis can mitigate the interest rate risk for the bank but at the cost of putting the project promoter at a disadvantage. Capital intensive infrastructure projects are not well positioned to handle this risk. Further, banks and the financial institutions have limited appraisal skills necessary for credit appraisal of such projects. The issue is that the banks cannot be the sole or even the dominant providers of funds for these projects. However, a project that is able to tap a diverse range of funding options could benefit greatly from timely bank finance. For this to happen, it is necessary to strengthen and reform the banking system.

The world over, long-term liabilities have been used to finance long-term assets, underlining the relative importance of insurance companies in infrastructure development vis-à-vis banks. The Indian insurance companies, however, have not played a significant role in financing infrastructure projects, particularly those sponsored by private companies.

Refinancing through ECBs

The existing guidelines do not permit domestic financial intermediaries to refinance existing rupee loans from external sources, although a potential market for the same exists. The refinancing of existing rupee loans through ECB, if permitted for infrastructure, could offer the following benefits:

• Some foreign financiers, who are not keen to participate in projects in early risky stage, may show interest in the post-construction period when the risks subside.

• Indian lenders to infrastructure projects would like to have some of their loans refinanced in order to enhance their assets portfolio, and at times, to limit their risks.

• Local promoters will benefit from greater diversity of funding sources as well as better price discovery. Refinancing from external sources would be particularly attractive in the situations when domestic interest rates are relatively high and the rupee is tending to appreciate.

The current ceiling of LIBOR+350 basis points for ECBs makes it difficult for the issuers to raise senior debt, subordinated debt, mezzanine financing or quasi equity as the maximum permissible return is not considered enough to match the perceived risk. Keeping in view the long-term nature of infrastructure projects and the need for risk capital (in the form of quasi equity), this all-in price ceiling on ECBs, if removed for senior, subordinated and mezzanine foreign debt for infrastructure projects, will ensure inflow of liquidity for longer tenors, and in many cases, protect promoters of infra projects from illiquidity in domestic loan markets arising due to seasonal factors.

Foreign Direct Investment (FDI)

The FDI policy has been liberalised since the initiation of economic reforms in India. FDI is permitted up to 100 per cent in greenfield projects under the automatic route. In the case of existing projects, however, FDI under automatic route is permitted upto 74 per cent and beyond 74 per cent the FIPB approval is required. Further, 100 per cent FDI is allowed under automatic route for coal and lignite mining, construction development projects, mining of diamonds, precious stones, gold, silver and minerals, petroleum and natural gas sector, power generation, transmission, distribution, power trading and manufacture of telecom equipments. Telecommunication services attract 74 per cent FDI ceiling subject to certain conditions. In the case of air transport services, upto 49 per cent FDI is allowed. Due to gradual liberalisation of FDI norms, the actual inflows into the infrastructure sector constitute a major share in the total inflows into the country.

Role of International and Multilateral Institutions

Globally, infrastructure financing is the forte of a wide range of international institutions, which include export credit agencies, international commercial banks, international bond markets, multilateral institutions and bilateral agencies. The international commercial banks are the largest source of private finance for infrastructure development in developing countries. The export credit agencies provide direct finance and guarantee commercial bank credit.

International bond markets

Bond financing is in many ways the ideal source of finance for infrastructure. Costs are higher than for syndicated loans, but maturities of ten to thirty years are typical, and even longer maturities are available for creditworthy borrowers. Globally, the modest scale of bond financing of infrastructure is on account of limited access to international bond markets. The pricing of private corporate securities issued in the international bond markets depends partly on corporate financial characteristics and partly on the country characteristics. The efficiency of bond pricing can be enhanced by issuing and actively trading the sovereign debt in the market. This increases country visibility, and the appetite for corporate securities. It further provides a benchmark against which corporate debt can be efficiently priced. Issuing sovereign debt, however, implies that countries must be willing to accept continuous scrutiny of macroeconomic performance and economic policies by international credit rating agencies.

Multilateral Institutions

The presence of a multilateral institution in the investment profile of an infrastructure project provides an additional attraction to long-term investors and extends comfort to the private investors. One, such institutions play the role of a catalyst in financing infrastructure projects by facilitating convergence of resources into private sector projects which deliver development impact. Two, they add value to private sector projects for sustaining the development process in the economy. The following paragraphs reflect on individual multilaterals pursuing these objectives in India.

The World Bank

The World Bank aligns its country strategies to the country's specific development priorities. The Country Strategy for India (2009-2012) is mapped out in sync with the Eleventh FYP. One of the focus areas of the strategy is to assist India to fast-track the development of infrastructure.

India is one of the founder members of the World Bank. The World Bank and IFC are collaborating to enable India to deal with the challenges of successful execution of the PPPs, especially in power transmission, roads, irrigation, rural infrastructure and urban development. This will now be extended to agri business, health & education, and renewable energy. The Bank and IFC are also working on long term finance; through the proposed IIFCL project. The country strategy for India envisages total proposed lending of US$ 14 bn for 2009-2012. As private sector financing dries up post the financial crisis, the Bank will provide US $ 3 bn additionally as part of total financing envelop of US $ 14 bn. Infrastructure focus is a crucial component of the country strategy for India.

