FIDC NEWS

Finance Industry Development Council

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

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Reconsider the barriers on PSL

NBFC AFCs have been recognized for their role in credit delivery in remote corners of India and have carved a niche for themselves in the semi-rural and rural segments of the country. NBFC-AFCs are also playing a vital role in furthering the cause of Financial Inclusion and in credit dispensation to the poor states/credit starved areas for over 5 decades. We are thankful to the Nair Committee for recognising the role played by NBFC - AFCs in the last mile connectivity as well as the fact that both banks and NBFC - AFCs have a role to play to achieve the above mentioned objective of financial inclusion and both can collaborate and partner each other to ensure that the same is achieved in a desirable manner. We would, however, like to add that from the present norm of no grant of Priority Sector Lending benefit for on lending by NBFC-AFCs to allowing the same as recommended by the Nair Committee is a step in the right direction. We suggest that the 5% norm be removed. In our view, so long as the end usage of the funds is clearly established to be for the priority sector, there appears no merit in imposing a ceiling for such on-lending. In this background, any credit availability to the needy segment, whether provided by banks or by NBFC-AFCs, should be welcomed without any restriction what so ever. . Hence, even if the RBI chooses to accept the recommendation of the Nair Committee as regards to a prescribed limit then, exclusion of securitisation / buy outs / on-lending by NBFCs to SFMF, micro enterprises and weaker sections is requested. We also suggest to include NBFC-AFCs as entitled to issue PSLCs. It is suggested that a new norm as recommended, requiring that at least 65% of the AUM be on the NBFCs balance sheet, be omitted. The pre-existing assets in the books of NBFC should not be excluded from eligibility under on-lending for the purpose of priority sector classification. It is requested that this new norm being recommended be omitted. The interest rate spread cap prescribed on the underlying loans provided by the NBFCs for eligibility under priority sector is 3.5% for NBFC – HFCs and 6% for NBFCs – AFCs. In our view, instead of imposing an arbitrary cap on spreads, it is suggested that RBI identify and implement measures as would encourage NBFC-AFCs to lend to the priority sector at competitive rates.

R Sridhar, Chairman, FIDC

Regulatory Perimeter

RBI NOTIFICATIONS:

1. Monitoring of frauds: RBI/2011-12/424, DNBS.PD.CC. No. 256 /03.10.042 / 2011-12, March 02, 2012; All Non-Deposit taking NBFCs with asset size of Rs.100 crore and above and Deposit taking NBFCs

2. Anti-Money Laundering (AML)/Combating of Financing of Terrorism (CFT) - Standards - RBI/2011-12/443, DNBS(PD).CC. No 257/03.10.42 /2011-12, March 14, 2012, All NBFCs/RNBCs.

3. Implementation of UNSCR 1929 (2010) on Non-proliferation –Government of India Order of November 04, 2011- RBI/2011-12/442, DNBS(PD).CC. No 258/03.10.42/2011-12, March 14 , 2012, All NBFCs/RNBCs

4. Draft Circular for Deployment of White Label Automated Teller Machines (WLAs) on 14 Feb.2012

5. Lending Against Security of Single Product – Gold Jewellery, No. DNBS.241/CGM (US)-2012 and DNBS.242/CGM(US)-2012, March 21, 2012

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आज ज़रूरत खुद आपका पता ढूंढ लेती है.

आज 1 लाख से ज़्यादा गांव, महिन्द्रा फ़ायनेंस की लोन सेवाओं का लाभ उठा रहे हैं.

आज कस्टमर्स हमें भी अपनी ख़ुशी में शामिल करते हैं.

आज 15 लाख परिवारों का अटूट हिस्सा है महिन्द्रा फ़ायनेंस.

6. NBFC-MFIs -Provisioning Norms- Extension of time- RBI/2011-12/ 463, DNBS.PD/ CC.No.263 / 03.10.038 /2011-12, March 20, 2012

7. NBFCs - KYC Norms/AML Standards/Combating Financing of Terrorism/Obligation of banks under PMLA, 2002- Assessment and Monitoring of Risk: RBI/2011-12/466, DNBS(PD).CC. No 264/03.10.42/2011-12, March 21, 2012

8. Non- Reckoning Fixed Deposits with Banks as Financial Assets: RBI/2011-12/446, DNBS (PD)CC.No.259 /03.02.59/2011-12, March 15, 2012

9. Guidelines on Fair Practices Code for NBFCs: RBI/2011-12/470, DNBS.CC.PD.No.266 /03.10.01/2011-12, March 26, 2012

Lending against security of Gold Jewellery

On account of the rapid pace of NBFCs business growth of predominantly engaged in lending against gold jewellery and the nature of their business model, which has inherent concentration risk and is exposed to adverse movement of gold prices, as a prudential measure, it is directed by the Reserve Bank on 21 March that all NBFCs shall: [I] hereafter maintain a Loan-to-Value(LTV) ratio not exceeding 60 percent for loans granted against the collateral of gold jewellery and [2] disclose in their balance sheet the percentage of such loans to their total assets. [3] NBFCs primarily engaged in lending against gold jewellery (such loans comprising 50 percent or more of their financial assets) shall maintain a minimum Tier I capital of 12 percent by April 01, 2014. [4] NBFCs should not grant any advance against bullion / primary gold and gold coins. [RBI circular, March 21]

Provisioning Norms for NBFC-MFIs extended for one year

RBI has deferred the implementation of asset classification and provisioning norms for NBFC-MFIs to April 01, 2013 taking into account difficulties faced by MFI sector. Such norms were to be adhered to by the MFI sector with effect from April 01, 2012. NBFC-MFIs are, however, asked by the RBI to comply with the other regulations laid down in the circular dated December 02, 2011.

RBI plugs tax flaw in NBFC guidelines

The RBI has shut a loophole in the non-banking finance company (NBFC) regulations which individuals exploited to escape taxes. This may now result in hundreds of NBFCs losing their licence. Finance companies that do not begin lending within six months of getting the licence will see their permission terminated, the central bank said in a notification. "If the business of NBFC is not commenced by the company within the period of six months from the date of issue of certificate of registration, the CoR will stand withdrawn automatically," it said. Ownership transfer will also be restricted. "There can be no change in ownership of the NBFC prior to commencement of business and regularisation of its certificate of registration," it said. [Eco. Times, 16 March]

Priority sector lending: Call to hike cap on bank loans to NBFCs

The 5 per cent cap on bank loans to NBFCs for classifying them as priority sector advances should either be done away with, or at least increased. The cap works against the very intention of extending credit to the credit-starved segment, said Mr Sanjay Chamria, Vice-Chairman and Managing Director, Magma Fincorp. One of the suggestions in the M.V. Nair Committee's draft guidelines on priority sector lending is that bank loans to non-bank financial intermediaries for on-lending to specified segments should be reckoned for classification under priority sector, up to a maximum of 5 per cent of bank credit. In a bid to get banks to take direct exposure to the priority sector, the RBI had withdrawn the priority sector tag to bank loans to non-bank intermediaries with effect from April 1, 2011.

While lauding the Committee for taking a practical view of banks' exposures to NBFCs, in his personal capacity, Mr Chamria said he would like to see some changes. The cap is not warranted and should be done away with. But if the regulator fears systemic risk, then at least the cap should be increased, he said. There is also need for clarity on whether the cap includes portfolios sold by NBFCs. This is not exposure to the NBFC but to the underlying customer to whom the loan has originally been given, Mr Chamria explained. [Business Line, March 2]

Nair panel paves way for NBFCs for PSL

The Reserve Bank had constituted the Committee under the chairmanship of Shri. M. V. Nair on Priority Sector lending on August 25, 2011. Among one of the main recommendations of the panel it is said: "Bank loans to non-bank financial intermediaries for on-lending to specified segments may be allowed to be reckoned for classification under priority sector, up to a maximum of 5 per cent of adjusted net bank credit [ANBC] or credit equivalent of off-balance sheet exposure [CEOBE], whichever is higher, subject to certain due diligence and documentation standards" Thus the committee paves way for reopening of doors for priority sector lending[PSL] to NBFCs. The report further elaborates in this regards:

3.12. Lending to non-bank financial intermediaries for on-lending

"Keeping in view the role of non-bank financial intermediaries like Primary Agricultural Cooperative Societies (PACS), Cooperative Banks, NBFCs, HFCs and MFIs in extending the financial services to the last mile, bank loan sanctioned to non-bank financial intermediaries for on-lending to specified segments may be reckoned for classification under priority sector, up to a maximum of 5 per cent of ANBC, subject to adherence to the terms and conditions stipulated in Para 4.2.

In respect of banks currently having portfolio of on-lending, buy-outs and securitization in excess of the proposed 5 per cent of ANBC, the Committee proposes stipulation of reducing such portfolio by at least 1 per cent of ANBC every year for reckoning under priority sector such that at the end of 5 years not more than 5 per cent of ANBC will be reckoned for priority sector classification. It is also stipulated that any new on-lending, buy-outs and securitisation by such banks would not be reckoned for priority sector purpose, until such time their portfolio of on-lending, buy-outs and Securitisation is reduced to 5 per cent of ANBC.

