FIDC NEWS

Finance Industry Development Council

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

APRIL-JUNE – 2012 VOLUME - 4 NO. – 1 FOR PRIVATE CIRCULATION

Need for Expansion of ECB window for NBFCs

Asset Finance Companies (NBFC-AFCs) and Infrastructure Finance Companies (NBFC-IFCs), are poised to play a vital role in the process of nation-building by financing infrastructure in India. These NBFCs rely heavily on External Commercial Borrowings (ECBs) as a source of long-term funds, and they on-lend to numerous Micro, Small and Medium Enterprises (MSMEs) in the infrastructure arena, thereby promoting inclusive growth. This creates a strong case for allowing NBFCs to access ECBs. Although, Union Budget 2012-13 has taken a number of steps aimed at increasing the scope for ECB in infrastructure sectors, nothing was done to channelize more ECB into NBFC-AFCs and NBFC-IFCs.

What really needed is a re-instatement of the ECB window that was available to NBFCs prior to the government decision in November 2003 when ECB access was totally cut off. Thereafter, the ECB window has got re-opened gradually, but still the NBFCs have had limited access to ECB. This can and is needed to be done by taking following few steps which would help facilitate them in making their due contribution to the India Growth Story, a dire need of the time when India is faced with slippage in growth:

- Allow NBFC-AFCs to utilize ECB for financing of domestically manufactured equipment as it would provide a strong fillip to this industry.
- There is a need to do away with the stipulation of linking ECB to the NBFC-IFC's Owned Funds by removing the embargo that total outstanding ECBs including the proposed ECB should not exceed 50% of the owned funds of the NBFC- IFC.
- The government should permit hedging up to maximum 50% of the loan only and. also allow raising ECB in domestic currency as that would enable taking care of the foreign exchange risk.
- Keeping in view the urgency of attracting ECB at this juncture, government may consider allowing full exemption of withholding tax on ECB.

R Sridhar, Chairman, FIDC

Regulatory Perimeter

RBI NOTIFICATIONS:

1. **Anti-Money Laundering [AML]/Combating of Financing of Terrorism [CTF]-Standards-:** RBI/2011-2012/487/DNBS(PD).CC. No. 20/03.10.42/2011-12, 4-4-2012.
2. **Implementation of Section 51-A of UAPA, 1967 - Updates of the UNSCR 1267 (1999)/1989(2011) Committee's Al Qaida Sanctions List-**RBI/2011-2012/486/DNBS(PD).CC. No 269/03.10.42 /2011-12-4-4-2012.
3. **Implementation of Section 51-A of UAPA, 1967-Updates of the UNSCR 1988(2011) Sanctions List** RBI/2011-2012/485/DNBS(PD).CC. No 268/03.10.42/2011-12-4-4-2012.
4. **Implementation of Section 51-A of UAPA, 1967-Updates of the UNSCR Committee's Al Qaida Sanctions List** RBI/2011-12/531-DNBS(PD).CC. No 271/03.10.42/2011-12-May 3, 2012.
5. **NBFCs - Rating of Fixed Deposits by Brickwork Ratings Pvt Ltd** RBI/2011-2012/555/DNBS.PD.CC. No 272/03.10.01/2011-12-May 11, 2012

AT A GLANCE

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6. Infrastructure Finance Companies - Eligible Credit Rating Agencies - Brickwork Ratings India Pvt. Ltd. - RBI/2011-12/556/DNBS.PD.CC.No.273/03.10.01 /2011-12-May 11, 2012

7. Foreign investment in NBFC Sector under the FDI Scheme-Clarification RBI/2011-12/562-A.P. (DIR Series) Circular No. 127-May 15, 2012

8. Bank Finance to NBFCs Predominantly Engaged in lending against Gold : RBI/2011-12/568/DBOD.BP.BC.No. 106/21.04.172/2011-12-May 18, 2012

9. Know Your Customer (KYC) guidelines - accounts of proprietary concerns : RBI/2011-12/579/DNBS(PD).CC.No 275/03.10.42/2011-12-May 29, 2012

10. All Infrastructure Finance Companies - Uniformity in Risk weight for assets covering PPP and post COD projects : RBI/2011-12/581 DNBS.PD.CC.No.276/03.02.089/2011-12 May 30, 2012

NBFC norms to be based on Thorat panel suggestions

The RBI while announcing annual monetary policy said it will issue the draft guidelines on the regulatory framework for NBFCs by June-end. These would be based on the recommendations of the Usha Thorat Working Group. The central bank also tightened norms for lending to NBFCs that lend predominantly against gold as collateral.

The Thorat Committee had recommended higher risk weights for exposure to sensitive sectors, an increase in minimum Tier-I capital to 12% to be achieved in three years, and liquidity requirements, similar to those for banks. Asset classification and provisioning norms too will be similar to those for banks. NBFCs that follow the 180-day classification norm for standard assets may have to shift to 90 days.

RBI will set up a working group that would undertake a detailed study of gold demand, trends in gold prices and lending by NBFCs against gold. The draft guidelines on overseas investment by core investment companies (CICs) will be placed on the Reserve Bank's website for public comments by end-April 2012. [FE BUREAU, April 18]

'Reduce exposure to NBFC's gold loans'

Worried over a spurt in gold imports, the RBI asked banks to reduce exposure to NBFCs, which give loan against the precious metal, at the earliest and bring it under the prescribed limit within six months. "Banks which are currently having exposures to such NBFC's (giving gold loans) in excess of the...regulatory ceiling will be required to reduce their exposure...at the earliest but not later than six months," RBI said in circular. Banks, according to the circular, are required to bring down their exposure ceiling to such NBFCs from 10 per cent to 7.5 per cent of its capital funds. The ceiling will apply to those NBFCs which are predominantly engaged in lending against gold and have provided such loans to the extent of 50 per cent or more of its total advances. This rule, RBI said, will not apply to those gold loan giving NBFCs if the additional fund provided by banks are meant on lending to infrastructure sector. In that case the exposure limit will be a higher level 12.5 per cent. [Financial Express, May 18]

Registration mandatory for investment overseas

Core investment companies (CICs) making overseas investment in the financial sector will require a Certificate of Registration, said the RBI. Currently, CICs with an asset size of less than Rs 100 crore are exempt from registration with the RBI. Investment in the non-financial sector by such exempted CIC, however, will not require CoR. CICs with an asset size of Rs 100 crore or more are considered as systemically important core investment companies and require a CoR from the RBI.

The RBI, in its 'draft directions' for overseas investment by CICs, said post overseas investment, a CIC should maintain the requirement of adjusted net worth of not less than 30 per cent of its aggregate risk weighted assets. The level of net non-performing assets of the CIC should not be more than one per cent of net advances. A CIC investing overseas should be earning profit continuously for the last three years. The aggregate overseas investment should not exceed 400 per cent of the owned funds of the CIC. The aggregate overseas investment in the financial sector should not exceed 200 per cent of its owned funds. The RBI said the subsidiary being established abroad by the CIC should not be used as a vehicle for raising resources for creating assets in India for the Indian operations.[Business Line, May 11]

Finance Minister introduces MFIs Bill in Lok Sabha

A Bill to regulate the micro-finance institutions (MFIs) providing micro-finance services was introduced by Finance minister in the Lok Sabha on May 22. This Bill seeks to empower the RBI to specify the maximum limit of the margin and annual percentage rate that can be charged by any MFI. Also, the Bill seeks to prohibit MFIs from carrying on the activities of micro-finance services without registration with the RBI. But existing non-banking finance companies registered with the RBI would be allowed to continue such services without registration.

