FIDC NEWS

Finance Industry Development Council

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

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Growing systemic importance of NBFCs

NBFC sector is getting into mainstream finance sector of the country gradually with apparent marked change in perception of not only the Regulatory Authorities but also the Governmental Authorities. It is based on sound and healthy performance of the entities of NBFC sector growing at a relatively rapid pace compared to its peers, especially the banking sector. This has led Reserve Bank of India to note in its Report published on 23rd Dec. 2015 on 'Trend and Progress of Banking in India' that "Operationally, the [NBFC] sector remained relatively stronger vis-à-vis the commercial banks in terms of capital adequacy and profitability. There has also been certain amount of consolidation in the NBFCs space, with some larger sized NBFCs having grown bigger and becoming well-connected with other financial entities."

Boston Consulting Group-Confederation of Industry [BCG-CII] in their white paper titled 'Enormous Potential in Non Bank Finance and Ways to Make it Happen' has rightly said: "Success of NBFCs is attributed to very sharp focus on product lines leading to better cost control, bad debt control, better customer service and consequently faster growth at higher profitability as compared to banks." NBFCs have gained share in the total credit in India. Between 2005 and 2015, NBFC share in credit rose from 10% to 13%. The share of NBFCs' assets as a proportion of Gross Domestic Product (GDP) at current market prices has increased steadily from 8.4% in 2006 to 12.5% in 2013.

But it does not mean that sky is reached. NBFC sector has vast potential to grow and expand its wings. That is why BCG-CII white paper rightly says:' NBFCs' credit penetration in GDP of India at 13% is well behind economies like Thailand and Malaysia at ~25% and China at ~33%. We expect the growth in NBFC credit to further accelerate over the next 5-10 years.'

From the NBFCs' perspective some of the key initiatives taken by Government of India and RBI have become the guiding factors for the future growth of the NBFC sector which could culminate into a growth trajectory envisioned in BCG-CII paper. These initiatives are: [1] Setting up of MUDRA Bank providing a refinance window for onward lending to MSMEs, [2] Measures taken for facilitation of 'ease of doing business' and [3] Shift from "Entity "Based Regulation to "Activity "Based Regulation. This last initiative needed to be actualised in practice to allow fair plays to NBFCs vis-à-vis other players of financial sector, by both the Regulator and the Union as well as State Governments.

A good beginning is made with the acceptance of one of the long standing demands of the NBFC sector while presenting the Union Budget for FY 2016-17. Finance Minister has included NBFCs in clause (c) of Section 36(1) (viia) Last year he has accepted FIDC demand to give coverage to NBFCs (with asset size of Rs.500 cr and above) under the SARFAESI Act. This I am sure will take place as soon as clearance of Parliamentary procedure is completed.

But still a lot is yet to be accomplished, especially, in respect of tax deduction at source [TDS], income recognition on NPAs, and dual taxation on lease/hire purchase. NBFCs have suffered for long from a distinct negative bias on tax treatment, in spite of undertaking similar activities like banks and other financial institutions.

It is well acknowledged that NBFCs have mastered the art of lending to the "unbanked" segment thereby furthering the Government's agenda on financial inclusion for the last seventy years now. NBFCs have also been the pioneers in asset backed retail lending. Authorities should ensure at least equal opportunities and treatment in fiscal and other matters to allow NBFCs' growth to help them serve the development of economy of the nation.

Raman Aggarwal, chairman, FIDC

REGULATORY PERIMETER

RBI NOTIFICATIONS & CIRCULARS :

Review of risk weights assigned to sovereign debt:RBI/2015-16/336; DNBR (PD) CC. No. 076/ 03.10.001/2015-16; March 10, 2016; [All NBFCs (excluding RNBCs)]

Frauds - Future approach towards monitoring of frauds in NBFCs: RBI/2015-16/327; DNBR (PD) CC.No.075/03.10.001/2015-16; : Feb 18, 2016. [All Deposit taking NBFCs (including RNBCs) and NBFCs- ND-SI]

NBFC – Factors (Reserve Bank) Directions, 2012 – Review: RBI/2015-16/326;DNBR.CC.PD.No.074/03.10.01/2015-16; Feb. 18, 2016. [All NBFCs – Factors]

Undertaking of Point of Presence (PoP) Services under Pension Fund Regulatory and Development Authority for National Pension System (NPS): RBI/2015-16/324; DNBR (PD) CC.No. 073/03.10.001/2015-16; Feb. 18, 2016. [All NBFCs]

Provision of Safe Deposit Locker facility by NBFCs: RBI/2015-16/302; DNBR(PD).CC.No. 072/03.10.001/2015-16; Jan. 28, 2016. [All NBFCs]

RBI revises risk weights for NBFCs' sovereign debt exposures

The Reserve Bank on March 10 asked non- systematically important deposit taking and non-deposit-taking NBFCs, including infra and micro-lenders, to set

AT A GLANCE

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aside 15% of their aggregate capital towards their holdings in Central and State Governments' debts as prudential measures. In a circular, the central bank said the new norms will be applicable to all deposit accepting non-systematically important NBFCs, systemically important non-deposit taking NBFCs, all NBFC-MFIs and all NBFC-infra finance companies.

They will "maintain a minimum capital ratio consisting of tier I and II capital not less than 15% of their aggregate risk-weighted assets on-balance sheet and of risk adjusted value of off-balance sheet items," the RBI said.

Under the new norms, these companies will attract zero risks to their exposures to Central Government debt, both fund based and non-fund based. The same will be the case for the Central Government-guaranteed claims, the regulator said. For exposures to State Governments debt, there will also be zero risk weight if their exposures are to direct loan /credit/overdraft exposure and investment from state government securities. But State Government-guaranteed claims, which have not remained in default, will attract 20% risk weight and if the loans guaranteed by the states have remained in default for over 90 days, the risk weight will be 100%.[DNA/PTI, 10 Mar]

Provision of Safe Deposit Locker facility by NBFCs

The Reserve Bank in response to NBFCs seeking approval for offering safe deposit locker facilities said that "providing safe deposit locker facility is a fee based service and shall not be reckoned as part of the financial business carried out by NBFCs." RBI directed that "NBFCs offering safe deposit locker facility or intending to offer it, shall disclose to their customers that the activity is not regulated by the Bank".[RBI website]

Reserve Bank ups threshold for reporting of fraud by NBFCs

RBI on Feb.17 increased the threshold for reporting of frauds and submission of quarterly progress reports on frauds, by NBFCs to the Central Fraud Monitoring Cell, from Rs. 25 lakh as on date to Rs.1 crore with immediate effect. As regards reporting and submission of quarterly progress reports below the revised threshold, NBFCs will have to furnish the same to the Regional Office of the RBI, DNBS, under whose jurisdiction the Registered Office of the NBFC falls. The RBI directive on frauds applies to all deposit-taking NBFCs (including RNBCs) and non-deposit taking NBFCs that are systemically important.

