FIDC NEWS

Finance Industry Development Council

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

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Don't throw out the baby with the bathwater!

It is a well established and widely recognized fact that NBFCs cater to the "Unbanked" segment of the society both in urban and rural areas. NBFCs play a complementary and supplementary role to banks in retail lending and NBFCs are key players in promoting Financial Inclusion. A "Wholesaler/ Retailer" relationship between banks and NBFCs is a model that has worked very well over the years. The recent concerns regarding steep rise in bank credit to NBFCs, leading to the withdrawal of priority sector status for bank lending to NBFCs, other than MFIs, may have arisen from the working of some MFIs and certain NBFCs engaged in lending in speculative areas. NBFC-AFCs have maintained a favourable track record both in terms of regulatory compliance and in meeting their liabilities. Recognizing the "Trouble Free" performance of NBFC-AFCs, RBI has even given preferential treatment to this class of NBFCs in matters pertaining to fund raising. Functioning of NBFC-AFCs had never been an area of concern for RBI.

Due to this drastic step specially the Small and Medium sized NBFCs will further feel the crunch in raising bank credit as the incentive for banks to lend to NBFC-AFCs has been taken away. Not only will the borrowing cost for SMEs, SRTOs and all other end users go up sharply, but they will also be deprived of an efficient channel of credit. The Transport Associations are of the view that the move by the banking regulator would create a multi-dimensional adverse impact and jeopardise the road transport also industry as a whole. They say 'If RBI expects its decision to make banks lend to the commercial vehicle industry, it is not going to happen as they are not culturally tuned to lend to this segment. It is the small road transport operators who are going to be hurt by the regulator's move.' On the other hand the banks may also find it difficult to meet their priority sector targets.

To quote Mr. S Viji, Chairman, Sundaram Finance Limited, "While appreciating the need for regulatory rigour in these uncertain times, I would urge the RBI to take into account the heterogeneity of the NBFC sector and the vital contribution of Asset Financing NBFCs in fostering financial inclusion, while framing new guidelines for the sector."

T. T. Srinivasaraghavan, Chairman, FIDC

Regulatory Perimeter

RBI NOTIFICATIONS:

Opening of Branch/Subsidiary/Joint Venture/Representative Office or Undertaking Investment Abroad by NBFCs: RBI/2010-11/566 -DNBS (PD) CC.No. 222/03.10.001/2010-11: June 14, 2011

Review of Guidelines on entry of NBFCs into Insurance Business RBI/2010-11/549-DNBS.PD.CC.No .221/03.02.002/2010-11, May 27, 2011

Guidelines on Credit Default Swaps (CDS) for Corporate Bonds RBI/2010-11/542-IDMD.PCD.No. 5053/ 14.03.04/2010-11, May 23, 2011

NBFCs/RNBCs - List of Terrorist Individuals / Organisations- under UNSCR 1267 (1999)and 1822(2008) on Taliban /AL-Qaida Organisation RBI/2010-11/540-DNBS(PD).CC. No220/03.10.42 /2010-11, May 20, 2011

AT A GLANCE

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NBFCs/RNBCs - Anti- Money Laundering/Combating Financing of Terrorism Standards RBI/2010-11/513-DNBS(PD).CC. No 218/03.10.42/2010-11: May 04, 2011

Policy Guidelines for issuance and operation of Prepaid Instruments in India RBI/2010-11/512 DPSS.CO.No.2501/02.14.06/ 2010-11, May 04,2011

KYC Norms/Anti- Money Laundering Standards/Combating Financing of Terrorism – NBFCs/RNBCs RBI/2010-11/495-DNBS(PD).CC. No.216 /03.10.42/2010-11; May 02, 2011

List of Terrorist Individuals/Organisations-under UNSCR 1267 [1999] and 1822 [2008] on Taliban- AL Quaida Organisation: RBI/ 2010-11/495 DNBS [PD].CC.No.217/ 03.10.42/ 2010-11; May 02 2011

Operation of deposit account with NBFCs and money mules RBI/2010-11/462 DNBS(PD)CC.No 215/03.10.42/2010-11; April 5, 2011

NBFCs not to be Partners in Partnership firms RBI/2010-11/453-DNBS.PD/ CC.NO. 214/03.02.002/2010-11; March 30, 2011

RBI nod must to open subsidiaries abroad

With an aim to regulate the credit system to the advantage of the country, the RBI on June 14 said NBFCs cannot open subsidiaries or enter into joint ventures abroad without its permission. "No NBFC shall open subsidiaries/joint ventures/ representative office abroad or shall make investment in any foreign entities without obtaining prior approval in writing from the RBI," the central bank said in a notification. It said investments will be permitted only in those entities having their core activity regulated by a financial sector regulator in the host jurisdiction or country. Besides, the aggregate overseas investment by NBFCs should not exceed 100% of their Net Owned Fund (NOF). "The overseas investment in a single entity, including its step down subsidiaries, by way of equity or fund based commitment shall not be more than 15% of the NBFC's owned funds," the RBI said. However, NBFCs will not be allowed to make investment in non-financial service sectors overseas. Besides as a general policy, NBFCs would not be allowed to open a branch abroad. For opening of a subsidiary abroad by the NBFC or entering into JV overseas, the parent NBFC would not be permitted to extend implicit or explicit guarantee to or on behalf of such subsidiaries. The central bank said the directions, which have come into effect from June 14 for NBFCs are necessary for the purpose of enabling it to regulate the credit system to the advantage of the country. [PTI, June 14]

RBI's fiat to NBFCs on partnership firms

The RBI has asked NBFCs to desist from contributing capital to any partnership firm or be a partner in partnership firms. In the case of existing partnerships, NBFCs should seek early retirement from the partnership firms, the central bank said in a notification to all NBFCs. This directive comes in the backdrop of the RBI coming across some NBFCs having large investments in, or contributed capital to, partnership firms. Industry experts are divided in their opinion on the RBI action. While one segment feels that the blanket ban is unwarranted and should have been restricted to only deposit taking NBFCs, the other segment is of the view that the move is justified as an NBFC's funds could be at stake if a partner surreptitiously withdraws from a partnership firm. NBFCs, especially non-deposit taking, contribute capital to or invest in a partnership firm, which is in the business of investments, to get higher returns, say experts.[Business Line, April 3]

Operation of Deposit Account with NBFCs and Money Mules

RBI by a circular dated April 5 advised NBFCs and RNBCs that 'Money mules' could be used to launder the proceeds of fraud schemes (e.g., phishing and identity theft) with the criminals by criminals who gain illegal access to deposit accounts by recruiting third parties to act as 'money mules.' In some cases these third parties may be innocent while in others they may be having complicity. The operations of such mule accounts can be minimized if NBFCs follow the guidelines contained in the Master Circular on Know Your Customer (KYC) norms/Anti-Money Laundering (AML) standards/ Combating of Financing of Terrorism (CFT)/Obligation of banks under PMLA, 2002. NBFCs are, therefore, advised to strictly adhere to the guidelines on KYC/ AML/CFT issued from time to time and to those relating to periodical updation of customer identification data after the account is opened and also to monitoring of transactions in order to protect themselves and their customers from misuse by such fraudsters. NBFCs are also advised to ensure that their accounts in banks are not used for the purpose of money laundering in the manner specified above. [RBI Bulletin- May 2011]

Infra Finance Cos told to make standard assets provision

The Reserve Bank of India has advised state-run infrastructure finance companies to make provisions for standard assets from March 2012 due to fears of increase in defaults amid uncertainty over pending infrastructure and power projects, two people from the power ministry familiar with the matter told ET. RBI's current guidelines exempt public sector financial companies from making provisions for standard assets. The rule is applicable till March 2012. Rural Electric Corporation, Power Finance Corporation and India Infrastructure Finance Company are some of the companies who come under this exemption. For banks and non-banking finance companies, standard asset provisioning is currently at 0.25% of the total credit. [Economic Times, May 26]

NBFCs lose priority sector tag, see red

RBI on May 3 said in its monetary policy announcement that bank loans to NBFCs, excluding microfinance institutions which are categorised as NBFC, would not be classified as priority sector loans. This means the cost of funds of most NBFCs will go up. NBFCs depend on banks for 80 per cent of their credit requirement. About 10-12 per cent of the total bank loans are classified as priority sector loans. A senior YES Bank executive said the rates on NBFC loans would definitely go up and there would also be some reduction of credit flow to the sector because some of these transactions were happening only because of priority sector classification.