The Bill also seeks to empower the RBI to specify sector related benchmarks and performance standards pertaining to methods of operation, fair and reasonable methods of recovery of loan advanced by MFIs. The RBI is also proposed to be empowered to set up a micro-finance development fund to be applied for providing loans, grants or seed capital as also for training of personnel engaged in micro-finance institution services [Business Line, May 22]

Foreign investment in NBFC Sector – Amendment to the FDI Scheme

Under the extant FDI policy, 'leasing and finance' is one of the 18 NBFC activities wherein FDI up to 100 per cent is permitted under automatic route, subject to minimum capitalisation norms. It is hereby clarified that FDI is permitted only in 'financial leases' (financial leasing activity) and not in 'operating leases' (operating leasing activity).[RBI's A.P. (DIR Series) Circular No. 121 dated May 8, 2012]

RBI approves Brickwork as rating agency for bank loans

The RBI has approved Brickwork Ratings as an eligible Credit Rating Agency (CRA) for bank loans/facilities. In effect, the RBI has accorded Brickwork, the ECAI (External Credit Assessment Institution) status under Basel norms, Brickwork said in a statement. Brickwork Ratings has been registered with the Securities and Exchange Board of India as a CRA since 2008. Brickwork Ratings has also been recognised by the National Small Industries Corporation under the Ministry of MSME, Government of India to rate the MSMEs. With this approval from the RBI, Brickwork is a full service rating agency in the country. Brickwork has rated NCD/bond issues, Issuer Rating, Security Receipts, Structured Obligation transactions, IPO Gradings, Financial Strength of Insurance Companies, Corporate Governance Ratings etc." Brickwork representatives are in Chandigarh, Coimbatore, Guwahati, Pune, Rajkot and Vadodara, it said. [PTI/Business standard, April 16]

RBI may tighten shadow banking rules

The RBI is looking at "shadow banking" activities closely and will tighten regulations if needed. "Next on the agenda is increasing the surveillance on shadow banking," Anand Sinha, deputy governor of RBI, said while addressing a meet organised by the Associated Chambers of Commerce and Industry of India. Shadow banking refers to financial sector services beyond the active regulatory purview of central banks. According to RBI, the unprecedented increase in shadow banking was a reason for the global financial crisis of 2008. Sinha added the central bank might tighten regulations if required. Strengthening regulations on such businesses are being addressed in the Basel-III norms, proposed to become applicable from 2017-18. Lately, NBFCs have attracted the central bank's attention for various reasons. Sinha said, "We are pro-NBFC, but it being essentially a part of the shadow banking system, it has to be tightened under Basel-III norms." [BS Reporter, May 1]

Securitization deals likely to take a hit

Loan securitization deals, or the practice of commercial banks buying out the loan portfolios of NBFCs, may see a significant drop in volume after the RBI tightened the norms on such transactions. The biggest impact will be on direct assignment deals, or bilateral deals between a commercial bank and an NBFC, as the new norms prohibit banks from taking any credit enhancements from these companies that originate the loans, said experts. Traditionally, banks prefer direct assignment deals as such transactions are

easier to execute. Banks take comfort in the credit enhancements, or the contribution of promoters, typically of 10-15%, as it ensures the commitment of the originators toward maintaining the quality of the loan pool. According to experts, with the removal of the credit enhancement, the investing banks will be exposed to the entire credit risk on the assigned portfolio and banks will not be comfortable with it.

"Banks could shift, at least partly, to the securitization route to meet these targets. However, the deterrents to such a shift to securitization are two-fold: high capital charge for the originators, and impact of mark-to-market for the investing banks," said Kalpesh Gada, head of structured finance at ratings firm Icra Ltd. "Further, the unresolved issue of income tax authorities' claim of taxing the SPVs involved in the securitization transaction as a separate entity is another factor likely to constrain a widespread move towards securitization," he said. [Livemint.com, 23 May]

Spate of regulations change face of financial sector

Over the last 12 months, the regulators (RBI and NHB) have tightened their grip on the Indian financial sector through a spate of regulations which have had a major impact on some key financial segments Some game-changing regulations proposed/issued by RBI/NHB are the release of the final guidelines on Basel III norms; discussion paper on dynamic provisioning framework; de-regulation of savings deposit rate; final guidelines on securitization; multiple regulations for gold financiers and removal of prepayment penalty and uniform rates for old and new customers for housing loans. These regulations have had a major impact on some key financial segments.

NBFCs may have to reinvent business models. Growth and return ratios are expected to decline. Removal of priority sector status for gold financing firms, loan-to-value (LTV) cap of 60% on gold loans, guidelines on securitization, recommendations for PSL and Usha Thorat committee recommendations for NBFCs intend to bridge the regulatory gap and strengthen balance sheets. [Livemint.com, May 24]

Non-banking units may have to go rural to set up urban ATMs

Non-bank entities that are keen to be a White Label ATM (WLA) operator may need to open three ATMs in rural and semi-urban areas to open one in a metropolitan city, said a senior banker who was part of the deliberations team formed by the Reserve Bank of India. In February, the RBI came out with guidelines on such ATMs where it said non-bank entities can set up, own and operate ATMs to accelerate their growth and penetration in the country. The central bank also mandated these WLA operator to have a minimum net worth of Rs. 100 crore. "We expect 60,000-80,000 white label ATMs roll-out in the next 6 to 8 months," a Finance Ministry official said.[Financial Express, June 6]

WHEN REGULATION CHOKES BUSINESS AND GROWTH

- C.GOPINATH

Regulation is a tricky business. You can want more and less of it at the same time, even while trying to meet the same objective. Even regulations that begin with noble intentions have a way of slowly going awry.

Businesses have a particularly hard time when it comes to meeting regulations. It pushes up costs of operations while trying to meet standards, making the firm less competitive, apart from tying up staff time to get permits, licences and file reports of compliance.

It is also discriminatory; only the large organisations have the money and stomach to deal with onerous regulations. They can afford the staff required to keep records and file reports. Small firms would drown in these requirements and look for ways to go around.

Regulations can also work against the interests of national development. For instance, when benefits are given to small businesses because they are small, size is defined in terms of sales revenue or numbers of people employed. This becomes an effective deterrent against growth; the thought of losing the benefit or operating to different standards can effectively result in the business staying small, and not crossing the threshold level. The nation sacrifices growth.

While on the one hand we celebrate small and entrepreneurial firms for their ability to create jobs, the number of regulations and permits that we pile on them can deter any but the bravest entrepreneur.

The governor of Massachusetts[USA] recently called for the review of over 800 regulations across 60 state agencies. Based on the on-going review, he decided to eliminate, or revise over 150 requirements that affect small businesses. These include rules that required multiple permits for sewer lines (reduced to one), and what size bass (a type of fish) can be caught by fishermen.

He has now required that no new regulation should be approved by any agency without consulting the small business community, and without asking questions like 'will this deter or encourage formation of business?' During the review, sometimes, nobody could explain to the officials what the rule was meant to achieve! The governor is quoted as saying, 'Let's focus on what's necessary and stop doing what's not.'

The World Bank publishes league tables on the ease of doing business by listing out the time taken to undertake various key activities. Brazil, one of our high-growth countries, recently started a clean-up of some of its regulations that is keeping the country at a rank of 120 out of 183 countries. Definitely too low for a BRIC!

HYC FORM?

Regulations are at the top of my mind now. I am not running a small business but I just completed a set of forms that the Reserve Bank of India site tells me is to prevent money laundering. As per the euphemistically called KYC or 'know your customer' norms, I am required to provide very confidential information, including account numbers, specimen signatures, photo, contact information, copies of passport, address proof, etc. all in one form. Clearly designed by somebody who hadn't had their first cup of coffee in the morning. I am threatened that my account will be frozen if I do not comply by a certain date. I have done this once before but bank rules require it to be updated regularly.

I cannot for the life of me understand why my bank cannot selectively identify large customers prone to money transfers, a more likely group for money laundering. Moreover, all this information placed on one form lends itself to leakages, stolen identity, and so on.

I couldn't find any report on whether any money laundering effort been prevented since these were instituted? At least till such a review is undertaken, the RBI may be better off calling this the HYC form, to stand for Harass Your Customer.

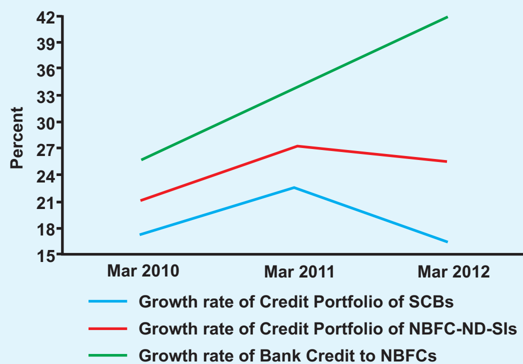
*[C.GOPINATH, Professor of International Business and Strategic Management at Suffolk University, Boston, US. April 8]

FINANCIAL STABILITY OF NBFCs

The assessment made by the Reserve Bank of India [RBI] says in its fifth Financial Satiability Report released in June 2012 says: "The financial system of the country remains robust despite increase in risks to stability primarily due to global risks and domestic macroeconomic conditions." The assessment in the report in respect of NBFCs is presented here under:

Credit growth decelerated amidst declining asset quality and profitability

NBFCs experienced deceleration in growth rate of credit though the credit growth continued to outpace that of the banking sector. Bank credit to NBFCs accelerated as did the reliance of NBFCs on bank credit as a source of funding. This could pose risks for NBFCs if banks are not in a position or unwilling to extend credit to the sector (Chart 1).



Source : RBI Supervisory Returns

The financial soundness indicators of systemically important non-deposit taking NBFCs (NBFC-ND-SIs) revealed a deteriorating trend with respect to soundness, asset quality and profitability (in terms of RoA). The CRAR remained above the regulatory requirement of 15 per cent, though it declined over the review period, (Chart-2). The downward movement in CRAR could partially be explained by the increasing asset base of the NBFCs. Further, the RoA remained healthy at around 2 per cent.