Lack of supervision: According to the RBI, a large number of frauds are committed by unscrupulous borrowers including companies, partnership firms/proprietary concerns, their directors or partners, through various methods that include fraudulent discounting of instruments, fraudulent removal of pledged stocks or disposal of hypothecated stocks (without the NBFC's knowledge), inflating the value of stocks in the stock statement, and drawing excess finance. Further, frauds are perpetrated through diversion of funds outside borrowing units, and lack of interest or criminal neglect on the part of the borrowers as well as their partners.

Frauds also take place due to managerial failure leading to the unit becoming sick, and lack of effective supervision by NBFC functionaries over operations in borrower accounts, thus leading to difficulty in recovery of the advance. [Business Line, Feb. 18]

RBI looking at ombudsman scheme for NBFCs too

Rising complaints against NBFCs regarding deficiency in services has prompted the RBI to examine the possibility of coming up with an NBFC-specific 'ombudsman scheme', akin to the one that has been operational for banks in the last two decades.

What is being envisaged under the scheme is that customers could lodge complaints against NBFCs for levying charges without adequate prior notice; non-observance of RBI directives on interest rates and engagement of recovery agents; and delays in sanction, disbursement or non-observance of prescribed time schedule for disposal of loan applications.

To begin with, the scheme could be made applicable to deposit-taking NBFCs, asset-finance companies, loan companies and microfinance institutions, say NBFC industry sources. [Business Line, Feb. 4]

Aadhaar not mandatory for Direct Benefit Transfers, clarifies RBI

Use of Aadhaar cards and seeding of bank accounts with those numbers are purely voluntary and not mandatory, RBI said in a clarification on the Direct Benefit Transfer (DBT) Scheme."... In view of the Supreme Court's interim orders dated August 11, 2015 and October 15, 2015... On usage of Aadhaar, it is hereby clarified that use of Aadhaar card and seeding of bank accounts with Aadhaar numbers is purely voluntary and it is not mandatory," RBI said in a communication to banks. [Business Standard, Jan. 14]

Comprehensive Master Directions on Know Your Customer (KYC)

RBI issued the Master Direction on Know Your Customer (KYC), Anti-Money Laundering (AML) and Combating of Financing of Terrorism (CFT). The Master Direction issued on Feb. 25 consolidates all relevant instructions issued by different departments of the Reserve Bank so far on the subject and will be applicable to all its regulated entities.[RBI press release, Feb 25]

RBI proposes changes in timeframe for share issuance

The Reserve Bank on Feb. 4 came up with draft norms on timelines for issuance of shares on receipt of FDI and reporting the same to the central bank in an attempt to align provisions of the Foreign Exchange Management Act with the Companies Act, 2013. As per draft norms, an investee company receiving FDI should issue shares within 60 days of receipt of foreign investment and file the report with the Reserve Bank. Timeline under FEMA is 180 days of the receipt of FDI. The report needs to be filed with the Reserve Bank within 30 days of the receipt of the FDI and within 30 days of the issuance of shares. [India Today/PTI, Feb. 4]

New customer registry to help banks check fraud

To minimise incidents of frauds, the Reserve Bank of India has operationalised a Central Fraud Registry (CFR) with effect from January 20. The registry will make available more information to banks at the time of starting a banking relationship, extending credit facilities or at any time during the operation of an account.

The CFR is a centralised searchable database which can be accessed by banks. The launch of the registry comes in the backdrop of the RBI expressing serious concern over the rising trend in loan-related frauds. According to the RBI, early detection of fraud and corrective action are important to reduce the quantum of loss. [Business Line, Jan 21]

RBI lends policy support to start-ups

To give the start-up community in India a boost, the Reserve Bank of India on January 2 announced regulatory relaxations supplementing the efforts of the government. On January 16, 2015 Prime Minister Narendra Modi had announced the 19-point action plan to boost the start-up industry. RBI Governor announced measures that would facilitate fund-raising and make the environment conducive for start-ups.

RBI's initiatives are expected to help start-ups to raise funds from foreign venture capitalists irrespective of the sector they are operating in. Under the Start-up India action plan, the government will exempt entrepreneurs and VCs from capital gains taxes on sales of company's assets. [Financial Express, Feb.3]

RBI proposes new NBFCs to act as account aggregator across

To enable individuals to get a consolidated view of their financial asset holdings, including bank deposits, mutual funds, insurance policies, and equity shares, the Reserve Bank of India on Thursday unveiled a draft regulatory framework to allow a new kind of non-banking financial company (NBFC), which could act as an account aggregator. The RBI said: "At present, persons holding financial assets do not get a consolidated view of their financial asset holdings, especially when the entities fall under the purview of different financial sector regulators.

"Account Aggregators (AAs) would fill this gap by collecting and providing the information of customers' financial assets in a consolidated, organised and retrievable manner to the customer or any other person as per the instructions of the customer." Investors will be able to make use of the service of an account aggregator purely at their option. Account aggregation services will be provided under specific application by the customer for getting such services and would be backed by appropriate agreements/authorisations. [Business Line, Mar 3]

Performance of Non-banking financial companies (NBFCs)

Based on their liability structure, the NBFCs are classified into two broad categories : (a) Deposit taking NBFCs, and (b) Non-deposit taking NBFCs.

As on March 31, 2015, there were 11,842 NBFCs registered with the Reserve Bank; out of which 220 were deposit-taking (NBFCs-D) and 11,622 were non-deposit taking (NBFCs-ND) entities. The two existing residual Non-Banking Finance Companies (RNBCs) are in the process of winding up their businesses.

The role of NBFC sector in the Indian financial system has become critical in terms of its size, spread and niche areas of operations. Many of the larger NBFCs have grown bigger and become more connected with other financial entities, necessitating periodical review of the regulatory framework for this sector. During the year, the Reserve Bank, with a view to addressing the regulatory gaps, arbitrage and risks associated with NBFCs, initiated a host of measures to strengthen regulation and supervision of NBFCs and harmonise their regulations with those of the banks in a phased manner as also to foster financial stability.

"Profitability of the NBFCs-ND-SI improved significantly as at end-March 2015. Net profit as a ratio to total income remained in double-digits and higher than last year's level."

"During 2014-15, the balance sheet of NBFCs-ND-SI expanded significantly on the back of marked growth in disbursement of loans and advances."

"Loans and advances extended by NBFCs-NDSI posted significant growth at 15.5 per cent during 2014-15, in contrast to the slowdown in commercial bank's non-food credit during the same period."

"Operationally, the sector remained relatively stronger vis-à-vis the commercial banks in terms of capital adequacy and profitability"

Table-1 : Consolidated balance sheet of NBFCs-D (as on March 31)

(Rs. billion)

Items	2014	2015 P	Percentage Variation
1. Share Capital	33	32	-0.7
2. Reserves and Surplus	274	276	0.9
3. Public Deposits	260	275	5.8
4. Debentures	417	408	-2.1
5. Bank Borrowings	520	551	5.8
6. Borrowings from FIs	16	16	2.6
7. Inter-Corporate Borrowings	1	2	32.7
8. Commercial Paper	93	78	-16.6
9. Borrowings from Government	38	38	-1.0
10. Subordinated Debts	79	78	-2.2
11. Other Borrowings	153	170	11.1
Total Liabilities/Assets	1885	1925	2.1
1. Loans and Advances	1585	1601	1.0
2. Hire Purchase and Lease Assets	46	39	-14.8
3. Investment	58	77	32.8
4. Other Assets	195	205	5.1

P : Provisional
Note : Absolute figures rounded-off.
Percentage variation is based on precise numbers.
Source : Quarterly returns of NBFCs-D.