The objective behind the RBI move is to plug the arbitrage which arises due to the stringent conditions attached to bank loans to microfinance institutions. For a bank loan to be classified as priority sector loan, banks are required to ensure a margin cap of 12 per cent and an interest rate cap of 26 per cent by the MFI. Since no such conditions are there for all other NBFCs, banks

would prefer giving loans to NBFCs rather than MFIs.

Funding for new and used commercial vehicles will be hit following the RBI's decision to do away with priority sector lending status for bank loans to NBFCs, say transport associations. With 90 per cent of commercial vehicle sales financed by NBFCs, the move by the RBI is expected to hurt the small road transport operators as it would be tough for them to access finance, which will also become more expensive. Although there are no industry data, it is estimated that the finance to new commercial vehicles is about Rs 50,000 crore, said an industry observer. Mr Chittranjan Dass, Secretary General, All-India Confederation of Goods Vehicle Owners Association, said the move by the banking regulator would create a multi-dimensional adverse impact and jeopardise the road transport system. If RBI expects its decision to make banks lend to the commercial vehicle industry, it is not going to happen as they are not culturally tuned to lend to this segment, he said. It is the small road transport operators who are going to be hurt by the regulator's move, said Mr Dass.

The RBI move will dry up the bank funding of NBFCs and thereby stifle their growth. It is reported that the country's largest private sector lender ICICI Bank has decided to stop buying bilateral securitised portfolios of NBFCs, said two people with direct knowledge of this matter. Banks buy securitised portfolios from NBFCs to meet their priority sector requirement and private banks are the largest buyers of securitised papers of NBFCs. In its last policy announcement, the central bank had removed priority sector status on lending to NBFCs, but it had left the securitised loan portfolios untouched at least on paper

Lack of clarity on the end use of NBFC funds has also led to such a move. "The year-on-year loan growth to NBFCs was rapid last year. A lot of financial institutions were funding car and commercial vehicle loans. There was a huge demand for cars and a large part of it was met by NBFCs. So we thought that we need to look at the ground reality," said Shyamala Gopinath, deputy governor, RBI. Though as of now bank loans to MFIs will be tagged as priority sector, the central bank clearly said this was an interim arrangement and banks would have to meet their priority sector obligations on their own. [Business Standard, May 5]

NBFCs will need 150-cr net-owned funds for PD entry

The Reserve Bank of India has said NBFCs, who intend to get into primary dealership business should have minimum net-owned funds [NOF] of Rs 150 crore. Banks who intend to expand to primary dealership business should have a minimum net worth of Rs 1,000 crore. Primary dealers [PD], are specialised traders in government bonds who have the market making mandate for government bonds and offer two-way quotes on bond trading. The revised guidelines, put up on RBI's website, have also said, in case a primary dealer intends to diversify into other permissible activities, such as brokerage and merchant banking , the minimum NOF shall be Rs.250 crore. The guidelines stipulate that banks should also have ratio of capital to risk-weighted assets, or CRAR, of 9% and net non-performing assets of less than 3%, in addition to a profit making record for the last three years. [Economic Times, May 5, 2011]

Now, credit default swaps in India

The Reserve Bank of India (RBI) has come out with a credit default swap (CDS) guidelines that would allow corporate entities including insurers, FIIs and mutual funds (MFs) to hedge risk against default in corporate bonds to which they subscribe. The guidelines, which were finalised by the RBI after receiving views from stakeholders, will come into effect from October 24, it said in a notification.CDS is a risk management product which helps entities guard against possibility of defaults in repayment of corporate bonds. As per guidelines, foreign institutional investors (FIIs), banks, insurers, NBFCs, listed companies, housing finance companies, provident funds and primary dealers can buy credit protection under the scheme. It further said that banks, primary dealers and NBFCs with sound financial and good track record will be allowed to act as market makers or facilitators (for buying and selling of such swaps).The bonds for the purpose of CDS would include unlisted and unrated debt instruments, including those issued by the infrastructure companies engaged in sector like road, port and telecommunication, power among others."CDS ... would increase investors' interest in corporate bonds and would be beneficial to the development of the corporate bond market in India," the RBI said. Elaborating on the guidelines, the RBI said that beside banks, the NBFCs and primary dealers with a net owned fund of Rs 500 crore will be permitted to act as market makers. The guidelines further said that entities will only be allowed to buy CDS contracts to hedge credit risk and not for speculation. Earlier in February, the RBI had formed the draft guidelines for allowing corporates to hedge risk against CDS. The central bank had in 2008 planned to introduce the CDS for corporate bonds, but postponed the move in view of the global financial crisis, which was caused by large scale trading in such debt instruments. [Financial Express, May 24]

Financial Holding Company model suggested

A Reserve Bank of India (RBI) panel suggested a new Financial Holding Company (FHC) structure to allow business conglomerates to operate banks, insurance companies and NBFCs as subsidiaries through an umbrella organisation. The new model, which seeks to align the Indian structure with international best practices, is expected to provide greater flexibility to FHC in raising capital and ensuring better utilisation of funds. "The FHC model should be pursued as a preferred model for the financial sector in India," said the report of the RBI Working Group headed by Deputy Governor Shyamala Gopinath on which the apex bank has invited comments by stake holders by June-end. India mainly follows the bank-subsidiary model under which the non-banking activities are carried out by the subsidiaries of bank or parent company. The RBI panel has suggested that FHC model should be extended to all large financial groups, irrespective of whether they contain a bank or not. "There can be banking FHCs controlling a bank and non-banking FHCs which do not contain a bank in the group," the panel said. Making a case for enactment of a separate law to regulate financial holding companies, the panel said, "RBI should be designated as the regulator for FHCs". [PTI, May 23, 2011]

RBI says NBFC together with arms can't hold over 50% in insurance JV

The RBI on May 28 clarified that a non-banking finance company (NBFC) together with its subsidiaries and group companies cannot hold more than 50 per cent stake in an insurance

company. "It is clarified that in case more than one company (irrespective of undertaking financial activity or not) in the same group of the NBFC wishes to take a stake in the insurance company, the contribution by all companies in the same group shall be counted for the limit of 50 per cent prescribed for the NBFC in an insurance joint venture," the central bank said in a notification. Earlier, the banking regulator had capped NBFC's stake in an insurance company at 50 per cent. [BS Reporter, May 28]

FSDC Sub-Committee meet

The second meeting of the Sub-Committee of the Financial Stability Development Council (FSDC) was held on May 24 in the RBI, presided over by RBI governor Dr. D. Subbarao, Governor. The Sub-Committee reviewed the recent macroeconomic and financial sector developments, focussing on issues related to systemic risk. It also deliberated upon concerns arising out of regulatory gaps in the non-banking finance companies (NBFC) sector and regulation of government sponsored NBFCs. The Sub-Committee agreed to strengthen regulatory framework for wealth management activities, to formalise an institutional mechanism for supervision of financial conglomerates and to put in place a robust reporting platform for over-the-counter (OTC) derivatives market. The Sub-Committee was also briefed about the implementation status regarding the budget announcements on investment in mutual funds by non-resident investors and setting up of infrastructure debt funds. The meeting was attended by Shri R. Gopalan, Secretary, Department of Economic Affairs, Shri Shashi Kant Sharma, Secretary, Department of Financial Services, Dr. Kaushik Basu, Chief Economic Adviser, Ministry of Finance, chairmen of SEBI, IRDA, PFRDA and Dy. Governors of RBI. [RBI Press release, May 24]

Nasty Shock NBFCs didn't deserve

SUSHILA RAVINDRANATH

The non-banking financial (NBFC) sector got a nasty shock last month. The priority sector status accorded to bank loans to NBFCs for lending to SMEs, small road transport operators, agri-based activities and SSIs was withdrawn by RBI. This has come at a particularly unfortunate time for the asset financing NBFCs (NBFC-AFCs).

