FIDC NEWS

Finance Industry Development Council

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

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RBI raises CAR to 15 percent for NBFCs

The RBI move is very disappointing. One of the things that we as asset-financing NBFCs have been pleading with RBI for several years now, is that risk capital should be tied to the type of assets that we finance and that different risk weights should be assigned to different classes of assets, based on their risk profile and our ability to repossess and realise value from these assets, should the need arise. Though some of us whose capital adequacy ratio[CAR] is well over 15%, do not have a problem, I don't think that is really the point.

If you have to provide more risk capital, then obviously it is more of a squeeze, especially given that NBFCs, barring the top few, are not the most favourite category of companies for investors. Hence, capital is always scarce for them, which is a tragedy. On the one hand, everybody loves to talk about financial inclusion, but we systematically exclude hundreds of smaller entities, and regulations like this one will only make life harder for them. That's not good news for the industry, or even for the economy , because these smaller NBFCs have time and again demonstrated their ability to deliver credit to the underserved sections of the population.

T. T. Srinivasaraghavan, Chairman

Regulatory Perimeter

Know Your Customer (KYC) Norms/ AML Standards/CFT:

RBI vide circular No. DNBS(PD).CC. No 210/03.10.42/2010-11 dated Feb. 14 has asked NBFCs to complete implementation of a statement dated October 22 issued by FATE.

NBFCs/RNBCs - Anti- Money Laundering/Combating Financing of Terrorism Standards:

By Notification No.DNBS(PD).CC. No 209/03.10.42 /2010-11 dated January 28, 2011 RBI has asked all NBFCs (including RNBCs) to take into account risks arising from the deficiencies in AML/CFT regime of notified countries, while entering into business relationships and transactions with persons (including legal entities and other financial institutions)as stated in a further statement dated October 22, 2010 issued by FATE.

Bullion dealers and jewelers should also be categorized by NBFCs as 'high risk'

All NBFCs (including RNBCs) are advised to take note of modifications to para 2 of Annex VI of the Master Circular No.184 dated July 1, 2010 and are required to apply enhanced due diligence measures on high risk customers. Some illustrative examples of customers requiring higher due diligence have also been given in the paragraph under reference. NBFCs have been further advised by the RBI vide Notification dated March 8, 2011

AT A GLANCE

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that in view of the risks involved in cash intensive businesses, accounts of bullion dealers(including sub-dealers) and jewelers should also be categorized by NBFCs as 'high risk' requiring enhanced due diligence In terms of paragraph 4 of Annex-VI, high risk associated with such accounts should be taken into account by NBFCs to identify suspicious transactions for filing Suspicious Transaction Reports (STRs) to FIU-ND.

NBFCs told to drive up CAR to 15%

Finance companies which raise public deposits will have to bring in more capital to do business. The new rule, laid down by the RBI, will apply to large NBFCs. This is in response to an RBI directive, which asks finance companies taking deposits from the public to maintain higher capital adequacy ratio (CAR) of 15% by March 2012. At present, finance companies are required to maintain a CAR of 12%.

Large finance firms which do not raise public deposits but are considered to be systematically important by the central bank, were asked to step up their CAR to 15% by March 2011 while the same was not applied for deposit-taking NBFCs. Systemically, important non-deposit-taking NBFCs are those companies which have an asset base of over 100 crore. The recent RBI circular said: “It has been decided to align the minimum capital ratio of all deposit- as well as systemically important non-deposit-taking NBFCs to 15%.” The RBI, however, has not given any reason for increase in CAR.

“This move was not necessary at this time. It will only create a liquidity crunch for NBFCs,” said Mahesh Thakker, director of FIDC. “Also, unlike in the past, this time RBI has not followed a consultative approach,” he added. [Economic Times, 18 Feb.]

Provision of 0.25% for standard assets of NBFCs

The Reserve Bank on January 17 in a press release said that all NBFCs are required to make necessary provisions for non performing assets. In the interests of counter cyclicality and so as to ensure that NBFCs create a financial buffer to protect them from the effect of economic downturns, RBI has directed NBFCs to make provisioning for standard assets also. Accordingly (i) NBFCs should make a general provision at 0.25 per cent of the outstanding standard assets. (ii) The provisions on standard assets should not be reckoned for arriving at net NPAs. (iii) The provisions towards Standard Assets need not be netted from gross advances but shown separately as 'Contingent Provisions against Standard Assets' in the balance sheet. (iv) NBFCs are allowed to include the 'General Provisions on Standard Assets' in Tier II capital which together with other 'general provisions/ loss reserves' will be admitted as Tier II capital only up to a maximum of 1.25 per cent of the total risk-weighted assets. For complience Notifications No. DNBS. 222 CGM(US)2011 and No. DNBS. 223 CGM (US) 2011 both dated January 17, 2011 be seen.

Amendment to Definition of Infrastructure Loan

The term “Infrastructure Loan” has been defined in Para 2(viii) of Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 and Non-Banking Financial (Non - Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007, respectively. It has now been decided by the RBI to include “Telecom Towers” also as an infrastructure facility for availing credit facility. RBI has further clarified by Notification No.DNBS(PD).225/ CGM(US)-2011 dated March 16, 2011 that only Credit Rating Agencies(CRAs) approved by the Reserve Bank can give the rating to Infrastructure Finance Companies.

[RBI website]

RBI clarifies stand on gold loan move

The RBI had asked banks to not classify loans extended to NBFCs which were lent by NBFCs against gold as priority sector loans. “Gold loan companies are lending the money at a very high rate to customers. The money may not be going to priority sector borrowers. We do not know whether the gold loan companies are using the money, which they borrowed from banks, for borrowers who come under priority sector,” K C Chakrabarty, deputy governor of the RBI, said on Feb. 5. He, however, clarified that banks could continue to lend to the NBFCs which are in the gold loan business. [BS Reporter, February 6]

RBI clarifies on NCD issue rule

The RBI clarified that a certificate from a single bank would suffice on the quality of assets of a non-convertible debenture (NCD) issuer, even if the issuer was maintaining multi-banking facilities. The NCD issuer would have to give an undertaking that its accounts at the other banks and financial institutions were classified as standard assets. RBI also said in raising funds through issuance of NCDs in multiple tranches, based on a single rating for the consolidated amount, each tranche need not be separately certified by the auditor. “However, where the issuer obtains a separate/fresh rating for an issuance, such issuance must be backed by an auditor's certificate, confirming the issuer's compliance with the eligibility criteria for issuance,” the RBI said. On December 6, while amending a notification on NCD issuance, RBI had said, “the borrowal account of the corporate is classified as a Standard Asset by the financing bank/s or institution/s”. A corporate entity is eligible to issue NCDs if the entity has a minimum net worth of Rs 4 crore and the company has been sanctioned a working capital limit or term loan by a bank.

[BS Reporter, December 28, 2010]

Services to Persons with Disability – Training for Employees of NBFCs

In continuation to a circular DNBS.CC.PD.No. 191/03.10. 01/2010-11 dated July 27, 2010, RBI has advised NBFCs on Jan. 28, 2011 that they may include a suitable module containing the rights of persons with disabilities guaranteed to them by the law and international conventions, in all the training programmes conducted for their employees at all levels. Further, NBFCs are advised to ensure redressal of grievances of persons with disabilities under the Grievance Redressal Mechanism already set up by them. [RBI Bulletin, Feb.2011]

RBI gives breather to MFIs

The RBI has asked banks to go easy on microfinance institutions (MFIs) by relaxing certain norms regarding loan restructuring. Banks can now restructure loans extended to MFIs even if they are not fully secured. As a special case, banks need not classify such loans as non-performing assets (NPAs). “This relaxation was given considering the fact the problems afflicting MFIs were not necessarily on account of any credit weakness per se but mainly due to environmental factors,” RBI said in a note. A top official of the Indian Banks' Association said total lending by banks and financial institutions to MFIs was over Rs 20,000 crore. Over 85 per cent of the exposure was to six-seven large players. “Banks will subject larger MFIs to greater scrutiny for books, pricing and recovery practices,” said the official.

The ad hoc measures required the various banks financing an MFI to come together to restructure the package. The common approach would improve information sharing and discipline in MFIs as borrowers, the official added. The restructuring will

involve giving more time for repayment, a cut in interest rates, making some sacrifice on the amount due, asking MFI promoters to bring additional capital and commitment to restructure clients' loans. These measures are applicable only to standard accounts. As a special case, when restructured, the unsecured loans to MFIs would be treated as standard assets. This would save banks from making provisioning for NPAs.