Deposit-taking NBFCs (NBFCs-D)

The Reserve Bank, as part of deliberate policy, has been discouraging the NBFCs from engaging in deposit mobilisation activities, with a view to protecting depositors' interests as also fostering financial stability. The regulations for the NBFCs-D have been strengthened so that only the sound and well-functioning entities remain in business.

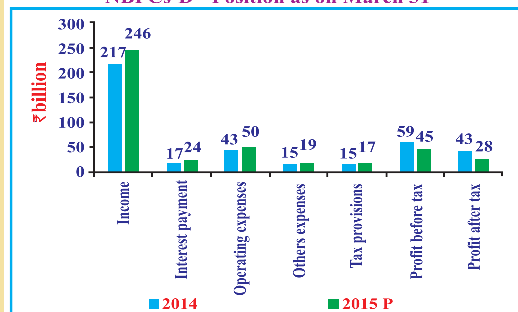
Financial performance

Balance sheet of deposit-taking NBFCs

The balance sheet of NBFCs-D expanded by 2.1 per cent during the year (Table-1). Loans and advances, which constituted close to three-fourth of their assets, rose marginally whereas investment activities of NBFCs-D witnessed a sharp rise during the year. On the liability side, the expansion was mainly in terms of public deposits, and bank borrowings. Borrowings from banks still constituted the largest source of funding for NBFCs-D. Mobilisation of funds through debentures, which constituted the second biggest source of funding, declined during the year. Borrowing through commercial papers also declined sharply during the year.

Financial indicators

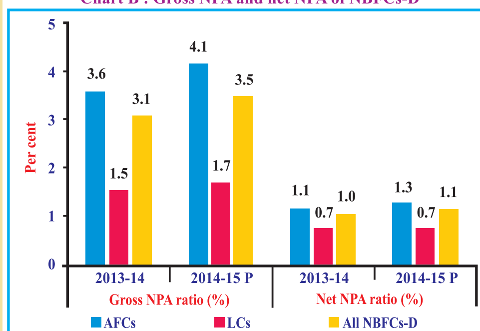
As compared to the previous year, growth in profitability declined during 2014-15 which inter alia may be attributed to increased interest payment burden and higher operating expenses (Chart- A).



Source : RBI supervisory returns.

Asset quality of NBFCs-D

Asset quality of NBFCs-D deteriorated as both gross and net NPAs increased during 2014-15 (Chart-B). Category-wise, deterioration in asset quality was more in respect of the Asset Finance Companies (AFCs) as compared to the Loan Companies (LCs).



Source : RBI supervisory returns.

Non-deposit taking systemically important NBFCs (NBFCs-ND-SI)

Financial performance

Non-deposit taking NBFCs with an asset size of Rs.1 billion or more were being classified as systemically important NBFCs (NBFCs-ND-SI) till November 2014. Since then, an upward revision in the asset size criterion for classifying NBFCs-ND-SI has been effected, which now stands at Rs.5 billion. During 2014-15, the balance sheet of NBFCs-ND-SI expanded significantly on the back of marked growth in disbursement of loans and advances on the asset side and sharp rise in borrowings on the liability side (Table-2).

Loans and advances extended by NBFCs-NDSI posted significant growth at 15.5 per cent during 2014-15, in contrast to the slowdown in commercial bank's non-food credit during the same period (Chart-C). Strong growth in credit extended by the NBFC - Infrastructure finance companies (IFCs), microfinance companies and loan companies contributed to sturdy growth in the loan portfolio of

Table-2 : Consolidated balance sheet of NBFCs-ND-SI-position as on March 31

(Rs. billion)

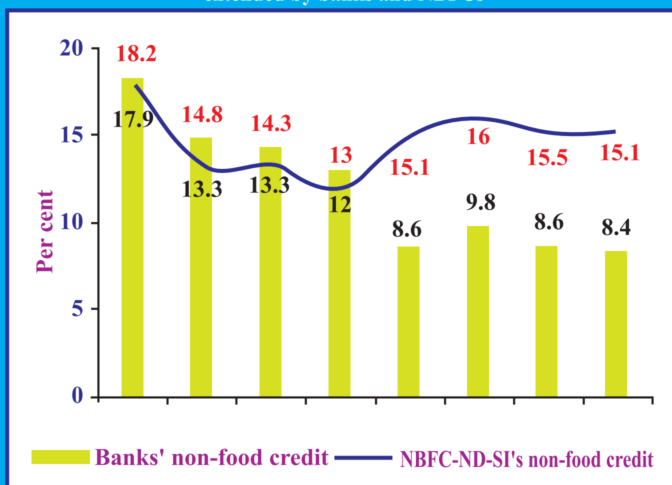
Items	2014	2015 P	Variation (Percent)
1	2	3	4
1. Share Capital	638	685	7.4
2. Reserves and Surplus	2311	2613	13.1
3. Total Borrowings	8669	10177	17.4
4. Current Liabilities and Provisions	608	691	13.6
Total Liabilities/Total Assets	12226	14166	15.9
1. Loans and Advances	8273	9555	15.5
2. Hire Purchase Assets	895	985	10.1
3. Investments	1888	2267	20.1
4. Other Assets	1170	1359	16.2

P : Provisional
Note : Data presented here pertain to 418 entities, which have consistently reported data for end March 2014 and 2015 respectively and accounted for more than 95 per cent of the total assets of the NBFCs-ND-SI sector.
Source : Monthly returns of NBFCs-ND-SI (Rs. 1 billion and above).

NBFCs-ND-SI. Among the sectors, infrastructure, medium and large-scale industries, and the transport sectors contributed to strong growth in credit off-take of the NBFCs-ND-SI.

During 2014-15, NBFCs-ND-SI raised funds mainly through debentures and commercial papers. Borrowings from banks, which earlier constituted the main source of funding, has been progressively reduced. A notable feature is the rising exposure of mutual funds to the financial instruments floated mainly by the NBFC-IFCs, LCs and NBFC-Micro Finance Institutions (NBFC-MFIs).