NBFCs say that they cater to the unbanked segment of society both in urban and rural areas. They play a complementary and supplementary role to banks in retail lending. A 'wholesaler/ retailer' relationship between banks and NBFCs is a model that has worked very well over the years. The AFCs that lend to the small road transport operators and NBFCs that lend to SME businesses and services play a very important role in the economy of the country. AFCs finance physical assets such as automobiles, tractors, lathe machines, generator sets, and earth moving and material handling equipment.

Task forces set up by the government and RBI have fully recognised and appreciated the role played by NBFCs and particularly by AFCs in the development of important sectors like road transport and infrastructure. The history of NBFCs in India began with the sector engaging in asset-backed lending; some of the early players are still in existence and have a proven track record of more than 50 years. Historically, NBFC-AFCs have maintained their reputation both in terms of regulatory compliance and in meeting their liabilities. Recognising the trouble-free performance of NBFC-AFCs, RBI has given preferential treatment to this class of NBFCs in matters pertaining to fund-raising. There has been no reported case of any default by any of the NBFC-AFCs.

NBFCs that finance SMEs are able to fulfil the credit needs of those for whom organised bank funding remains elusive. Banks are only used to financing people who have a bank account, people who are capable of providing collateral and producing post-dated cheques, etc. Those who cannot fulfil these criteria turn to moneylenders, who charge huge rates of interest. NBFCs step in to fill this gap. They have an intimate knowledge of their clients' income patterns, credit histories and family details; they use this knowledge to make an accurate credit assessment, which helps at the point of collection.

Total funds requirement for the road transport sector in India has been increasing over the years. Demand for new trucks has accelerated due to the increased movement of goods (thanks to a booming economy) and the heavy infrastructure spending by the government. Plus, due to recent judgements, trucks that are more than 15 years old have to be phased out. This also translates into an additional demand for funds. Under the current regulatory framework, banks can lend directly to the priority sector. There is no prohibition. However, they are not able to do so effectively as they do not have the reach of NBFCs in this business. Banks are under no compulsion to lend to NBFCs, but are doing so to meet their priority sector lending targets.

Apparently, the reason behind last month's step has been the recent data on sectoral development of credit released by RBI, which shows an increase in credit to the NBFC sector by 55% as compared to the increase in overall bank credit of 20% during the year ended March 31. NBFC industry sources say that mere increase in bank credit to the NBFC sector is not a matter of concern. But one should look at which NBFCs have benefited from the increased credit. This would throw light on the end use of funds. Sources point out that a major portion of the increased bank credit to the NBFC sector has gone into funding of a few large public sector entities like the Infrastructure Development Finance Company and the Power Finance Corporation. If the increased credit has gone for infrastructure financing or for small road transport operators and SMEs, then this has to be welcomed. On the other hand, if credit has flowed to risky and speculative asset classes, it needs to be viewed seriously and suitable steps must be taken to curb this.

The move to restrict bank credit to NBFCs will force them to cut down on their lending. The customers of these NBFCs who were able to borrow at competitive rates would now be forced to approach the unorganised sector for borrowing and their borrowing cost would increase automatically. This drastic step has been taken without any consultation with the industry. The borrowing cost for SMEs, small road transport operators and all other end-users will immediately increase by at least 2%. Banks may also find it difficult to meet their priority sector targets. Industry sources say that bank finance to self-help groups for onward lending is still recognised as a priority sector advance. In such case, singling out NBFCs is unfair and unjustified.

The economy is slowing. The automobile sector is showing signs of strain. Large truck manufacturers depend on NBFCs for a large number of their sales. The country is full of transport operators who own two or three trucks who get their finance through NBFCs. The industry leaders say that instead of throwing out the baby with the bathwater, RBI should identify the problem areas and tighten the regulations for those NBFC categories. Given the heterogeneous nature of the sector, a 'one shoe fits all' approach would not work. [Financial Express, June 22]

Removal of priority sector tag will push up interest costs for NBFCs

Interview of Mr. R. Sridhar, Managing Director, Shriram Transport Finance Company Ltd.

R. Sridhar,
Managing Director
Shriram Transport Finance Company Ltd.

Of the recent RBI regulations, which has impacted NBFCs the most?

Among the regulatory changes, the hike in capital adequacy ratio (CAR) to 15 per cent from 12 per cent is significant. This will impact the functioning of NBFCs as it will reduce their ability to leverage the extent of money flow to sectors. The sectors we cater to are not financed by organised players. There is a huge requirement of funds from the small road transport operators' segment which is in the grip of the unorganised sector, paying exorbitant interest rates.

We have brought in institutional credit and, thereby, brought down interest rate from 40 per cent in used vehicles to 20 per cent today. We have cut interest cost by almost 50 per cent by bringing in institutional credit. Thereby, small road transport operators are able to access credit at better rates.

There is still a large requirement for capital in this segment.

We have been asking the regulator to reduce the risk weight on assets such as commercial vehicles from 100 per cent to 50 per cent, like what the housing sector is enjoying.

What about the removal of priority sector lending tag to NBFCs?

It is double whammy, coming after the hike in CAR. It will increase the cost for some big companies like ours but there will be no liquidity issues. Banks will continue to lend to us on non-priority basis on commercial rates.

With concessional rate no longer being available, the problem will be only on the interest cost front.

However, there are small- and medium-size companies that will face liquidity and interest cost issues. As these companies no longer enjoy priority sector lending, banks may take a stand that they would lend only if they have 'AA' or 'AA-plus' rating.

Isn't the RBI's move intended to make banks lend directly to the priority sector?

Yes, but the point is many banks have no capabilities to meet the credit needs of this segment for various reasons. Some of them have used NBFCs to meet their priority sector target, on-balance sheet and off-balance sheet. Recently, the on-balance sheet has been removed so it's a direction given to banks, and not to us; in the process NBFCs may get impacted. This twin move will push the cost for small road transport operators.

Have NBFCs made representations to the RBI?

We have met the RBI and expressed our views and they have announced that a committee will look into it. Once it is constituted we would be making a representation on the impact of withdrawing the priority sector tag and why it should not be withdrawn. The committee will take a view and make recommendations to the RBI.

Are interest rate hikes affecting the sales of commercial vehicles, and are you witnessing a slowdown?

Yes, interest rate is a killer. Like other sectors of the economy that would be impacted by the interest rate hike, so would commercial vehicles. The commercial vehicle industry is cyclic, which comes down in a few years mainly due to excess capacity in the system; but this time round it is because of interest rate.

Truck owners borrow at a fixed interest rate that continues for five years. When interest rates move up, they take a 'wait-and-watch' approach, for signs of interest rate moderation. They defer purchases. This year the commercial vehicle industry could be flat or witness moderate growth.

For moderate growth to happen, commercial vehicle manufacturers must introduce subventions. If all the stakeholders absorb the excess cost there could be moderate growth, which has been practised earlier. It also depends on the monsoon (in July-August). If the monsoon is good and agricultural production healthy, things could pick up from the third quarter.

Will delinquency go up due to interest rate hikes?

It would not affect the viability and payment schedule of the borrower as they take loans at a fixed rate. Delinquency will happen only when freight rates are under pressure. Interest rate hikes may dampen demand, but will not affect the repayment for the borrower.

Usually it is the demand for new vehicles that gets affected more than for used vehicles?

This slowdown will have a lag effect if interest rates continue to be high for the next six months. Truckers will defer buying used vehicles just as they would defer purchase of new vehicles. If there is a slowdown due to excess capacity, then we would not be impacted as used vehicles do not create additional capacity.

"Among the recent regulatory changes, the hike in capital adequacy ratio to 15 per cent is the most significant. This will affect the functioning of NBFCs by reducing their ability to leverage the extent of money flow to sectors."