RBI has advised banks to recycle the collections of MFIs. This translates into MFIs using the repayment amount for further lending and operational purposes. These temporary measures are applicable to MFI loans restructured till March 31, 2011. RBI said this would help ease the liquidity crunch until action was taken on the recommendations submitted by the Malegam committee.

Priority sector loans to cover actually disbursed amount

The RBI, based on reported mis-classification of priority loans at the time of the annual financial inspections of banks, interalia among other aspects, has noticed that "typically when banks buy loans from intermediaries like MFI/NBFCs given to eligible priority sector borrowers, they reckon the present value of the loans arrived at by discounting at their rate of lending which is typically much lower than the actual rate charged to end–borrowers by such intermediaries. This has the effect of overstating the actual amount of priority sector loans to the extent of premium paid by banks to such intermediaries". The RBI has asked the banks on January 28 that they must report the nominal amount actually disbursed to end priority sector borrowers and not the premium-embedded amount paid to the intermediaries.

RBI forms panel to look into NBFCs' regulation

The RBI has formed a working group headed by Usha Thorat, a former deputy governor to examine issues regarding regulation of NBFC. "The working group will focus on the definition and classification of NBFCs, addressing regulatory gaps and regulatory arbitrage, maintaining standards of governance in the sector and appropriate approach to NBFC supervision," a press release from the RBI said. [Reuters, March 7]

No NBFIs licensed for Tripura: RBI Governor

RBI Governor Dr D Subba Rao has expressed concern over the growth of non-banking financial institutions (NBFI) in Tripura while making it clear that they did not allow any NBFIs to do business in the state. He requested the state government to take legal action as per IPC and CrPC provisions against unauthorised agencies and the RBI would do as per the existing law. In a meeting with Tripura Finance Minister Badal Chaudhury at the RBI headquarters in Mumbai, Dr Rao made it clear that as many as 114 NBFIs, which had been operating in Tripura, were not issued any licence or permission to do business in the state. Mr. Chaudhury said, at least 17 officials of several NBFIs had been arrested in Tripura and investigation was still on.

RBI to cut NBFCs' exposure overseas

Overseas subsidiaries of Indian NBFCs might have to drastically cut back pledging assets of their parent firms when they want to access low-cost funds from foreign markets. The government and the RBI might bring in quantitative limits to how much guarantee an Indian NBFC can offer its foreign subsidiaries which are in the borrowing and lending space. The firewall will force these subsidiaries to make deeper investments to build their own resources, instead of getting loans on the basis of credibility and goodwill of their India-based parents. After the global meltdown, RBI became uncomfortable with NBFCs extending guarantees on behalf of their overseas units, as it meant the domestic entities were exposing themselves to financial liabilities over whose size or scope the RBI could exercise no control.

RBI's steps are aimed at ensuring the smooth functioning of domestic NBFCs. "For this, it is essential that these entities do not have undue exposure to assets having high risk. The subsidiaries of these institutions should have sound financial fundamentals of their own," a senior government official said. The central bank's planned move is its first measure to put the brakes on overseas activities of NBFCs. [Financial Express, Dec 29, 2010]

RBI to plug regulatory gaps in NBFC biz

The RBI plans to strengthen the regulatory framework for non-deposit taking systemically important NBFCs as tightening of the regulation for the banking sector has increased the incentives for regulatory arbitrage by moving business to NBFCs. Pointing out that setting up an NBFC is a more attractive option as entry point norm for them (at present net owned funds of Rs 2 crore) is low as compared to that for banks (Rs 300 crore) and that they are subject to relatively lighter touch regulation, the RBI, in its second financial stability report said "some concerns remain especially in the context of the rapidly expanding NBFC sector."

Among the reasons why regulatory gaps need to be plugged include NBFCs not being subject to any restrictions regarding investment in the capital market thereby leading to enhanced market risk; nor do they have any restrictions on setting up of subsidiaries, thereby allowing setting up of possibly opaque structures with concomitant transparency issues. Further, quality of corporate governance and management can give rise to serious concerns, the report said.

Another concern that arises is in the context of definition of an NBFC in terms of its "principal business" which makes it possible for an NBFC to conduct some other non-financial activity by deploying funds in non-financial assets, leading to a lack of level playing field vis-à-vis banks. Multiple regulators for non-banking financial entities in the country and an entity-based approach to regulation gives rise to possible regulatory gaps-functional activities remaining unregulated, gaps in regulation permitting surrogate raising of public funds, leveraged activities by entities like merchant banks, portfolio managers and brokerages not being subject to prudential regulation. These, according to the report, will need to be urgently addressed. [Business Line, 9 Jan. 11]

RBI to stop NBFCs from raising surrogate deposits

The RBI is in the process of formulating guidelines in conjunction with the ministry of corporate affairs, to plug a regulatory gap that permits surrogate raising of deposits by NBFCs. RBI said in its second Financial Stability Report, released on Dec. 30. NBFCs are exempt from the provisions of Section 67 of the Companies Act, 1956, in terms of which the issuance of shares or debentures to more than 49 investors needs to be through public issuance.

This means that NBFCs, particularly those not regulated by the Reserve Bank, could issue debt or quasi-debt instruments to a large number of retail or institutional investors on a private placement basis. This would be tantamount to raising public deposits outside the extant regulatory framework. Specific concerns in this regard have arisen in the past in the context of private placement of Convertible Preference Shares (CPS) by few NBFCs, the RBI said. The apex bank observed that internationally, the tightening of the regulatory regime for the banking sector has raised the possibility of increased regulatory arbitrage vis-a-vis the non-banking financial sectors. In India, too, according to RBI, this remains an area where vigilance will need to be continuously exercised in view of the strong cross-linkages between the various segments of the financial sector.
[FE Bureau, Jan 01, 2011] ■

Promoting Financial Inclusion Through Non-Banking Finance Companies (NBFCs)

Presented by :
RAMAN AGGARWAL
Co-Chairman, Finance Industry Development Council (FIDC)

Financial Inclusion

- Not just microfinance i. e. small loans
- Not just multiplying deposit accounts which remain inactive
- Not merely providing reliable & efficient payments system like mobile phone led retail payments
- Financial Inclusion is providing accessibility of financial services to the poorest of the poor at an affordable cost in every part of the country
- Financial Inclusion, therefore, represents reliable, affordable, flexible and easy access to savings, loans, remittances and insurance services to every citizen of the country – even to children at least for the purpose of opening their savings accounts

Financial Inclusion & Financial Regulation

- There cannot be a trade off between financial inclusion & financial regulation
- Both must work in tandem
- Importance of regulation for promoting financial inclusion
  - Financial Inclusion is possible only through banking services. Banking without regulation would be a catastrophe.
  - Intermediaries need capital and achieve some optimal size, Capital is required for technology and economies of scale in order to deliver affordable services.
  - Regulations enhance confidence of the customers and the Investors & Lenders are also comfortable in dealing with regulated entities.
- The recent concerns on functioning of some of the MFIs arise mainly due to lack of regulation for MFIs

Why NBFCs?