India was the largest IDA and second largest IBRD borrower from the Bank in the fiscal 2008. The Bank's US $ 15.1 billion portfolio in the country covers 61 active investment projects. During the FY 2008, the Bank's board approved US $ 2.7 billion for new projects for India covering a range of sectors including infrastructure, education, health & rural development.

The World Bank has traditionally funded public sector infrastructure projects. In South Asia, the World Bank has played a major role in funding infrastructure development and approved nearly US$5.65 billion for South Asia by 2010.

The International Finance Corporation (IFC)

The private sector arm of the World Bank Group, the IFC plays an important role in financing private sector infrastructure, but its scale of operation is relatively modest. The IFC is the world's largest multilateral source of equity and loan financing for private enterprises in developing economies. IFC has made infrastructure financing a priority since it impacts the living standards and plays a significant role in development of all other sectors. An important feature of IFC syndication in financing private sector infrastructure is that it has brought in non-bank financial institutions, including international insurance companies, to finance infrastructure projects in developing countries.

Since 1956, the IFC has invested in 151 projects in India, providing nearly $2.5 billion as loans and $875 million as equity participation. IFC's portfolio of $3.4 billion for the financial year 2009 to India makes India its largest country of operations with 9.8 per cent share, followed by Brazil and Russian Federation. IFC has supported the establishment of first PPP in India's power transmission sector through Powerlinks, a joint venture between Tata Power Company and Power Grid Corporation of India. IFC is also an existing shareholder in IDFC with an equity stake of around 6 per cent.

Asian Development Bank

India is the founder member of the Asian Development Bank (ADB) and is its fourth largest shareholder. The ADB offers direct assistance to the private sector in an array of segments. It assists private enterprises to undertake financially viable projects with significant economic and social merit and thereby achieve positive development impact. ADB's total financial support for a project, including loan, equity investment, partial credit guarantee, and underwriting commitment is limited at 25 per cent of the total project cost or US$50 million, whichever is lower. ADB also provides political risk guarantee coverage without the host government's counter-guarantee of up to 50 per cent of the total project cost or US$100 million, whichever is less. Further the ADB also guarantees loans.

Infrastructure financing has been the traditional forte of the ADB. Since inception, the ADB has approved 144 loans for India amounting to $22,228 million. As at the end of 2009, the ADB's portfolio included 53 ongoing loans for $8.4 billion, with $2.8 billion to transport, $1.5 billion to urban infrastructure, $2 billion to the energy sector, and $1.5 billion to the financial sector. Three MFF tranches for $1.1 billion have been approved in 2009.

ADB has drawn a programme - India assistance strategy - over the period 2008–2010. The program includes provision of loans to help improve water resource management in Orissa ($200 million, 2008); North Eastern States Integrated Flood Control and River Erosion Mitigation project ($200 million, 2009); and Sustainable Coastal Zone Protection and Management project ($200 million, 2010).

[To be concluded in Part-3 in next issue] ■

Applicability of service tax on financial leasing

S Madhavan, Leader Indirect Tax Practice, Pricewaterhouse Coopers

In a recent decision, in the case of Association of Leasing and Financial Companies Vs. Union of India and Others (2010-VIL-17-SC-LB-ST), the full bench of the Supreme Court had occasion to deal with the constitutional validity of the levy of service tax on financial leasing transactions including hire purchase and equipment leasing of goods. The issue before the Apex Court was whether hire purchase and leasing transactions involved any element of service, in order for the service tax to apply, especially where such transactions were explicitly chargeable to the VAT, being a tax in relation to goods. Thus, the question was again whether there could be a charge of both the goods and the services tax on the same transaction, thereby resulting in double taxation.

The appellants argued that they were engaged in the business of hire purchase and leasing and that the 46th Amendment to the Constitution of India had inserted Article 366(29A) to deem a set of six transactions enumerated therein as constituting a sale of goods. These six transactions included the transfer of the right to use of any goods for any purpose as well as hire purchase transactions. Consequently, the State had imposed a sales tax, now VAT, on these transactions and the entire amount paid to the hirer/ lessor by way of instalments was made chargeable to VAT. It was further argued that once the subject matter of hire-purchase and leasing was constitutionally characterised as a deemed sale the transactions could only be taxed by the State under Entry 54 of List II of the seventh schedule of the Constitution and such transactions could not be taxed by the Central Government under Entry 97 of List I of the same schedule.

Relying on the Report of the Law Commission, which preceded the 46th amendment referred to above, the appellants also submitted that the object behind the aforesaid amendment was to reserve the exclusive competence to tax hire-purchase and leasing transactions with the State legislatures and exclude Parliament therefrom. Consequently, the service tax on leasing and hire purchase transactions was unconstitutional.