[Excerpts from the interview by S Bridget Leena, Business Line] ■

Financial Stability Report, June-2011

❝Asset quality and profitability improved over the previous year.❞

❝There is also a need to bring in Alternative Investment funds including private pools of capital such as hedge funds, private equity funds, etc.❞

[The RBI presented its assessment of the health of India's financial sector in its Financial Stability Report (FSR), released on June 14, 2011. Excerpts from FSR on NBFCs are presented hereunder]

NON-BANKING FINANCIAL COMPANIES (NBFCs)

Increase in the business was concomitant with improvement in the financial soundness indicators

Non-Deposit taking Systemically Important NBFCs (NBFC-ND-SIs)

3.61 The balance sheet size of NBFC-ND-SIs increased by 21.1 per cent in 2010-11, mainly on account of borrowings which increased by 25.3 per cent. Borrowings from banks/FIs formed a major proportion (30.3 per cent) of their total borrowings. On the asset side, loans and advances increased by 27.6 per cent. Asset quality and profitability improved over the previous year, though capital adequacy ratios showed marginal decline, nonetheless remaining well above the regulatory minimum stipulated (Charts 3.45 and 3.46).

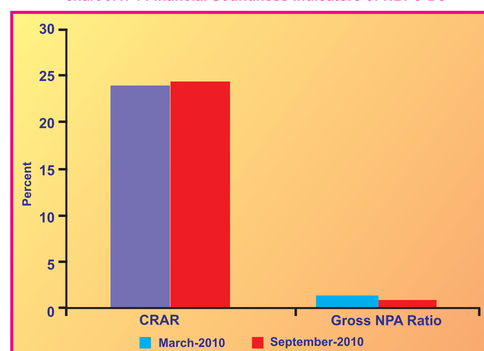
NBFCs Deposit taking (NBFC-Ds)

3.62 In case of NBFC-Ds, loans and advances increased by three per cent as at end September 2010[10] over previous half year. Asset quality and capital adequacy ratios showed improvement (Chart 3.47).

Regulatory architecture - revisions in light of systemic interconnectedness

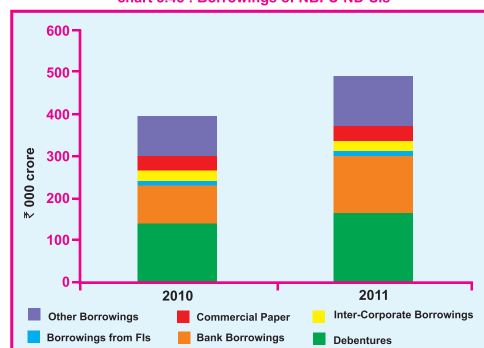
3.63 Keeping in view the economic role and heterogeneity of the NBFC sector and its systemic interconnectedness, the regulation of this sector has been progressively tightened. As a part of the important regulatory initiatives taken recently in this regard, the CRAR of both NBFC-ND-SIs and NBFC-Ds have been aligned to 15 per cent from the earlier stipulation of 12 per cent (stipulation in case of NBFC-Ds becoming effective as at end-March 2012). Provisioning of 0.25 per cent for standard assets and a prudential cap on banks' exposures to debt oriented mutual funds have also been stipulated. There were concerns arising due to concentration risk in NBFCs engaged primarily in making loans against gold jewellery, high interest rate charged by these companies, difficulties in ensuring end use of funds, collateral risks in such exposures, etc. As a measure to address these issues, the Reserve Bank directed that the bank loans to NBFCs for on-lending against gold jewellery, would be no more eligible for classification under agriculture sector. Further in a separate move, it was announced that bank loans to NBFCs, other than to such MFIs which fulfilled certain recently introduced eligibility conditions (as mentioned in next paragraph), would not be eligible to be classified as priority sector loans. As discussed in Chapter IV, a Working Group has been formed to address the entire gamut of issues relating to the regulation of NBFCs.

chart 3.47 : Financial Soundness Indicators of NBFC-Ds



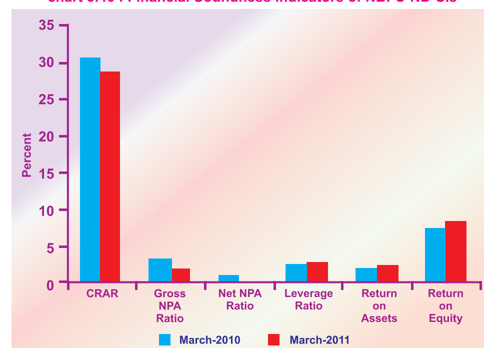
Source : RBI Supervisory Returns

chart 3.45 : Borrowings of NBFC-ND-SIs



Source : RBI Supervisory Returns

chart 3.46 : Financial Soundness Indicators of NBFC-ND-SIs



Source : RBI Supervisory Returns

Addressing issues in the MFI sector

3.64 Pursuant to the Malegam Committee recommendations on microfinance sector, bank loans to all Micro-finance Institutions (MFIs), including NBFCs working as MFIs, will

be eligible for classification as priority sector loans only if the prescribed percentage of their total assets are in the nature of ‘qualifying assets’ and they adhere to the ‘pricing of interest’ guidelines to be issued in this regard. Bank loans to other NBFCs would not be reckoned as priority sector loans with effect from April 1, 2011. Further, following the sharp drop in collections by MFIs in Andhra Pradesh and some incipient signs of contagion spreading to other States, a special regulatory asset classification benefit was extended to the restructured MFI accounts, which were standard at the time of restructuring, even if they were not fully secured.

3.75 The regulation of non banking finance companies has been progressively tightened in order to plug regulatory gaps and dissuade regulatory arbitrage.

Non Banking Financial Sector

The non-banking financial sector in India – within a regulatory ambit

4.20 Strengthening regulation and supervision of shadow banking has been identified by the G20 Leaders as a critical issue for financial sector regulation. In the Indian context, as reported in previous FSRs, the NBFC sector is not typically a shadow banking sector as in the case of advanced economies since the sector is largely regulated by the Reserve Bank, SEBI, IRDA and NHB. Money market instruments like commercial paper and short term non-convertible debentures (NCDs) are regulated by the Reserve Bank while SEBI regulates mutual funds and longer tenure NCDs.

Gaps in regulation remain even as the entities continue to be closely interconnected

4.21 The previous FSR highlighted the fact that while NBFCs are subjected to prudential regulations, the regulations vis-à-vis banks is asymmetrical, with banks being subjected to more stringent regulations. It was also highlighted that the presence of multiple regulators for the NBFCs in the country and an entity based approach to regulation give rise to possible regulatory gaps. Many entities, which are borrowing both from the markets and the banks, have the capability of being over-leveraged and, being deeply interconnected, can pose systemic risks. Both banks and mutual funds also invest in corporate paper of NBFCs thereby enhancing the financial integration of these entities. Some restrictions exist on the NBFC exposures that banks can take and the Reserve Bank has recently announced a prudential cap on banks' exposures to debt oriented mutual funds[8]. Several measures to tighten the regulatory framework for NBFCs have also been announced, as discussed in Chapter III of this Report. Nevertheless, these entities remain closely interconnected.

4.22 There are also differences in regulatory requirements of different NBFCs carrying on similar activities and gaps in regulation of certain entities give rise to potential for regulatory arbitrage. The previous FSR highlighted some such instances. Further, there are important differences in the regulatory requirements applicable to brokers for margin trading and those applicable to NBFCs undertaking similar activities especially with respect to requirements of minimum net owned funds, restrictions on borrowings, availability of margin trading facility for initial public offerings and other risk management prescriptions. There is also a need to bring in Alternative Investment funds including private pools of capital such as hedge funds, private equity funds, etc. within the regulatory perimeter. Further, NBFCs set up by banks to carry on activites that can be undertaken by banks presents a clear case of regulatory arbitrage both on the assets and liabilities side.

Systemic importance of Government sponsored NBFCs warrants their being subject to prudential regulation

4.24 There are at present 37 Government owned NBFCs (five NBFCs owned by the Central Government and 32 by various State Governments). Nine of these entities are deposit taking NBFCs, with deposits amounting to nearly ‘2,000 crore as on March 31, 2010, while the total advances of the 37 companies stood at nearly ‘ 2.9 lakh crore. Further, the assets of these companies have been progressively increasing over the years with funding largely through public markets.

4.25 These entities have so far been exempted from the prudential regulatory framework for NBFCs as they are under the administrative control of a ministry of the Government and because they were deemed to pose less supervisory concern with regard to protection of depositors' interest. Over time, the systemic importance of the Government entities has increased with the expanding size of their balances sheets and their growing interaction with the financial system. At the same time, the regulatory framework for NBFCs has also acquired an explicit focus on the systemic risks posed by the sector and on regulatory arbitrage. It has, therefore, been decided to revisit the exemptions granted to these NBFCs in consultation with the Government.