- Successful track record of more than 60 years
- Key aspects of financial activity are well regulated (almost at par with banks):
  - Registration with the regulator
  - Minimum size (Net owned Fund)
  - Minimum Capital Adequacy Ratio
  - Prudential Norms on asset classification, income recognition and provisioning
  - Know Your Customer (KYC) & Anti Money Laundering Guidelines
  - Asset Liability Management Guidelines
  - Credit Concentration Norms
  - Maintenance of SLR
  - Code of Fair Business Practices

How suitable are NBFCs for Promoting Financial Inclusion

	Banks	MFIs	NBFCs
Reliability	Max. - Most regulated entity	Low-lack of regulation has put a question mark	High-13 yrs of regulations almost at par with banks
Affordablitiy	Highest	Doubtful Recent concerns on exuberant lending rates	High-compared to MFIs & Local money lenders
Accessibility	Low Only 5% of habitations have bank branches in India	Highest-As they work at the grass root	High-As they cater to unbankable segment in rural & semi urban areas
Flexibility	Low-due to size & rule bound and takes time to change or take different decisions	Highest-has been misused leading to high delinquencies	High-A balance between flexibility & low delinquencies maintained
NBFCs have all the key characteristics to achieve Financial Inclusion			

- Promote Urban Financial Inclusion also (in addition to rural financial inclusion)
- Use modern technology and have developed sound MIS
- NPA levels have been lower than that for banks
- Small & Medium NBFCs are having a local/ regional presence (and the large NBFCs through their branches or franchisees) are well versed with the local conditions/requirements
- Prevent concentration of credit risk in banks only and complement the banking services
- Product innovation gives NBFCs an edge
  - used vehicles/machinery financing
  - Small ticket personal loans
  - Two wheeler/ three wheeler financing
  - Financing for tyres & fuel
- Services not restricted by working hours and hence customer relationship is stronger
- Provide prompt & tailor made services with least hassles
- Provide a personalized touch – Guidance in insurance matters and help in their hour of need at any time of the day
- Cater to a class of borrowers who :
  - are "unbankable"
  - Do not necessarily have high income
  - are honest & sincere (gauged by the personal touch maintained with them)

Role of NBFCs as Recognized by Expert Committees

- **1971 - Bhabatosh Datta Study Group**
  - NBFCs usefully supplement the activities of banks in both deposit mobilization & lending
  - Capable of playing a dynamic role in the economy
- **1975 - James Raj Study Group**
  - Need for regulation and not prohibition of deposit acceptance by NBFCs
- **1987 - Chakaravarty Committee**
  - Regulation for NBFCs should not curb their activities which genuinely help trade & Industry
- **1991 - Narasimham Committee**
  - Full regard to the important and growing role of Leasing & Hire Purchase Institutions
  - Need to have linkage by banks with NBFCs
- **1992 - Shah Committee**
  - NBFCs provide tailor made services to clients
  - Higher levels of customer orientation, simplicity & speed
  - NBFCs cater to a section of borrowers left outside the purview of banks by the monetary & credit policy
  - NBFCs play a role in enlarging the degree of financialization of savings
  - Growth of NBFCs & general economic growth are positively co-related
- **1996 - Khanna Committee**
  - NBFCs play a significant role in economy, especially in - dispensation of credit to Road Transport & SSI sectors mobilization of deposits
- **1998 - Vasudev Committee**
  - NBFCs have greater reach & flexibility
  - Provide retail services to small & middle businesses and Road Transport Operators
  - Constitute an important link between banks and requirer of services
  - Leasing & Hire Purchase Finance Companies perform a very important intermediation role conducive to the country's economic well being
  - Small NBFCs are more efficient in consumer finance
- **2003-The Parliamentary Standing Committee on Finance**
  - NBFCs work like quasi banks
  - Provide funds to the sectors where a credit gap exists
  - NBFCs play a complementary & competitive role
  - Easy access, absence of many formalities & easy money availability make NBFCs attractive to public

Issues : Overview

- NBFCs not included in the official agenda on Financial Inclusion
- RBI guidelines on Business Correspondents for banks exclude NBFCs
- Focus has been on "regulation" instead of "development" of NBFCs
- Need for the regulator to also play the developer's role
- Lack of level playing fields with banks & FIs
- RBI discourages acceptance of public deposits by NBFCs despite regulations; on the contrary, the MFIs have been accepting public deposits without regulation
- No insurance for deposits held by NBFCs despite regulation almost at par with banks
- Some of the State Govts treat NBFCs as money lenders under the State Money Lenders' Act despite regulation by the RBI

Issues : Funding of NBFCs

- Bank Funding
  - Lack of linkage by banks with NBFCs despite strong recommendations by various Expert Groups
  - Need for liberal Bank Funding at competitive rates
  - "Wholesaler – Retailer" relationship between banks and NBFCs needed
- Deposit acceptance limits have not been changed since 1998
- Securitization Guidelines issued by RBI have restricted securitization of receivables – it needs to be 'Originator – friendly'
- Urgent need for Refinance window for NBFC-AFCs – SIDBI & NABARD along the lines of NHB funding to HFCs

Issues : Taxation of NBFCs

- Income Tax Benefits
- Income Tax Act - Deduction allowed to banks, FIs & HFCs, for non-recongnition of income on NPAs and provisions made against NPAs – denied to NBFCs only
- Exemption from TDS requirements denied to NBFCs only
- TDS on lease rentals entails deduction of TDS from the principal component also
- Service Tax on Interest component of financial lease & hire purchase transactions make them unviable as compared to a loan transaction
- Multiple taxation of financial lease & hire purchase transactions – VAT, Service Tax, Interest Tax & TDS

Issues : Recovery Mechanism

- There is no laid out Recovery mechanism to facilitate recoveries by NBFCs
  - Timely Recovery of our dues shall ensure timely payment of our liabilities including deposits
- Debt Recovery Tribunals (DRTs) are not available to NBFCs
- NBFCS are not covered under SARFAESI Act :
  - It just needs a notification by RBI
  - There is no apparent reason for denial of this benefit
  - If the private ownership and subjectivity of decision of invocation of these provisions is the issue, RBI may appreciate that even urban cooperative bank

managements are also private and more subjective than the highly professional management of NBFCs

What Needs to be Done?

Need for Policy Statement from Govt. of India

- Unambiguous message that NBFCs are part of the mainstream financial sector
- A 'Wholesaler – Retailer' relationship between banks & NBFCs
- Clear message to State Govts to exempt NBFCs from the purview of Money Lenders' Act
- Road Transport Finance & Infrastructure Finance to be given a special status similar to Housing Finance
- Coverage to NBFCs in all the Financial Sector legislations like SARFAESI Act, DRT Act, Income Tax Act, etc.

Need for Supportive Environment

- Leasing as a tool for lending to low capital SMEs needs to be promoted
- Clarity on definition and taxation of leasing
- Supportive laws governing accounting rules, property rights and contract enforcement will be of prime importance
- Fast track recovery mechanism like Repossession of Assets using "private" means within the legal framework
- A new regulatory approach
  - NBFCs are a vital link in Financial Inclusion
  - Development of NBFCs to ensure co-existence with Banks & FIs
  - Removing inequitable restrictions vis –a-vis banks
  - Stable & Long term policy framework enabling the players to evolve long term strategies
  - Closer consultation with representative bodies
  - Play the dual role of growth enabler and the regulator

[Mr. Raman Aggarwal was invited to make a presentation at EuroFinance India 2010 Conference on Cash, Treasury and Risk Management in India held in New Delhi on Nov. 23-24, 2010. He had made this presentation in the session on 'Strength in Diversity and Financial Inclusion'.] ■

'Govt has power to attach properties of financial cos who dupe investors'

The Supreme Court has said the Government has the power to attach the properties of financial companies who dupe gullible depositors of their money by promising high interest rates, and then disappear even overseas, thereby leaving the depositors and the State Police high and dry. The court was hearing an appeal against an order by a Full Bench of the Madras High Court that held as constitutionally valid the Tamil Nadu Protection of Interests of Depositors (in Financial Establishments) Act, 1997 (or the Tamil Nadu Act). The apex court observed that the Act "rightly" provides for measures for attachment of the properties of the financial establishments as well as mala fide transferees and to bring these properties for sale for realisation of the dues payable to the depositors speedily without dragging them into a legal battle. "The Tamil Nadu Act is …focused on remedying the situation of the depositors who were deceived by the fraudulent financial establishments," the apex court Bench said. "Without the aid of the Act, it would have been impossible to recover their deposits and interest thereon," the court said.

Though the appellant cited a Full Bench decision of the Bombay High Court by which a similar Act of Maharashtra — the Maharashtra Protection of Interests of Depositors (in Financial Establishments) Act, 1999 — was held to be unconstitutional. However, the apex court said the Full Bench of the Madras High Court is correct, while the judgment of the Full Bench of the Bombay High Court is not correct. The appellant also submitted that the Act is liable to be struck down as the field of legislation is already occupied by legislation of Parliament being the RBI Act, 1934, the Banking Regulation Act, 1949, the Indian Companies Act, 1956 and the Criminal Law Amendment Ordinance, 1944 as made applicable by the Criminal Law (Tamil Nadu Amendment) Act, 1977. It was also contended that the Tamil Nadu Act was arbitrary and unreasonable and that it violates of the Constitution. But the apex court said none of these submissions have any merit.