Portfolio buy-out, securitization and loans to intermediaries for on-lending would be classified as priority sector provided the underlying asset (asset to be financed, in case of on-lending) is eligible for classification under priority sector advances. However, loans extended against gold jewelleries by NBFCs and other intermediaries may continue to be excluded as a part of priority sector classification."[RBI Press Release/Nair Committee Report]

RBI mulls ATMs entities by non-banking entities

The RBI said it will allow non-banking institutions to set up, own and operate ATMs. In draft guidelines released on Feb. 13, the central bank said: "Such ATMs will be in the nature of White Label ATMs (WLA) and would provide ATM services to customers of all banks."

The WLA operator can earn fees from the banks as acquirer for all transactions but will not be allowed to charge customers. In the proposed guidelines, RBI said that the prospective WLA operator should have minimum net worth of Rs 100 crore. The WLA operator should also have a sponsor bank to manage cash and a network operator to connect all its ATMs. [BS Reporter, Feb 15]

RBI details foreigners' direct play in stocks, MFs

The RBI released the detailed guidelines for investment by qualified foreign investors (QFIs) in equity shares and rupee denominated units of domestic mutual funds. Only QFIs from jurisdictions, which are Financial Action Task Force (FATF) compliant and with which Sebi has signed MoUs (memorandum of understanding) under the International Organisation of Securities Commissions (Iosco) framework will be eligible to invest in equity shares under this scheme, said a circular issued by RBI. The individual and aggregate investment limits for the QFIs shall be 5 per cent and 10 per cent respectively of the paid up capital of an Indian company.DPs will ensure KYC of the QFIs as per the norms prescribed by SEBI. [Financial Chronicle, Jan 13] ■

ROLE OF NBFCs*

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"NBFIs play a crucial role in broadening access to financial services, enhancing competition and diversification of the financial sector."

"Indeed it is evident in India that with the development of NBFCs segment within the overall financial system, it challenged the other segments, viz., banks to innovate, to improve quality and efficiency, and deliver at flexible timings and at competitive prices."

Introduction

An essential feature of the evolution of financial system has been the emergence of non-banking financial institutions, outside the traditional banking system including finance companies, leasing companies, merchant banks and trust and investment companies. The deep and broad-based financial system has invariably enhanced access to finance at a reasonable cost, and reduced volatility thereby reducing risk by improving transparency, inducing competition and diversifying products and services and also efficient delivery of them. Diversification of the financial sector has been one of the principal features of economic growth in both advanced and emerging economies. It has been well established that improvements in financial architecture quite often precede and contribute to economic performance in most countries (World Bank, 2003). Tremendous progress of financial system, especially during the 1980s and 1990s, was mainly due to the rigorous efforts of the non-banking financial institutions (NBFIs) world over. Therefore, Non-banking financial companies (NBFCs) have been the subject of special focus during the eighties and nineties including in India. In particular, the rapid growth of NBFCs, especially in the nineties, has led to a gradual blurring of dividing lines between banks and NBFCs, with the exception of certain exclusive privileges for the commercial banks. Over a period, both banks and non-bank financial institutions have become key elements of broad-based and sound financial system in India. The growing importance of NBFCs was recognised by series of committees and working groups since early 1970s including Banking Commission till the second Narasimham Committee (1998). Further, the Reserve Bank of India in its Discussion Paper on Harmonisation of the Role and Operations of DFIs and Banks(1999) and the Report of the Working Group on Money Supply (1998) (Chairman: Dr. Y.V. Reddy) had also discussed their importance.

In the recent global crisis, however, the role of non-bank financial intermediaries (NBFIs)1 had been widely reproached. NBFIs, in general, were known for taking higher risks than the banking system. The nexus between the banking system and the NBFIs during the global crisis (2007-2009) put the entire financial system in distress. Traditionally, the debate regarding the banks expansion into non-banking activities veered around certain activities, viz., insurance, investment banking, etc. However, the recent global crisis has extended the debate to the inter-connectedness of the banking system with the NBFIs, as excessive inter-institutional exposure put the entire financial system into vulnerability.

Importance of the Role of NBFIs

By now it is well established, with the experience, that the robust growth and effective functioning of a financial system is vital for economic development. There is universal agreement that a well functioning financial system is necessary for a thriving modern economy (Kroszner, 2010). In all advanced economies, for example, sophisticated financial systems efficiently deliver a broad range of financial services and act as a critical pillar in contributing to macroeconomic stability and sustained economic growth and prosperity (World Bank, 2003). Moreover, the well developed financial markets facilitate mobilization of savings, by offering savers and investors wider choice of instruments. Further, with

NBFCs coming up on the financial system, investors could place their funds at more attractive returns in comparison to the bank deposits. This is the single most important reason to explain as to why the NBFCs are popular among lower and middle class population including India. This development paradigm is increasingly recognized around the world, especially in the aftermath of repeated emerging market crises in countries with bank-dominated financial systems. According to a report from the World Bank (2003), developed financial markets also have enhanced access to finance for more firms and individuals at reasonable cost, reduced volatility and distortions, by operating in an environment that is transparent, competitive, and characterised by the presence of a diverse array of products and services, including instruments for effective risk management. All these were made possible because of widening the financial system with effective participation of NBFIs.

Referring to NBFIs, Greenspan (1999) had stated: "…enhance the resilience of the financial system to economic shocks by providing it with an effective 'spare tyre' in times of need…" Moreover, while short term loans required by the industry and agriculture are provided by the banking system, the other types of services required by industry as well as other segments of economy are provided by NBFCs and other similar financial institutions, such as factoring, venture finance, and so on. A common feature in all the advanced economies is their financial systems are well developed to deliver a wide range of financial services and sophisticated products at competitive price that are demanded by the sophisticated clientele. This was possible because of institutions such as NBFIs that were found to be more aggressive and innovative. More importantly, it resulted in improving the efficiency by inciting competition between NBFIs and banking system and ultimately stated to have contributed to macroeconomic stability and sustained economic growth.

Indeed it is evident in India that with the development of NBFCs segment within the overall financial system, it challenged the other segments, viz., banks to innovate, to improve quality and efficiency, and deliver at flexible timings and at competitive prices. In fact, in a number of un-treaded paths, NBFCs were the ones to enter first to try the market and develop before banks entered the field. In India, for instance, the loans against gold jewelleries were introduced by the NBFCs2 much before the nationalised banks entered this market. Similarly, lending to small traders and small transport operators, used-commercial vehicle financing, in particular, were initiated by the NBFCs. Practically, many specialised financial services, such as the factoring, lease finance, venture capital finance, financing road transport, etc., were pioneered by the NBFCs. NBFCs have also played a leading role in the business of securities-based lending such as Loan against Shares (LAS), Margin Funding, Initial Public Offering (IPO) Financing, Promoter Funding, etc. These customized credit products have added liquidity and encouraged retail participation in public issues in particular and equity markets in

** [Excerpts from a well documented staff paper titled "Inter connectedness of Banks and NBFCs in India: Issues and Policy Implications" released on 2 January, 2012. For full text please see following link: http://rbi.org.in/scripts/PublicationsView.aspx?id=13979#S1*

general, resulting in better price discovery according to a report by the Task Force appointed by FICCI. Even housing finance was taken to newer heights by the NBFCs. In the recent years, NBFCs also played important role in wider reach of microfinance. Moreover, development of such alternative financing vehicles adds to the liquidity and diversity of the financial system,

thereby increasing its effectiveness as an engine for economic growth and enhancing the financial system's capacity to absorb shocks (Carmichael et al, 2002).

In view of the above, both banks and non-bank financial intermediaries are key prerequisites of sound and stable financial system and development of both sectors offer important synergies. It is interesting to note that the growth in the non- bank financial services industry in many countries has been more rapid than the deposit / lending activities of commercial banks. As a result, banking institutions have sought to diversify away from the traditional commercial banking business i.e., accepting deposits and providing loans to non-traditional banking activities, viz., investment banking, IPO financing and other capital market related activities besides the lease finance etc. NBFIs thus, in general '…tend to offer enhanced equity and risk-based products...' (RBI, 2005).

With the rise of middle class in India which has reached a certain stage of discernible economic development, there is a growing demand for property ownership, small-scale investment, and saving for retirement and a growing need for housing finance, contractual savings, insurance services, pension plans management and asset management. These varied requirements cannot be met by the banking system alone as commercial banks in India are not functioning as a full-fledged 'universal banking'. This is being met by opening non-banking financial subsidiaries by practically all the major banks in India2. These subsidiaries are in the form of merchant banks, mutual funds, insurance companies, primary dealers and other NBFCs. Thus, NBFIs play a crucial role in broadening access to financial services, enhancing competition and diversification of the financial sector (RBI, 2005).