Chart C : Comparative growth (y-o-y) in credit extended by banks and NBFCs



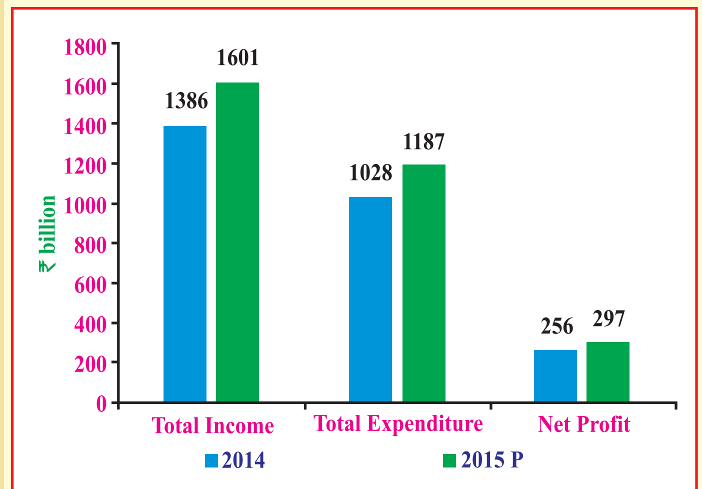
Note : Data pertains to NBFCs-Si with asset size of 1 billion and MFIs.
Source : RBI

Financial indicators

Profitability of the NBFCs-ND-SI improved significantly [to Rs. 297 b from Rs.256 b] as at end-March 2015 [Chart-D]. Net profit as a ratio to total income remained in double-digits and higher than last year's level.

Nevertheless, asset quality of systemically important NBFCs continued to deteriorate and the NPA ratio rose marginally compared to the previous year (Chart-E). Amongst the NBFCs-ND-SI, LCs accounted for the major chunk of NPAs followed by NBFC-IFCs and AFCs as at end-March 2015. The asset quality of the NBFC-MFIs witnessed some improvement albeit it still remained at an elevated level.

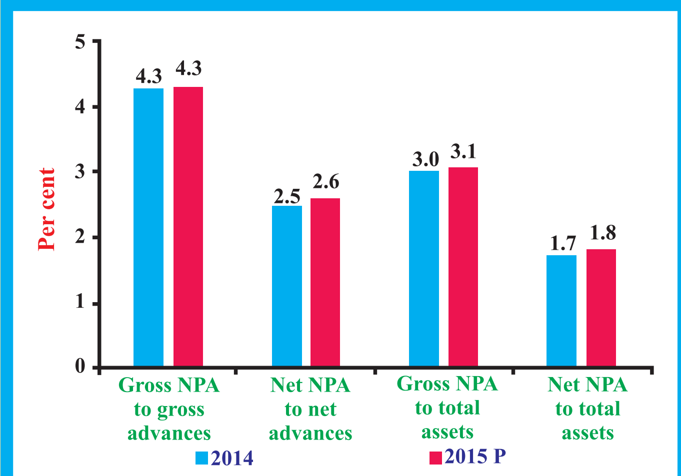
Chart D : Financial performance of NBFCs-ND-SI-position as on March 31



P : Provisional.
Source : RBI supervisory returns.

NPAs of the NBFCs-ND-SI sector were primarily concentrated in infrastructure sector, transport operator segment, and medium and large scale industries. However, the systemically important NBFCs remained well-capitalised. The capital adequacy ratio of these entities remained far above the mandated level of 15 per cent .

Chart E : NPA ratios of NBFCs-ND-SI - position as on March31



P : Provisional.
Source : RBI supervisory returns.

Overall assessment

The dynamics of the NBFCs sector is reflective of its evolving role in niche areas of specialised services. Operationally, the sector remained relatively stronger vis-à-vis the commercial banks in terms of capital adequacy and profitability. There has also been certain amount of consolidation in the NBFCs space, with some larger-sized NBFCs having grown bigger and becoming well-connected with other financial entities, which has financial stability implications. In order to address the issue of recovery of bad loans, bigger NBFCs, with an asset size of Rs. 5 billion and above, have been proposed to be brought under the SARFAESI Act, 2002…. **[Extract from the RBI Report on Trend and progress of Banking in India, 23 Dec. 2015]**

Enormous Potential in Non Bank Finance and Ways to Make it Happen

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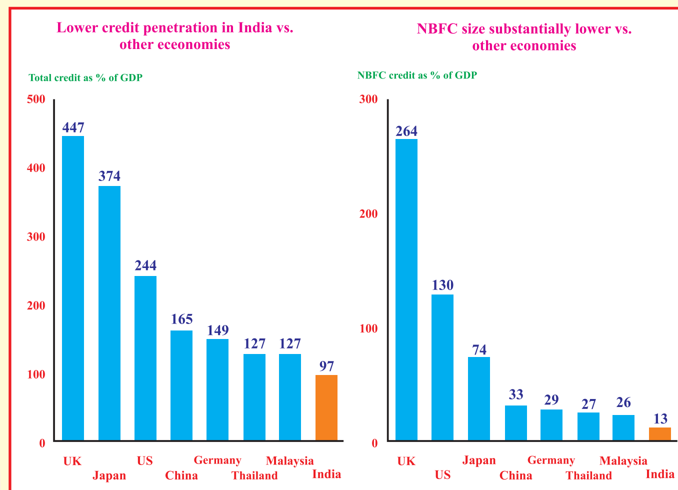
"Success of NBFCs is attributed to very sharp focus on product lines leading to better cost control, bad debt control, better customer service and consequently faster growth at higher profitability as compared to banks."

"NBFCs have to embrace digital to dramatically enhance internal productivity (sales, operations and pricing) and to reimagine the end to end customer experience."

"Despite the perception of higher cost of funds disadvantage, on an average, NBFCs have outperformed banks on "Return on Equity (ROE)" by 1.5-2.0%... NBFCs' business models have had unique strengths and thus are able to deliver such performance consistently."

OVER VIEW: Non Bank Finance Companies (NBFCs) are here to stay. Between 2005 and 2015, their share of credit in India went up from 10% to 13%. The share growth is not only observed in traditional NBFC domains like commercial vehicle (CV) finance but also in products like mortgages where commercial banks are very active. Success of NBFCs is attributed to very sharp focus on product lines leading to better cost control, bad debt control, better customer service and consequently faster growth at higher profitability as compared to banks. NBFCs' credit penetration in GDP of India at 13% is well behind economies like Thailand and Malaysia at ~25% and China at ~33%. [See Chart alongside]. We expect the growth in NBFC credit to further accelerate over the next 5-10 years.



Source : EIU, International Financial Statistics Database, RBI, Global Shadow Banking Monitoring Report 2015, BCG analysis.

The promise of accelerated growth is predicated on NBFC sector transforming itself to serve the latent credit needs of emerging India. Both consumption as well as commercial credit demand are characterized by lack of income proof documents owing to large scale self employment in the country. Lack of documents can now be compensated by huge amount of surrogate data available in digital ecosystems. NBFCs have to find a way to use the digital surrogate data to make better credit decisions. Indian consumers and businesses are adopting digital at a rapid pace. NBFCs have to embrace digital to dramatically enhance internal productivity (sales, operations and pricing) and to reimagine the end to end customer experience.

The winners in next decade – NBFC 2.0 – will augment the strengths of NBFC 1.0 in four key areas. Firstly, high touch model for credit and collections will be augmented with surrogate digital data based analytical techniques. NBFC 1.0 relied mostly on a standalone business model with few partnerships. NBFC 2.0 will heavily rely on partnerships to gain access to data and to create unique customer experiences. NBFC 1.0 won on the basis of sharp product-customer focus. NBFC 2.0 will be diversified in different product segments and gain synergies based on data analytics on customer data. And finally, NBFC 1.0 had a heavy physical model with predominantly cash transactions. NBFC 2.0 will be a bionic model that will synergize human touch with digital interface and process.