The apex court also noted that the 'financial companies' in the present case had not obtained any licence from the RBI, and hence they are not governed by the RBI Act and the Banking Regulation Act. The court added that activities of these financial companies do not come within the meaning of the term 'banking' as defined in the Banking Regulation Act or the RBI Act. Due to this, they escaped from public control, the court said.[Business Line, March 8]

Drawer of bounced cheque should not be punished twice

In a case of bounced cheque, the Supreme Court (SC) has ruled a person convicted for issuing the instrument cannot be prosecuted again on the charge of cheating about the same cheque. The cheque issued without sufficient balance in the account is a case under Section 138 of the Negotiable Instruments Act. The offence of cheating is under Section 420 of the IPC. In this case, Kolla Veera vs Gorantla Rao, the convict submitted he was found guilty in the cheque case; so he could not be punished a second time for issuing the cheque as a case of cheating. [Business Standard, Feb.21]

SEBI sets listing norms for securitised debt

In a move that is expected to improve liquidity and deepen the securitised debt market, the Securities and Exchange Board of India (SEBI) introduced a 'Listing Agreement for Securitised Debt Instruments'. This is expected make these instruments more transparent and attract more participants. "With a view to enhance information available on the public domain on performance of asset pools on which securitised debt instruments are issued, it has been decided to put in place a Listing Agreement for securitised debt instruments," SEBI said in a circular. It will help bring in transparency in listing of securitised debt instruments, as the issuers will now need to disclose information of three levels – the pool level, tranche level and select loan information. According to industry experts, this will help increase the number of deals in the securitised debt market.

The SEBI regulations issued in 2008 provided for issuance and listing of securitised debt instruments by a special purpose distinct entity (SPDE). These SPDEs, which are already listed and come out with frequent issues of securitised debt instruments, will now file "umbrella offer documents", on the lines of shelf prospectus. [BS Reporter, March 17]

New MFI Bill to leave no space for state laws

The new law to regulate the microfinance sector may make similar state legislation null and void.The Bill — to centrally regulate microfinance institutions (MFIs) — may also cap the rates charged by these institutions or limit margins, that is, the difference between the rate charged from the borrower and the lender's cost of funds. The Microfinance Bill is being drafted on the lines of the report of the RBI's Malegam committee. A finance ministry official, who did not wish to be identified, said under the proposed law, there would be a cap on rates. MFIs would also not be allowed to take deposits from the public, he said. The Malegam committee has recommended a margin cap of 10 per cent for MFIs with a loan portfolio of Rs 100 crore and above and 12 per cent for smaller MFIs. It has also suggested a 24 per cent cap on rates charged from individuals.

The Centre plans to draft the Bill in such a way that microfinance is seen as an activity enabling the poor to use credit to improve their lives. If microfinance was defined as just a money lending activity, if would come in the Constitution's State List, said the official. Finance Minister Pranab Mukherjee, in his Budget speech, had given a strong indication that the government would come up with a law for MFIs.

The finance ministry official said such microfinance institutions would be treated as non-deposit taking non-banking finance companies and the proposed Bill would be in sync with RBI regulations for NBFCs. RBI Governor D Subbrao has said it will take a view on the Malegam Committee report by April-end. [Business Standard, 5 March, 11] ■

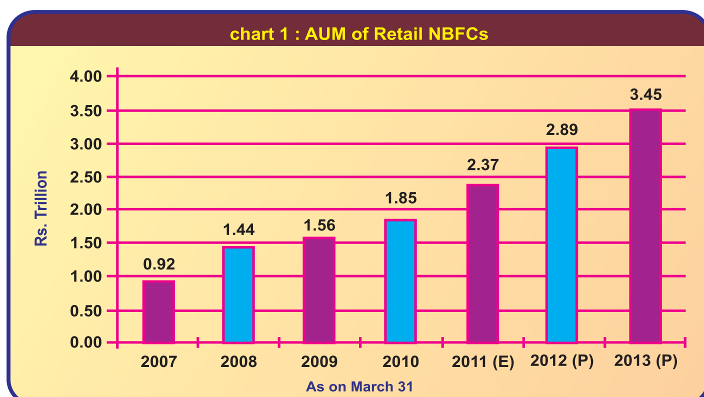
NBFCs' Growing role in retail finance

CRISIL SAYS:

- **NBFC sector is emerging as a strong financial intermediary in the retail finance space.**
- **Retail NBFCs' are expected to report a compound annual growth rate (CAGR) of 20 per cent between 2011 and 2013.**
- **The sector's assets under management (AUM) are expected to double by 2013 from the 2010 levels.**
- **NBFCs may continue to gain market share at the expense of banks.**
- **New groups are entering the NBFC sector in pursuit of growth opportunities offered by the various product segments.**
- **NBFCs, especially the domestic players, are well poised to move towards the next phase of growth and scale up their operations.**

Retail NBFCs to witness healthy growth, despite temporary hiccups

CRISIL believes that retail NBFCs will witness healthy growth over the medium term. As per CRISIL estimates, the AUM of these NBFCs, which reported two-fold growth over the period 2007-10, will again nearly double by end-March 2013 *(refer to Chart 1)*. The growth in coming years will be driven by growth in new product segments such as gold financing and LAP; the growth rate in gold financing is, however, expected to ta per, primarily due to the removal of priority sector status.

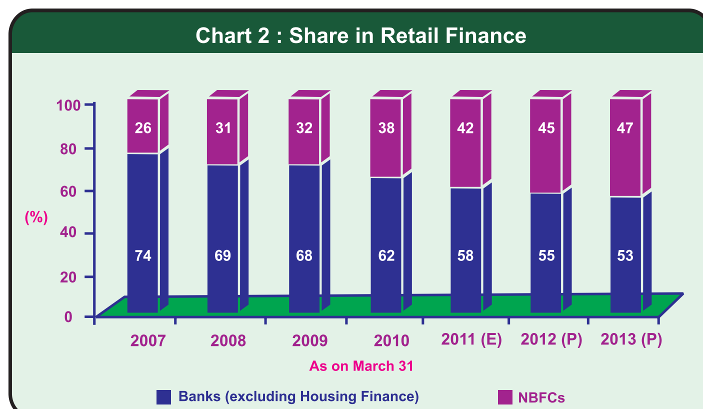


The retail NBFC sector has been able to recoup quickly from the economic downturn of 2008-09 (refers to financial year, April 1 to March 31), as reflected in AUM growth of 19 per cent in 2009-10 as against 8 per cent in 2008-09. Furthermore, following the economic revival from the second half of 2009-10, vehicle finance NBFCs have also witnessed a healthy revival in growth, and are now expected to achieve stable growth.

Within the retail NBFC sector, domestic NBFCs will remain the dominant contributor; contribution from foreign NBFCs will remain limited over the medium term. Despite improvement in the operating environment, the overall performance of the foreign NBFCs remains muted. Competitive pressures and high delinquencies in the unsecured retail loan portfolios led foreign NBFCs to downsize their operations; On the upside, peaking of losses in the unsecured portfolio and movement to secured asset classes is expected to improve their growth going forward.

NBFCs to continue to gain market share at the expense of banks

The steady pace of growth for the NBFC sector vis-a-vis slower growth rate for banks has resulted in a significant increase in the NFBC's share in the total retail finance pie over the past few years. CRIS1L expects NBFCs to almost match the share of the banking sector by the end of March 2013. As on March 2010, NBFC's share in retail finance, as compared to banks, has already increased to around 38 percentfrom 26 per centthree years ago *(refertoChart2)*.



While NBFCs have grown steadily over the past three years, the non-housing retail assets of banks have displayed subdued growth, registering a CAGR of around 5 per cent; in fact, banks registered a decline in growth of around 7 per cent in 2009-10 in their non-housing retail portfolio. High delinquencies in the unsecured loans portfolio, particularly for private sector banks, slowdown in automotive loan growth during the economic downturn in 2008-09, and a greater focus on the relatively safe housing finance business, resulted in sharp decline in the banking sector's non-housing retail finance growth. With the revival in the macroeconomic environment from the second half of 2009-10, CRISIL expects banks' retail assets portfolio (excluding housing loans) to record positive, albeit moderate, growth over the medium term.

Retail finance business-Key growth enablers

In CRISIL's view, the core strengths of NBFCs lie in their sizeable presence in Tier II and III cities, given the NBFCs'good understanding of regional dynamics, which enables them to build strong customer relationships. This, coupled with product innovation and superior product delivery, has enabled NBFCs to maintain and enhance their competitive positioning, despite stiff competition from banks.