Non-Banking Financial Companies (ND-SI)

Impact of credit risk on capital not very significant

5.22 A stress test on credit risk for NBFC-ND-SI sector was carried out as on March 2010 under two scenarios (i) Gross NPA increased two times and (ii) Gross NPA increased 5 times from current level. It was observed that first scenario did not warrant any additional provision as the sector had excess provision towards NPAs while in the second scenario, it was observed that even though there was shortfall in provisioning the impact on CRAR was negligible as the sector had a higher level of CRAR of 37.1 per cent as against the required level of 12 per cent.

5.24 The credit risk stress tests on NBFC-ND-SI and scheduled UCBs revealed that the impact on CRAR under different scenarios would not be alarming. ■

" A bubble that started in the US housing sector snowballed into a major crisis is a vivid illustration of the risks arising from the interconnectedness of the global financial system and the risks of procyclicality. The lesson clearly is that as much as microprudential supervision is necessary, it needs to be supplemented by macro-prudential oversight to prevent systemic risk building up."- From a speech delivered on "India and the Global Financial Crisis What Have We Learnt?"

Dr. Duvvuri Subbarao, Governor, RBI.

Money-Lenders Act, 1946, cannot transgress on the field occupied by the Law of Parliament: Guj. High court

The High Court of Gujarat[single judge bench] had earlier held in its judgment dated 13.01.2010 that the Bombay Money Lenders Act, 1946 is not applicable to NBFCs[See for details FIDC News December-January, 2010 issue]. Gujarat government filed LPA against the said judgment.

In the LPAs filed by the State of Gujarat, the High Court of Gujarat (Bench, consisting of Chief Justice Mr S J Mukhopadhaya and another Justice K M Thaker), the following questions were decided:

I) Whether the Bombay Money-Lenders Act, 1946 applies to Non-Banking Financial Companies?

ii) Whether the Bombay Money-Lenders Act, 1946, is repugnant to the extent of Non-Banking Financial Companies registered under the Reserve Bank of India Act, 1934?

The Bench, after having considered the provisions of the Bombay Money- Lenders Act, 1946 and the Reserve Bank of India Act, 1934 (Chapter III B), decided in favour of Non-Banking Financial Companies registered with RBI, on the following ground:-

Chapter III B of The Reserve Bank of India Act, 1934 (Central Enactment) has occupied the field of controlling and regulating, (including initiation of penal action) Non-Banking Financial Companies registered under The Reserve Bank of India Act, 1934. Therefore, the State Law, namely, the Money-Lenders Act, 1946, cannot transgress on the field occupied by the Law of Parliament.

Conclusion:-

In the light of the above judgment, Non-Banking Financial Companies registered with RBI are not governed under the provisions of Bombay Money-Lenders Act, 1946.

Latest Development:-

The Gujarat Government, has recently passed a bill on Money-Lenders Act, 2011 in which Non-Banking Financial Companies registered with RBI need not register under the new Act, but shall comply with other provisions of the Money-Lenders Act. Against the new bill, Sundaram Finance has filed a Special Civil Application No. 6223 / 2011 before the same Bench which passed the above judgment. The same has been admitted and notice has been ordered to the Government. In the course of hearing, the Bench expressed that so long as the above judgment is not set aside by the Supreme Court, it holds good and binds the State. [Contributed by Mr. V Srinivasan, DGM, SFL]

SC accepts higher bid after auction of firm says it will benefit creditors

The Supreme Court last week set aside the judgment of the Gujarat high court and directed the sale of a wound-up company in Veraval at a higher price so that creditors will get their dues. The company judge had first ordered the sale at a one price, but recalled its order when a higher offer was made by another party. However, when one of the losing bidders moved the division bench of the high court, it confirmed the sale at the earlier price on the ground that a confirmed auction sale cannot be set aside merely because subsequently a higher price was offered by one of the bidders. Now the bidder offering higher price appealed to the Supreme Court. It set aside the division bench order asserting that the offer of a higher price should be welcomed as it would benefit all the creditors. "If the order of the division bench is sustained, the creditors are bound to suffer because the amount available for repayment of the dues of the creditors would be a paltry sum of Rs.127 lakhs. As against this, if the new offer is accepted, the official liquidator will get an additional amount of more than Rs.4.25 crores. The availability of such huge amount will certainly be in the interest of the creditors including Gujarat Industrial Investment Corporation," the Supreme Court said in the judgment, Shradhha Aromatics Ltd vs Official Liquidator of Global Arya Industries Ltd. The court clarified that this decision would not be a precedent for similar cases. "Ordinarily, this court is loathe to accept an offer made by any bidder or a third party after acceptance of the highest bid/offer," the judgment said. [Business Standard, May 30]

Mortgage suits cannot be sent for arbitration: SC

All disputes are not capable of settlement through arbitration; some by nature have to be adjudicated by courts, according to the Supreme Court. A suit for sale, foreclosure or redemption of mortgaged property should be tried by a court and not by arbitral tribunal, the court stated in the judgment, Booz Allen & Hamilton Inc. Vs SBI Home Finance Ltd. In this case, two firms took loan from SBI to buy flats in Mumbai and they entered into leave and licence agreements with Booz. The borrowers did not repay the loan and so SBI filed a mortgage suit before the Bombay high court. Booz moved the high court for arbitration which was dismissed. Its appeal was also dismissed by the Supreme Court. It stated that a court where the mortgage suit is pending should not refer the parties to arbitration as it is not an "arbitrable" issue. This is so because only a court can protect the interests of third parties. Arbitration deals with only disputes between parties to the arbitration agreement. The court gave similar instances where arbitration should not be attempted, like insolvency and winding up matters, tenancy, wills, criminal offences, matrimonial disputes and guardianship issues. [Business Standard, May 9, 2011]

Lok Adalat cannot pass an order to pay the insurance money: Supreme Court

The Supreme Court has stated that a Lok Adalat cannot pass an order to pay the insurance money when there was no compromise between the parties, in the case, Life Insurance Corporation vs Suresh Kumar. Lok Adalat cannot take over the function of the regular courts. In this case, the Lok Adalat tried to arrive at a compromise between the parties, but failed. Then it passed an order to LIC to pay Rs 1 lakh to the claimant. LIC appealed to the high court, which dismissed it. However, the Supreme Court allowed LIC's appeal and stated that the Lok Adalat and the high court committed serious error.

Hearty Congrats to Mr. V P Nandkumar, Chairman, Manappuram Group of Companies, who was presented Dhanam Businessman Award, 2010 at the Dhanam Business Summit and Award Night-2011 on May 28 at Kochi. The jury noted that as a Chairman of Manappuram Group, through his vision, dedication, commitment and professionalism, he has steadily built up the company through extensive expansion and reach to a universally acclaimed business model.

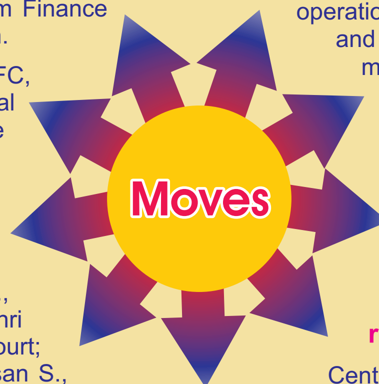
Govt to come out with market-friendly stamp duty norms shortly

The centre is likely to come out with a uniform and market-friendly stamp duty structure for transactions in the capital and commodities markets within two weeks, a senior finance ministry official said. "Department of Economic Affairs and Department of Revenue are in consultation to evolve a market friendly stamp duty structure," a senior ministry official said. The new structure, he added, would help the states modify their stamp duty regulations for various instruments like equities, futures and other products. "We could recommend stamp duty structure for various products in next two weeks," he said. Different stamp duty rates are imposed on transaction of securities, futures, delivery and other instruments in the share market and commodity exchanges. Since the Stamp Duty is levied by the states, the centre can only persuade them to adopt a structure that would bring about some uniformity in rates across the country. [Economic Times, June 23]

FIHPA organized National Convention at Chennai

The Federation of Indian Hire Purchase Associations (FIHPA), the apex body representing the regional affiliated association involved in asset finance Business organized its 23rd National Convention at Chennai on 24th June 2011 for NBFCs & Partnerships and individual asset financiers where 480 delegates attended the convention from across the country.The convention was inaugurated by Sri A.K. Bansal, Executive Director of Indian Overseas Bank. Shri T.T. Srinivasaraghavan Managing Director, Sundaram Finance Ltd., was the Chief Guest in the valedictory session.