Rapid rise of gold loan companies could be a cause of concern

The exponential growth in balance sheets of NBFCs engaged in lending against gold in recent years coupled with the rapid rise in gold prices along with expansion in the number of their branches could be a cause of concern. The gold loan companies exhibited high dependency on the banking system for their resources which could pose risks to the banks, in case the business model of these companies falters. This growing interconnectedness of gold loan companies with banks was sought to be addressed through recent regulatory measures viz., the de-recognition of priority sector status of bank finance to NBFCs for on-lending against gold jewellery and through the prescription of a lower exposure limits on bank finance to NBFCs. Further, as a prudential measure, the Reserve Bank also directed the gold loan companies to maintain a minimum Loan to-Value (LTV) ratio of 60 per cent for loans granted against the collateral of gold jewellery and a minimum Tier I capital of 12 per cent by April 1, 2014.

With more than 90 per cent of the loan assets being collateralised by only one product viz. gold jewellery, the business model of gold loan companies has inherent concentration risks. The risks, however, would materialise only in case of a steep adverse movement in gold prices.

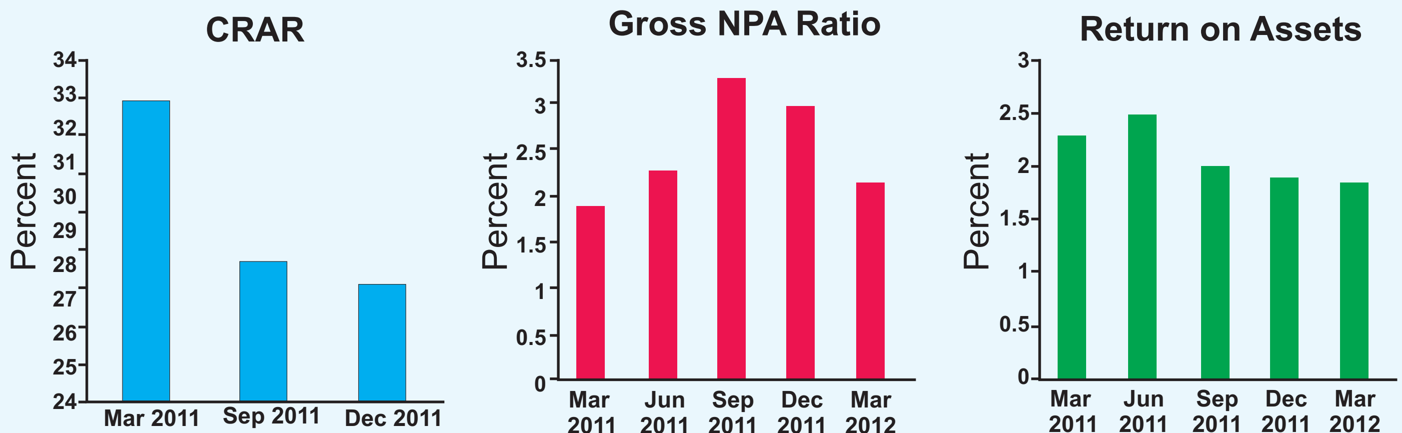
Resilience of Financial Institutions

The resilience of the financial institutions was assessed through a series of stress tests which imparted extreme but plausible shocks based on supervisory data pertaining to end-March 2012. The resilience of SCBs to various stress scenarios was tested using both the top down and the bottom up approaches as also through a series of macro stress tests. A number of single factor sensitivity stress tests were also carried out on scheduled UCBs and NBFC-ND-SIs (Non deposit taking systemically important NBFCs) to assess their vulnerabilities and resilience under various scenarios.

NBFCs able to withstand credit risk shocks

A stress test on credit risk for NBFC-ND-SI sector for the period ended December 2011 was carried out under two scenarios assuming an increase in gross NPA by 200 per cent and 500 per cent respectively.

It was observed that, in the first scenario, CRAR reduced marginally from 27.5 to 26.8 per cent, while in the second scenario CRAR reduced to 24.3 per cent.



Source : RBI Supervisory Returns

FRAUD : AN EVER PRESENT DANGER

Prevention, Detection & the Tools to Manage It

- By Jerry Oldham

This article addresses corporate fraud and malfeasance as a given in today's business finance environment. Not that it is prevalent in every corporate financing transaction, or even in a majority or them — but when it is present in a company being financed or its management team, it is both costly and disruptive to the victim. The costs can be measured as real costs, opportunity costs and even brand dislocation or wasting.

In its Report to the Nation, The Association of Certified Fraud Examiners (ACFE) summarizes its study of corporate fraud. The report brings to light certain types of fraud, their characteristics and the magnitude of corporate fraud in the workplace. The following are a few conclusions of the report:

The Cost of Fraud : Fraud costs U.S. organizations an estimated $660 billion annually.

Frauds by Organization Type : Privately held companies suffer the largest median losses, followed by public companies, not-for-profit organizations (a close first through third in the ranking) and government agencies (a distant fourth).

Frauds by Organization Size : The most costly abuses occur in organizations with less than 100, or more than 10,000 employees.

Frauds by Position : The median loss involving owners and executives is more than six times as high as the median loss caused by managers, and more than 14 times as high as the median loss caused by employees.

Frauds by Gender : Men and women commit an equal number of frauds, but the median loss is significantly higher in schemes committed by men.

Frauds by Age : Nearly half of all frauds, 49%, are committed by individuals over the age of 40, while only 17% are committed by employees under 30.

Frauds by Educational Background : Half of all frauds are committed by perpetrators with no more than a high school education, but the median loss in schemes committed by those with post-graduate degrees is 6.5 times larger than the median loss in schemes committed by those with a high school degree or less.

So what does this mean to asset-based lenders and other corporate finance professionals?

It means that lending professionals that manage and assess the risk of fraud within their prospect companies do not have the luxury of discriminating when to perform such an assessment based upon the type or size of the organization, the owners or managers' exact position or title, age or gender. In fact, crimes of fraud are not limited to executives and owners, with employees with an education no greater than high school committing half of the schemes. For sure, the problem is broad, deep and a significant financial consequence.

Prevention

The ACFE's Report to the Nation also reinforces the common belief that the most cost-effective way to deal with fraud is to prevent it. According to its findings, once an organization has been defrauded it is less likely to recover its losses. The median loss recovery among victims in this study was only 20% of the original loss. Nearly 40% of the victims recovered nothing.

Simply put, prevention for lenders and other secured creditors is the key to minimizing the risk of fraud, and this means utilizing a "Best Practices" approach to due diligence and post-closing monitoring. It also means performing background investigations as a regular part of the best practices due diligence process.

The Due Diligence Process : A Brief Recap

Broadly speaking, in addition to management interviews and site visits by the lender, the due diligence process often includes the following key components, many of which are frequently outsourced because of the demand for specialization:

Background Investigations : These include investigations performed upon the borrowing entity and the management team.

Financial Statement Reviews & Analysis : These include audits and field examinations.

Collateral Evaluations : These include appraisals of personal and real property.

Legal Reviews : These include reviewing corporate fitness and business legitimacy.

A Historical Perspective

My purpose here is to present the case for the utilization of background investigations as a tool to prevent, detect and manage fraud — before the loan is made. I would also like to advance the thesis that the performance of background investigations as an integral part of the due diligence process is more prevalent than in the recent past, and should be part of the post-closing and on-going due diligence.

My Top Ten list to support the growing need to perform background investigations is as follows :

1. Company owners and managers are involved in more businesses than ever, many of which are across state or country borders and may involve different and multiple partners.
2. Lenders are more often participating with other lenders and equity providers in the same capital structure, sharing increased risk with each other. Participants are relying upon the lead lender's pre and post-closing due diligence in most cases.
3. The global market is a greater target for new business and new business partners, and lenders are more in need of the best worldwide information in order to make an informed decision.
4. The media plays a more intense role and more than ever works in real time. Lenders must know what the media knows and more.
5. The world is more litigious, and litigation costs real time and real money.
6. Information is more readily available within a time frame that "beats the bell" at a cost that doesn't "beat the bank."
7. Lending relationships are frequently more transactional and less relationship driven. Banking services are often accepted by borrowers more a la carte, in spite of banks' best intentions to cross sell expanded capabilities as the best

value proposition.

8. Now, more than ever, time is of the essence with competition for the same deal much more intense and coming from various financing vehicles. Lenders and borrowers share the same desire for a speedy decision, requiring the fastest due diligence possible.

9. Corporate fraud, scandals and corporate governance have become more common in our business vocabulary. Corporate scandals are now front-page news, and the executives convicted of these illegalities against shareholders, investors and lenders are being held accountable.