It is therefore, necessary to view NBFIs segment of financial system as a catalyst for economic growth and to provide proactive regulatory policy support for their contribution towards economic development.

Structure of NBFIs in India

Indian financial system is predominantly institution oriented unlike many developed economies such as the US where the financial system is predominated by capital market. The institutions include both banks and non-bank financial institutions4, though banking system takes dominant position as it is the main conveyor of core financial services. Over the years, the non-bank financial entities came into existence with multiplicity as well as importance in mobilizing the public savings and channelising the same to industry and other economic activities since the country's independence.

The NBFCs form the major sub-sector of NBFIs in India and is widely recognized for its heterogeneous character. Presently, for the purpose of regulatory convenience, the NBFCs are broadly being classified into two categories based on whether they accept public deposits, viz., (i) NBFC-Deposit taking (NBFC-D) and (ii) NBFCs-Non-Deposit taking (NBFC-ND). Besides, there are only two residuary non-banking finance companies (RNBCs) which are also deposit taking companies of different character. Among the NBFCs-ND, companies with asset size of Rs. 100 crore and more have been categorized as systemically important (NBFC-ND-SI). Further, since 2006, both of deposit taking and non-deposit taking NBFCs were reclassified based on whether they were involved in the creation of productive assets. Under this new classification, the companies creating productive assets were divided into three major categories, i.e., asset finance companies (AFCs), loan companies (LCs) and investment companies (ICs).

In the recent years, infrastructure finance gained greater importance, and considering this; a fourth category of NBFC involved in 'infrastructural finance' was introduced in February 2010. These companies are called as 'infrastructure finance companies' (Annex I). In a nutshell, all deposit taking companies are classified

under three categories, viz., AFCs, ICs, and LCs. The non-deposit taking systemically important NBFCs (NBFCs-ND-SI) are also classified along the similar line as AFCs, ICs, and LCs. Besides, new set of companies, viz., infrastructure finance company (IFC) called as core investment companies (CIC) are also included recently.

Size of NBFCs Sector and their Growth

In line with the global trend, NBFCs in India too emerged primarily to fill in the gaps in the supply of financial services which were not generally provided by the banking sector, and also to complement the banking sector in meeting the financing requirements of the evolving economy. Over the years NBFCs have grown sizably both in terms of their numbers as well as the volume of business transactions (RBI, 2009). The number of such financial companies grew more than seven-fold from 7,063 in 1981 to 51,929 in 1996.8 Thus, the growth of NBFCs has been rapid, especially in the 1990s owing to the high degree of their orientation towards customers and simplification of loan sanction requirements (RBI, 2000). Further, the activities of NBFCs in India have undergone qualitative changes over the years through functional specialisation. NBFCs are perceived to have inherent ability and flexibility to take quicker decisions, assume greater risks, and customise their services and charges according to the needs of the clients. These features, as compared to the banks, have tremendously contributed to the proliferation of NBFCs in the eighties and nineties. Their flexible structures allowed them to unbundle services provided by banks

Table 1 : Sources and Application of Funds by the NBFCs-D

(Percentage Share in the Total Assets/ Liabilities

	2001	2005	2006	2007	2008	2009	2010	2011p
Sources								
Paid up Capital	4.18	6.13	4.83	4.67	4.38	4.95	4.13	3.46
Reserves & Surplus	11.79	12.62	14.87	12.07	11.66	12.20	12.92	12.81
Public Deposit	20.90	10.90	6.47	4.28	2.74	2.56	3.00	3.85
Borrowings	31.86	64.01	65.94	66.84	67.83	72.47	68.01	66.22
of which								
from Banks & FIs*	NA	30.18	39.21	45.99	37.56	44.45	49.71	50.59
Other Liabilities	31.27	6.34	7.90	12.14	13.39	7.82	11.92	13.66
Application								
1. Investments	11.26	10.99	11.44	15.27	15.03	20.34	19.63	20.01
i) SLR Securities @	8.57	6.21	0.77	8.83	9.58	12.20	10.23	12.79
ii) Other Investments	2.68	4.78	10.66	6.44	5.45	8.13	9.41	7.22
2. Loan & Advances**	31.60	35.41	28.25	22.78	25.24	27.98	75.29	73.89
3. Hire Purchase Assets	32.58	40.00	52.89	54.01	44.96	46.44	-	-
4. Equipment Leasing Assets	12.45	5.62	3.97	2.81	1.41	0.79	-	-
5. Bill business	1.95	1.31	0.12	0.01	0.02	0.03	0.05	0.08
6. Other Assets	8.04	6.67	3.33	5.12	13.34	4.42	4.83	6.01
7.Accumted. balance of loss	2.13	0.00	0.00	0.00	0.00	0.00	0.00	0.00

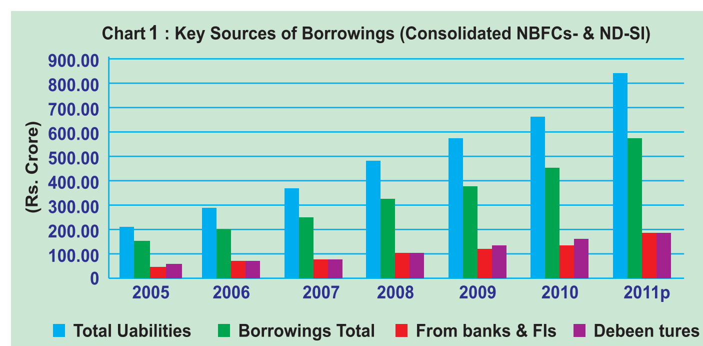
NA = Not available
P : Provisional
@ : SLR Asset comprises 'approved securities' and 'unencumbered term deposits' in Scheduled Commercial Banks.
* : percentage share to total borrowings.
** : Break-up into hire purchase and equipment leasing for 2010 and 2011 not available.
Source: worked out based on the absolute figures available from the Report on Trend and Progress in Banking in India, various volumes, RBI.

and market the components on a competitive basis. Banks on the other hand, had all along been known for their rigid structure, especially the public sector banks. This compelled them carry out such services by establishing 'banking subsidiaries' in the form of NBFCs. The willingness of NBFCs to engage in varied forms of financial intermediation, hitherto unavailable to the banking system, has provided the valuable flexibility in financing new areas of business. Though the NBFCs are different species and smaller in size as a segment when compared with the banking system, their relevance to the overall economic development and to certain specified areas cannot be undermined.

Over a period as the regulatory requirements were made progressively stringent, the total number of NBFCs registered with the Reserve Bank stood at 12,409 by end-March 2011. The number of NBFCs-D declined considerably with conversion into non-deposit taking companies, besides closure and mergers of weaker companies. Incidentally, the regulatory regime also seems to be in favour of reducing the number of deposit taking NBFCs and consequent migration of depositors towards the banking system which is better regulated and supervised in line with the global standards.

It may be underlined that the public deposits of NBFCs, after showing a steady increase till 2007, declined thereafter and sharply by end-March 2011. However, the size of total assets, have grown more than double from Rs. 53,878 crore as at end-March 2001 to Rs. 1,16,897 crore by end-March 2011, clearly indicating greater demand for the services provided by these companies in a fast growing economy. The net owned fund (NoF) of NBFCs has also increased sharply between end-March 2001 and end-March 2011 by more than three times to Rs. 17,975 crore, showing the strength of the NBFCs segment.

Over the years, especially with the Reserve Bank's regulation becoming progressively more broad-based and stringent, the size of the NBFCs (in terms of numbers) as a segment has been reduced drastically as most of the unviable and substandard companies disappeared from the scene. It is also clear from the percentage share of non-banking deposits of household sector saving in gross financial assets, which decreased from around 4.0 per cent in 1997-98 to 1.8 per cent in 2008-09.



Further, the ratio of deposits of NBFCs to aggregate deposits of scheduled commercial banks (SCBs) showed a consistent decline revealing the regulatory focus of the Reserve Bank which emphasised on the discouragement of deposit taking NBFCs.

Thus, in comparison with the banking system in India the size of deposits in respect of NBFC-D showed a constant decline over a period and reduced to very small in size. Interestingly, the ratio of NBFC-D assets to banking sector since 2006 seems to have reversed from the declining trend as their asset size began swelling, though when compared with the banking system it is very small. As the size of deposits is not growing in tandem with the growth of their assets, obviously it becomes inquisitive to ascertain the source of funding the asset growth of NBFCs. In this context, analysis of sources and application of funds in respect of NBFCs-D revealed that among the sources, there is consistent increase in the borrowings and it emerged as the major source of finance to the tune of more than 72 per cent of the total liabilities at the end of March 2009. However, it slowed down to 66.7 per cent by end-March 2011.

Even in the case of deposit taking NBFCs, public deposit as a share in the total liabilities have been drastically reduced to a meagre 3.85 per cent at the end-March 2011 from as high as 21 per cent in end-March 2001, while the borrowings shot up. It is of particular significance to note that funding by banks and FIs have been on the increase to reach more than 50 per cent in the total borrowings (Table 1).