The subjects/speakers were: Partnership Vs NBFC, Strength, Weakness and Solutions-Shri Madanlal Gundecha, Chairman, Gundecha Finance Corporation and Shri Venkatesan S., CFO, Sundaram Finance Ltd; Funding and Reorganization for Small Financiers-Smt. Subhashri, ED, Shriram City Union Finance Ltd; Arbitration, Insurance Claims, Settlements, Transfers and Related Issues-Shri Sundar S.R., Senior Advocate, Madras High Court and Shri Ramarajan, Senior Advocate, Madras High Court; State Money Lenders Act – Issues-Shri Srinivasan S., Vice President, Royal Sundaram Alliance and General Insurance Company Ltd.; An overview of Commercial Vehicles Business-Shri Dilip Moolchandani, President, Eastern Regional Office, Shriram Transport Finance Company Ltd.; Recovery, Repossession and Information on Interaction with various Government Agencies-Shri Ramman Aggarwal, Co Chairman, Finance Industry Development Council.



Loans to NBFCs in agriculture space could get priority sector tag

The government may ask the central bank to accord priority sector tag to bank loans to smaller NBFCs that lend largely to agriculture and small and medium enterprises. The Reserve Bank, in its monetary policy review on May 3, had struck down NBFCs from banks' priority list except for those lending to microfinance institutions. Banks are required to lend 40% of their total advances to 'priority' sectors, including agriculture, SMEs and MSMEs and weaker sections.

NBFCs, which now face a cut in financing after the RBI move, have petitioned the different arms of the government, including the ministry of small and medium enterprises, or MSME. "We expect that RBI should take a lenient view on those asset financing companies, which finance agriculture and SME sector through loans for equipment, plant and machinery, and also to small road transport operators (SRTOs)," said a government official. The Reserve Bank is also expected to take up this issue on May 13 when a working committee on NBFCs, headed by former RBI deputy governor Usha Thorat, will meet industry representatives.

RBI has expressed concern over a 55% increase in credit to NBFCs in the year ended March 2011 as compared to a 20% increase in the overall bank credit. "RBI's concern is that whether this increase is because NBFCs are lending for activities that banks are restricted to. They want to remove such regulatory arbitrage," said a finance ministry official. The government admits that bank loans to systemically important NBFCs, which are mostly into 'loan and investments', should not be tagged as priority. "We support RBI's view that there should be a more stringent framework for such NBFCs who may have taken exposure in capital markets as well," the finance ministry official said. [Economic Times, May 11, 2011]

SEBI forms panel on corporate bond market

Market regulator the Securities and Exchange Board of India (SEBI) on March 31 constituted a 16-member committee which will suggest a roadmap for developing corporate bond market in the country. The 'Corporate Bonds & Securitisation Advisory Committee' would be chaired by RH Patil, chairman of Clearing Corporation of India (CCIL), the SEBI said. The committee would advise the regulator on development of corporate bond market and the market for securitised instruments in the country. The committee would "advise SEBI on implementing the recommendations of the high-level committee on corporate bonds and securitisation", it said. It would also suggest removal of regulatory hurdles and advise on issues which need to be taken up with other regulators as also highlight the operational and systemic risks, if any, in the corporate bonds and securitised instruments market. "This would help make the corporate bond and securitisation market more active and dynamic," SMC Global Securities Strategist & Head of Research Jagannadham Thunuguntla said. Earlier this month, the SEBI allowed listing of securitised debt instruments or certificates on exchanges, and said that the move would help improve the secondary market liquidity for such instruments. [PTI, March 31

Central Bank ties up with NBFCs to grow retail biz

Central Bank of India has entered into a tie-up with NBFCs such as Future Capital, Bajaj Finance, and Reliance Capital to grow its retail portfolio. Retail portfolio, comprising home, auto and personal loans, constituted 12.5 per cent of the public sector bank's total advances of Rs 1,31,407 crore as of March-end 2011. "We have to crack the retail business. We have put in place infrastructure such as loan processing cells across the country. Besides our branches, the NBFCs we have tied-up with will originate loans for us," said Mr S. Sridhar, CMD..The bank has set a target of increasing its retail portfolio by Rs 5,000 crore in the current financial year, said a senior bank official. "We want to increase the retail portfolio from the current 12.5 per cent to 25 per cent of the total advances in the next couple of years. We will also buy-out securitised retail portfolio from the NBFCs," he said.

A novel method to move defaulters repay loans

Walk into some Corporation Bank branches across the country and you are likely to see a few individuals with their photographs on the notice-boards, much like the wanted list that one sees in police stations. Those at the bank branches are, however, not criminals in the normal sense of the word, but simply wilful defaulters on loans taken from the bank. Once their pictures and names are thus put on the notice-boards, the bank says the social stigma attached to it forces most to repay their loans. "We have made substantial recoveries through this method," the public sector lender's Chairman and Managing Director, Ramnath Pradeep, told reporters. Apart from the stigma attached, "it also makes it difficult for the defaulters to get credit from other sources," he said. ■

SMEs may turn to factoring firms, NBFCs for credit needs

Small and medium enterprises could find factoring firms and NBFCs a good source of finance in the current rising interest rate scenario. According to Mr Sudeb Sarbadhikary, CEO, India Factoring and Finance Solutions, as banks raise interest rates and become more selective in lending to SMEs, this segment will be forced to turn to factoring firms and NBFCs for their credit requirements.Factoring firms provide credit support to SMEs in the form of lending against receivables and credit invoices. Mr Sarbadhikary estimated that in the current market scenario, SMEs may get less than 60 per cent finance from banks, against 75 per cent earlier, and they will have to make do the rest with non-banking sources of finance. However, pointing out that an NBFC cannot be the primary financier for SMEs, Mr Sarbadhikary said these firms can be good sources of support financing, but the core financing has to still come from banking sector. [Business Line, 20 May]

Bank credit to NBFCs jumps 55% in April

Credit off-take by NBFCs and commercial real estate sectors rose substantially on a year-on-year basis in April 2011 vis-à-vis April 2010, according to the RBI's data on sectoral deployment of credit. A break-up of the RBI data shows that credit growth to NBFCs at 55.7 per cent on a y-o-y basis in April 2011 was significantly higher than the 15.1 per cent growth in the corresponding period of the previous year. Credit to NBFCs shot up by Rs 62,244 crore between April 23, 2010, and April 22, 2011.

Bank credit to NBFCs, however, is likely to come down going forward, say bankers. This is so because the RBI, in its annual policy for 2011-12, said that bank loans to the NBFC sector (except for microfinance institutions that are classified as NBFCs) will not get the priority sector tag. Hence, banks will undertake direct lending to the priority sector. [Business Line 1 June]

Big-ticket mergers will need competition panel's nod from June 1

The Competition Commission of India (CCI) has notified the long-awaited regulations on big-ticket M&As. The new norms, drafted with the objective of curbing anti-competitive practices, will come into effect from June 1. However, M&As that commenced before June 1 with definitive action have been kept outside the competition watchdog's purview. The notified Sections 5 and 6 of the Competition Act will enable the CCI probe any combination that is likely to have an appreciable adverse effect on competition in the relevant market, said Mr Dhanendra Kumar, Chairman, CCI. But CCI will have to take decisions within 180 calendar days of the proposal.