The recent introduction of payment banks, small finance banks, and proposed bill payment service providers will deconstruct the banking value chain in India. This opens up very strategic opportunities for NBFCs to partner with asset management companies, and payment banks to create complete financial offering for customers including savings, investments, transactions and borrowings. This "best of breed" banking model could be better than the bundled offer of traditional banks. NBFCs will need to take the initiative to put the coalitions together.

RBI's policy stance has been pro-innovation and pro-competition. It should support the NBFC sector to fill the gaps left by banks in serving demand.

1. NBFCs should get full parity with banks in tax treatment of loan loss provisions
2. NBFC lending should come in the ambit of SARFAESI along with HFC and banks
3. NBFC sector should get support from the RBI in the form of lending of last resort
4. Expedite legislative changes to permit use of utility bill payments data to be part of information bureaus
5. Expedite digitization of title search, hypothecation, mortgage creation to permit NBFCs to offer end to end digital experience to consumers
6. Release regulatory guidelines to encourage innovative new FinTech start up in areas like peer to peer lending market places
7. Consider a regulatory architecture that can permit large ticket deposits with NBFC sector directly from HNI customers. Such large ticket deposits could be instruments for wealth management with higher yield and higher risk as compared to bank deposits

NBFCs ARE HERE TO STAY- THE COMPELLING CASE FOR GROWTH ACCELERATION

NBFCs steadily gaining share of credit

NBFCs have gained share in the total credit in India. Between 2005 and 2015, NBFC share in credit rose from 10% to 13%.

If we consider narrow product segments, the gain in market share is even more pronounced. In home loans, HFCs' share has gone up from 26% to 38% between FY09 and FY15. In the last 3 years, NBFCs' share in CV financing has gone up from 42% to 46%.

In smaller ticket segments like micro finance, consumer durables, two wheeler etc, NBFCs dominate. Clearly when it comes to credit with wide reach, NBFCs are winning.

NBFC share of overall credit steadily growing, especially in segments like home loans and CV financing.

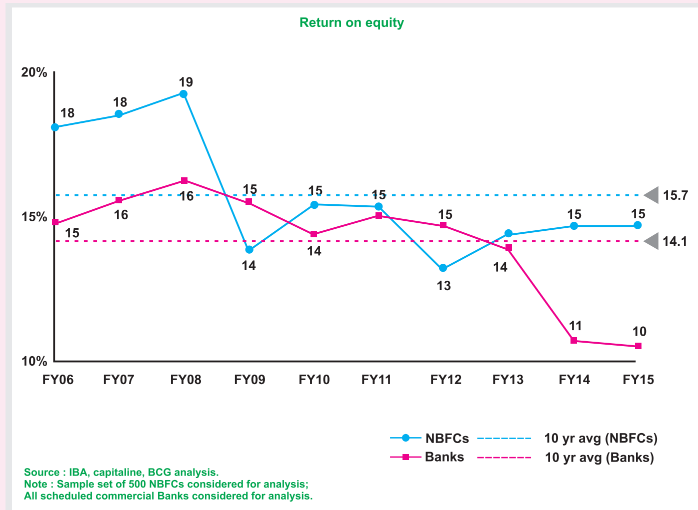
NBFCs likely to maintain high growth momentum

Developments and trends augur well in medium term

Large number of government initiatives such as smart cities, improvement in the ease of doing business in India and renewed focus on infrastructure development will create demand for credit. Similarly, Digital India and ecommerce growth will give impetus to SME sector and demand for credit. Consumer consumption is also going to see significant rise. NBFCs are likely to benefit from underlying trends and developments in the Indian market.

NBFC industry has maintained higher profitability

Despite the perception of higher cost of funds disadvantage, on an



Source : IBA, capitaline, BCG analysis.
Note : Sample set of 500 NBFCs considered for analysis;
All scheduled commercial Banks considered for analysis.

average, NBFCs have outperformed banks on "Return on Equity (ROE)" by 1.5-2.0%. In the last ten years, only for two years has the average ROE of NBFCs dipped below the average ROE of banks. Higher profitability with higher growth is clearly a massive value creation story. [See Chart above]

NBFCs' business models have had unique strengths and thus are able to deliver such performance consistently.

Need to embrace new levers of competitive advantage

Winning NBFCs have mostly sought advantage in a high touch credit and collection model. The NBFCs have mostly been standalone companies with sharp focus on one customer product segment and most of the dealings have been physical (in cash).

The technological and digital consumer trends require NBFCs to adjust to the new opportunities. Credit has to be data enabled, given the huge surrogate data captured in the digital age. NBFCs should forge partnerships to create differentiated customer experience. Data analytics can create synergies between different product economics. And cash has to give way to an electronic fund flow.

Growth in middle class and next billion segments will spur demand for consumption and commercial finance

The largest household group by income category by 2020 will be the next billion group with annual income in range of Rs 1.5 – 5 lakh per annum.

This segment along with middle class will drive demand for consumption and productive credit.

NBFCs which focus on these segments will benefit from the huge market developing over the next 5 years.

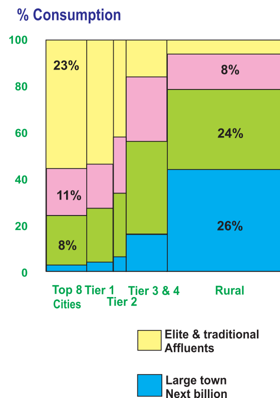
Significant increase expected in consumption in hinterland

The accompanying graphs show how geographic profile of consumption expenditure will evolve till 2020.

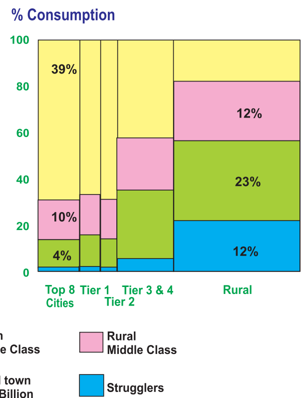
The concentration of business in the top few cities will give way to a vastly dispersed pattern with significant consumption in smaller towns and rural areas.

Many NBFCs are focused on smaller towns as their home markets. Such NBFCs with distribution presence and understanding of hinterlands, will find significant tailwinds as the income profile shifts.

2010 consumption breakdown by category



2020 consumption breakdown by category



Elite & traditional Affluents | Urban Middle Class | Rural Middle Class | Large town Next billion | Small town Next Billion | Strugglers

Sources : Euromonitor, National sample survey office; BCG proprietary research of 6,300 consumers : BCG analysis.
Note : Population of Top 8 cities exceeds 4 million. Population range of tier 1 cities is 1 million to 4 million; of tier 2 cities is 500,000 to 1 million; of tier 3 and 4 cities is 10,000 to 500,000, of rural area is less than 10,000.

INNOVATION AND FOCUS: NEEDS A DIGITAL MAKEOVER

NBFCs follow different business models than banks

NBFCs operate at higher yields given that they operate in underserved markets. Despite the cost of funds disadvantage, they operate at higher NIM. Their operating costs as well as bad debt expenditure is lower as compared to banks leading to much higher ROA. Even though they are at a lower leverage as compared to banks, NBFCs deliver higher ROE.