On the deployment of funds, the major chunk is in the form of loans and advances and hire purchase assets together accounted for more than 73 per cent as at the end of March 2011. It needs to be underlined that they, by and large, are medium to long term assets, while major part of the funding of these assets are not of long term sources.

Banks' Exposure to NBFCs

In the context of the recent global crisis, it was observed that undue reliance on borrowed funds can be a source of risk and a more stable retail base of deposits are good for both the bottom line and resilience of the financial institutions. In that context, analysis of liabilities side of the balance sheets of NBFCs14 revealed that the major sources of finance are public deposits, debentures, borrowings, commercial papers and inter-corporate loans. Liabilities of the consolidated balance sheets of NBFCs revealed that borrowings constitute the largest size of liabilities, even for the deposit taking NBFCs; corresponding to this, the size of public deposits are very miniscule as pointed out earlier.

The consolidated balance sheets of NBFCs (both the categories i.e., deposit taking and non-deposit taking and systemically important companies) revealed that more than 68 per cent of the consolidated balance sheet constitutes borrowings. Out of which, 30 per cent resources are borrowed from banks and financial institutions as at the end of March 2011. These borrowings are in the forms of direct advances and loans (both secured and unsecured). These apart, borrowings by way of debentures issued by the NBFCs constituted around 33 per cent and of which a sizable portion is subscribed by the banking system. Both of these are on the rise over a period (Chart 1).

It needs to be underlined that higher dependency of NBFCs on the banking system for their resources will not only strain banks at the time of crisis but also place NBFCs themselves into vulnerable situation. For, there are possibilities that banks can become over sensitive to a liquidity crisis or imminent crisis and they can either become too reluctant to lend to NBFCs or at the extreme case, they may completely refrain from lending to NBFCs which would further precipitate the situation, especially when NBFCs are in dire need of funds. The recent global crisis is a pointer in this direction. Further, this type of situation would compel NBFCs to turn to money market with higher costs to wade over the tight liquidity conditions impacting the money market as well. It may also be pointed out that a significant portion of their funds are also being funded by the mutual funds (RBI, 2010A). Even here similar situations are possible: NBFCs were stressed as bank loans to them had dried up and interest rates had increased in money markets, leading to higher costs of borrowing (RBI, 2010).

It may be pointed out that NBFCs are also having exposures to banking system as they keep their funds in the form of fixed deposits, albeit it constitutes relatively a smaller proportion of say 11 to 12 per cent of their total assets.

It is thus clear from the analysis that NBFCs are highly reliant on the banking system for their large chunk of funds. As a policy when the NBFCs are discouraged from raising public deposits, these companies are becoming non-deposit taking, while increasingly substituting public deposits with borrowings from the banking system. Some NBFCs, being deposit taking companies, rely heavily on borrowings from banks. Thus there seems to be strong growing systemic inter-connectedness between banks and NBFCs with high dependency of the latter on the former. This has even more systemic concerns than NBFCs directly raising resources by way of public deposits. NBFCs' high dependency on the banks for their funding means short term funding of longer term assets of NBFCs. ■

NBFCs – CHALLENGES & OPPORTUNITIES

MAHESH THAKKAR
Director General
FINANCE INDUSTRY DEVELOPMENT COUNCIL

"NBFCs in India have played a vital role in financing various sectors of the economy, particularly those that have been underserved by the commercial banks."

"There has emerged therefore a need to rationalize the process of regulation so that the objectives of the Government's policy are optimally met while simultaneously ensuring that NBFCs remain a "bankable" entity."

The NBFC sector in India has evolved considerably in terms of operations, variety of market products and instruments, range of technological innovation etc. In the recent past, NBFCs have assumed increasing significance in the financial sector and have added considerable depth to it.

The role of NBFCs in creation of productive national assets can hardly be undermined. A conducive and enabling environment has been created for the NBFC industry globally, which has helped it grow and become an essential part of the financial sector for accelerated economic growth of the countries. This is not the case in our country. It is, therefore, obvious that the development process of the Indian economy shall have to include NBFCs as one of its major constituents with a very significant role to play.

NBFCs, as an entity, play a very useful role in channelizing funds towards acquisition of commercial vehicles and consequently, aid in the development of the road transport industry. Needless to mention, the road transport sector accounts for nearly 70% of goods movement and 80% of passenger movement across the length and breadth of the country and the role of NBFCs in the growth and development of this sector has been historically acknowledged by several committees set up by the Government and RBI, over the years. NBFCs have a proven track record in financing the acquisition of vehicles in rural India for over six decades.

It is relevant to note that trucks are often referred to as 'Mobile factories', providing direct employment to at least 20 persons per vehicle, besides many more on an indirect basis. NBFCs are also involved in financing earthmoving equipment, which aid the development of infrastructure and in the process, provide employment to thousands of persons in the rural sector. The reach and location of these entities in remote corners of the country has enabled them to stay in close touch with the customers and they have the necessary knowledge and skills in credit appraisal and understanding the needs of the borrowers.

A developing economy like India always craves for financial resources. Demand for credit is ever-increasing and the traditional banking system is often not able to meet it. NBFCs in India have played a vital role in financing various sectors of the economy, particularly those that have been underserved by the commercial banks. Today, many financial institutions are forming NBFCs to take advantage of their greater flexibility in dealing with customers. There are, of course, some important and persistent policy issues for NBFCs, which need to be resolved at the highest level.

NBFCs have entered into many of the newer areas of financial services. NBFCs are now also into derivatives and structured products. They have entered into the markets for raising funds through CPs and NCDs apart from accessing bank funds directly. Given all these developments, a detailed study of the issues, challenges and the future facing the sector has become imperative.

NBFCs are today at a critical phase in their history. The IFRS convergence process is going to affect them, and given the recent economic turmoil, some fine-tuning in the NBFC space may also be necessary. There are many legitimate issues and concerns pertaining to the entry norms, management, classification, size and categories of NBFCs which need to be sorted out in an amicable and rational manner, creating a win-win situation for all concerned parties.

The recent global financial crisis has however highlighted the importance of widening the focus of NBFC regulations to take particular account of risks arising from regulatory gaps, from arbitrage opportunities and from the inter-connectedness of various activities and entities comprising the global financial system. In India, the policy and regulatory framework for NBFCs is different in many aspects from that for banks. Given the growing importance of NBFCs for the Indian financial system, it has become critical to ensure that the dynamism displayed by NBFCs in delivering innovation and last resort connectivity for meeting the credit needs of the productive sectors of our growing economy is not stifled. There has emerged therefore a need to rationalize the process of regulation so that the objectives of the Government's policy are optimally met while simultaneously ensuring that NBFCs remain a "bankable" entity.

In fact, RBI's Report titled "Report on trends on progress of banking in India 2003" observes: The regulatory challenge is, thus, to design a supervisory framework that is able to ensure financial stability without dampening the very spirit of maneuverability and innovativeness that sustains the sector."

We do hope that continuous interaction and deliberations by FIDC representatives and the regulators will go a long way in achieving these objectives. ■

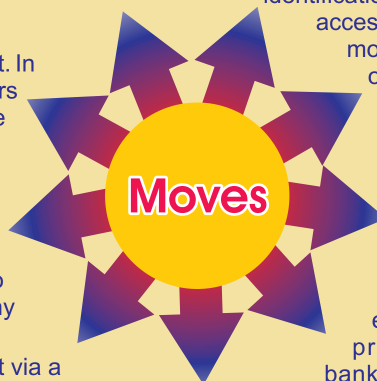
E-voting in listed firms set to take off

Thousands of small investors will soon get an opportunity to cast their votes on crucial corporate actions till the last minute, from the comforts of their home or office. Electronic voting (e-voting), launched a little over two years earlier, is set to get a boost after platforms provided by the country's two depositories, Central Depository Services Ltd (CDSL) and National Securities Depository Ltd (NSDL), have been certified for user-friendliness and security in facilitating such transactions.

Last May, the Union ministry of corporate affairs (MCA) made its approval mandatory for agencies appointed to provide and supervise an e-voting platform. It also asked these agencies to obtain a certificate from the Standardisation Testing and Quality Certification (STQC) directorate, an attached office of the department of information Technology. Depositories create database of investors of companies opting for e-voting. They communicate user address and password to each investor via post or e-mail. Once an investor receives this login address and password, he can go to the depository website and register for the e-voting facility. He will be asked to change the password the first time and this would be the permanent password for future use. In future, if an investor wants to use the e-voting facility for another company, he just needs to login with his registered password and vote. The system will also result in cost-saving for companies. According to officials, on the average, companies have to spend Rs 20 per shareholder in stationary and postage to conduct voting through postal ballot. [Business Standard, Feb 08]

e-cheques that save paper, but look real

Traditional cheques may soon be a thing of the past. In perhaps a world's first, a team of British researchers claims to have developed an electronic cheque which offers the advantages of the traditional system but cuts down much of the processing and transport costs to the bank. The hi-tech cheque book looks and works much the same as the one used for generations.But to write on it, one needs a digital pen which has got a tiny camera attached to it to record any strokes made against millions of tiny dots printed on the surface, say the researchers.