As opposed to this, it was urged, on behalf of the Union of India, that it was incorrect to argue that by extending the definition of sale under Article 366(29A) to include leasing and hire purchase transactions, the Union Government had divested itself of the power to levy service tax on such transactions. It was argued that the levy of service tax was not in existence at the time when the 46th amendment to the Constitution was enacted, in 1982. Thereafter, reliance was placed on the decisions of the Supreme Court in Tamil Nadu Kalayana Mandapam Association Vs. Union of India (2004-TIOL-36-SC-ST), Gujarat Ambuja Cements Ltd. Vs. Union of India (2005-TIOL-53-SC-ST) and All-India Federation of Tax Practitioners Vs. Union of India [(2007) 7 SCC 527] to argue that the levy of service tax was held to be constitutionally valid, in somewhat similar circumstances and despite similar arguments made by the appellants.

The Government relied upon the doctrine of pith and substance to argue that service tax could be imposed on financial leasing services. It was canvassed that imposition of service tax on financial leasing did not, in pith and substance, result in the imposition of service tax on a deemed sale as defined under Article 366(29A), read with the relevant entries in the Constitution.

The Supreme Court took note of these arguments and came to the conclusion that the taxable service category "banking and other financial services", under service tax, included within it hire purchase and leasing transactions. These were services rendered to their customers by banks, NBFCs, etc. The taxable event under the relevant law was the rendition of service. The impugned tax was not at all a tax on either materials or sale. Consequently, the service tax that had been imposed on the transactions in question was constitutionally valid. The Court came to this determination by carefully examining the several relevant provisions of the Constitution viz. article 246(1), article 248 and entry 97 of List I. The Court held that article 246(1) conferred upon the Central Government not only exclusive powers to make laws in respect of entries 1-96 of List I but also residuary powers, through entry 97, on any other matter not enumerated in List II and List III, including any tax not mentioned in either of these lists. Further, the Court analyzed the expression 'taxable service', 'value of taxable service' and others in the service tax law to hold that the interest or finance charges, together with the lease management fee/processing fee/documentation charges, were to be treated as consideration for the services rendered and accordingly these charges constituted the value of taxable services on which service tax was payable.

The taxable event was the service rendered by the hire purchase or leasing company to its customers and the service tax applied only on such service and not on the deemed sale transaction of hire purchase or lease. Therefore, the Centre undoubtedly had legislative competence to charge the tax on the above service. Further, the Supreme Court distinguished this matter from the famous BSNL judgement by holding that legislative competence was not the issue before the apex Court in the BSNL case and the primary question involved there was whether mobile phone connections constituted a sale or service or both. It accordingly approvingly quoted the following para occurring in the BSNL judgement:

"No one denies the legislative competence of the States to levy sales tax on sales provided that the necessary concomitants of a sale are present in the transaction and the sale is distinctly discernible in the transaction. This does not however allow the State to entrench upon the Union List and tax services by including the cost of such service in the value of the goods."

It held the above principle was not violated in the case in point. It thus interpreted the BSNL case in this very significant way and consequently differentiated it from the present case.

In sum, the Supreme Court has upheld the charge of service tax on hire purchase and leasing transactions, if forming part of 'financial leasing services' under service tax law, notwithstanding that the same transactions were chargeable to the VAT. There was no double taxation of one transaction to two taxes in this instance, as per the Supreme Court, even though both taxes were chargeable on the same base. It also noted that the service tax was, in fact, chargeable only on 10% of the finance or leasing charge.

It is hoped that the proposed Goods and Services Tax (GST) regime would redress this vexatious problem of potential and real double taxation currently being faced by the banking and financial industry, which has been further accentuated, as a result of the above decision. ■

Transfer of bank debts: SC sets aside court order

The Supreme Court on Sept. 30 set aside a Gujarat high court order that prohibited banks from transferring debts, including non-performing assets, to one another. A three-judge bench headed by Chief Justice S H Kapadia held that the transfer of debts between banks is legal and the Banking Services Regulation Act allows this activity. "There is nothing to prohibit under the banking regulation act. We set aside the judgement of the high court," the bench said. The apex court judgement came in response to a clutch of petitions filed by major banks, including ICICI Bank, Kotak Mahindra Bank and Standard Chartered, challenging the Gujarat high court judgement. The case relates to the transfer of a basket of non-performing assets by ICICI Bank to Kotak Mahindra Bank along with underlying security interest. One of the borrowers, APS Star Industries, objected to the transfer and the matter landed in court. A division bench of the Gujarat high court held that the Banking Regulation Act did not allow for trading in debt. Had it not been overturned, the high court judgement would have serious implications for the nascent securitisation business, which relates to buying of a pool of debts by one bank from another and trading in them.[PTI, Sept.30]

Tax authorities won't rush to court over petty sums

Tax authorities will not take legal recourse in cases where the disputed amount is below a certain threshold, as the government looks to reduce unproductive litigation. The new rules are in sync with a national litigation policy that seeks to make the government an efficient and responsible litigant. "The purpose of the policy is to ensure that valuable time of the courts is not spent in resolving pending cases and to bring down the average pendency time in the courts," a tax department official explained.