10. There are now regulations that require a certain level of background investigation. A few short years ago there were no insurance requirements or federal statutes that required a state or national bank or federally chartered savings and loan institution to check a list for terrorists, international narcotics traffickers or those engaged in the proliferation of weapons of mass destruction. The FDIC and the FSLIC changed all of that subsequent to the passing of the Patriot Act of 2001.

Some Best Practices Tips

Lenders and lessors should be consistent about the methodology they employ. Lenders that perform background investigations by exception rather than as a standard practice will be compromised exceptionally — when it happens.

- Hire a background investigations firm that is consistent about its methodology as well. Ask the firm about its best practices methodology.
- An investigation must include a thorough research effort into determining all of the jurisdictions (counties or countries) in which the subject has resided or done business.
- Research must be performed in every jurisdiction where it has been determined the subject has resided or done business. To except even one jurisdiction could be to leave out the one where the "deal killer" resides.
- An investigation into public records (i.e., civil and criminal litigation histories, tax liens, judgments and bankruptcies) should always include a combination of independent on-site and on-line research. We find adverse public record information in approximately 30% of the cases as a result of performing on-site research that we don't find when performing on-line research, using the best data bases available, a percentage too high to ignore.

And finally, a few truths to live by

Establish written risk management, due diligence and background investigations guidelines to live by, and follow them without exception.

Back up your best interviewing skills and intuition with the best information.

When in doubt, it's always better to walk away from a deal.

It's always management that ultimately repays the loan. Know whom the owners and managers really are.

Maintain your sense of humor because, when the collateral is gone and you're left to work out a deficiency with a known felon who has ravaged his last three ventures and committed untold acts of indiscretion, you'll need it.

[Jerry Oldham is co-founder, chairman and CEO of 1st West Financial Corp. Excerpt from an article in Asset Management]

RBI-Pulling every lever

India's central bank is one of its best institutions

Judging by the numbers, the Reserve Bank of India [RBI] is among the world's best central banks. Its record on balancing growth and inflation is decent enough. Since 1995 wholesale prices have risen by an average of 6% a year, not too far from the RBI's comfort zone of about 5%. Growth has averaged 7% a year. The RBI is also in charge of the safety of the financial system, to which end it yanks more levers than Willy Wonka in a chocolate factory. Its record here is excellent. Despite a current-account deficit that leaves India vulnerable to global jitters, the country sidestepped the 1997 Asian crisis ("nobody gave us a chance," recalls a former governor) and the West's banking crisis in 2008. The RBI also coped with big and potentially destabilising capital inflows in the euphoric years before Wall Street began to totter, and has avoided a domestic financial crisis despite fast growth in banks' assets for many years.

Some fancy the RBI is a model for the kind of full-service central bank that is back in fashion worldwide—both the Federal Reserve and the Bank of England, among others, are now in charge of financial stability as well as interest rates. In truth, it would be hard to run a rich economy the way the RBI does India, with its financial system only partly liberalised. But the central bank has new clout abroad and at home its stock is high…."if you look at its people and those of the Fed, there's no comparison," laments one bigwig—relative to most Indian state bodies the RBI has more brains, muscle and integrity. It is about the only institution in the country you never hear accused of graft.

After 1991, when a balance-of-payments crisis led India to deregulate, the central bank rediscovered its spine. Agreements fully enacted in 1997 and 2006 stopped the state using it as an ATM, and as interest rates were liberalised and the bond market developed, the RBI began to look more like a normal central bank, setting short-term policy rates to try to balance inflation and growth.

And like a triumphant wearer of flares that have at last come back in fashion, the RBI's wide remit—minting coins, managing the exchange rate, acting as banker for the government, and supervising banks and the bond market—is now seen as a template. These responsibilities helped it deal with the 2008 crisis: in short order it defended the currency, loaned money to cash-strapped banks, gave forbearance on troubled loans, soothed the bond market and eased banks' capital requirements. Today a process of constant tweaking continues. In December, after a panicky fall in the rupee, the RBI introduced several obscure measures to bolster it, such as making it more attractive for Indians resident abroad to deposit money in the homeland.

Such fiddling has a cost….In 2009 an official review of finance chaired by Raghuram Rajan, a former chief economist of the IMF, worried that conservative regulation was inhibiting India's potential. One local bank boss says the RBI "runs a repressed financial system which is intolerant towards innovation. If the US was at 90 out of 100 in terms of complexity and sophistication, we are at 10…I sometimes get the impression it [the RBI] is resting on its laurels, not realising that more financial innovation could help India's development."

Still, after years of financial convulsions abroad it is hard to say that the RBI has got the balance between safety and thrills wildly wrong. Indeed, the thing that endangers India today is not its financial markets but its government.

In this respect, as with its strong supervisory record, the RBI may have lessons for the world. Other central banks, including the euro zone's, are propping up sovereign-bond markets. Mr Rajan talks of "the conceit that central banks are independent. When they find that the governments are not going to budge [on cutting their deficits] few feel able to just walk away." In a speech on February 1st, Mr Subbarao, the RBI's governor, worried that "in the presence of large sovereign borrowing…central banks typically have little choice."

[Excerpts from an article from the Economist, London]

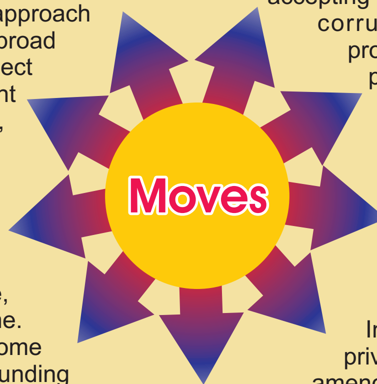
FDI may be allowed in more NBFC activities

The Government may consider widening the list of Non- Banking Financial Companies (NBFCs) activities that can get foreign direct investment. The RBI has endorsed such a move.The new activities are likely to find place in the FDI Press Note which will be effective for 2012-13. The Department of Industrial Policy and Promotion (DIPP) is readying this note. At present, 18 NBFC activities have been permitted for FDI. A person familiar with the development told Business Line that "there is a proposal to reorganise the 'leasing and finance' business (one of the 18 specified NBFC activities for FDI. The reorganisation may be into four activities — leasing, loans and advances, hire purchases and factoring."

NEW SERVICE: Another proposal is about a new 'payment system activity by non-banks.' This may include issue of prepaid payment instruments, mobile wallets or e-wallets, and setting up technology infrastructure for supporting retail payments in areas relating to payment through credit/debit cards and prepaid instruments. He said that this new activity may be considered for 100 per cent FDI under the automatic route. However, there would be a condition that the new activity is in compliance with the Payment and Settlement Systems Act 2007 and conform to a suitable capitalisation norm, he added.

There is another proposal to allow 100 per cent FDI for primary dealership in government bond market. This permission can be given under the automatic route subject to minimum capitalisation norms and the RBI guidelines for primary dealer business, he said.

A senior Government official said that before any new activity is considered for FDI, the Government might approach financial sector regulators for views on certain broad parameters. These will include the regulatory aspect of new financial services, the existence of sufficient number of and well developed domestic players, and capitalisation norms commensurate with risk profile. [Business Line, April 4]



Funding cost of NBFCs is set to rise in F Y 2012-13

Cost of funding is set to increase for NBFCs, especially those that provide equipment finance, due to the RBI's new guidelines on the same. Therefore, profitability of such companies could come under pressure in 2012-13, said Fitch Ratings. Funding costs may increase by 75-100 basis points for some major NBFCs," said Fitch ratings. In May, the RBI released final guidelines on securitisation wherein it has prohibited credit enhancements of direct assignment transactions. Such a move may deter banks to invest in such transactions as the entire credit risk will be transferred on their portfolio. Costs of raising capital will jump. Dependence of bank funding unlikely to change, for want of alternatives," said Ehsan Syed, director of financial institutions ratings at Fitch. Further, owing to the slowing economic growth and the pressures on asset quality, some NBFCs may have to diversify into other avenues.[Financial Express, June 6]

Islamic NBFC AICL to move court against RBI

The cold tussle between advocates of Islamic finance, which forbids the use of interest rate, and the Indian banking regulator, which is adamant that local laws prohibit such funding, is headed for a climax. Alternative Investments and Credits (AICL), the Kerala-based firm that has been stripped of its licence to carry out non-banking finance activities by the Reserve Bank of India, is planning to move court against the central bank. AICL, which is among the very few Islamic finance entities in the country, will also take up its case with the finance ministry. A director of the company told ET that the board is weighing legal options to obtain a stay on the regulator's decision to cancel the certificate of registration.