The pen sends the details to the bank of the client via a wireless link. And as the cheques and digital pen work only with the customer's own secure computer hub, they are said to be of no use to a thief, say the researchers. "The beauty is that it's safe and cheap electronic transaction for banks, but it's a physical paper-based transaction for the customer," he was quoted by the 'Daily Mail' as saying. The researchers from York, Newcastle and Northumbria universities have said that they would hold talks with banks. Currently, a digital pen costs 80 pounds but this is expected to fall sharply. Michelle Mitchell of Age UK said: "Hopefully banks will invest in this kind of innovative design which preserves what many people find invaluable about cheques." [Press Trust of India / London Feb 13]

Fed-up SBI 'to name and shame' defaulters

The State Bank of India, the country's biggest lender, will name and shame 'wilful' defaulters and put their pictures in newspapers to get them to pay up, a leading business daily said. "The fresh approach will ruffle a few feathers," the paper quoted a bank executive as saying. A 'wilful defaulter' is one who does not meet payment obligations even when he or she has the funds. Bad loans in the country could jump to as much as 5.8% of the total within two years in a severe risk scenario, up from 2.8 percent in September, according to an RBI report. The non-performing loan ratio for Indian banks was 2.3% in the last fiscal year. [Reuters/Business Standard, Feb 04]

Financial services raise focus on money laundering: KPMG

Rising corruption cases, terrorism and heavy fines paid by global financial institutions have forced the financial services industry in India to increase their focus on money laundering, says the India Anti-money Laundering (AML) Survey 2012, released by KPMG. Globally, it is estimated that the amount of money laundered in one year is two-five per cent of the global gross domestic product (GDP) or $800 billion. The survey was conducted across the financial services sector, covering public and private sector banks, general and life insurance companies, mutual funds, non-banking financial companies and other institutions in the sector covered under the Prevention of Money-Laundering Act. According to the survey, 86 per cent of respondents noted their senior management took an active interest in AML-related issues and discussions. Although an increasing number said (65 per cent) they conducted periodic risk assessments (either half-yearly or yearly) to evaluate their money-laundering risks, a significant number (32 per cent) said they undertook this based on a change in product, procedure or regulatory change. The survey also showed, 77 per cent said they had specific procedures in place for identifying politically-exposed persons (PEP). PEPs were also viewed as having the highest risk in relation to account opening. Not only was the risk of money laundering being taken more seriously, an overwhelming 82 per cent of the survey respondents indicated the cost of AML compliance would increase over the next two to three years. [BS Reporter, Feb 08]

RBI asks banks to adopt unique customer identification

The RBI has asked banks to develop a unique system of customer identification across the banking system. This could be accessed by all banks while vetting loan proposals. The move follows concern on the multiple lending model, one in which a customer can avail of loans from multiple lenders. Limited knowledge on borrowers' credit histories has been a challenge for banks. RBI deputy governor Anand Sinha said, "Unique customer identification in the banking system is of paramount importance. While some banks have started the unique customer identification process, this is not present across the banking system, that is, on a shared database. This could enable borrowers to circumvent guideline risk profiles and obtain multiple facilities from banks."Though RBI had asked banks to share information with each other and obtain declarations from borrowers about all loan facilities availed of by them, this was not followed. The central bank feels the unique identification should eventually graduate to a legal entity. Sinha said the central bank's financial stability board had backed the idea and the G-20 also favoured it. He added issuances of Aadhaar numbers provided hope on this. [BS Reporter, Mar 08]

ICICI, Citi, BoB to form NBFC to fund core sector

In a first of its kind alliance, three lenders have joined hands to form a NBFC to support infrastructure development in the country. The ICICI Bank, the Bank of Baroda, and Citi Financial (the NBFC arm of Citigroup) will form the first infrastructure development fund (IDF). While ICICI Bank and BoB will pick up 30 per cent stake each, Citi Financial will have close to 30 per cent. The balance will be shared by other financial entities. ICICI Bank, the sponsor bank in the joint venture, has received Reserve Bank of India (RBI) approval to commence operations and the lenders will announce the venture at a function. The minimum capital requirement for setting up an IDF-NBFC is Rs 300 crore. In his Budget speech last year, Finance Minister Pranab Mukherjee announced the setting up of the IDF to increase long-term fund flow to the infrastructure sector. An IDF can be set up as a trust or a company. A trust-based IDF would normally be a mutual fund, while a company-based IDF would normally be an NBFC. Banks are expected to take the NBFC route for setting up the IDF, for which they need RBI's approval.

[Business Standard, March 05] ■

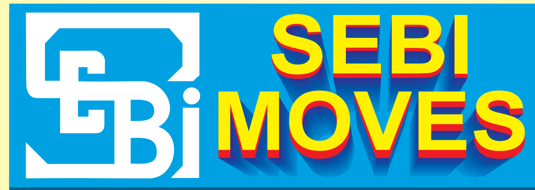
More KR Agencies in offing

KRA helps KYC-compliant investor to avoid duplication of KYC process while opening an account for stock trading, mutual fund investments or opening demat accounts. NSDL became the second organisation to start a KYC Registration Agency (KRA) after Central Depository Services Ltd (CDSL). At present, there are a total of about 1.6 crore demat accounts with National Securities Depository (NSDL) and Central Depository Services, out of which, at least over one crore are active investors.

According to U K Sinha, chairman, SEBI has received two more inquires for setting up of KRAs. “I believe there will be more competition. We already have a few inquiries. However, as there will be inter-operatibility among KRAs, the clients will not face any extra difficulty,” he said. Sinha also said SEBI was in talks with other regulators to use the uniform KYC platform for all financial products. “We are in a dialogue with them. If this system proves to be robust, then maybe other regulators can have a look at it,” he said.[Business Standard, 26 Jan.]

Uniform rating norms mooted for all securities

The SEBI has further tightened the guidelines for credit rating agencies (CRA). On 1st March, the capital markets regulator said SEBI-registered CRAs that rate securities not regulated by it also need to be governed through the same stringent norms as those applicable for rating of securities issued through public and rights issues. The regulator had observed CRAs also carry out rating of securities, instruments, loans and other facilities that are provided by banks, but not regulated by SEBI. “Such ratings are being used by other regulators or their regulated entities for specified purposes,” SEBI said. It added CRAs should follow the “applicable requirements” pertaining to the rating process, the methodology, its records, transparency and disclosures and avoidance of a conflict of interest. [BS Reporter, Mar 02]



Buyback gets investor friendly

The SEBI on Feb.7 notified new buyback rules, which, experts said, are more small investor-friendly and stringent on companies. SEBI asked companies to reserve 15 per cent of the shares to be bought back for small investors, or those who hold shares worth less than Rs 2 lakh. According to SEBI, shares to be bought back should be divided into two categories; one for small shareholders and the other for other shareholders, and entitlements of shareholders in each category would be calculated accordingly. SEBI also brought down the time frame for share buyback to 10 working days. Under the earlier regime, companies could keep a buyback offer open for up to one year or till such time they manage to mop up the proposed number of shares. The date of opening a buyback offer shall not be less than five working days from the date of dispatch of the letter of offer. [Financial Chronicle, Feb 07]

SEBI asks firms to disclose details of utilisation of warrants

In order to bring more transparency to capital markets, regulator the SEBI on Feb. 8 said listed firms will have to disclose details regarding utilisation of funds raised through warrants. "In order to enhance disclosure requirements, listed entities have been mandated to disclose utilisation of funds raised upon conversion/exercise of warrants issued along with public or rights issue of specified securities," the SEBI said in a circular. It said the new rule, a part of its amendments to the equity listing agreement, will take effect immediately. "The SEBI circular has directed that companies disclose details regarding the usage of funds raised through warrants. The regulator is trying to monitor the reason for which companies raise the warrants and ensure that they are used for proper reason. [PTI/Financial Chronicle, Feb 08]

SEBI curbs listing day volatility with call auction session

In a move to check volatile price movements on the first day of trading in newly listed and re-listed stocks, market regulator SEBI has said that normal trading can now take place only after a call auction session. Since the regulator was looking at various options, it took SEBI more than a year to get this act together. The regulator was looking at a mechanism to curb the volatility and it has finally come out with one wherein all the IPO stocks and the companies which are relisting again will have to go through a pre-open call auction for 45 minutes after which there would be a settlement of trades. Only after that will the opening trade begin at 10:00 am instead of 9:15 am. So that's a one hour period where you have to put in all your bids and the entire thing would be delivery based.