The Central Board of Excise and Customs (CBEC), the apex indirect taxes body, has directed its officials that an appeal will not be filed in the appellate tribunal if the amount involved, including fine and penalty, is Rs.1 lakh and less. Similarly, appeals will not be filed in high courts if the disputed amount is Rs. 2 lakh and less. Tax authorities will also not appeal if the matter is covered by a series of judgements of tribunals and high courts, which have not been challenged in the Supreme Court. The new policy also lays down that no appeal shall be filed where the assessee has acted in accordance with the long-standing practice. However, adverse judgements would have to be contested irrespective of the amount involved in cases where the constitutional validity of the provisions of an Act or rule is under challenge or where a notification/instruction/order/circular has been held illegal. Tax authorities will also file appeals in cases where the department has accepted an audit objection in a case.

Finance minister Pranab Mukherjee had, in August, pulled up the two boards and set up two panels, one each for direct and indirect taxes, to draw up a road map to reduce rising litigation. [Economic Times, 11 Nov.]

Nominee of bank account does not get succession rights

The Supreme Court (SC) has clarified the nominee of a depositor in a bank does not get ownership of the money in the account after death of the depositor. The nominee gets exclusive right to receive the money lying in the account. It gives him all the right of the depositor as far as the depositor's account is concerned, according to Section 45ZA of the Banking Regulation Act. But the banking law is not concerned with the succession. The money in the account will form part of the estate of the deceased depositor and devolve according to the rules of succession. In this case, Ram Chander vs Devender Kumar, one son was the nominee of his mother. After her death, he claimed he was the owner of the money in the account, to exclusion of his brother. The same rule will apply to government savings and other investments. [BS Reporter, Nov. 15]

Panel to clean up financial sector laws soon: Mukherjee

The government will soon set up a commission to "rewrite and clean up" financial sector laws, in a bid to make them more relevant to the changed economic scenario, Finance Minister Pranab Mukherjee said on 19 Nov. "The government has decided to set up a financial sector legislative reforms commission (FSLRC) to rewrite and clean up the financial sector laws and bring them in line with the requirements of the sector," Mukherjee said. [Economic Times, 19 Nov.]

India plans microlenders' regulatory bill - Minister

The Indian government proposes to introduce a bill to regulate microfinance institutions, a deputy finance minister said on 23 Nov. "The Department of Financial Services proposes to introduce the Micro Finance (Development & Regulation) Bill, 2010, after taking into account the views of RBI and the Malegam Committee recommendations," Namo Narain Meena said in a written reply in the upper house of Parliament. The Malegam committee is expected to submit its recommendations in three months. The fast-growing, largely unregulated small loans sector has come under scrutiny after fears of large-scale defaults due to high interest rates and reports of suicides due to mounting debt.

In the meanwhile state legislature of AP has passed "The Andhra Pradesh Micro Finance Institutions (Regulation of Money Lending] Bill, 2010." [REUTERS, 23 Nov./BS Reporter]

Redefinition to check indirect hold over Indian cos

The government will make it tough for foreign firms to exercise control over Indian businesses though indirect arrangements by updating the ambiguous definition of 'control' in foreign direct investment policy with the precise one used in the Companies Bill. Finance Secretary Ashok Chawla has asked RP Singh, secretary at the department of industrial policy and promotion, to amend the definition of 'control' in FDI guidelines. "The DIPP would take necessary steps to amend the definition of control in Press Note 2 of 2009, subject to the receipt of written confirmation from the ministry of corporate affairs, on the specific formulation of 'control', which has been proposed in the draft companies bill," Mr Chawla said in a letter to Mr Singh. While the DIPP is the nodal department for FDI policy, the finance secretary heads the foreign investment promotion board (FIPB), which vets investment proposals not falling within certain guidelines fixed by the government.

The current foreign investment policy says any Indian company 'owned or controlled' by a foreign company would be considered a foreign company. While a more than 50% equity holding was sufficient for establishing foreign ownership, control was defined as ability to appoint a majority of directors. This precluded other indirect ways of obtaining control such as lein over voting rights and equity purchase agreements — a loophole used extensively by foreign investors to control Indian ventures without violating the sectoral caps. Such arrangements violated the FDI policy in spirit while paperwork was in order. "A number of companies that show foreign investment much below 50% have issued quasi-equity instruments with voting rights to foreign investors," said a government official dealing with FDI policy changes. "This allows the investor to effectively exercise control over the entity indirectly," he said, requesting anonymity.