Till now there was a widely shared perception that while commercial banks planning to offer Islamic banking products will run into legal hurdles, non-banking finance companies will face no restrictions. That has now changed, with RBI directing AICL to stop financing business almost a decade after it was founded. Earlier, the central bank had pointed out that the NBFC was not complying with the fair practices code under which the financier has to lay down the terms and conditions of funding, including the interest charged. "Basically, the Indian banking and finance system runs on the interest concept and Islamic finance is based on profit-sharing," said an RBI spokesperson on a day after the regulator revoked AICL's registration.[Economic Times, 7 May]

India to have comprehensive financial sector consumer protection legislation: RBI

India is examining the possibility of enacting a comprehensive financial sector consumer protection legislation the Reserve Bank of India said. Although India has a law for consumer protection it is not specifically for the financial sector consumers. Currently a bank customer can approach the banking Ombudsman, to resolve its dispute with the bank. This was indicated by the deputy governor K C Chakrabarty at a panel discussion on financial literacy and consumer protection at Washington recently. He indicated that the aim is to ensure consumers are protected even in case of plain vanilla products, [ET Bureau, April 25]

Government introduces Public procurement bill 2012 in Parliament

The government has introduced the Public Procurement Bill 2012 in the Lok Sabha that seeks to seeks to regulate award of government contracts above Rs 50 lakh to ensure "transparency, accountability and probity" in state purchases. The legislation proposes imprisonment of up to five years for public servant found guilty of accepting bribe and vitiating bidding process in order to check corruption and ensure transparency in public procurement. It will codify the basic norms to regulate public procurement and provide for debarring bidders found engaged in corrupt practices. Currently, there is no overarching legislation governing public procurement by the central government and central public sector enterprises. The General Financial Rules, 2005, govern procurements made by the Centre. [Economic Times, May 14]

Govt working on private sector corruption law

In an attempt to bring the fight against bribery to the private sector, the home ministry is working on tough amendments to the anti-corruption law. The amendments, if passed, will be so tough that tipping the parking attendant in your office for a better slot could leave you facing jail time. It will make receiving a gift a crime, if it a court says it was in return for undue favours. Offenders will be punished with a maximum 7 years in jail. According to the draft circulated to the states, the amendments will criminalise a person offering or giving (or soliciting or receiving) an "undue advantage" to anyone to get the person to act in breach of his duties. Anti-corruption activists welcomed the proposals but lawyers aren't so sure about its wide and loosely defined provisions.

Existing laws only criminalise corruption amongst public servants. A manager in a private firm accepting money for awarding a contract isn't a crime under bribery laws. The distinction was made since public sector corruption takes a toll on efficiency of public services, raises the cost of transactions and undermines public confidence. [Hindustan Times, May 17]

Allow customers to opt for electronic repayment: RBI to banks

Following complaints from customers, the Reserve Bank has made it clear to banks that there are no restrictions in allowing use of electronic modes for various transactions including repayment of loans. "It is, therefore, advised that all banks should allow the customers to choose National Electronic Funds Transfer (NEFT) as one of the electronic modes of making payment towards loan EMIs or repayments etc." the RBI said in a notification. The RBI had allowed regional rural banks (RRBs) and cooperative banks also to participate in the centralised payment systems. [PTI/Economic Times, April 13]

Common KYC norms on the anvil, says SEBI

Insurance policyholders, bank account holders and equity investors may not be required to provide separate documents for know-your-customer (KYC) norms in the near future. The SEBI chairman UK Sinha said, "To ease procedural hurdles that investors face, we are in talks with other regulators like the RBI and the IRDA, for common KYC norms across the financial sector." At present, investors or policyholders have to submit various personal documents in order to avail financial services. Most of these documents are common across the financial sector. "In the near future, one KYC with any one of the KYC registration authorities (KRAs) will suffice for all the transactions across the spectrum of the financial sector," added Sinha at the Confederation of Indian Industry's (CII) annual general meeting. SEBI has already come out with a common KYC for securities transactions. If an investor registers with any of the three KRAs, then for any other transaction in the securities market, he does not need to go for another round of KYC. [Financial Chronicle, April 17]

Investment funds under SEBI ambit

SEBI has announced guidelines to bring unregistered and lightly regulated investment funds, such as hedge funds and private equity and venture capital funds, under its ambit. The Alternative investment funds [AIFs] Regulations cover all AIFs, including PEs, real estate funds and hedge funds and makes it mandatory for them to register with SEBI. The regulator has exempted the existing PEs and VCs from registration till their mandates to run the funds end. However they will not be able to raise fresh funds from investors, SEBI has said. [ET Wealth, May 28]

SEBI to align corporate governance norms with OECD principles

The SEBI is in talks with the Organisation for Economic Co-operation and Development (OECD) to keep the domestic corporate governance norms aligned with the global standards ratified by it. Paris-based OECD, an international grouping of top economic powers, has ratified six 'Principles of Corporate Governance', which have become a benchmark for policymakers, investors, corporations and other stakeholders worldwide. "SEBI is having bilateral talks with OECD for keeping the corporate governance aligned with six fundamental principles ratified by OECD," SEBI Whole-Time Member, Mr Rajeev Kumar Agarwal, said. These six principles involve ensuring the basis for an effective corporate governance framework, the rights of shareholders, equitable treatment of shareholders, role of stakeholders in corporate governance, disclosure and transparency, and the responsibility of the boards. [PTI/Business Line, May 25]

SEBI MOVES

SEBI keeps consent window open to settle serious offences

The market regulator on May 25 issued a new framework for settling market offences through consent mechanism. According to the new rules, it has excluded certain serious defaults like insider trading, front running, failure to make an open offer, redress investor grievances and respond to the summons. However, SEBI has said in its circular, that its high-powered advisory committee (HPAC) or panel of whole-time members (WTMs) may settle even defaults that have been excluded from the process. This means the regulator still has the discretion to settle any case, including insider trading and front running through the consent process.

HPAC, which consists of a retired high court judge and three external experts, makes recommendations on a consent application before SEBI's WTM panel takes a final call on it. Experts say this option should not be used as a loophole and only be exercised in exceptional cases. "There could be certain exceptional situations, like what happened during the Satyam case. You can't blame the new management for the offences committed by the earlier promoter," said Amit Tandon founder and managing director of Institutional Investor Advisory Services. Market experts say if a public sector entity is charged of say, insider trading, then the President of India cannot be tried and hence, a provision is needed to make exemptions in such cases.

The consent process, introduced in 2007 and modelled on the US system, is a settlement of proceedings between SEBI and the alleged violator without admission or denial of the guilt, subject to a fine and also a voluntary ban in some cases.

The consent process was introduced with a view to cutting down on costs and time involved in the enforcement actions. "The new consent framework is a step in the right direction, by not allowing serious cases to be settled through this route," said Shriram Subramanian, managing director of a Bangalore-based proxy advisory and corporate governance research firm. [Business Standard, May 28]

SEBI quantifies settlement for consent orders

Stock market regulator SEBI has quantified the levy of penalty for offences that could be settled through the consent route. The earlier SEBI circular of April 2007, did not disclose the methodology to calculate penalty. SEBI has provided a mathematical basis to arrive at the settlement amount. It enables applicants to propose the consent terms.

SEBI has defined the type of offence under heads such as fraudulent and unfair trade practices, failure to disclose, insider trading, violation of code of conduct and default under open offer. The impact of these offences is categorised under major, minor, serious or miscellaneous to be treated accordingly. The provisions take into the profile of the applicant such as intermediary, promoter, financier, whole director/ chairman, other directors/ key management personnel, listed companies, front or dummy entity, key operator, FII or its sub account and lead managers, besides asset management companies. Base amounts are assigned to every category of offence according to the category of the applicant. The regulatory action factor (RAF) is the sum total of earlier orders against the applicant and value of order or direction for which the consent application is filed. The RAF is lower for first time offenders and lower categories of offences. [Business Line, June 1]

KYC details to be submitted to KRAs by Mar 2013: SEBI

Market regulator the SEBI asked all market intermediaries including mutual funds and stock brokers to submit Know Your Customer (KYC) details of the existing customers with KYC Registration Agency (KRA) by March 31, 2013. "All market intermediaries to upload the KYC details of the existing clients in the current KRA system in a phased manner," SEBI said in a circular. KRA are institutions which maintains KYC details. Wholly-owned subsidiaries of stock exchanges and depositories are eligible able to act as KRA. The regulator has announced five phases for updating KYC details of the existing customers ending March 31, 2013. [PTI/Business Standard, April 13]

Regional offices to clear IPO proposals of Rs 500cr: SEBI

Market regulator SEBI said its regional offices would be delegated powers to clear public offer proposals of companies planning to raise up to Rs 500 crore. "Regional offices can clear proposals of IPO up to Rs 500 crore. Regional offices will be delegated powers with respect to mutual funds, inspection..", SEBI Chairman U K Sinha said after inaugurating the southern regional office. SEBI has planned to open 10 new regional offices, Sinha said [PTI/ Business Standard, May 07]

Pvt cos, PSUs must hike public holding to 25% by Aug 2013: SEBI

Capital market regulator SEBI said that both public and private sector companies will have to increase public shareholding to a minimum of 25% by August 2013 and there will be no relaxation of the guidelines. "Companies will have to see that public shareholding is 25% as per the time-frame. As far as private listed companies are concerned, it is June 2013 and for the public sector firms it is August 2013," SEBI Chairman U K Sinha said. [PTI/Business Standard, April 13]

Reform Inertia

"There is an overall feeling of anger and rejection on how things which were so good four-five years back, not only in India but many other parts of the world, have come to such a stage. What is it that went wrong? What is it that we need to do?" Some of the reforms have been on the anvil for almost a decade and are yet to come through. That is something for all of us to ponder very seriously, on how long we can go on deferring this."