The regulator has gone one step further and said that any IPO below Rs 250 crore will have a price band after 10:00 am and any IPO above Rs 250 crore will have a 20% price band. It also says that IPOs below Rs 250 crore will have to go through a 10 day period where they will be trade for trade (T2T). This basically means that you can trade in the scrip only if you have shares in your account, which means there won't be any speculative trading in these stocks. So that's a big move from SEBI to curb the listing day volatility. [CNBC TV 18, Jan 20]

SEBI proposes strict norms for collective schemes

Market regulator the SEBI has sought a complete overhaul of the current regulations for 'collective investment schemes', as it fears that loopholes in current rules allow for gullible investors being taken for a ride. In a 'Collective Investment Scheme (CIS), the payments are pooled in by the investors for certain pre-specified purposes and profits or income are later shared among them. However, there have been numerous cases of investors being cheated in the name of CISs and in many cases the operators of these schemes disappear after some time and the investors are left in a lurch. A senior official at SEBI said that more than one lakh investor complaints are currently pending with it, and in most of the cases the matter is sub-judice since long. Some of the most famous CISs are related to investments for real estate properties, plantation and agriculture industry and art funds, among others.

In a board memorandum submitted during its last meeting on January 3, SEBI said that "it is clear that certain individuals/companies are able to raise money from gullible individuals by taking advantage of the loopholes in the legal provisions and also taking advantage of lack of clarity about roles of different agencies like MCA, SEBI, RBI, state governments, registered co-operative societies etc." SEBI further told its board that certain exemptions in the current regulations also "leave scope for people to take a stand that their scheme is not a collective investment scheme and that they have got relevant licenses/approvals from the competent authorities." "There appears to be a need to bring this matter under one principal regulator to deal with all cases where pooling of money is taking place and investments are being made," SEBI said. It further said that various exemptions also needed to be either completely removed or drastically pruned. As per SEBI, there is only one entity registered with SEBI as a Collective Investment Management Company, but it has not launched any scheme as yet. On the other hand, as many as 32 cases are currently under examination for applicability of SEBI (CIS) Regulations, while there are 1.09 lakh complaints pertaining to CIS. [PTI / Business Standard, Jan 10]

Disclose track record of public issues: SEBI to merchant banks

With a view to enable investors to take well-informed investment decisions, market regulator the SEBI directed merchant bankers to disclose the track record of the performance of the public issues managed by them. SEBI added: "The track record shall be disclosed for a period of three financial years from the date of listing for each public issue managed by the merchant banker." The track record will have to be disclosed on the website of the merchant banker and a reference to this effect shall be made in the offer documents of public issues managed in the future. [PTI/Business standard, Jan 10] ■

Dud cheques in revival mode

The Supreme Court ruled that cases of bounced cheque are independent of the revival bid of a sick company. Proceedings in bounced cheque cases under the Negotiable Instruments Act will continue even if there is a scheme to revive the sick company. The revival attempt under the Companies Act will not affect prosecution of charges under Section 138 of the Act. The charges cannot be compounded as in other cases under the Criminal Procedure Code (CrPC), the court stated in a large batch of appeals titled JIK Industries Ltd vs Amarlal. The Supreme Court dismissed appeals of the companies against the Bombay high court judgment which rejected their argument. The charges cannot be compounded as provided under Section 320 of the CrPC without the consent of the secured and unsecured creditors. Though Section 147 of the Negotiable Instruments Act provides for compounding, it does not provide for a special procedure. In its absence, the procedure under the CrPC should be followed. Therefore the consent of the creditors is essential, the court said. [Business Standard, Feb.6]

Takeover of mortgaged properties: District bodies must help FIs, says court

State Governments should direct district administrations not to prevaricate or look the other side but, instead, act with dispatch when faced with request for police assistance from secured creditors in taking over mortgage properties of the defaulters, the Bombay High Court said. The court ruled thus in a matter that came up before it on a petition filed by the Housing Development Finance Corporation Ltd . The financial institution used the power given to it by the Securitisation Act, 2002 to takeover the mortgage assets in order to be able to recover the dues from the recalcitrant borrowers without any court intervention.

The Act, realising the possible resistance to such a move, has followed it up with the right to the affected financial institutions to petition the Collector/District Magistrate for police help to overcome such resistance. Frustrated in its efforts when Collectors of the districts concerned more often than not stonewalled its request for assistance, HDFC filed a writ petition before the Bombay High Court which, while pointing out the object of the Act — expeditious recovery of dues to banks and financial institutions — ordered the Maharashtra Government to issue circulars to all the Collectors to put in place a dispensation whereunder Collectors keep records of request for help and act expeditiously but in no case later than two months from the date of the request. The court passed this order after it was apprised of the widespread practice of defaulting borrowers mounting pressure, directly or through those wielding influence locally, on the Collectors who tended to succumb to such pressures and chose not to act, especially in the absence of a strict guidelines from the Securitisation Act as to the timeframe for acting on such requests. [Business Line, Feb.1]

Madras HC rejects petition to curb micro-lending in state

The Madras high court has not granted relief to a petitioner seeking the introduction of legislation in Tamil Nadu to curb microfinance activities by private players in the state. A similar law passed by the Andhra Pradesh government in October, 2010, which banned weekly collection of dues, severely affected microlenders, eroding their profitability and threatening their existence. The high court, however, said the state government should step in to protect the interest of self-help groups if it found microfinance institutions (MFIs) were resorting to “unfair and unhealthy” practices. It added there was a need to empower self-help groups.

“We also hope steps taken by the Reserve Bank of India in introducing the Micro Financial Institutions Bill becomes an Act to provide the necessary safeguard to affected parties and provide a successful check on the unhealthy practices of MFIs,” judge Chitra Venkataraman stated in the order.[Business Standard/Sify Finance, Feb. 16] ■

Government may ease harsh rules for NBFCs suggested by RBI panel

- Sugata Ghosh

Amid intense lobbying by finance companies, the government has stepped in to water down the harsh, new rules prescribed by a Reserve Bank of India panel. A group, constituted by the finance ministry, has suggested that since non-banking finance companies play a significant role in asset creation and reach out to borrowers that high-street banks can't deal with, they should be given adequate time to raise capital and fulfill stricter provisioning standards.

While the RBI panel, headed by former deputy governor Usha Thorat, has given its recommendations for quite some months now, the regulator is yet to come out with the guidelines. Meanwhile, the key advisory group formed by the government and comprising senior bureaucrats, industry representatives, professionals and even central bank officials, has finalised a parallel set of recommendations which were submitted to the ministry less than a fortnight ago.

The advisory group's report, which has the backing of the government as well as the industry, may hold back the central bank from introducing the sterner norms recommended by the panel. Among other things, the committee had recommended that NBFCs should have tier-I capital adequacy level of 12%. At present, NBFCs have the flexibility of maintaining a minimum capital adequacy ratio of 12-15% (depending on categories) on the strength of its tier-I (or capital and free reserves) and tier-II (long-dated bonds) capital. Thus, if the RBI panel recommendation is implemented, then NBFCs will have to raise enough equity to avoid any disruption in business activity - a condition that most firms will find tough to meet.

According to members of the group, the government-constituted panel has suggested that all NBFCs should get at least three years to reach the prescribed capital adequacy standard and during that period, they should be allowed to grow their business.

The advisory group also felt the RBI committee's recommendation that there should be provisioning on loans with past dues of 90 days or more, could significantly impact profitability and capital of many NBFCs. (At present, a loan is treated as non-performing by an NBFC if the borrower fails to service the interest or EMI for 180 days). The advisory group is in favour of giving NBFCs three years to migrate to a new provisioning standard.

The group thinks that there should be a new category of priority sector NBFCs, and there should be provisions for NBFCs to have access to debt recovery tribunals and security enforcement law for quicker recovery of dues.

The RBI panel recommendations are aimed at discouraging banks from promoting NBFCs (which currently have to follow less stringent rules than banks on risk weightage and provisioning). The regulator wants to end the practice where banks use NBFC arms to pursue businesses which would be tougher in banks. Thus, if NBFCs (like banks) have a 90-day provisioning and same risk weightage for activities like loan against shares, there will be very little incentive for banks to float NBFCs.

"Since about 64% of the NBFC funding comes from banks, the RBI panel thinks, and rightfully so, that banks should have more capital and the large ones pose systemic risk... But, it's felt that under present circumstances, imposing rules that business finds too difficult to follow could adversely affect the business environment," said a person familiar with the deliberations.

The advisory group, however, has endorsed the RBI panel recommendation that only NBFCs with asset book of 50 crore and above should be registered with the regulator, which will enable the latter to focus on medium and large firms. Of 12,400 NBFCs, only about 1,800 have assets of over 50 crore.

"It was broadly felt that NBFCs reach out to segments that banks can't and have a more cost efficient structure with no elaborate organisational set up. Besides, the regulator should not paint all NBFCs with the same brush," said a group member.