Strong market penetration and increasing operating efficiency

Retail NBFCs have strengthened their presence in the semi-urban and rural areas where retail finance penetration is low. While banks, especially public sector banks, have a large presence in these areas, it is largely to meet agricultural loan requirements. As per CRISIL estimates, semi-urban and rural segments account for more than 60 per cent of retail NBFCs[1] business. A significant part of the growth seen in NBFCs is, therefore, also a form of substitution of the credit typically extended by the unorganised sector, thereby contributingto the financial inclusion agenda.

Systems and process upgrade, focus on high-potential branches, and enhanced orientation towards the relationship-based model, has resulted in healthy improvement in operating efficiencies for NBFCs. A CRISIL analysis reveals that some of the large NBFCs have been able to increase their operating efficiency (measured by business per branch) by 35-40 per cent over the past three years, further contributing to thejr business growth.

Product innovation and superior delivery.

Given their deeper understanding of customer needs, NBFCs continue to focus on product innovation and customising product offerings. This helps NBFCs maintain their niche positioning, and gives them an edge over banks. A classic example of product innovation is the building of an organised market in used vehicle financing, a segment largely untouched by banks. Similarly, NBFCs have built a scalable business model in gold financing, despite banks' longstanding presence in this segment. An example of customisation would be the structuring of monthly installments while accounting for seasonality of cash flows, in case of construction equipment loans. Similarly, in the case of gold loans and LAP, NBFCs provide superior delivery by optimising turnaround time on loan disbursals.

Growth Drivers in Various Sectors of NBFCs

Sector : Vehicle Finance
Estimated CAGR 2011-13 in AUM : 15%
Key Drivers

- Comprises 50 per cent of total loans in the secto
- Growth expected to be in line with economic growth
- Large NBFCs to remain committed to their core areas of growth
- Better growth prospects in tractor loans and construction equipment financing segments

Sector : Loan against Property
Estimated CAGR 2011-13 in AUM : 17%
Key Drivers

- Secured avenue to fund working capital requirements of micro, small, and medium enterprises. Conservative loan-to-value ratios provide comfort
- High property prices enable unlocking value
- NBFCs have a niche presence in Tier II and III cities and, therefore, have an edge over banks, given their quicker turnaround times in meeting borrower needs

Sector : Gold Loans
Estimated CAGR 2011-13 in AUM : 40-50%
Key Drivers

- Growing willingness to borrow against jewellery
- Substitution effect of NBFCs exiting personal loans
- High stock of gold In the form of jewellery in India
- Highly under-penetrated market for gold loans
- Safe asset class given low volatility in gold prices and high liquidity
- NBFCs' first-mover advantage in the untapped markets in the country
- Growth Is, however, expected to reduce due to removal of priority sector status

In CRISIL's opinion, retail NBFCs have also benefited from their abiding focus on core segments. The ones that had ventured into unrelated businesses are rebalancing their activities with increased focus on core businesses; diversification is being pursued in a measured manner, and is largely restricted to activities that are related to the core segments.

NBFCs better equipped to withstand economic cycles

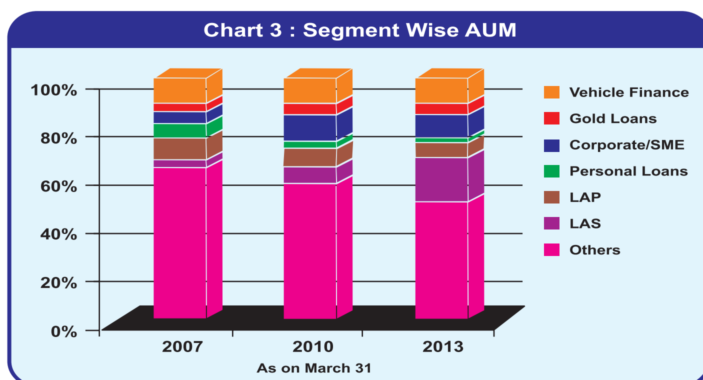
In CRISIL's opinion, positive developments in the NBFC sector, ranging from widening regulatory ambit, revamp in business strategies, and improved investor confidence, ensures a fair degree of stability in the sector. The NBFC sector withstood the economic downturn of 2008-09 well, when compared with the one in the late 1990s. No defaults were reported during the recent economic downturn, as against a high numberof defaults and exits during the economic downturn in the 1990s.

Increasing regulatory coverage

Regulatory supervision for the NBFC sector has been increasing over the past few years and is likely to be tightened further. In December 2006, the Reserve Bank of India (RBI) issued single-party and group exposure norms, thereby reducing concentration risk. This was followed by the issue of guidelines for non-deposit taking systemically-important NBFCs (NBFC-ND-SIs) in August 2008, stipulating prudential norms covering NBFCs' capital adequacy and asset-liability management requirements. NBFC-ND-SIs will need to maintain a capital adequacy ratio of at least 15 per cent from April 2011. Similar capital adequacy norms have recently been made applicable for deposit-taking NBFCs. CRISIL believes that the increasing regulatory coverage for the sector will result in greater transparency and strengthen the sector, thereby enhancing the confidence of stakeholders.

Greater focus on secured asset class: Product suite now more diversified

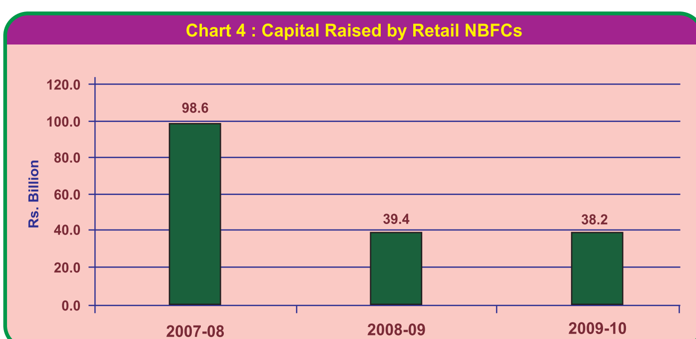
Growth in the sector has been characterised by an enhanced focus on secured asset classes. CRISIL expects the proportion of secured lending by NBFCs to increase to almost 99 per cent of overall AUM by March 2013 from around 96 per cent in March 2010 and 91 per cent in March 2008. High delinquencies have compelled NBFCs to either exit, or significantly curtail exposure to, asset classes such as personal loans, credit card loans, and unsecured business loans; these segments have been substituted by new product segments such as gold financing and LAP, which are inherently secured in nature. In fact, by March 2010, NBFCs' personal loan portfolio had almost halved its peak size of two years ago.



Growth in the NBFC sector will also be accompanied by a greater diversity in the product suite, unlike in the past, when the traditional segments, such as vehicle finance, constituted over 60 per cent of the AUM. Given the expected high growth in new product segments, the sector is expected to have a more balanced product profile by March 2013 *(refer to Charts),*

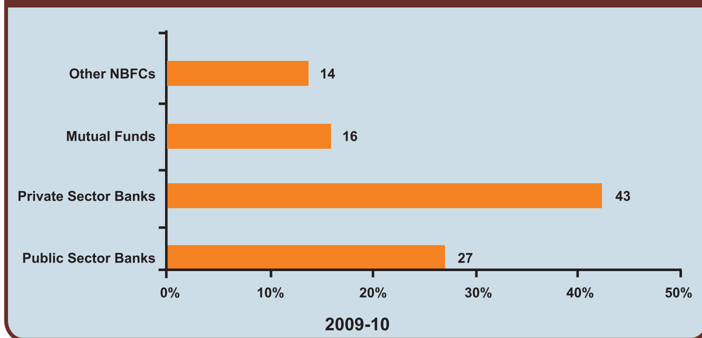
Good investor interest, ensuring adequate access to capital and securitisatIon

The NBFC sector has witnessed active equity investor interest, as reflected by healthy equity capital inflows of over Rs.175 billion *(refer to Chart 4)* into the sector over the past three years. ACAGR of 24 per cent in the market capitalisation of large NBFCs overthe past five years also reflects strong investor confidence in this sector. The steady infusion of capital has enabled NBFCs to maintain growth in their loan portfolio while adequately covering asset-side risks. The capital cover for net non-performing assets for NBFCs was comfortable, at around 17 times, as on March 31,2010. Given the medium-to-long term potential of this sector to demonstrate sustainable growth, investor appetite is expected to remain strong for NBFCs that are well placed to raise fresh capital to support their growth plans.