This has been possible due to very focused business model designed around a product – customer segment. This focus has enabled the NBFCs to operate with better response times and service levels, leading to faster growth as compared to banks.

NBFCs have disproportionate share in niche segments

Over the years, a number of product segments have been monopolized by the NBFCs.

The story of Shriram Finance creating a whole new market in used truck finance is legendary. Consumer durables are largely in the NBFC domain. Even relatively safe products like mortgage are well covered by the NBFCs. This is due to the massive self employed customer base which does not have adequate income proof. New car finance in small towns is also served by the NBFCs.

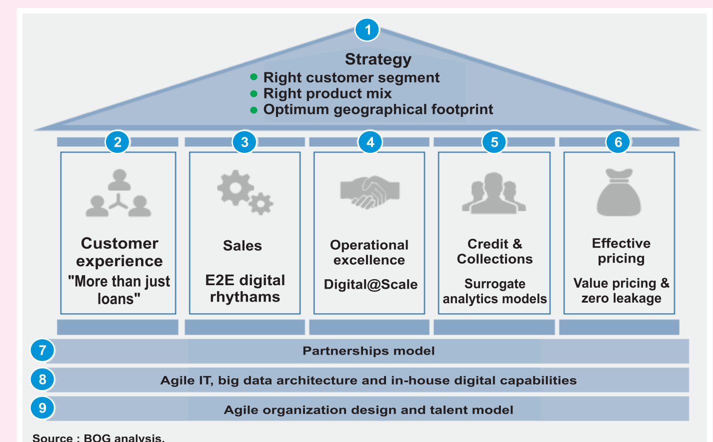
WINNERS OF THE FUTURE WILL BE BIONIC ENTITIES

Current landscape: Wide dispersion in performance

Even as the sector as a whole shows better performance as compared to banks, there is a wide dispersion in the performance of NBFCs.

Clearly not all the fine tuning of economics is right.

NBFC-2.0: Nine elements in the winning NBFC of the future



Source : BOG analysis.

Traditional sources of advantage for NBFCs will erode over time with deepening of banking in the country. It is imperative that NBFCs harness latest trends in technology, digital adoption by customers, and the web of partnerships to innovate and come up with new models.

Three enablers – (1) Partnership model, (2) Agile IT & data platform and (3) Agile organization structure are needed to support any strategy in the digital world. NBFCs must strive for excellence in five pillars – customer experience, digital sales, digital operations, advanced credit and collections, and pricing system. These are detailed in following para.

Right product mix selection is extremely important for NBFCs

For growth avenues, NBFCs of the future might look to diversify like multi product conglomerates. However, as a general trend, diversification leads to a reduction in ROE, unless the product strategy and synergies are carefully planned and managed.

As the NBFCs chart their strategy and product portfolio, a few key questions need to be answered regarding the choice of products /business lines

- What is the synergy between business lines and how it will be harnessed?
- How to stay lean and maintain a low risk profile like a monoline?
- How to prevent centre from becoming an excess overhead?

Financial institutions have started re-imagining processes to dramatically improve customer experience and offer "more than just loans"

Advent of digital is permitting the entire customer experience to be reimagined. Financial institutions are creating end to end customer journeys through appropriate partnerships that do not just offer a loan but the entire experience of search, choice, and ownership. It is expected that this trend will accentuate further as more and more finance moves to digital platforms.

The home loan journey is being redesigned by some players from imagining a dream house, looking for available choices, legal and technical due diligence, buying, taking a mortgage, to completion of interiors

Digitally enabled rhythms to enhance productivity

20%+ productivity enhancement potential

Deployment of digital tools and analytics can enhance sales force productivity by as much as 25%. Digital device in the hands of sales staff allows alerts for action to be pushed to them in time, provide product information at their finger tips, and help on the spot sales closure.

Increasingly, a number of leads would come on digital channels and they have to be qualified quickly. An advanced call centre is critical. Digital channels have to be designed in a manner that they engage the customers and generate leads. Many financial institutions are aiming to generate up to 20% of all new business, purely online.

End to end digitization of processes can improve service, reduce costs, and reduce operations risks. NBFCs have to adopt Digital@Scale

End to end processes needs to be reimagined and digitized. Digitization has to be undertaken with an aim to fundamentally improve customer experience with objectives like:

- Fulfillment at first touch point
- Paper truncation at first instance
- System driven checks for operations risks
- National centralization
- Proactive end to end visibility to customer
- Single face of company across multiple channels

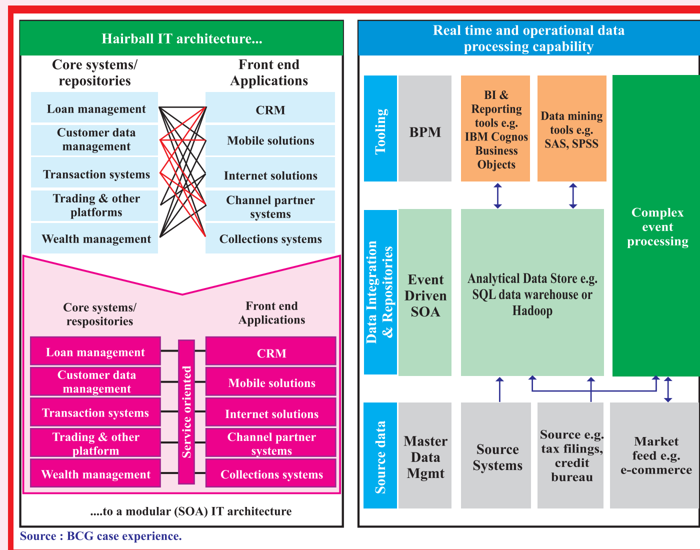
Credit analytics and monitoring leveraging electronic surrogate data

Rapidly evolving ecosystems is permitting generation and capture of surrogate data on borrowers

With increasing digitization of ecosystems, more and more data on borrowers is available electronically. This data is not financial information but non financial information that can be used to infer credit risk through smart use of analytics. Such analytics can be used for ongoing monitoring and planning of collections initiatives as well.

One major source of data is the rise in ecommerce market place platforms where over a million SME are expected sign up to sell goods ad services over next 5 years. These platforms capture massive electronic data on the sellers that can be used to create straight through lending systems.

Digital ready agile IT architecture is a basic necessity. NBFC need data architecture and analytics capabilities to capture right customer data and generate relevant insights



Source : BCG case experience.

None of the ideas in the report are implementable without a robust and agile IT architecture that is digital ready.

Many banks struggle with legacy IT systems that prevent advanced digital propositions from being rollout out rapidly. NBFCs need to put in place a modern and agile IT architecture.

Customer data has to be captured and stored in a manner that can lend itself to analytics. The IT architecture has to be suitable for capture of massive unstructured customer data beyond the regular financial and accounting information.