The Companies Bill, which is under Parliament's consideration, has a more comprehensive interpretation of control. Apart from the already mentioned right to appoint a majority of directors, the bill defines control to include the ability to influence management or policy decisions. The bill goes on to say that this ability to influence decisions could be by virtue of direct powers such as shareholding or management rights, or indirect ones such as shareholders agreements or voting agreements or in any other manner. Effectively, the new bill covers every possible way of exercising control. Company law experts say inclusion of the new definition of control will remove the loopholes in the FDI policy. [Economic Times, 20 Oct.] ■

NBFCs profit growth outpaces rise in total income

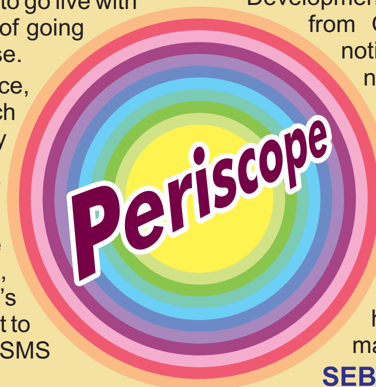
Net profit of non-banking finance companies (NBFCs) in percentage terms has grown at a higher rate between 2005-06 and 2009-10, compared to an increase in total income during the same period. The net profit of 171* NBFCs witnessed a compound annual growth rate (CAGR) of 19.8%, while the average total income of these NBFCs increased by 17.7% in the same period. In actual value terms, the net profit of 171 NBFCs rose by 105.8% from Rs 7,796 crore in 2005-06 to Rs 16,043 crore in 2009-10. During the above period, the highest growth of 45.3% in net profit was seen in the year 2007-08. On the other hand, the total income of these NBFCs steadily increased by 91.8% from Rs 36,781 crore to Rs 70,540 crore in the same period. Here highest growth of 25.9% in total income was seen in the year '06-07. The NBFCs as a whole account for 9.1% of the assets of the total financial system.

Among the 171 NBFCs, the significant CAGR in net profit was seen in the case of asset finance companies like Shriram Transport Finance, L & T Finance and Magma Fincorp. According to the director's report, this was driven by higher business volumes, increased loan assets, improved operating efficiency and asset quality. [Financial Express, Oct.8] * includes HFCs also.

Instant mobile payment service

The National Payment Corporation of India is rolling out an instant interbank mobile payment service that will enable retail customers of seven banks to enjoy 24X7 funds transfer. State Bank of India, Bank of India, Union Bank of India, ICICI Bank, HDFC Bank, Axis Bank and YES Bank on Nov. 22 became the first set of banks to go live with the IMPS. While seven banks are in the process of going live with IMPS, 22 others are in the preliminary phase.

To avail themselves of the mobile banking service, customers need to register with their banks, which will issue them a unique seven digit mobile money identifier (MMID) and mobile banking personal identification number (MPIN). Irrespective of whether their mobile is low-end or high-end, customers can download and activate the mobile banking application. To initiate a mobile payment, all that a sender has to do is key in the beneficiary's mobile number, the beneficiary's MMID, the amount to be sent and the MPIN. The sender will get SMS confirmation for the money sent.



The RBI has permitted banks to offer mobile banking service to their customers, subject to a daily cap of Rs 50,000 a customer for both funds transfer and transactions involving purchase of goods/services for end-to-end encrypted transactions. Transactions up to Rs 1,000 can be facilitated by banks without end-to-end encryption. The disbursal of funds to recipients of such services can be facilitated by banks at ATMs or through business correspondents. In this case the maximum value of such transfers is Rs 5,000 a transaction. Banks are required to place suitable cap on the velocity of such transactions, subject to a maximum value of Rs 25,000 a month, per customer. Banks will be offering IMPS free to customers up to March 31, 2011. [Business Line, 22 Nov.]

India's wealth to double in 5 years; may grow to $6.4tn.

India's robust economic growth is likely to drive the country's fortune to a whopping $6.4 trillion in the next five years, reflecting a nearly two-fold jump from the country's current wealth, says a report. According to the Credit Suisse Global Wealth Report published for the first time, the total wealth of India has trebled in a decade to $3.5 trillion. By 2015, the country's wealth could nearly double to $6.4 trillion. Besides, the global wealth, which stood at $195 trillion will rise by an impressive 61 per cent to $315 trillion by 2015, primarily driven by the robust economic expansion in the emerging markets.

Interestingly, Asia Pacific boasts of more billionaires than Europe. There are over 1,000 billionaires globally, of which 500 are in North America, followed by 245 in Asia Pacific and 230 in Europe. Besides, the report said that there were 24 million high- net-worth individuals (HNIs), whose average wealth per adult stood in the range of $1-$50 million. China has over 800,000 HNIs , India has around 170,000 while rest of the Asia Pacific as over four million HNIs.

"The Report confirms that Asia Pacific countries, which now make up the bulk of the world's middle class of emerging consumers, are driving the growth of the world's wealth," Credit Suisse CEO (Asia Pacific) Osama Abbasi said. Also, the middle segment of the wealth, which is composed of one billion individuals whose average wealth per adult falls in the range of $10,000 to $1 million, is located in the fastest-growing economies of the world that hold one- sixth or $32 trillion of global wealth. In total, almost 60 per cent or 587 million individuals in the middle segment of the wealth pyramid are located in the Asia Pacific region. [Economic Times, 9 Oct.]