Furthermore, NBFCs continue to actively tap the securitisation/assignment route, which enables them to reduce borrowing costs and also provides them with capital relief. As per CRISILestimates, 25 to 30 per cent of NBFCs' AUM was securitised or assigned as on March 31, 2010, most of which was subscribed by banks. While a substantial portion of the securitised transactions comprised commercial vehicle (CV) pools, newer product segments such as gold loans have also seen a sizeable surge in securitisation or assignment volumes over the past couple of years. This is primarily because assets securitised by NBFCs are eligible to be classified under priority sector lending, in the CV, tractor, and agriculture gold loan (till January 2011) segments, thereby assisting banks in fulfilling their priority sector lending commitments as per RBI regulations. In 2009-10, of the total CRISIL-rated

Chart 5 : Investors in CRISIL rated NBFC pools



securitised pools of NBFCs, public and private sector banks have been the investors in around 70 per cent of these pools *(refer to Charts).* CRISIL believes that the assets generated by NBFCs have potential for securitisation, given the reasonable investor appetite, notwithstanding removal of priority sector benefits for gold loans. However, any further tightening in regulatory guidelines on securitisation or priority sector status could adversely impairthe NBFCs'ability to securitiseinfuture,

Keychallenges in the growth path of retail NBFCs

While retail NBFCs continue to have good growth potential, the sector is expected to face certain challenges as it makes the transition to the next growth phase. As articulated by RBI in its recent 'Financial Stability Report', CRISIL expects NBFC regulations to be tightened further, so as to align them with those for the banking sector. While this will result in further strengthening of the sector, NBFCs are likely to face challenges in aligning their business model with the regulations. Stronger regulations are likely for product segments that have seen very high growth in the recent past. Any adverse changes in securitisation and/or priority sector guidelines will constrain NBFCs' resources profiles, and, therefore, impair their growth over the near term. Further, given the sector's high exposure to India's financially under-served population, specific state-level regulatory actions, such as the recent regulations for microfinance entitles in Andhra Pradesh, have potential to disrupt operations.

Ensuring availability of adequate debt funding at competitive costs is one such key challenge. CRISIL believes that NBFCs will require an additional Rs.910 billion of debt funding over the next two years. While banks are expected to cater to the bulk of these requirements, exposure constraints may restrict banks from a continuing increase in disbursements to the NBFC sector. The banks' exposure to the NBFC sector has increased to nearly 4 per cent of advances as of September 2010from 2.2 per cent as of March 2005. In order to maintain their growth, NBFCs will, therefore, also have to look to alternate sources in the market and compete with other issuers/asset classes, thereby increasing their cost of borrowings. /

Additionally, availability of experienced and good-quality manpower is a key challenge for NBFCs. In CRISIL's opinion, the financial sector is, as a whole, likely to face this challenge, given the expansion plans of existing players and expected entry of new players, especially the new private sector banks. Many established retail NBFCs are poised to achieve a far higher scale (above Rs.100 billion of assets), and will, accordingly, need to continuously strengthen their management, and make more effective use of technology.

Conclusion

CRISIL believes that NBFCs have, over the years, emerged from the banks' shadow, and established a strong and Independent identity in the retail finance space. Retail NBFCs will maintain their steady growth trajectory, backed by their ability to innovate, reach out to under-served customers, and resilience to economic cycles. While a tightening regulatory framework and financial and human resource challenges will test the ability of NBFCs to grow, CRISIL believes that the NBFCs will continue to constitute a critical financial intermediary in the Indian retail finance space.

Courtesy : CRISIL. An article from a report titled 'Retail NBFCs: The shine is back, but will it last?' in CRISIL Insight series.

Working group for reform in NBFC-CIC regulation

Mr. Mahesh Thakkar, Director General, FIDC and Co-Chairman, Indian Merchants' Chamber (IMC) Finance and Banking Committee making a presentation on "NBFCs- Issues and Challenges" at a seminar organised by IMC at Mumbai on 24 02 11. Also seen are Mrs. Shyamala Gopinath, Deputy Governor Reserve Bank of India, Mr. Dilip Dandekar, President, IMC and Mr. Chandan Bhattacharya, Chairman, IMC Finance and Banking Committee.

The Reserve Bank of India has set up a Working Group to suggest various reform measures needed in the Non-Banking Finance Companies (NBFC) and Core Investment Companies (CICs) sector, according to Mrs Shyamala Gopinath, Deputy Governor of the RBI. Addressing a seminar on "NBFCs— Issues and Challenges" organized by Indian Merchants' Chamber recently, Mrs Shyamala Gopinath appealed to all stakeholders in the sector to submit their suggestions to the Working Group for consideration.

The IMC President, Mr Dilip Dandekar, welcomed the distinguished speakers and participants at the Seminar, and said that the concept of NBFCs was comparatively new in India, where NBFCs were extremely heterogenous in nature, highly diversified in their businesses, and widely varied in their sizes and operational scale. The NBFCs were playing a vital role in the Indian economy, supplementing and complementing the services rendered by the mainstream banks, even though they were hamstrung by problems such as small balance sheets, high cost of funds, non-performing assets, and lack of refinance facilities. "Adding to these handicaps, the convergences of International Financial Reporting Standards is expected to affect their operations seriously," Mr Dandekar said.

Responding to a suggestion by Mr Asokan Arumugam, the RBI's Deputy Governor said that she was aware of the issues faced by NBFCs, and the RBI's working group of experts would now study them and come up with recommendations soon. "There is a class of CICs that accepted deposits from the public and operated on a large scale. And there is also another segment, whose total asset is, say, less than Rs 5 crore, and did not accept public funds. RBI is considering a suggestion to exempt the latter segment from registration. When NBFCs and CICs are involved with public funds, they cannot be left unregulated." Mrs Shyamala Gopinath emphasized.

Mr Suneet Maheshwari said that NBFCs financing the infrastructure sector faced a serious dilemma, because 'infrastructure' was being defined differently by the RBI, and various government departments and banks. "RBI alone has three definitions of 'infrastructure'. And these definitions are not in line with the Government's definitions. It is necessary to evolve a single 'harmonized definition'," he stressed.

Mr Chandan Bhattacharya pointed out that NBFCs had a crucial role to play in the Indian financial sector, especially for delivering tailor-made financial services to the needy. "It is clear that the banking sector alone cannot handle the task of ensuring 'financial inclusion' by reaching out to the SMEs, artisans and other needy sectors. It is necessary to involve NBFCs in this task; and they can complement the banking services in this connection," he said.

Mr Mahesh Thakkar said that RBI policy on NBFCs was obsessively focused on 'regulation', ignoring the need for 'development'. He said that NBFCs suffered for want of a long-term infrastructure funding window, due to RBI curbs on the limits for acceptance of deposits, due to lack of refinance window, denial of income-tax benefits, exemption of TDS, and also due to lack of a laid-out loan recovery mechanism. He suggested that "NBFCs should function as retailer, while the banks as wholesaler. Also it is extremely important to provide NBFCs with a fast-track recovery mechanism like 'repossession' of assets using 'private' means within the legal framework."

Among other distinguished speakers at the seminar were Ms Uma Subramaniam, Chief General Manager (DNBS) at the RBI, Mr Asokan Arumugam, Chief Compliance Officer of Reliance Capital, Mr Suneet Maheshwari, CEO of L&T Infrastructure Finance Co, Mr Mahesh Thakkar, Director-General of Finance Industry Development Council, and Chandan Bhattacharya, Chairman of IMC's Finance & Banking Committee, and Former Managing Director of State Bank of India. [IMC press release, 4 March 11]

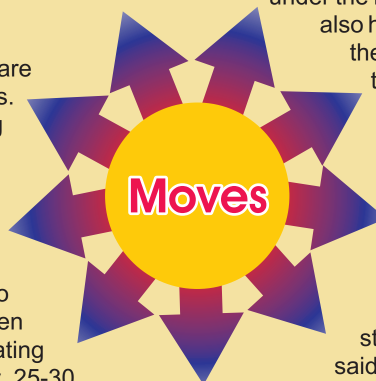
No alternative to vibrant corporate bond market

The Economic Survey has stressed the need to deepen the domestic capital markets and the role of non-banking financial institutions especially in the corporate bond and debt markets. "With bank finance drying up for long- term infrastructure projects in view of asset liability problems faced by the banking system, the need for further development of a deep and vibrant corporate bond market can hardly be overemphasised," said the Survey.