Partnership can completely revolutionize the banking experience in India. NBFC can orchestrate a partnership for "best of breed" solution including non banking elements

Presently, banks offer a bundled set services to their customers including savings & investments, payments, and borrowing all in one. Introduction of specialized players like payment banks, prepaid service providers, bill payment service providers, etc will deconstruct the value chain of banking.

It is possible for NBFCs to put together partnerships with specialist players addressing each of these needs in a "best of breed" manner. These partnerships can include non financial service players in housing, education, shopping and health-care to create an entirely new customer experience.

NEED TO ENCOURAGE VIBRANT NBFC SECTOR IN THE COUNTRY

It is in major national interest to create a vibrant NBFC sector in the country. Need to create a positive regulatory architecture to encourage growth and innovation

Recognition that NBFCs will play a very critical role in extension of credit and deepening finance in India.

- Their role is going to increase over next decade due to unique nature of demand in India
- NBFC platform is uniquely suited to foster much needed innovation to break the compromises in self employed and MSME credit

Create a level playing field vs. banks

- Tax treatment
- Access to SARFAESI Act

[Continued on page-11]

New reporting norms for high value transactions from April 1

In order to check black money, the CBDT has notified norms under which cash receipts and high value transactions beyond a certain threshold will have to be reported to the Income Tax authorities with effect from April 1.

Under the new norms, cash receipts, purchase of shares, mutual funds, immovable property, term deposits, and sale of foreign currency will have to be reported to the tax authorities in a prescribed format, which is Form 61A.

The Finance Ministry notification said the registrar will have to report purchase and sale of all immovable property exceeding Rs. 30 lakh to the I-T authorities. It further specified that professionals will be required to inform the tax department of receipt of cash payments exceeding Rs. 2 lakh for sale of any goods or services.

It further said banking companies or financial institutions will also have to report to the authorities payments made by a person aggregating to Rs. 1 lakh or more in cash or Rs. 10 lakh or more by another mode against bills in respect of one or more credit cards in a financial year.

The notification has also laid down the reporting norms for cash payment of Rs. 10 lakh or more in a financial year for purchase of bank drafts or pre-paid instrument issued by RBI. Cash deposits or withdrawals aggregating to Rs. 50 lakh or more in a financial year in one or more current accounts of a person will have to be reported by the bank to the I-T authorities. A company will be required to report receipt of Rs. 10 lakh or more from a person in a financial year for acquiring bonds, debentures, shares or mutual funds. [Business Line/PTI, Jan 3]

CBDT notifies procedure for email communication between taxman,taxpayer

The CBDT has notified the format and procedure for the taxman and taxpayers to usher in an ambitious pilot project of using emails as the new mode of communication between the two sides, as part of the government's bid to reduce grievances of the tax-paying public. An official notification has been issued which spells out the procedure, formats and standards for ensuring "secured transmission" of emails between the Assessing Officer (AO) of the IT department and the assessee stating all communication between the two sides will be done through PDF file format and over bonafide email ids. [Business Standard/PTI, Feb. 4]

Government may permit 100% FDI in 25 more NBFC segments

The government is expected to propose 100% FDI in 25 more segments of NBFCs including commodity broking and infrastructure debt fund with a view to attract more foreign inflows. The proposal, according to sources, is based on the announcement for allowing FDI in more categories of Non-Banking Financial Company (NBFCs) activities, made by Finance Minister Arun Jaitley in his Budget speech. He had said that Foreign Direct Investment will be allowed beyond the 18 specified NBFC activities in the automatic route in other activities which are regulated by financial sector regulators. The other segments of NBFCs and NBFIs (non-banking financial institutions) include insurance intermediaries, pension management company, asset finance company and depository participants.

Currently, 100% FDI through automatic route is permitted in 18 NBFC activities including merchant banking, under writing, portfolio management services, financial consultancy and stock broking. Now it has been proposed to permit 100 FDI through automatic route in 25 more activities, sources said. [FPJ Bureau, Mar 22]

Making ATMs mini-branches

Automated teller machines (ATMs) might soon give customers instant personal credit, top-up loans and approve credit card applications. The move to make ATMs more than just a cash dispensing tool would help the lender. Arvind Kapil, senior executive vice-president, HDFC Bank, said making ATMs double up as branches will lead to cost efficiency. The cost of setting up a branch was typically 10 times more than the cost of setting up an ATM.

In the first phase of the exercise, which starts in February, the bank would offer loans under 10 seconds across its ATM network. Last year, the bank had launched a new product using its backend advance analytics that can disburse personal loans in under 10 seconds.

The second phase, which would begin in April, would have ATMs disbursing top-up loans, renewing gold loans and approving credit cards. These services would initially be offered to bank customers. The lender would use advanced analytics to determine a customer's worthiness.

However, Kapil said these ATMs would now also become an acquisition tool and would help in reaching out to potential customers. [Business Standard, Feb. 1]

CBDT eases rules for 'staying' tax demand

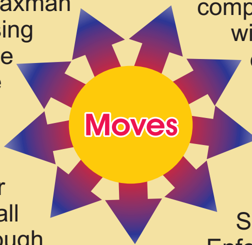
In some relief to taxpayers, the Central Board of Direct Taxes has revised guidelines for stay of demand at the stage of first appeal. Now, Assessing Officers can grant a stay of demand until the first appeal is disposed if the taxpayer pays 15 per cent of the disputed demand.

"It has been reported that field authorities often insist on a payment of a very high proportion of the disputed demand before granting stay of the balance demand. This often results in hardship for the taxpayers seeking stay of demand," said the CBDT in a recent missive to field offices. [Business Line, Mar 3]

BUDGET 2016:

Bankruptcy code coming for finance sector

"A systemic vacuum exists with regard to bankruptcy situations in financial firms. A comprehensive Code on Resolution of Financial Firms will be introduced as a bill in parliament during 2016-17," Jaitley said while presenting next financial year budget in parliament. "This Code will provide a specialised resolution mechanism to deal with bankruptcy situations in banks, insurance companies and financial sector entities. This Code, together with the Insolvency and Bankruptcy Code 2015, when enacted, will provide a comprehensive resolution mechanism for our economy," he added. [Business Standard, 1 Mar.]



Government eases norms for Asset Reconstruction Companies

Finance Minister Arun Jaitley has proposed to amend Securities and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 to allow sponsors to hold 100 per cent equity in the ARCs. Non-institutional investors will be allowed to invest 100 per cent in security receipts, making it easier for the ARCs to raise funds. At present, the sponsors' stake is capped at 49 per cent and the rest has to be held by an individual, restricting capital inflow.

Apart from this, in order to get more investment in ARCs, the government has proposed to allow complete pass-through of income-tax to securitisation trusts, including trusts of ARCs. As a result, this income will be taxed in the hands of the investors, which are mainly banks. However, the trusts will be liable to deduct tax at source. As of now, there has been confusion over who pays the tax on the interest income from recoveries. [Business Standard, 1 Mar.]

DDT exemption will pave way for REITs launch: Experts

Finance Minister Arun Jaitley's proposed removal of dividend distribution tax has received a thumbs-up from the real estate sector which has been looking for clarity to launch Real Estate Investment Trusts (REITs) for raising funds. "DDT is considered to be one of the biggest hurdles left in making REITs financially viable. The government has already taken various steps to ease path for REITs. With most of the hurdles getting removed, we may see introduction of REITs here soon," Colliers International India Senior Associate Director, Research, Surabhi Arora said. [PTI, 29 Feb.]