U K Sinha, Chairman, SEBI

No double jeopardy if cheating case also filed on dishonour of cheque: Apex Court

The Article 20 (2) of the Constitution does grant immunity against award of more than one punishment for the same crime but if the ingredients of the two cases are different, there is no bar on launching two different proceedings that could culminate in separate punishments for the two crimes. So, held the Supreme Court in Sangeethaben Mahendrabhai Patel vs State of Gujarat and another.

On dishonour of cheque for Rs 20 lakh, the Respondent No. 2 had launched proceedings under Section 138 of the Negotiable Instruments Act and soon, thereafter, also under Sections 406 and 420 of the Indian Penal Code as well for breach of trust and cheating.

The Supreme Court while upholding the Gujarat High Court stand that the two simultaneous proceedings were maintainable pointed out that while the proceedings under the Negotiable Instruments Act are for the crime of issuing the cheque without funds in the bank account, the proceedings under the IPC are against criminal intent.

In the prosecution under Section 138 of the Negotiable Instruments Act, *mens rea* i.e. fraudulent or dishonest intention at the time of issuance of cheque is not required to be proved. Besides, the offence punishable under Section 420 of the Indian Penal Code is a more serious one as a longer sentence of seven years can be imposed. [Business Line, May 3]

Guarantors to pay on debtors' default: SC

The guarantor of a loan is liable to pay it if the debtor fails to clear it, the Supreme Court has ruled while maintaining that financial institutions too cannot act like property dealers in recovering the debts.

The SC bench also said the guarantor cannot insist that the creditor must first exhaust all remedies against the principal debtor before recovering the debts from the surety holders. "There can be no dispute to the settled legal proposition that in view of the provisions of Section 128 of the Indian Contract Act, 1872, the liability of the guarantor/surety is co-extensive with that of the debtor. "Therefore, the creditor has a right to obtain a decree against the surety and the principal debtor. "The surety has no right to restrain execution of the decree against him until the creditor has exhausted his remedy against the principal debtor for the reason that it is the business of the surety/ guarantor to see whether the principal debtor has paid or not," said Justice Chauhan, writing the judgement for the bench.

The apex court gave the ruling on an appeal by one Ganga Kishun, who had stood as a guarantor to a bank loan, raised by one Ganga Prasad, who had died without clearing it. Ganga Kishun had come to the apex court against the Uttar Pradesh government's decision to recover the loan arrears from him after the death of principal debtor Ganga Prasad. While dismissing Ganga Kishun's appeal, the apex court, however, faulted the government's decision to auction Ganga Kishun's entire stretch of land for Rs 25,000 to recover an arrear worth Rs 8,500 only and not confining the auction to only 1/3rd of the land which could have fetched the arrears. The apex court added the financial institutions cannot be allowed to act like property dealers to recover their loans. [Financial Express, May 29] [Financial Express, May 29]

Arbitration clause survives contract

Even if the contract which contained an arbitration clause expired by efflux of time, the arbitration itself will not come to an end, the Supreme Court said, while appointing retired Justice N K Sodhi as the sole arbitrator in a dispute between Lufthansa German Airlines and the Airport Authority of India. The agreement had expired in March 2007. The dispute started during the subsistence of the contract and spilled over to later years. The airport authority failed to appoint its arbitrator. Therefore, the airlines moved the court. It stated that the dispute over damage to cargo was arbitrable and appointed the arbitrator. [Business Standard, Mar 26]

Apex court annuls Kerala Chit Funds Act

The Supreme Court has annulled the Kerala Chit Funds Act of 1975, dismissing an appeal against the order of a single judge. The Supreme Court declared that only the Central Chit Funds Act, 1982, would be applicable to all chit fund firms operating in the country. A five-member Constitution Bench chaired by Chief Justice S. H. Kapadia ruled that the Kerala act had become redundant in the context of a Central Act of 1982. The Supreme Court also annulled an amendment Kerala had incorporated in the 1975 Act in 2002. The amendment had stipulated that any chit company having at least 20 per cent of its subscribers domiciled in the State should get itself registered under the Kerala Act. But the amendment had excluded Kerala State Financial Enterprises, a State government-owned chit company, and cooperative institutions from its ambit. This was challenged in the High Court by 44 private chit fund companies, who argued that the State could not legislate on a subject already acted on by the Centre. [Business Line, May 9]

Chit fund act extended to Gujarat, Kerala, four other states

Chit funds, an informal pooling of funds from individuals for lending, will come under the Chit Fund Act of 1982 in six states including Gujarat and Kerala, helping millions of people access the dispute settlement mechanism. Nagaland, Haryana, Tripura, and Arunachal Pradesh are the other states that will come under the Act, providing a cushion for small savers who are at the mercy of local operators. Since these funds are not managed professionally, investors face difficulty in getting disputes resolved. Over 12,000 registered chit funds manage in excess of 35,000 crore a year, according to chit fund industry estimates.

Company name in bounced cheque

The Supreme Court has ruled that an authorized signatory of a company cannot be prosecuted for issuing a dishonoured cheque without the company itself being arraigned as an accused person. The issue involving Section 138 and 141 of the Negotiable Instruments Act had divided a bench of two judges earlier and it was referred to a three-judge bench. The same issue of interpretation arose in the case of Section 85 of the Information Technology Act, 2000 which is identical to Section 141 of the Negotiable Instruments Act, dealing with those responsible for an offence, like directors of a company. It says that when a company commits an offence, “every person who, at the time the contravention was committed, was in charge of, and was responsible to, the company for the conduct of business of the company as well as the company, shall be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.” In both cases, the concerned companies were not made accused, which was wrong. The first case was Aneeta Hada vs M/s Godfather Travels & Tours Ltd. The second one was Ebay vs State. Both the appeals by the executives were allowed, clarifying the law on this point. [Business Standard, May 14]

23 Tax Tribunal Members Under CBI Scanner for ‘Fixing’ Verdicts

An estimated 69 orders passed by as many as 23 members of various benches of the Income Tax Appellate Tribunal (ITAT) are now the subject matter of an unprecedented nationwide inquiry for alleged corruption by the Central Bureau of Investigation (CBI). [The Indian Express/Wall street Journal]

US Supreme court rules in credit bid bankruptcy case

The U.S. Supreme Court unanimously ruled that a secured creditor cannot be denied the right to make what has been known as a “credit bid” involving the sale of property or other assets as part of a bankruptcy reorganization plan. Under a credit bid, the creditor can purchase its collateral at auction by crediting the purchase price against the secured debt rather than paying cash. Debtors argued that a such a credit bid discourages third parties from participating in the auction. Creditors argued that denial of their right to credit bid could force them to take less than the full value of the assets.