MFIs cannot charge more than 26% interest: RBI

The Reserve Bank has capped interest rates charged by micro finance institutions from small borrowers at 26 per cent, but opened for MFIs the bank credit line which was curtailed following the crisis faced by the sector in October, 2010. The loan by the banks to MFIs for on-lending to small borrowers will fall under 'priority sector' category if the RBI guidelines are met. [Economic Times, May 3]

Norms for infra debt fund cleared

In order to raise long-term resources for funding the infrastructure sector, the government on June 24 said Infrastructure Debt Fund (IDF) could be set up either as a company or trust. The IDF, which was proposed by Finance Minister Pranab Mukherjee in the Union Budget for FY12, is aimed at accelerating and enhancing flow of long term debt for funding the ambitious programme of infrastructure development in the country. "An IDF may be set up either as a trust or company... A trust based IDF (Mutual Fund) would be regulated by SEBI; an IDF set up as a company (NBFC) would be regulated by RBI," the Finance Ministry said in a statement.

Elaborating on the structure of IDF as a company, the release said it could be set up by NBFCs or banks, with a minimum capital of Rs 150 crore. Such a fund would be allowed to raise resources through rupee or dollar denominated bonds of minimum five year maturity. These bonds could be traded among the domestic and foreign investors. Company based IDFs would be allowed to fund projects in public-private partnership (PPP) which have completed one year of commercial operations. Potential investors in this category, include off-shore and domestic institutional investors, high networth individuals and non-resident Indians. [PTI, June 24]

Now, NBFCs taking non-convertible debenture route to raise funds

With banks hiking interest rates, NBFCs are tapping non-convertible debentures (directly raising resources from public) to lock-in the rates and broad-base their source of funds. Mr R. Sridhar, Managing Director, Shriram Transport Finance, said, "With high inflation and rising interest rates, we lend to truck owners at fixed interest and, therefore, it makes sense for us to borrow at fixed rates as well." He said if a company with good track-record wants to raise large resources in a short span, NCD is the "way to go" as in two weeks the issue could be wrapped up. [Business Line, 22 June]

EASING THE RULES FOR NBFCs

Ground realities being what they are, it makes sense for banks to collaborate with NBFCs and see their role as complementary, rather than competitive.

The Reserve Bank of India's move to allow banks to buy loans from NBFCs — and treat the process as priority sector lending — represents a slight relaxation in the tight framework of regulations that now govern the non-banking financial sector. This will not only make the funding window for NBFCs a little more secure, it will also help prevent interest costs from spiralling higher for those who borrow from such NBFCs. When the RBI announced two months ago that bank lending to NBFCs would no longer qualify as priority sector lending, that was a blow to the industry. The RBI's reservations were about the end use of funds or their misuse. Funds classified as priority sector lending were going elsewhere and the money was misused by some NBFCs. More recently, one of the causes for concern has been the rapid growth of the gold loan business of a couple of NBFCs.

NBFCs have also come under the scanner because of opportunities for regulatory arbitrage. While banks have traditionally functioned under tight regulatory control and supervision, the former enjoyed a shade more freedom and flexibility. This has often led to banks and industrial groups lending money through an NBFC to avoid closer scrutiny. No one can quarrel with the RBI's intention to get banks to lend directly to the priority sector. However, ground realities being what they are, it makes sense for banks to collaborate with NBFCs and see their role as complementary, rather than competitive. To some extent, this was happening, as banks did chase NBFCs in an effort to buy up their portfolios and thus fulfil their priority sector targets. (NBFCs largely served the single-truck owner market and this qualified as priority sector lending). This situation changed to some extent when the priority sector tag was removed. NBFCs engaged in pure asset financing found their access to funds getting costlier and their clients bearing a higher burden. Given the current environment of a looming slowdown in the economy, higher financing costs can only further decelerate growth in the commercial vehicles industry. The point these NBFCs are making is that their funding of trucks and tractors has been a significant contribution to the goal of financial inclusion — long before the term became fashionable. Now, they think they are being penalised for the sins of a few. Arguably, the banks, especially private and foreign banks, would have struggled to meet their priority lending targets if the earlier rule had stayed. Given their limited network and reach in rural areas, these banks can now invest in securitised paper of NBFCs or buy their loans to fulfil statutory obligations. So, this relaxation will also do these banks some good.

[Business Line July 6]

Global News

Impact of Interest rate restrictions in Europe

The results of a wide-ranging study into interest rate restrictions in 6 European markets, including the UK by European commission were published on 25 January. The European Commission found that rate restrictions tended to reduce access to credit (particularly for low-income borrowers), reduce the choice of products available to consumers, and increase the overall cost of credit in parts of the market. The study also found little evidence that credit price restrictions helped to reduce over-indebtedness. The study also confirmed many of the concerns Finance & Leasing Association had voiced to British Parliamentarians and Ministers in the UK adds FLA.

Allow NBFCs to access global market for borrowings: ASSOCHAM

Industry chamber ASSOCHAM said that NBFCs should be allowed access to international and other sources of borrowings at competitive rates in the interest of overall credit system. “NBFCs serve vital lending needs of under-served sectors like small and medium enterprises. They should be allowed to deduct provisions for bad debts as an expense before computing taxable income,” the chamber said. It also suggested that the benefits extended to banks should be extended to NBFC sector as well. Banks are able to recover funds from loans that have gone bad under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Sarfaesi) 2002 Act. Similarly, NBFCs should also be covered under its provisions for restructuring their loans and sale of non-performing assets, it added.

“To develop markets globally for significant reach of financial services, NBFCs and other financial service companies should be allowed to tap international markets,” the chamber said in communication to the Reserve Bank’s review group while emphasising on macro-level need for realignment of opportunities for them. Credit offtake from NBFCs grew by 55 per cent last year as compared to 23 per cent growth in the banking sector due to better business penetration and efficient turnaround time for financing. Putting curbs on NBFCs can be reflection of non-recognising market forces and significant demand for credit from them, it said. [May 15, 2011]

Motor Insurance database access arrangement

UK’s Finance & Leasing Association’s agreement with the Motor Insurers’ Bureau for streamlined access to the Motor Insurance Database (MID) took effect on 1 February. It will help motor lenders to check the insurance status of their vehicles and so protect their assets. It will also help lenders to prepare for the new Continuous Insurance Enforcement regulations which will penalise the registered keepers of vehicles that are uninsured. The regulations take affect from 1 April. [FLA News letter, March 2011]

Fraud intelligence sharing system of FLA of UK

Finance Leasing Association [FLA] of UK said that there was obvious risk of surge in fraud during the recession. FLA’s fraud intelligence sharing system [operated by Dun & Bradstreet] has helped mitigate this. FLA claims in its report that 200 possible fraudulent applications for asset finance have been investigated leading to estimated saving for FLA members of 7 million pound sterling. FLA has also made significant progress in developing arrangement for secure marking and registration of equipment. FLA’s director general Stephen Sklaroff claims that FLA- sponsored Vehicle Fraud Unit now includes dedicated police officers at the seaports

Debt collectors ask for respect

As a longtime debt collector, Lesllie Rogers has been insulted, pummeled with obscenities, crudely propositioned and threatened with violence by the people she calls. “They want you to feel as small and insignificant as possible,” said Rogers, who works for a collection agency in Rochester (Minnesota). “The guy who sits across from me just was threatened with getting his legs and arms cut off.” Debt collectors like Rogers are well aware that they are not a sympathetic lot. But now they are saying enough is enough. The trade association that represents them is engaged in an unlikely charm offensive to change their lowly image, while also trying to shape the rules that govern them as they face the prospect of a tough new regulator.

These are boom times for collection agencies, which have been swamped with work as many Americans gorged on debt and then struggled to repay it. Last year, 140,036 complaints were filed against debt collectors, a 17 per cent increase over the previous year, according to the Federal Trade Commission (FTC). The complaints told of menacing late-night phone calls and threats of jail time or confiscating a house. In one instance a jury awarded a Texas man $1.5 million after a debt collector left voicemail messages using vulgarities. Those are the exceptions, the industry’s trade association says.