Pointing out that the government securities market had evolved over the years and expanded due to the increasing borrowing requirements of the Centre, the Survey said that, in contrast, the corporate bond market had languished, both in terms of market participation and structure. In 2009-10, private placements of corporate bonds listed on the BSE and NSE had raised Rs 212,635 crore. Till November 2010, Rs 147, 400 crore were raised through this route. The number of issues were also fewer – from 1,278 issues in 2009-10 to 929 issues till November 2010.

Among the emerging markets, India ranks among the lowest for money raised through bond issuances. In 2009, Brazil raised $10.1 billion, Russia $10.8 billion, China $3.3 billion and India $2.2 billion. "The corporate bond market is only about 14 per cent of the total market in India. With the intervention of the Patil Committee recommendations, the corporate bond market is slowly evolving," observed the survey. [Business Standard, Feb.26]

NBFCs look at new fund sources



With cost of funds seeing a sharp rise, NBFCs are adopting different strategies to protect margins. They are preferring fixed interest rates over floating rates. NBFCs are also lowering dependence on banks and tapping cheaper sources of funds like debentures, commercial papers, mutual funds (MFs), other institutions and bonds. On Feb.3, nearly 75 per cent of NBFCs' incremental borrowings are at fixed rates. A year ago, it used to be half. There was a time, say till March 2010, when 50 per cent of incremental borrowings were at floating rates, but now, it is only 25-20 per cent. Only 25-30 percent of the working capital needs are met through funds at floating interest rates. This proportion was skewed in favour of floating rates till May 2010, said a senior official of a Chennai-based NBFC.

Similarly, NBFCs are seeking to lower their dependence on bank funding, which still constitutes roughly 75 per cent of their borrowings. However, on an incremental basis, nearly half of their funding requirements are met through non-banking sources like retail bonds, securitisation and institutional investors like LIC and MFs.

The most important aspect is the return of MFs as a source of funds, according to an analyst with an international rating agency. "Though the level of exposure has not yet reached the pre-crisis levels of 2008, when more than 10 per cent of the working capital needs of NBFCs were met by MFs, it is steadily rising," he said. "Bank funds are getting costlier, whereas money from other sources such as retail, MFs and FIIs is cheaper by 50-100 basis points. "In some cases, banks are charging nearly 11 per cent, that too on a floating basis, which is at least 200 basis points higher than what retail lenders and MFs charge," said an official of an infrastructure financing NBFC.

"With rising interest rates, NBFCs, particularly the ones with lower ratings, will find it hard to maintain margins. The average cost of funds has already reached around 10.5 per cent, compared to 8.5-9 per cent six months earlier. Post-crisis, a lot of them stayed away from MFs, but they are slowly staring to tap these sources again," said an analyst at LKP securities. However, NBFCs with good ratings, well-diversified asset-liability mix, high capital adequacy ratio and better parentage are likely to handle the situation well, as they are better placed to bargain and raise funds at cheaper rates, according to him.

Bill on 'factoring' coming in Budget session

The Government will, in the upcoming Budget session of Parliament, introduce a Bill on 'factoring' so as to provide a comprehensive legal and regulatory framework for such services, Mr Namo Narain Meena, Minister of State for Finance, has said. The proposed legislation would provide adequate protection for major players to further develop the factoring business in India, Mr Meena said.

New partnership helps motor lenders tackle uninsured drivers

The Finance & Leasing Association (FLA) of UK has announced a new partnership between motor finance companies and the Motor Insurers' Bureau (MIB). From 1 February motor finance lenders, who are members of the FLA, were given access to the motor insurance database (MID). Lenders will be able to check the central database of all insured vehicles in the UK and satisfy themselves that a vehicle has the appropriate insurance cover, as required under the motor finance credit agreement. The partnership will also help lenders to improve road safety and to prepare for the Continuous Insurance Enforcement regulations that will come into effect from late Spring this year. [FLA, 9 February, 11]

China's Financial Lessors Support Agriculture Market

Assets of China's financial leasing companies totaled 310 billion yuan ($47.15 billion) in 2010, up from 160 billion yuan the previous year, playing an increasing role in promoting agriculture. "They have strong financial strength and profitability capabilities," said Cong Lin, vice director at the Financial Leasing Committee of the China Banking Association. The total assets of financial leasing companies increased to 310 billion yuan in 2010, from 20 billion yuan in 2007 and 160 billion yuan in 2009, and their net profits after tax rose to 3.7 billion yuan last year, from 1.1 billion yuan in 2008.

After the government approved banks setting up financial leasing companies in 2007, banks were shareholders in nine of the 17 companies by the end of 2010.

Cong said that the ICBC Leasing Co made a deal for more than 60 cotton pickers worth 70 million yuan in Xinjiang Uygur autonomous region, the largest agricultural leasing deal last year. Cong said the agricultural industry has great potential because the mechanization rate of crops is now 49 percent and will grow to more than 60 percent by 2020, according to industry estimates.

Cai Esheng, vice-chairman of the China Banking Regulatory Commission, said that financial leasing can contribute greatly to the agricultural sector. "It can lower the capital pressure on farmers and make capital use more efficient," Cai said. However, the financial-leasing industry would face large risks in the event of natural disasters in that farmers would have difficulty paying rent as their productivity would be cut.

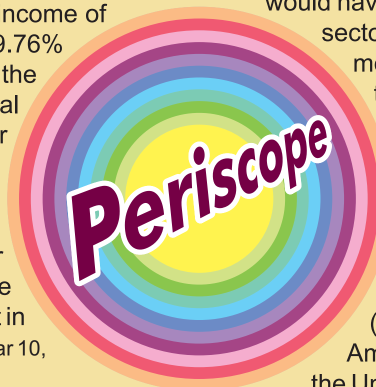
The capital-adequacy rate of the 17 companies is more than 12 percent and the required rate is 8 percent. Cai encouraged them to use financial tools to enlarge their assets and set up mechanisms to control risk. [World Leasing News, 7 March] ■

Heartiest compliments to Mr. R. Sridhar, CA, Managing Director, Shriram Transport Finance Company Ltd. and member of Managing Committee of FIDC was conferred an award "Business Achiever - Financial Services" by ICAI for the year 2010 for exceptional performance and achievements at a glittering awards function at Kolkatta on the 30th January 2011.

NBFCs log 21.2% growth in income

India's NBFCs posted decent growth in revenues and profits in the October-December quarter 2010, despite higher provisioning. An analysis of 355 NBFCs[covers HFCs also] showed an improvement in their performance in the three-month period.

The RBI, which has been continually strengthening the supervisory framework for the sector, had asked NBFCs to make a 0.25% provision on standard assets or performing loans. Of the 355 NBFCs selected for this study, 46% was found to have increased their efficiency during the third quarter of the fiscal. Aggregate income of 355 NBFCs rose 27.2% to Rs. 24,156 crore during October-December2010 from Rs. 18,991 crore in the same period of the previous year. Their combined net profit posted a higher rise, increasing by 36.5% to Rs. 5,123 crore, resulting in a sharp increase in return on total income of 21.21% in the quarter under review from the 19.76% recorded in the previous year. However, 190 of the 355 NBFCs witnessed a fall in the PAT-to-total income ratio, while 165 NBFCs showed a higher ratio in the quarter over the previous year. Mortgage lenders posted significant profit growth compared with other lenders on the back of a substantial increase in loans and lower non-performing assets. Auto finance companies also posted significant improvement in the third quarter of this fiscal. [Financial Express, Mar 10, 2011]



International biggies setting up shop in NBFC sector

A panel discussion covered a variety of topics pertaining to the NBFC sector and the growth phases and challenges faced by the sector in India. Hemal Shah, Partner-Advisory Services, E&Y, the moderator of the discussion said, “NBFC industry per se has undergone a huge change both quantitatively and qualitatively, especially in the way the sector players have managed to differentiate their functional specialisation.” Other panel members were Pratap Paode, Lakshmi Narasimhan V and Pradeep Bandivadekar.