The case involved a debtor, RadLAX Gateway Hotel, which owns the Radisson Hotel and a neighboring parking structure at Los Angeles International Airport. During the bankruptcy case, it sought to block lender Amalgamated Bank from credit bidding — swapping its debt for the hotel in a bankruptcy-court-overseen auction rather than paying cash. U.S. government attorneys supported the bank. They said the right to credit bid was an essential protection for secured creditors, especially for lenders such as the U.S. government and federal agencies that often are unable to bid cash. [Reuters-Washington May 29]

EU Leaders Ease Debt-Crisis Rules

In Brussels on June 29 chiefs of the 17 euro countries dropped the requirement that taxpayers get preferred creditor status on aid to Spain's blighted banks. They also opened the way to recapitalizing lenders directly with bailout funds once Europe sets up a single banking supervisor. The guardians of the euro faced a make-or-break summit to restore confidence in their currency bloc. [Bloomberg, June 29]

European parliament approves contested financial tax

The European parliament adopted by a strong majority proposals on a French-inspired financial transaction tax (FTT) which has been bitterly opposed by Britain. Britain says the tax would undermine London as a global financial centre. The resolution in favour of the FTT, approved with 487 votes in favour, 152 against and 46 abstentions, calls for the implementation of the tax by the beginning of 2015 "even if only some member states opt for it." "The FTT is an integral part of an exit from crisis," said parliamentary rapporteur Anni Podimata. "It will bring a fairer distribution of the weight of the crisis." Parliament approved the tax rates proposed by the Commission, 0.1 percent for transactions of shares and bonds, and 0.01 percent for derivatives. [AFP-BRUSSELS]

BIS: Global economy is still at risk from crushing debt

Governments, banks and households struggling with too much debt are dragging down the world's economy and more needs to be done to make the banking system safer, a global organization of central banks warned on June 24. The Bank for International Settlements[BIS] said in its annual report that the world economy remains out of balance, with advanced economies struggling with debt and emerging economies growing strongly but facing risks of their own version of boom and bust.The BIS said it's key for governments to make banks take responsibility for their losses and force them to rebuild their finances. Meanwhile, the threat from risky bank behavior is growing again. [Associated Press, June 24]

Companies Aim to Start Spending Trillions They're Hoarding

Corporations around the globe are finally planning to spend some of the nearly $8 trillion in emergency cash they've amassed. According to the latest American Express/CFO Research Global Business & Spending Monitor, released on May 15, 45% of the world's chief financial officers and other executives say they're likely to switch from hoarding cash to spending their reserves in the course of 2012. Only 34% say they're sticking with a strategy of building rainy-day funds. That's a notable change from last year, when 62% of respondents said they were preserving cash in case of emergency.

Where will the cash go? Broadly speaking, corporate executives say they're planning to boost operating capacity, research and development and mergers and acquisitions. Importantly, some 53% hope to raise headcount over the 12 months.[Wall street Journal, May 15]

Basel III places unfair burden on Asian banks, experts say

Speakers at an industry conference said the Basel III regime is designed to resolve issues plaguing the European and U.S. banking systems and is imposing unnecessarily complex capital requirements on Asian financial institutions. Brian Lo, head of market risk at DBS, said Basel III's approach to liquidity management will increase risk within Asia's banking sector. "Basel III is a prescription for failed financial institutions, as well as regulators, and as a result of these failures, everybody has to take the same track globally," Lo said. [Risk.net, May 28]

Concerns mount about risks building up at clearinghouses

Paul Tucker of the Bank of England, Federal Reserve Chairman Ben Bernanke and other regulators have been warning that clearinghouses could wreak havoc on the financial system if they fail. Risks related to clearinghouses are building because officials from the Group of 20 nations have deemed them a solution to issues in the over-the-counter derivatives market. [The Economist, April 7]

"Too big to fail" banks are bigger than before crisis

President Barack Obama said two years ago that he would deal with risks presented by banks deemed "too big to fail," but such companies are even bigger than before the credit crunch. Five years ago, assets at the five biggest banks equaled 43% of economic output; the percentage reached 56% at the end of last year. [Bloomberg, April 16]

Issuance of bank bonds worldwide reaches 7-year low

Global banks have issued $523 billion in bonds this year, the lowest level in seven years and a reflection of the eurozone crisis and tougher regulation, Dealogic said. [Financial Times- London, May 13]

Europe's leveraged-loan defaults could hit 25%, Moody's warns

As Europe's economy continues to go downhill, 25% of leveraged-buyout firms with debt maturing by the end of 2015 might default on their obligations, Moody's Investors Service said in a report. "The 2014-2015 refinancing risk remains large and worrisome given our expectations of protracted macroeconomic weakness, combined with the weak average credit quality of this universe," according to the report. [Bloomberg, May 29]

EU seeks to give regulators "bail-in" power over banks

The EU is working toward authorizing regulators to subject senior unsecured creditors at troubled banks to write-downs as a way to ensure taxpayers aren't on the hook for rescuing the lenders. Regulators' write-down authority would apply to senior unsecured debt and derivatives, while secured debt and deposits would be protected. The draft plan calls for regulators to have such "bail-in" power starting in 2018. [Bloomberg Businessweek, May 26]

China cuts reserve ratio; data signals slowdown

China's central bank lowered the level of reserves that banks must hold, a move to support growth after a spate of data revealed weakening economic momentum. The People's Bank of China it will cut the reserve-requirement ratio by 0.5 percentage points, effective from May 18, which will free up funds to be loaned out by the banking system. It is the third cut in the reserve ratio so far in the current cycle of monetary-policy loosening, with the previous two cuts in November and February. The ratio, or the level of deposits that banks must hold in reserve rather than lend out, will decline to 20% after the latest cut takes effect. “It is a signal to the public and the markets that they are aware of the situation and they will keep loosening policy, which is much needed," said Goldman Sachs economist Yu Song. China's National Bureau of Statistics said that industrial production rose 9.3% from a year earlier in April, down sharply from 11.9% in March, and substantially undercutting expectations for an acceleration to 12.2%. [Beijing-MarketWatch, 18 May]

China plans tougher rules for IPOs, securities market

The China Securities Regulatory Commission said it is working on regulations aimed at protecting investors from inflated share prices during initial public offerings. The regulator said deals will come under closer scrutiny when share price-to-earnings ratios are higher than those of comparable companies in the same industry. Guo Shuqing, in his short time as head of the China Securities Regulatory Commission, has released a wave of rules to tackle market manipulation, insider trading and other issues. However, retail investors remain skeptical of Guo and his ability to straighten out markets. [Xinhuanet.com (China) /Reuters, April 1]

India's downturn becomes a drag on global economic recovery

India's short-term growth is declining, inflation is rising, the rupee is falling and the deficit is mounting. As the nation's economic problems deepen, hope is fading that India, along with China and a few other growing non-Western economies, will inject life into the global economy. [The New York Times, May 29]

Asian currencies take a hit, with more declines likely

Currencies across Asia declined last week amid gathering storm clouds over the world economy. Leading the way were India's rupee and Malaysia's ringgit, as central banks forecast slower growth at home and abroad. "Slowdowns in Europe, China and the U.S. will clearly impact Asian exports, and the regional currencies will continue to see some selling pressure," said Kozo Hasegawa, a trader at Sumitomo Mitsui Banking. [Business Standard/Bloomberg, June 24]

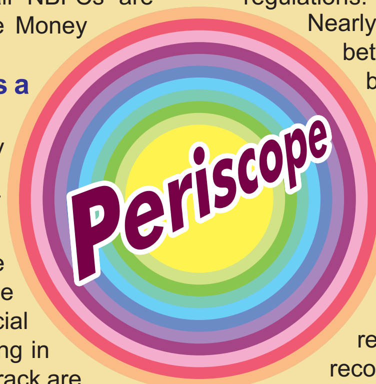
Strengthen recovery mechanism for NBFCs: Finmin panel

To strengthen the NBFC sector, a finance ministry-appointed committee has suggested that non- banking finance companies[NBFCs] should be allowed to recover bad loans in line with banks by bringing them under the Recovery of Debts Due to Banks Act. The advisory group under the chairmanship of Alok Nigam, Joint Secretary (Banking Operations), recommended that NBFCs should be allowed to recover their debt in line with banks. The committee has urged the Finance Ministry to consider bringing NBFCs under the purview of the Recovery of Debts Due to Banks (RDDB) Act.

"It would empower NBFCs in recovering their loans at par with banks and without significant delays. The existing procedure for recovery of debts by NBFCs, which takes a lot of time, has resulted in NBFCs treating a significant portion of their debts as unproductive loans," the report submitted by the group said.

The advisory group, which was constituted in September, 2011, suggested extending the provisions of wilful defaulters to NBFCs. In case of deliberate loan defaults, it said, credit information goes to credit information companies (like CIBIL), which in turn alert banks and financial institutions as to ensure that further bank finance is not made available to them.

The panel also favoured exclusion of non-banking finance companies (NBFCs) from states' Money Lenders Act. "The basis of this is to avoid the dual registration requirement and dual regulation of NBFCs, thereby making it essential that all NBFCs are excluded from the ambit of the respective state Money Lenders Act," it said. [PTI/Economic Times, April 8]



If interest rates stay at current levels, it's a bonus: Sundaram Finance MD

The macro economic environment looks very uncertain and far from encouraging, said Mr T.T. Srinivasaraghavan, Managing Director of Sundaram Finance Ltd. "It's very difficult and dangerous to forecast from what we know now," he said when he was asked to comment on the company's growth prospects for the current financial year. With global uncertainties increasingly playing in Indian markets, "most of the key parameters we track are not looking great". On the interest rate front, he said he would even stick his neck out and say the rates can move in only one direction — up. "If it stays at current levels, it's a bonus."[Business Line, May 28]

False TDS returns may attract penalty

Attempting to raise revenue, the government has targeted Tax Deducted at Source (TDS) and proposed penal provisions for inaccurate details and ensuring filing of corrective returns from July 1. "From July 1, government may impose penalty of Rs 10,000 and Rs 1,00,000 for inaccurate TDS returns and also for corrective filings after proposed amendments in the Finance Bill is cleared," Income tax joint commissioner (TDS) A K Dey said. Presently, there is no penal provisions for mistakes in both first and corrective TDS filings if wrong details had been provided. TDS returns are filed quarterly and incorrect PAN number, amount deducted and details are among the wrong inputs. Penal provisions have already been introduced for late filing of returns. [PTI /Economic Times May 3]

Untapped growth prospects lure PE firms to NBFCs

Despite the recent regulatory clampdown, NBFCs, are generating significant interest among private equity firms, which have invested about Rs 1,400 crore in the sector so far this year. PE firms are betting on the untapped growth prospects in the niche sector and expect 20-22% return on investment, while focusing on NBFCs with good governance model. "Private equity firms see it as a financing route. They can use the debt structure to reach to a wider group and portfolio companies. People are evaluating opportunities, as returns on investments are reasonable," says Naresh Makhijani, partner, KPMG.