Warehousing Act comes into force

Much-awaited Warehousing (Development and Regulation) Act, 2007 has come into force with effect from October 25, 2010. The Act, legislated by Parliament three years ago, makes warehouse receipts negotiable. The introduction of a negotiable warehouse receipt system in the country will not only help farmers avail better credit facilities and avoid distress sales but also safeguard financial institutions by mitigating risks inherent in credit extension to farmers. The pledging/collaterisation of agricultural produce with a legal backing in the form of negotiable warehouse receipts will lead to an increase in the flow of credit to rural areas, reduce the cost of credit and spur related activities like standardisation grading, packaging and insurance and in development of chain of quality warehouses.

The government has also decided to constitute a Warehousing Development and Regulatory Authority under the Act with effect from October 26 with the publication of the relevant notification in the official Gazette. Besides mandating the negotiability of warehouse receipts, the Act prescribes the form and manner of registration of warehouses and issue of negotiable warehouse receipts including electronic format. The Warehousing Development and Regulatory Authority will register and accredit warehouses intending to issue negotiable warehouse receipts and put in place a system of quality certification and grading of commodities with a view to protecting the interests of holders of warehouse receipts against negligence, malpractices and fraud. [Economic Times, 27 Oct.]

SEBI announces new norms

SEBI chairman announced on 26 October several new norms, which are in nutshell as under:

- Enhances retail application limit to Rs 2 lakh from Rs 1 lakh across all issues in case of IPOs.
- Disclosures of risk factors specific to IPOs by insurance companies
- Tightens preferential allotment framework for promoters
- Mandatory for companies to pre-announce dates for dividend payment and bonus shares
- QIB status to insurance funds set up by Department of Posts
- SEBI also notified the framework for rights issue of Indian Depository Receipts (IDRs).

Fighting crime and fraud

The Finance & Leasing Association (FLA) of UK is working with dealers and with the police to cut levels of car fraud. It took part in Car Crime Awareness Week with a media campaign highlighting to consumers how they can avoid becoming a victim of finance fraud by carrying out a simple check on a car's history before they buy it. Further media messages highlighted the need for people with cars on finance to avoid unwittingly committing finance fraud. If a car is on finance, it is owned by the finance company until the customer has made all the payments on the car. Selling it on without permission is counted as fraud. Dealers are at the forefront of the fight against crime and foil ten attempts at fraud for every one that is committed. Rigorous checks on credit records and address data mean that dealers can spot all but the most sophisticated fraudsters at the application stage. ■

Centre for NBFC role in urban financial inclusion

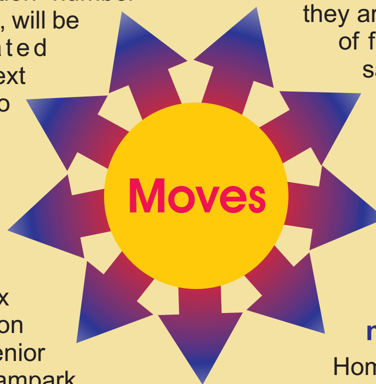
The government will seek a larger role for non-banking financial companies in its plans to provide better financial services to the urban poor. It may urge the RBI to allow NBFCs function as business correspondents in urban areas, a move aimed at widening the scope of financial inclusion. "There are various models being considered, letting NBFCs play a wider role is one of them," said a senior finance ministry official. The central bank had barred banks from appointing NBFCs as business correspondents in its September guidelines, citing a possible conflict of interest and further co-migrating of funds.

Rakesh Mohan panel to evolve infra. funding

The government has set up a high-level panel under the chairmanship of Rakesh Mohan.to evolve an enabling policy framework for $1-trillion investment in infrastructure during the 12th Five-Year Plan, which starts April 2012. In order to upgrade infrastructure facilities in the country, the Centre aims to double investments in 10 sectors, including transport, power, telecommunications, and oil and gas. It will also facilitate the removal of regulatory impediments to investment. The report will be submitted in 18 months. [FE Bureau, Nov 19]

I-T dept introduces new number for taxpayers

Taxpayers will now have to procure a 'new number' for filing returns and making any communication with the Income Tax department. The unique Document identification number (DIN), on the lines of numbers like PAN and TAN, will be quoted on "every" income tax-related communication, including returns to be filed next year for the financial year 2010-11. According to the new guidelines brought out by the Central Board of Direct Taxes (CBDT), the DIN will be mandatory "in respect of every notice, order, letter or any correspondence" with the department, by the taxpayers. "The DIN will be generated by the I-T department and will be useful, essentially, for error-free filing of tax returns, claiming refunds and other communication with the department by the assesses," a senior Finance Ministry official said. The 'Aykar Sampark Kendras' will hand out the DIN from this month, the official said. [Economic Times, 29 Nov.]



Centre & states agree to stamp duty changes

The Centre and states have concluded consultations on the contours of the new law that will drop several archaic provisions in stamp duties laws. "After several rounds of discussions spanning more than five years, the Centre and the states are looking at rationalisation in duty structure on a number of items including insurance," a government official privy to the discussions said.

Reforms in the century-old Indian Stamp Act are crucial as stamp duty has been kept out of the proposed goods and services tax (GST) that seeks to replace a plethora of state and central taxes. The existing stamp act, which gives powers to states to impose duties on various transactions, can undermine the nation-wide GST by dividing the market along state boundaries because of the difference in levies.