Indeed, Mark Neeb, the association’s incoming president, says that most debt collectors are the “salt of the earth” and are tired of being defined by the worst members of their profession. And it is they who are feeling harassed. “There really ought to be a law on how consumers behave towards debt collectors,” said Neeb, whose employees routinely use aliases on the phone to protect their identity from hostile debtors. After several years in which the overzealous tactics of debt collectors have been the focus of regulators and media alike, ACA International has beefed up its lobbying operation in Washington to pursue a wish list of laws and regulations that it would like changed. At the urging of the organisation, debt collectors are travelling to Washington and state capitals, hoping to convince regulators, legislators and attorneys general that they are decent people who are doing an important but thankless job. [Business Standard, June 14]

Illegal hiring contributes to rise in car fraud

Motor finance fraud cases rose by 17% in the first three months of 2011, according to figures from the Finance & Leasing Association (FLA), released to coincide with the start of Car Crime Awareness Week. While applications for credit made using false information remain a problem for lenders, the rise in fraud was mostly due to the increase in ‘first party fraud’. This type of fraud involves people taking out car agreements on behalf of other drivers, as well as customers “sub-hiring” financed vehicles, which accounted for 45% of fraudulent activity in the first three months of 2011. The value of motor fraud cases overall in the first three months of 2011 was £3.8 million, up 13.8% on last year’s value. There were 230 cases of motor fraud in the first quarter, and 865 in the last 12 months. FLA member finance companies prevented over 2,000 cases of attempted fraud in the first quarter of 2011. This prevented at least £26 million of fraudulent deals.

Central bankers agree on bank capital surcharge plan

Global banking regulators have agreed on a proposal to slap an extra capital charge on the world's biggest banks to make them safer by 2019. The surcharge is part of a series of regulatory reforms launched in response to the financial crisis, which forced countries worldwide into costly bailouts of their banking sectors to prevent systemic collapses. The Group of Governors and Heads of Supervision (GHOS) said after a meeting in Basel on June 25 that the proposal would be put out to public consultation next month. "The additional loss absorbency requirements are to be met with progressive common equity tier 1 capital requirement ranging from 1 percent to 2.5 percent, depending on a bank's systemic importance," the group said in a statement. An additional 1 percent surcharge would also be imposed if a bank becomes significantly bigger, pushing the total to 3.5 percent. The plans, which need approval from world leaders (G20) in November, would be phased in between January 1 2016 and end of 2018. [Reuters, 25 June] ■

NBFC representatives meet RBI officials, raise industry concerns

In the pre-credit policy meeting, representatives from Finance Industry Development Council (FIDC), an association of NBFCs, met RBI Deputy Governor Mr. Subir Gokarn and raised concerns on recent steps taken by the central bank.

A major concern taken up in the meeting was RBI's decision to increase the minimum capital adequacy ratio (CRAR) for deposit-taking NBFCs from 12 per cent to 15 per cent, thereby aligning them with non- deposit-taking NBFCs. "The decision by the regulator to increase the CRAR was unwarranted. There are a lot of other requirements which the deposit-taking NBFCs have to comply with, like maintaining 15 per cent SLR. This is not required by non-deposit-taking NBFCs. So, this decision was totally unnecessary," said FIDC Director General, Mahesh Thakkar.

NBFCs also demanded that a differential risk weightage system should be introduced for NBFCs to replace the current uniform risk weightage system. "We demanded that risk weightage to commercial auto loans be brought down from 100 basis points to 50 basis points. If this happens, only then can the NBFC sector absorb the impact of the hike in CRAR," Thakkar said. Currently, all NBFCs have to provide a risk weightage of 100 basis points against all types of advances.

The NBFCs also expressed concerns on the current liquidity and inflationary situation. "Though there are signs of liquidity easing, interest rates have to come down, as they are already eating into the margins of companies," said an NBFC official. [BS Reporter, April 08]

Bank Loans to NBFCs - Priority Sector Status

FIDC took up with RBI Governor the RBI action of withdrawal of priority sector status accorded to Bank Loans to NBFCs for On Lending to SMEs, Small Road Transport Operators (SRTOs), Agri. based activities, SSIs etc. with effect from April 1, 2011 as it has come as a shock to the NBFC sector, particularly, the Asset Financing NBFCs (NBFC-AFCs). [see for details p.5-6]. FIDC acted swiftly to safeguard the interest of NBFC sector in this regards. Media has also supported the cause effectively.

Securitised assets continue to have Priority Sector status

RBI's Master Circular titled 'Lending to Priority Sector' dated July 5 issued to banks now makes it clear that Outright purchases from NBFCs of any loan asset eligible to be categorised under priority sector shall be eligible as bank priority sector loan assets.

The purchase of priority sector portfolio by banks from NBFCs will continue to be treated as priority sector loans in the books of banks post securitisation. Relevant paras in Part [ii] of the said Circular are as under:

(I) Investments by banks in securitised assets, representing loans to various categories of priority sector, shall be eligible for classification under respective categories of priority sector (direct or indirect) depending on the underlying assets, provided the securitised assets are originated by banks and financial institutions and fulfil the Reserve Bank of India guidelines on securitisation. This would mean that the banks' investments in the above categories of securitised assets shall be eligible for classification under the respective categories of priority sector only if the securitised advances were eligible to be classified as priority sector advances prior to securitisation.

(ii) Outright purchases of any loan asset eligible to be categorised under priority sector, shall be eligible for classification under the respective categories of priority sector (direct or indirect), provided the loans purchased are eligible to be categorized under priority sector; the loan assets are purchased (after due diligence and at fair value) from banks and financial institutions, without any recourse to the seller; and the eligible loan assets are not disposed of, other than by way of repayment, within a period of six months from the date of purchase.

The said Circular, however, adds:

1.4 Loans not eligible for classification as direct/indirect finance to agriculture

1.4.1 Loans sanctioned w.e.f. April 1, 2011 to NBFCs (other than MFIs which adhere to the criteria specified in paragraph 3.2) for on-lending. The bank loans extended prior to April 1, 2011 to NBFCs, and classified under Priority Sector will continue to be reckoned under Priority Sector till maturity of such loans.

1.4.2 Loans sanctioned to NBFCs for on-lending to individuals or other entities against gold jewellery, investments made by banks in securitised assets originated by NBFCs, where the underlying assets are loans against gold jewellery, and purchase/ assignment of gold loan portfolio from NBFCs.

2.3 Loans not eligible for classification as direct or indirect finance to MSE sector

2.3.2 Loans sanctioned w.e.f. April 1, 2011 to NBFCs (other than MFIs which adhere to the criteria specified in paragraph 3.2) for on-lending.

"At last, this is a good news after a long time ! Everything is not lost as yet !" said Shri Mahesh Thakkar, Director General, FIDC. He was responding to withdrawal of priority sector status to bank credit for such loans granted by NBFCs with effect from 1st April 2011 by the RBI as announced on May 3.

FIDC In Action

Worries of NBFC Sector

A spate of circulars issued by RBI in the last couple of months, all of which have been against the interests of NBFCs has caused concern in second largest sector (i.e. NBFC) in financing industry. The major area of concern voiced was in respect of the following issues:

1 Increase of CRAR from 12% to 15%

2. Definition of 'Asset' for AFCs and exclusion of cars and 2-wheelers therefrom.

3. Withdrawal of Priority Sector status for banks lending to NBFCs for the stated purposes.

4. No prior consultation in any of these matters by RBI with the sector.

Meeting with Working Group set up by RBI

FIDC has responded to the questionnaire from the Working Group set up by RBI under the chairmanship of Mrs Usha Thorat. The views and suggestions of FIDC thereto, were presented to the Committee at a meeting held in Mumbai on 13-05-11. It was emphasized that the RBI should give NBFC-AFCs a roadmap and it is also needed to play a developmental role for the sector. The long standing demand to create a window for providing refinance to NBFC-AFCs as is the case with Housing Financing Companies was reiterated stating that this was one of the key recommendations made by the Parliamentary Standing Committee on Finance in their 45th Report in June, 2003.

Meetings:

Meetings of the Managing Committee of FIDC were held at Mumbai on May 13, 2011 and at Chennai on June 25, 2011. The venue and lunch for Chennai meeting were sponsored by Finance Companies Association (India).

Ensuing meeting of the Managing Committee is proposed to be held at Mumbai on September 20, 2011 and thereafter in Jaipur on November 26, 2011.

Seventh Annual General Meeting of members of FIDC is proposed to be held on September 20, 2011 at Mumbai.

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

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