“The role of the NBFC is defined as the financial intermediary and the particular task has been well recognised by the finance sector as well as the customers. The key drivers of this sector are the quick decision making abilities, risk management and the intricate understanding of the customer needs. “The way the NBFC players have managed to spread their operations in urban as well as semi-urban areas in the span of a few years, is simply commendable. Today, the role of NBFC has become important from the macro as well as the Indian economic point of view,” Mr Shah commented.

The panelists hailed from different arenas in the finance sector bringing with them years of experience and talent in macro as well as micro finance subjects. The discussion kick started on an enthusiastic note, with the members expecting positive returns and outcomes from this sector in the near future. According to the panellists, the future of this sector seems to be picking up with the government as well as private players realising and understanding the future of this industry.

According to Mr Pratap Paode, CEO, Shriram Equipment Finance , “The NBFC sector is dominated by the construction, equipment and the commercial vehicle market and the other assets included under this. This industry has been growing consistently at a rate of 20-25% barring the negative fall in the year 2008, which was due to the global scenario. However, the industry has revived very quickly and has crossed volumes of more than that of 2007. The expected growth of return from this sector in the near future looks to be about 30-35%”.

Sharing his thoughts on the future of this industry, Mr Pradeep C Bandivadekar, COO, Tata Capital Ltd said, “The general growth rate to be expected is more than 15-20% in the next quarter, which includes banks and other NBFCs. There is more than three and half lakh crore non-deposits taking place in the NBFC sector and around 85,000 crore deposits taking place.”

The most drastic change that has been seen recently in the NBFC segment is that of the big international companies setting shop in the NBFC sector. Till sometime back, no big company would have even thought about investing and trading in this sector. We have Siemens , Caterpillar , GE and many more industries taking steps towards estab-lishing their foothold in this market.[Economic Times, 22 Dec]

India is most over-regulated country: survey

India has topped a list of the most “over-regulated countries in the world” in a survey on Asian business and politics by Hong Kong-based Political and Economic Risk Consultancy (PERC). The survey used responses from American executives about regulatory conditions in the United States to provide a benchmark against which to assess the Asian scores.

India was rated worst in terms of over-regulation, scoring 9.16 points out of 10, followed by China with 9.04 points, Japan in third position with 3.28 points and the US at fourth with 1.51 points. Hong Kong received the best score in the survey of 0.98 point, while Singapore was second with 1.08 points, according to the survey done in the last quarter of 2010, based on responses from 1,370 executives.

In general, regulations were complex and non-transparent, while standards and certifications procedures were onerous in India, according to the PERC survey findings. Foreign exchange, capital transactions and some credit operations were subject to approvals, restrictions and additional requirements that went far beyond what most other countries require, concluded the survey. It also cited specific examples from the World Bank's Doing Business Survey of why India's regulatory system deserves to be graded as poorly as it was. It can take a month-and-a-half to register property, almost 200 days to obtain a construction permit, over 1,400 days to enforce a contract and seven years to close a business. “Documentation requirements for both exports and imports are onerous,” the PERC survey pointed out. Regulations in the country were frequently not enforced, which raised the question of why they were on the books at all, noted the survey. [PTI, January 26, 2011] ■

Pre-budget memorandum on direct and indirect taxes applicable to NBFC-AFCs

On behalf of Asset Financing NBFCs[NBFC-AFC] the FIDC in its pre-budget memorandum requested union finance minister to consider to allow deduction, for provision for NPAs made by NBFC-AFCs, under section 36(1)(viia) in the Income tax Act as is allowed to banks. Further, it was also suggested that Sec.43D of the IT Act be extended to include in its scope NBFCs registered with RBI, as in the case of other financial institutions. It was pleaded that the construction equipments which are used in the infrastructure development should be also be extended the benefit of higher depreciation rate of 100%.

As per Sec 194A of IT Act, TDS @10% is required to be deducted on the interest portion of the installment paid to NBFC under loan/finance agreements whereas banks/PFIs are exempted from the purview of this section. This provision creates severe cash flow constraints. Further, Having regard to growth, inflation, volume of transaction and economic development threshold limit where the TDS is required to be deducted should be increased u/s 194A to Rs.25,000 and u/s 194H and 194J to Rs. 50,000.

It was also suggested that the threshold limit u/s 40A(3) should be increased to Rs.1 lakh and disallowance should be restricted to 20%.

Since the portfolio of the NBFCs is similar to banks, NBFCs registered with RBI should also be exempt from the applicability of Sec 269T of the Act.

To remove the genuine hardship that will be faced by senior citizens/other small depositors, it was suggested that sub-section 2 of section 206AA be removed to enable the depositors to furnish declaration forms 15G/15H without providing PAN.

In respect of indirect taxes FIDC said that the application of Rule 6(5) of Cenvat Credit should be extended to any services that results in generation of service both Taxable and Non-Taxable Services. The input credit should be seamless. In respect of service tax on hire purchase/lease transactions FIDC said that even a partial levy i.e. incidence of a service tax on 10% of the interest component should be withdrawn. Lease and Hire Purchase transactions should be considered as 'Deemed Sale' and subject only to VAT not Service Tax'. An Assessee apart from Self Assessment procedure is subject to attending different queries from different service authorities under the statutory power vested in them by the Finance Act, 1994. FIDC said, “we require a single window approach whereby an assessee is answerable to queries from a single statutory body and in one go.”

FIDC In Action

NBFCs seek parity with banks, FIs

NBFCs and asset financing companies (AFC) have sought parity on tax exemptions granted to banks and financial institutions at the pre-budget consultations with the finance minister on January 18. Unlike banks, loans from NBFCs are subjected to a different tax regime. Interest on loans granted by NBFCs are taxed at 10%, the banks and FIs enjoy tax exemptions. “NBFCs have a critical role to play in financial inclusion, we need to have a level playing field with the banks and FIs and one of the areas that needs to be looked into is the tax regime,“ said Raman Aggarwal, co-chairman, FIDC. According to Section 194A of the Income Tax Act, all borrowers of NBFCs are liable to pay a 10% tax deducted at source (TDS) on the interest portion of the installment paid under loan or finance agreements while banks, LIC, UTI among others are exempted from the purview of this clause.

The banking division of the finance ministry, including financial services secretary R Gopalan were present at the pre-budget consultation. The banking sector and FIs were represented by SBI chairman OP Bhatt, Uday Kotak from Kotak Mahindra Bank, KR Kamath from PNB among others. Finance minister Pranab Mukherjee said that the government has accorded high importance to financial inclusion to cover the entire gamut of financial services pertaining to savings, credit, insurance and transfers. "These inputs would help in budget making and improving the policy management of the economy in the coming months," he said. [Hindustan Times/Economic Times 18 Jan.]

Classification of Asset Financing NBFCs

FIDC has taken up with RBI headquarters the concern of some of the member AFC-NBFCs from Tamilnadu and Kerala in view of stand taken by some of the RBI's inspecting officials that 'finance for the purchase of passenger cars, two-wheelers, etc would not qualify to be treated as Asset finance'. They have been asked that 'such Assets should be excluded while calculating the percentage of income and assets for the 60% norm prescribed for determining the status as an AFC.' They have also contended that these assets are for the personal use of the borrowers and do not generate any income and therefore should be excluded for the purpose of classification as AFC.

In view of the seriousness of the matter FIDC chairman T.T.Srinivasaraghavan has requested RBI 'to suitably clarify that financing of all tangible/physical/real assets, as laid out in the RBI Directions, would be eligible for reckoning the classification of NBFC-AFC'.

Sundar Committee accepts status quo for S.51 in its report:

Sundar Committee has submitted its report to the Ministry of Transport on the amendments to The Motor Vehicles Act. Due to the forthright and timely representation made by Mr. Raman Aggarwal on behalf of FIDC earlier on November 27, the committee has recommended to maintain status quo on all matters pertaining to marking of lien in the RC books in favour of the financier. However, the committee has not incorporated other suggestions made on issues like fraudulent deletion of lien and issuance of fresh RC in the name of the financier in a speedy and just manner etc.

Co-Chairman has also made a power point presentation on behalf of FIDC on Issues faced by NBFC-AFCs pertaining to Financing of Commercial Vehicles, before The Working Group on Roads under National Transport Development Council (NTDC) constituted by Ministry of Transport, Govt of India on 25th February, 2011. The Working group members expressed keen interest and appreciation on the issues raised and the matter is under their active consideration. ■

Views expressed herein are not necessarily the views of FIDC.

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