The act still contains a number of provisions from the British era, which are proposed to be dropped as part of the overhaul. Apprenticeship deed, article of clerkship, award, cancellation deed, charter party that currently face duty may be exempted from the current draft. The draft has already been circulated to the states and will be finalised soon in line with their suggestions, the official said.

The Centre is also trying to convince states to reform the stamp duty structure for financial instruments as a part of the current makeover exercise. The stamp duty reform in case of real estate is being tackled as part of the Jawaharlal Nehru National Urban Renewal Mission. Many states have already cut stamp duty on real estate transactions to avail of the incentives provided by the scheme. Parliament has the powers to prescribe stamp duty rates on instruments such as bills of exchange, cheques, promissory notes, bills of lading, letters of credit, insurance policies, transfer of shares, debentures and proxies. In the case of other instruments, the power to prescribe rates rests with the states. [Economic Times, 8 Nov]

Govt to set up authority to help duped investors

In the wake of various financial frauds the Government is planning to set up an authority to compensate duped investors by recouping money from fraudsters. The disgorgement authority, which will be under the administrative control of the Corporate Affairs Ministry, was mooted in the aftermath of various stock market scams in which small investors lost crores of rupees. Disgorgement, as a financial term, means the forced giving up of profits obtained illegally or unethically. [PTI, Nov.28]

Banks use 'negative list' gambit to make defaulters pay up

To recover dues, bankers are trying to put the fear of God into obstinate defaulters to pay up. And how? By making it plain that they could get reported to the Credit Information Bureau, bankers have been able to achieve a modicum of success in recoveries. Some defaulting borrowers do see the writing on the wall when they are sensitised about the deleterious consequences of finding their names on the bureau's negative list, say bankers. By delivering the simple key message that the doors of other banks will be shut for the defaulters once they are on the negative list, banks are gradually making headway in recoveries. The prospect of future banking relationship getting jeopardised convinces some defaulters to repay loans. [Business Line. 22 Nov.]

NHB, Cibil to set up central registry of mortgaged houses

Home loan frauds are expected to drop sharply with the NHB and the Cibil joining hands to set up a central registry of mortgaged houses. The biggest reason behind bad loans in mortgages are frauds where the borrower takes a loan from more than one lender using duplicate/forged documents. This will soon end. On Sept. 2, Cibil launched the country's first mortgage repository in consultation with the National Housing Bank(NHB). The National Housing Bank is also pushing for mandatory registration of equitable mortgages. This would increase the cost of home loans as lenders would have to pay a stamp duty which is related to the property value. The stamp duty is in turn recovered from the borrower. NHB is also working with 10 major banks in the country to set up a central mortgage repository which will have an electronic registration of mortgages, which will be mandatory for everybody, following the announcement made in the latest union budget.

US Council eyes non-banks rule by Jan

The new top council of U.S. financial regulators will propose in January a new rule giving it authority over non-bank financial institutions and by mid-year will propose a new rule for oversight of derivatives markets, U.S. Treasury Secretary Timothy Geithner said on Nov.23. "First in January the council is going to propose a rule governing the designation of non-bank financial institutions," Geithner said in opening remarks to a public session of the Financial Stability Oversight Council. "This critical step will help enable the council to place under heightened oversight all financial institutions, not just banks, that could pose a threat to our financial system," [Washington, Reuters, Nov. 23] ■

FIDC pleads for revising risk weightage of financed assets

FIDC, while placing the issues concerning NBFC-AFCs before RBI Governor, pleaded for calibrating risk weightage according to risk profile of respective assets rather than at the uniform rate of 100 percent, reiterated need for alternative long term funding arrangement for asset financing companies[AFCs] and removal of sub-limit of Rs.10 crore for acceptance of public deposits by small unrated NBFCs. FIDC office bearers met top officials of regulatory authority prior to review of second quarter monetary and credit policy for current financial year on 18 October.

FIDC office bearers also requested the RBI authorities to suitably advise all state governments that NBFCs regulated and supervised by it should be excluded from the purview of money lenders' act as the NBFCs are registered with the RBI are fully regulated by it.

Mr. T.T.Srinivasaraghavan, Chairman, FIDC said that "it is a well documented fact, based on the detailed analysis undertaken by credit rating agencies that commercial vehicles, cars and construction equipment have a much lower risk profile as compared to other categories of assets."FIDC suggested that the risk weightage for assets financed by NBFC-AFCs be revised according to the risk profile. This will provide NBFC-AFCs a degree of capital relief, which is also in consonance with the Basel II requirement for banks, he added.

According to a RBI notification issued way back in 1998 an asset financing NBFC (NBFC-AFC) which is unrated can accept public deposits up to 1.5 times its NOF or Rs. 10.00 crore, whichever is lower. Despite raising of the minimum (entry level) NOF prescribed for registration of NBFCs with RBI from Rs. 25.00 lakh to Rs. 2 crore the deposit acceptance limits have remained unchanged. Even the number of deposit accepting NBFCs have drastically reduced from about 30,000 in 1998 to barely 300 in 2010. FIDC represented that all eligible unrated deposit taking NBFC-AFCs, which maintain a capital adequacy ratio of 15%, should be allowed to accept public deposits up to 1.5 times their NOF and the cap of Rs.10 crore be removed.