[ET Bureau Feb 20] ■

Watchdogs to drag shadow banks into the light

Beyond the reach of regulators, and about half the size of the world's banking industry, a thriving breed of "shadow banks" is emerging that could trigger the next chapter in the global financial crisis. Spurred by this concern, the watchdogs are turning their attention to the fringes of the global financial system, where hedge funds and money market funds are filling the gaps left by retreating banks."In America, increased financial activity is taking place between non-banks which are subject to little or no regulation, and Europe is catching up fast," said Godfried De Vidts, director of European Affairs at ICAP, a brokerage firm that trades only with large professional clients, such as investment banks. The effort is the latest attempt by regulators to make the financial system safer, four years after the start of the global banking crisis. This has already led to a rewriting of the rules that will change the face of banking for good.

But despite these efforts, large swathes of the financial system remain outside the remit of the regulators, even though they provide essential funding to banks, and were at the heart of the global financial crisis. This sector, known as "shadow banking" -- much to the chagrin of the people operating in it -- is huge. The size of the sector was some $60 trillion in 2010, making it as big as roughly half the global banking industry. "Shadow banking is not really well named. It would be preferable to have a better description of what is a wide range of non-bank intermediaries. As it stands, it sounds a bit pejorative," said ICAP's De Vidts. A run on its funds is as much a real risk for a shadow bank as it is for a normal bank, regulators say, and could have devastating consequences for the global financial system because the two sectors are so closely linked.

The Financial Stability Board has signaled a two-pronged approach to regulating shadow banking, with tough rules such as possible capital charges and limits on the size and nature of a mainstream bank's exposure to shadow banks. Other shadow banking activities which are seen as less systemically risky could face greater transparency requirements. Critics of this regulatory drive say that the definition the FSB uses to describe shadow banks is intentionally vague, allowing them to probe and potentially regulate corners of the financial universe that are seen as harmless. [Reuters- London, Feb 7]

Central banks' joint efforts sustain global system

Never before have the world's central banks sent so much money sloshing through the global financial system. From slashing interest rates and buying government debt to dangling cheap loans to banks and taking on their risky assets, central banks have taken extraordinary steps since the 2008 financial crisis to nurse the international banking system back to health. Over the past 3½ years, the central banks of the United States, Britain, Japan and the 17 countries that use the euro have pumped out so much money that their balance sheets have reached a combined $8.76 trillion. That's a record, by far. The infusion of money has eased borrowing costs and raised confidence in banks, governments and companies. The central banks feel compelled to take such far-reaching action because of their role as a nation's lender of last resort. This function is in addition to their core task of managing interest rates and inflation through the money supply. Each central bank's balance sheet reflects assets it's taken on, such as bonds and mortgage-backed investments.

Critics counter that the flood of cash has made high inflation more likely. And they point to rising prices for oil, food, gold and other commodities as evidence. [WASHINGTON (AP) , March 1]

ECB's Draghi questions role of ratings companies after S&P downgrades

European Central Bank President Mario Draghi said investors largely priced in the euro-area sovereign downgrades from Standard & Poor's and questioned the importance of ratings companies. “I will never comment on ratings as such, but certainly one needs to ask how important are these ratings for the marketplace overall, for investors?” Draghi said at the European Parliament in Strasbourg. “It seems to a great extent markets have anticipated these ratings changes and priced them in. We should learn to do without ratings, or at least we should learn to assess creditworthiness” with less reliance on the ratings companies, he said. S&P stripped France and Austria of their top ratings on Jan. 13 and cut seven other euro countries in a move that left Germany with the bloc's only stable AAA grade. In an echo of the rally in Treasuries following S&P's lowering of the U.S. sovereign rating in August, investors shrugged off the judgment on Europe, with France's borrowing costs dropping at its latest debt sale. [BLOOMBERG, Jan 17]

Regulatory changes hit record levels globally: Report

A stressed economy and new regulations propelled federal regulators to issue record levels of regulatory changes in 2011. Companies can expect those numbers to continue to rise in 2012, according to a recent report conducted by the Governance, Risk and Compliance business unit of Thomson Reuters. According to the report, “The State of Regulatory Reform 2012,” companies around the world struggled to keep abreast of 14,215 regulatory changes from December to November 2011—more than 60 regulatory events each day.

Banks ordered to provide 'living wills' to regulators

US Federal regulators finalized a regulation that requires the nation's largest banks to provide “living wills” for dismantling them if they collapse. The rule from the Federal Deposit Insurance Corporation (FDIC) obligates banks with more than $50 billion in assets to submit a blueprint for dissolution that would minimize broader damage to the financial system. The living wills are intended to allow the FDIC to take apart a dying bank while limiting losses and returning funds — an attempt to avoid a repeat of the crisis that played out in 2008, when problems at large institutions nearly toppled the financial system. The final rule applies to 37 different banks. [The Hill on the Money, 17 Jan.]

Illinois attorney general sues Standard & Poor's

The Illinois [USA] attorney general filed a lawsuit on Jan. 25 accusing Standard & Poor's of misleading investors by assigning its highest ratings to risky mortgage-backed investments during the years leading up to the crash of the housing market. The lawsuit from Lisa Madigan's office alleges the agency compromised its independence by issuing high ratings for unworthy or risky investments as part of a strategy to boost revenue and market share. The lawsuit cites internal emails and conversations, including an instant messenger exchange in April 2007 in which an employee tells another that an investment "could be structured by cows and we would rate it." "Publically, S&P took every opportunity to proclaim their analyses and ratings as independent, objective and free from its desire for revenue," Madigan said. "Yet privately, S&P abandoned its principles and instead used every trick possible to give deals high ratings in order to retain clients and generate revenue." Madigan's lawsuit singled out mortgage-backed securities, saying Standard & Poor's misrepresented the risks by giving the investments its highest rating of AAA.

A spokesman for Standard and Poor's rejected the claims. [Associated Press, Jan 26]

China wants more companies to use lease finance

The Chinese Commerce Ministry plans to promote financial-leasing companies overseas to help domestic manufacturers go global. The ministry also is pushing financial-leasing firms to do more business with foreign construction companies for equipment leases.[China Daily, Beijing, Dec. 28]

Regulators and banks look into revamping LIBOR process

Claims that the London Interbank Offered Rate might have been manipulated prompted regulators and major banks to look into overhauling the way such rates are calculated and regulated. "As part of the normal reviewing processes of LIBOR, a number of contributing banks met [Monday] to consider future regulatory and market developments, such as the incoming liquidity rules, relevant to the parameters that LIBOR measure," according to the British Bankers' Association, which sponsors LIBOR. [Reuters March 6] ■

FM tells US firms to invest in debt

Pitching for foreign investment in the infrastructure sector which needs $1 trillion in the 12th five-year plan, finance minister Pranab Mukherjee asked the US investors to access the Indian debt market through a mechanism of regulated entities with a sustained long-term interest rate. Meeting leaders of Fortune 500 companies in Chicago, he assured them that India has evolved a transparent and stable regulatory regime in sectors such as electricity, telecommunications, ports, airports, petroleum and natural gas, and a regulator for the coal sector is on the anvil. Mukherjee said India has recently liberalised foreign participation in the debt-equity market by allowing foreign investors to invest in the Indian equity directly. Seeking a "greater degree of involvement" of foreign investors, Mukherjee said the "debt requirement for the infrastructure sector is very large." [Financial Chronicle, Jan 29]

Factoring business to grow 30%

India Factoring & Finance Solutions, a joint venture between Punjab National Bank (PNB) and Malta based FIMBank, Italy based Banca IFIS and Blend Financial Services of Mumbai, is riding high on the passage of the Factoring Bill during the winter session of the parliament. The company expects many new players to join the fray and the overall factoring business in the country to grow by 30-35 per cent per annum over the next two-three years. Its own business is expected to grow by over 50 per cent per annum during this period, taking the first mover's advantage.