There is so much interest among PE firms to invest in NBFCs that at times as many as 10 investors are found chasing one NBFC, says Mahesh Thakkar, director general, Finance Industry Development Council (FIDC), a representative body for NBFCs. The NBFC segment continues to be niche and lacks penetration, thus holding huge growth potential. Though there are some 12,000 NBFCs in the country, a majority of them are not active and also it is not easy to get a licence due to stringent regulatory guidelines. Thakkar of FIDC adds: "Once the final guidelines of the Usha Thorat Committee and Nair Committee are in place, this sector will see more interest."

"Given the increased complexities that corporates face today and the appetite from both global and Indian investors in debt market, there is a potential for high quality credit institutions - that are well-capitalised and lead with talent - to offer faster, more innovative solutions in the credit space," says Dhanpal Jhaveri, Partner and CEO, Everstone Capital. [Economic Times, June 5]

Regulation 'pushing up financial firms' costs'

Extraterritorial regulations, rules that affect businesses outside the country that enacts them, are pushing up costs and driving banks, insurers and asset managers away from particular markets, a survey of global financial firms has found. More than half the groups that participated in a survey that the Protiviti regulatory consultancy will unveil on Monday said they had decided not to enter – or had exited – specific countries because of concerns about their laws and regulations.

Nearly that many, or 45 per cent, said they are spending between a 10th and a quarter of their compliance budget dealing with laws outside their home bases, a significant increase that many respondents tied to the 2008 financial crisis. US laws such as the Dodd-Frank financial reform legislation and the Foreign Account Tax Compliance Act were cited by overseas groups as particularly intrusive and onerous.

Their survey of more than 40 institutions in 19 countries comes at a time when lawmakers and regulators around the world are pushing through a record number of reforms aimed at making the financial system safer. One recent study suggested financial services firms were being hit with 60 rule changes every working day. Many new rules, particularly in the US, UK and EU, deliberately reach out and affect business outside the enacting jurisdiction.

The survey also turned up intriguing differences in the way the industry is coping with the regulatory changes. About 70 per cent of UK-based firms are trying to influence rule makers overseas, while the proportion is reversed in the US, where only 30 per cent are looking abroad. [May 13, 2012]

Debt crisis: a $46 trillion problem comes sweeping in

We've already got the banking and the eurozone sovereign debt crises. Next comes the corporate funding crisis. Just as you thought things couldn't get any worse, credit markets are about to be hit by a veritable tsunami of maturing corporate debt. Standard & Poor's estimates that companies in Europe, the US and the major Asian economies require a combination of refinancing and new money to fund growth over the next four years of between $43 trillion and $46 trillion. The wall of maturing debt is unprecedented, raising the prospect of further, extreme difficulties in credit markets. With the eurozone debt crisis still at full throttle, the Chinese economy slowing fast and a still tepid US recovery, it's not clear that the banking system is in any position to deal with this incoming wave of demand. In the US, there is at least a highly developed corporate bond market to act as an alternative to bank funding. That's not the case in Europe. "Much will depend on the continued ability of banking system regulators to pilot a path through the minefield that lies ahead", S&P observes. [Telegraph-London, 28 May] ■

Key Advisory Group constituted by Ministry of Finance

RBI Notification on Working Group Report headed Mrs. Usha Thorat is expected by 1st week of July 2012. Key advisory Group constituted by the Ministry of Finance has considered the new road map drawn and recommendations made by said working group and submitted its report to the Finance Ministry. It is learnt that many of the suggestions made by the said Group were discussed and their adverse impact on the NBFC sector were elucidated by the Key Advisory Group. It is hoped that the RBI will have a meeting with the members of Key Advisory Group before finalising the guidelines and consider the recommendations made by the Key Advisory Group. FIDC endeavours to have such a joint meeting of the members of Key Advisory Group formed by MOF and RBI for discussion on the Working Group Report by Mrs. Usha Thorat.

Mr. Anand Sinha to be the chief guest at FIDC meets

RBI Dy Governor Mr. Anand Sinha has ageed to be the chief guest at FIDC AGM and Managing Committee Meeting, proposed to be held from 11 am to 02 pm on September 4, 2012 at Indian Merchants' Chamber,Mumbai. He will interact with the members on recent developments in the financial sector with particular referernce to the role and roadmap for NBFCs.

Representation on Fair Practice Code

The FIDC proposes to make a representation on Fair Practices Code issued by RBI recently. Among others, the issue of communication and documents, including the agreements to be given to borrowers in all vernacular languages is to be taken up.

Representation on ECB

FIDC submitted to the Union Finance Minister Pranab Mukerjee a post-budget memorandum on April 30 pleading for expanding External Commercial Borrowing window for NBFCs and IFCs.

Constitution of FIDC Core Group

Mr. Sanjay Chamria, Chairman of the Representation Committee made a detailed presentation on how FIDC should move forward in terms of representations, follow-ups with authorities, eliciting support of media, public, other chambers, end-users of funding, etc. The regulator has been very pro-active in last 18 months in issuing various guidelines for NBFCs, most of which are detrimental to the interest of the sector and has impacted its growth. FIDC proposes to form the Core Group comprising of its key members and meet more often, preferably on a monthly basis and work out the strategy to deal in all these matters.

The Core Group, for which a blue print is being prepared, will consider inter alia, issues like whether FIDC membership should be open only to AFCs or all other similarly placed categories of NBFCs in different types of asset finance including gold loans or whether FIDC should demand for the separate and exclusive regulator for NBFCs like NABARD. NHB etc. The Core Group blue print will cover modalities of its working and decide on its members, fund collection, dealing with regulators, media, public and other chambers, issues to be taken up, frequency of the meeting, membership expansion, statistics collection from the industry, its compilation and dissemination etc.

Don't consider rescheduled or restructured loans as sub-standard

Present norms of Reserve Bank specifies that where any asset, even if it is a standard asset, if it is rescheduled or restructured, it has to be classified as a Sub Standard Asset. In the current tight economic scenario many customers are demanding rescheduling and restructuring. Mr. Raman Aggarwal, immediate past co-chairman of FIDC suggested that RBI should give relief in this regard, may be as a temporary measure to overcome the prevailing tough economic conditions.

Exclude NBFC-AFCs from state money lending acts as provided in MFI bill

Mr Raman Aggarwal said that the Draft Bill on Regulation of MFIs is under the active consideration of the Government. As per this bill, all corporate MFIs shall have to register as NBFCs with RBI. Some of the provisions in this bill for MFIs, which cater to the long standing demands of the NBFC sector include RBI, the regulator to play a developer's role by prescribing credit rating norms for MFIs, creation of a new refinance window for MFIs and a clear provision stating that MFIs registered under this Act shall not be covered under any of the state Money Lending Acts. FIDC will represent to the Ministry of Finance and RBI to extend these benefits to NBFC – AFCs also.

Managing Committee meeting at Chennai

Meeting of the Members of the Managing Committee of FIDC was held on June 16, 2012 at Chennai. The committee members of FCA, FIHPA and SIHPA also joined the deliberations at the meeting. ■

Extent of India's Global Integration

A metric frequently used to measure the degree of a country's global integration is the ratio of external trade to GDP. That ratio has gone up over four times, from 8 per cent of GDP in 1972 to 37 per cent in 2011. Over this period, flow of money around the world has far outpaced the flow of goods. So, a more complete measure of a country's global integration is the two way flow of goods and finance in and out of a country. That ratio has moved up nearly eight times in these four decades, from 14 per cent in 1972 to 109 per cent in 2011. What this means is that India's trade integration has been deep; but its financial integration has been deeper.

Dr. D Subbarao, Governor, RBI

Views expressed herein are not necessarily the views of FIDC.

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Suggestions and feed-back

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