NBFCs tell RBI they are better-placed to float bank

NBFC have told the RBI that they are more competent to float a bank, since they are already in the business of lending and are familiar with RBI regulations. The issue came up on Oct. 7 in a meeting with RBI on discussion paper issued by RBI for giving new bank licences. Three RBI deputy governors — Usha Thorat, KC Chakrabarty and Subir Gokarn — were present in the meeting. Five prominent NBFCs — Mahindra & Mahindra Finance, Indiabulls Financial Services, Reliance Capital , Srei and Sriram Transport — attended the meeting which was led by FIDC.

"We have pointed out to RBI that NBFCs who are asset financing with good track record are better placed to run a bank than a corporate house. Secondly, NBFCs are competent because unlike corporates, they are familiar with RBI regulations," said Mahesh Thakkar, director general of Finance Industry Development Council, who was present in the meeting.

On the issue of capital requirement, Mr. Thakkar said the level should be high and the NBFC sector would be comfortable with the levels proposed by the RBI. "We are comfortable with Rs. 500 crore net owned funds that would be gradually raised to Rs.1,000 crore in five years as proposed. We need high capital base to meet the business requirements, he said. On promoters' holding, FIDC has said they would be willing to start with anything between 26-40 per cent, which would be brought down to 10 per cent gradually as per the central bank's requirements.

Mr.Thakkar said the NBFC participants at the meeting also conveyed to the RBI that they were better placed as a vehicle for spreading the financial inclusion message. "NBFCs are already working in deep interiors of the country and are often the first point of interaction with clients for their banking needs. Many rural people experience credit for the first time through NBFCs since we are there for last mile." He added.

FIDC has further indicated to RBI that a conversion of NBFC into a bank will take a longer time for it to commence business and thus they would prefer if NBFCs are allowed to sponsor a bank. FIDC had also told RBI that NBFCs should be given 10 years time to lower the stake below 10%. [ET/Financial Chronicle, Oct.8]

FIDC In Action

Leave granted by SC to file the FIDC Handbook on Repossession

In the matter of Citicorp Maruti Finance Ltd. v/s S. Vijayalaxmi, the matter was listed for hearing on 3rd Dec., 2010 before the Supreme Court bench of Justice Altamas Kabir and Justice Cyriac Joseph. The bench has granted leave to FIDC to file the FIDC Handbook on Repossession by way of an additional affidavit. Mr. Uday U Lalit, Senior Counsel appeared on behalf of FIDC.

New regulation of MFIs should not affect NBFC-AFCs: FIDC tells Malegam panel

FIDC was invited by the Malegam Committee constituted by the RBI to 'study issues and concerns in the micro finance sector' to present FIDC views. FIDC Chairman Mr. T T Srinivasaraghvan, Co-Chairman Mr.Raman Aggarwal and Director General Mr. Mahesh Thakkar met the committee at RBI office in Hyderabad on 16th December and emphasized that "any new regulation of MFIs registered as NBFCs with RBI should not overlap or affect the prevailing regulations prescribed for NBFC-AFCs." This was in view of the fact that existing RBI regulations governing NBFC-AFCs are comprehensive and bank-like in nature. While MFIs are placed on a different footing since their lending is mostly unsecured and the regulations governing them may have to address their specific issues.

FIDC delegation also suggested that "all NBFC-AFCs should be clearly exempted from the provisions of all Money Lending Legislation of the states since they are fully regulated by RBI," as any coverage under such State Money Lenders laws creates avoidable confusion. Moreover, experience has shown that any such development leads to undue harassment.

Issues for follow up with RBI

The Managing Committee of FIDC at its Kolkata meeting decided to take up with regulatory authority the following issues as may be necessary: 1. Draft securitization guidelines, 2. Inclusion of NBFCs as Business Correspondents, 3. Risk-weightage for commercial vehicles, 4. Long-Term Funding, 5. Separate Refinance window, 6. Removal of sub-limit of Rs 10 crore for public Deposits, 7. Applicability of Money Lenders Act to NBFCs, 8. Financial Inclusion.

VAT on repossessed vehicles

Legal Committee of FIDC will undertake a comparative study on VAT vs. Service Tax in view of imposition of VAT by some states on repossessed vehicles. A view on legal recourse on the issue can be taken after Magma Fincorp case is decided by the court.

Next at Kochi meeting

The Managing Committee decided to appoint Mr. H N Sinor as a Permanent Special Invitee to FIDC.

The next meeting of the Managing Committee of FIDC will be held in Kochi on 26th February, 2011. ■

Views expressed herein are not necessarily the views of FIDC.

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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

"It's a scandal! He says he doesn't accept bribes!"

(Courtesy : Business Line)

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