Factoring services, which according to Factors Chain International, a global association of Factoring companies worldwide, has experienced a growth rate of 100 per cent across the world in the last five years, benefits the small entrepreneurs not only by providing much needed liquidity for their business (which is not linked to balance sheet) but also by way of professional debt administration and collection services. This enables SMEs to control and use their receivables more efficiently. [Financial Chronicle, Feb 14]

Large broking houses now diversify into retail lending

Large capital market players such as Reliance Capital, Edelweiss, India Infoline, Religare and India Bulls have diversified and are now lending to retail, small and large companies to stabilise earning and offset profitability pressures. The loan books of these broking firms are expected to grow 24 per cent and cross the Rs 31,000-crore mark by March 2013, according to Crisil. In 2011-12, profits from lending are expected to exceed those from the capital market business. The lending book is projected to grow at a compounded annual growth rate of 30 per cent over the next two years. In tandem, the profit contribution from the lending business may triple to more than 60 per cent in 2012-13, from 20 per cent in 2009-10. [Bs Reporter, Jan 18]

India is world's sixth most innovative country: Survey

India has been ranked the sixth most "innovative" country in the world in multinational conglomerate GE's Annual Global Innovation Barometer, driven by financial support from public authorities and long-term support from investors. The report, based on a survey of 2,800 senior business executives in 22 countries, including 200 respondents in India, identifies the top enablers for innovation in the country as talent ('creative' talent and people with technical expertise), financial support from public authorities and long-term support from investors. When asked to identify three countries they consider "innovation champions", 65% of the global respondents identified the US, followed by Germany (48%), Japan (45%), China (38%), Korea (13%) and India (12%). Only 12% of respondents identified India as one of the top three innovation champions, compared with 23% of Indian respondents. [PTI/Financial Express, Jan.20]

Dr. A C Shah passed away:

Dr. A. C. Shah[79] passed away on January 16, 2012 in Mumbai. The members of Managing Committee of Finance Industry Development Council (F I D C) expressed deep sorrow on his sad demise. He was a well-wisher of NBFC sector and the Chairman of the Working Group formed by RBI which gave the road-map for the all-round development of the NBFC sector. He was the eminent banker, economist, educationist and a philanthroper. He was an ardent supporter of the NBFC sector and always stood by the positive and pivotal role it played in the development of financial sector and economy of India.

India's per capita income crosses Rs 50K

Reflecting growing prosperity, India's per capita income grew by 15.6 per cent to Rs 53,331 per annum in 2010-11, crossing the half-a-lakh rupees mark for the first time. "The per capita income at current prices is estimated at Rs 53,331 in 2010-11, as against Rs 46,117 for the previous year, depicting a growth of 15.6 per cent," said the Quick Estimates of National Income released by the Central Statistical Office (CSO). The growth in per capita income comes on the back of 8.4 per cent expansion of the Indian economy during the last fiscal. However, the increase in per capita income at constant (2004-05) prices, after discounting for inflation, was about 6.4 per cent in 2010-11. It was Rs 35,993 in 2010-11, as against Rs 33,843 in the previous year.

As per the Quick Estimates, private final consumption expenditure (PFCE) in the domestic market at current prices was estimated at Rs 43,59,792 crore in 2010-11, as against Rs 37,22,036 crore in 2009-10. At constant (2004-05) prices, the PFCE stood at Rs 30,87,047 crore in 2010-11, as against Rs 28,52,301 crore in the previous fiscal. "In terms of GDP at market prices, the rates of PFCE at current and constant (2004-05) prices during 2010-11 are estimated at 56.8 per cent and 58.9 per cent, respectively, as against the corresponding rates of 57.6 per cent and 59.7 per cent, respectively, in 2009-10," the data said. The per capita PFCE in the domestic market in 2010-11 stood at Rs 36,760 at current prices and Rs 26,029 at constant (2004-05) prices, as against Rs 31,812 and Rs 24,379, respectively, in 2009-10. [Financial Express, Jan 31]

Pace of fixed capital formation dismal

The advanced estimates released by the Central Statistical Office (CSO) on Feb.7 only confirm the slowing in India's economic growth. Thanks to the high inflation that forced the Reserve Bank of India to raise policy rates 13 times between March 2010 and October 2011, the cost of capital has risen and is hurting private consumption, as well as investment plans across various segments. These have also led to a deceleration in gross fixed capital formation (GFCF). Based on data provided by the CSO, GFCF grew a mere 3.5 per cent in the first six months of 2011-12, compared with 10.7 per cent in the corresponding period of 2010-11. Notably, it has declined 0.6 per cent in the second quarter of 2011-12, the first contraction in as many as six quarters. [BS Reporters, Feb 08]

Union Budget 2012 - FIDC Achievement

After reading the fine print of the Union Budget 2012-13, it is noticed that FIDC has one achievement to its credit in respect of enhancement of **threshold for TDS on payment of interest on debentures.**

Under the existing provisions of section 193 of the Income-tax Act, a person responsible for paying interest to a resident individual on listed debentures of a company, in which the public are substantially interested, is not required to deduct tax on the amount of interest payable if the aggregate amount of interest paid during a financial year does not exceed Rs.2,500/- and the interest is paid by account payee cheque. However, in the case of unlisted debentures of a company, no threshold limit is specified for deduction of tax on payment of interest. In order to reduce the compliance burden on small assessees and companies, it is proposed that no deduction of tax should be made from payment of interest on any debenture, (whether listed or not) issued by a company, in which the public are substantially interested, to a resident individual or Hindu undivided family, if the aggregate amount of interest on such debenture paid during the financial year does not exceed Rs.5,000 and the payment is made by account payee cheque. This amendment will take effect from 1st July, 2012.*[Clause 69]*

This was part of FIDC Pre-Budget Memorandum was raised by Mr. Raman Aggarwal, past Co-chairman during the Pre-Budget meeting with the Hon'ble FM. It shall go a long way to provide to lot of small NBFCs who issue Secured Debentures on Private Placement basis. Currently, they have to deduct TDS on even One rupee of interest paid. Now, there will be a threshold limit of Rs.5,000/-.

Representation before FM by FIDC

Raman Aggarwal, immediate past Co-chairman of Finance Industry Development Council, a representative body for NBFCs said that industry has asked for higher depreciation rate for construction equipment at the pre-budget briefing meeting of heads of financial institutions and banks with finance minister Pranab Mukherjee. "We have also asked for some relaxation in taxation structure, especially for non-performing assets," he said. NBFCs also sought tax breaks on loans and NPAs. NBFC's deduct tax at source on instalment of borrowers under a Section 194A of Income Tax Act, whereas banks, LIC or UTI are exempted. "NBFCs should also get exemption under Section 194A," said Raman Aggarwal, Director of FIDC and an official of SREI Infrastructure Finance.

The head of country's top lender also sought tax breaks on provisioning for non-performing assets.

While banks sought full tax deduction on their provisions for NPAs, the Finance Industry Development Council (FIDC) pointed out that non-banking finance companies (NBFCs) do not get any tax deduction on the provisions made by them for bad and doubtful debts. "Our plea to the Finance Minister was that asset financing NBFCs registered with RBI should be allowed to avail themselves of deduction for their NPA provisioning," Mr Raman Aggarwal, Co-Chairman of FIDC told *Business Line* after the meeting. [Eco. Times[20-1]/Deccan Herald[10-3]/Business Line[18-1]

FIDC In Action

Asking to implement draft guideline!

It was noticed that some of the RBI Inspecting team members insisted on implementation of **Securitisation Guidelines**, even though it is in the 'Draft' stage and not issued as Notification by the authorities so far. As it was perceived that this is unjust FIDC took up up the matter with RBI.

Follow the FIDC Handbook on Repossession

In respect of **Repossession** case judgement pronounced by the Hon'ble Supreme Court, Mr. T T Srinivasaraghavan, past chairman of FIDC informs the members that the Supreme Court has left the matter of laying down the Guidelines on recovery/repossession to RBI and it has more or less agreed to the code laid down in FIDC Handbook on Repossession, The basic right to repossess is not challenged, and that the repossession can be done 'under the due process of law' which can be ensured by complying to the terms set out in the RBI Circular dated April, 2009 and which has also been incorporated in the handbook. The members were advised to strictly follow the steps as laid down in the Handbook.

FIDC Actions

FIDC representatives met Usha Thorat Committee members on 29 09 11, Reserve Bank Governor Mr.D Subbarao and all Dy.Governors on 10 10 11 and Nair Committee members on Priority Sector Lending on 24 11 11. Further, three of the FIDC Managing Committee members are the members of the **Key Advisory Group** constituted by Ministry of Finance and after deliberations at several meetings, the draft of recommendations to be sent by the Group to RBI is ready and may be forwarded to RBI any time. Many of NBFCs issues are positively addressed in the draft report..[See ET Report on it on Page 9 of this issue]

Membership fee for small NBFCs

The fee prescribed for small NBFCs is a token amount of Rs. 1,000/- per annum only. Pals it is time to join FIDC whole heartedly and muster solidarity of the NBFC sector..You well know that FIDC is putting up lots of efforts to protect the interest of NBFC sector and also endeavours to bring in the required legislations for the NBFC–AFC sector, which benefits all companies, big or small.

Appointment of Mr. B L NEELAKANTA MURTHY:

.Mr.B L Neelkantamurthy is appointed as director of the company in place of casual vacancy caused due to resignation of Mr Sunil Kanoria.:

Representation on the Report of the Nair Committee on Priority Sector Lending

Appreciating the recognition of role played by NBFC-AFCs by the Nair Committee in the last mile connectivity as well as the fact that both banks and NBFC - AFCs have a role to play to achieve objective of financial inclusion in a desirable manner FIDC submitted to RBI a representation on 26 March on certain key recommendations made by the Committee and its impact on the NBFC - AFC sector and made some suggestions on key issues regarding priority sector lending to be channelized through NBFC-AFCs. ■

Views expressed herein are not necessarily the views of FIDC.

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Suggestions and feed-back

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