Sops for International Fin. Centre give GIFT a fillip.

Among the sops for international financial centres (IFCs), FM less than halved minimum alternate tax (MAT) to 9% from 18.5%, waived off security transaction tax (STT), commodity transaction tax (CTT), dividend distribution tax (DDT) and long term capital gain (LTCG). Recent announcement of IT/ITeS policy and waiver of stamp duty on share broking transactions in this Gujarat-based IFC, the Budget announcement relating to IFCs will further boost the development of India's first IFC. [TNN, 29 Feb]

Conflict of debt laws resolved

While dismissing the appeals of Madras Petrochemicals Ltd in a complex litigation involving three high courts and debt recovery tribunals, the Supreme Court has laid down five rules clarifying the interplay of laws on debt recovery. According to them, the Sick Industrial Companies Act (Sica) will continue to apply in the case of unsecured creditors seeking to recover their debts from a sick unit. This is because this Act overrides the provisions of the Recovery of Debts due to Banks & Financial Institutions Act. A secured creditor of a sick unit can invoke Securitisation Act (Sarfaesi) notwithstanding Sica. The court laid down guidelines when the secured creditors who have separate claims cannot agree on recovery from the sick unit.[Business Standard, Feb.7]

'Cheques are not ornamental'

The question whether cheques that bounced were issued in discharge of a debt/liability or it was only a security resurfaced in the Supreme Court in its judgment, Don Ayengia vs State of Assam. In this case, two parties agreed on building a multi-storied tower but later terminated the project. Don had given Rs 10 lakh to the other partner and he wanted it back. The partner issued a promissory note offering to pay the amount in a month. He also issued five cheques as 'security'. The payment was not made on time and the cheques were tendered to the bank, which rejected them due to 'insufficiency of funds'. Don prosecuted his partner and the trial court sentenced him to one year simple imprisonment and imposed compensation of Rs 12 lakh. On appeal, the district court changed the order to a fine of Rs 2,000 and payment of Rs 12 lakh. The Gauhati high court set aside all these orders maintaining that the payment was as security. Therefore, Don appealed to the Supreme Court. It allowed the appeal stating that the cheques were towards the debt. It said: "The cheques were not ornamental but meant to be presented if the amount was not paid within the extended period." [Business Standard, Feb.7]

Interest on excess I-T payment upheld

The Calcutta High Court last week ruled that the Income Tax Appellate Tribunal was justified in granting interest to Birla Corporation on refund arising due to excess payment on self-assessment. It also stated the relevant provision, Section 244A of the Income Tax Act, did not bar payment of interest on such refunds. The court thus dismissed the appeal of the Commissioner of Income Tax against the judgment of the tribunal. The revenue authorities argued the law did not provide for interest.

Rejecting their contentions, the high court stated when an assessee out of abundant caution pays tax after self-assessment, on which claim is accepted, resulting in refund, the assessee should be entitled to interest. The provision was inserted in the Act as a measure of rationalisation to ensure that the assessee is compensated by the government for monies legitimately belonging to the assessee and wrongfully retained by it. [Business Standard, Feb.7]

Tenants protected from creditors

In a judgment that grants relief to tenants, the Supreme Court has declared that the provisions of the Securitisation Act (Sarfaesi) cannot be used to override the provisions of the Rent Control Act.

In the case, Vishal Kalsaria vs Bank of India, the court further explained that while Sarfaesi is concerned with non-performing assets of banks and financial institutions, the Rent Control Act governs the relationship between a tenant and the landlord and specifies the rules of ejectment with respect to tenants.

The banks had proceeded to take possession of the properties of landlords, who had defaulted on payments for the loans taken by mortgaging the properties. The tenants were caught in between. "If the contentions of the banks are to be accepted," the judgment said, "it would render the entire scheme of all rent control Acts operating in the country as useless and nugatory. Tenants would be left wholly to the mercy of their landlords and in the fear that the landlord may use the tenanted premises as a security interest while taking a loan from a bank and subsequently default on it.[Business standard, Jan. 31]

Overloading no bar to claim damages

The Supreme Court has held that the mere fact of carrying more passengers than the permitted seating capacity in a goods vehicle by the insured person did not amount to a fundamental breach of the terms of the policy and the insurance company would still be liable to pay damages. In this case, Lakshmi Chand vs Reliance General Insurance, six passengers were travelling in a goods vehicle whereas only one along with the driver was allowed. It met with an accident caused by the rash driving of another vehicle. The owner of the first vehicle demanded money to repair the vehicle. The insurer denied it on the ground that the vehicle had violated the policy conditions. The Haryana and National Consumer Commissions accepted the view of the insurance company. Reversing their rulings, the Supreme Court stated that the burden to prove breach of condition was on the insurance company and in this case, it had not proved that the accident occurred due to overloading.[Business Standard, Jan. 17]

Panel suggests sweeping changes to Companies Act

A government-appointed panel on Feb. 1 suggested sweeping changes to the Companies Act, 2013, making it easier for companies to raise funds and reward senior management and ensuring that steps to enhance shareholder democracy don't cripple the functioning of firms and the businesses they run. The committee, chaired by the corporate affairs secretary, proposed easing regulations for shareholders' approval to the managerial remuneration and removal of the restriction on layers of subsidiaries and investment companies, moves that could address concerns raised by corporate groups after the 2013 overhaul of the Act.

Among the major recommendations of the panel are a change in the definition of associate company and subsidiary company to ensure that only "equity share capital" is the basis for deciding holding-subsidiary relationship, instead of "both equity and preference share capital". It also proposed simplification of the private placement process and doing away with separate offer letter and pitched for easing of the process of incorporation and reducing the number of filings to the Registrar of Companies (RoC).

It also wants companies being allowed to give loans to entities in which directors are interested after passing special resolution and adhering to disclosure requirement. The committee also wants rationalising penal provisions with reduced liability for procedural and technical defaults, while penal provisions for small companies has been sought to be reduced.

The panel has proposed changes in 78 sections of the Companies Act, 2013, which along with consequential changes, would result in about 100 amendments to the Act. Approximately 50 amendments to the Rules have also been proposed. The recommendations cover significant areas of the Act, including definitions, raising of capital, accounts and audit, corporate governance, managerial remuneration, companies incorporated outside India and offences/penalties. [FE Bureau, Feb 2]

Company judge or OL cannot exercise its power or interfere in sale of secured assets by secured creditors under 2002 Act.

In the instant case, i. e. Pegasus Assets Reconstruction Private Limited Vs. Haryana Concast Limited and another [29 Dec 2015], the question to be answered is "Whether Company Court, directly or through OL can exercise any control in respect of sale of secured asset by secured creditor in exercise of powers available to such creditor under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (2002 Act)".

The SC held that no order is required by Company Judge for association of OL in order to protect interest of workers and to realize their dues. Sufficient provisions have been made for this purpose under 2002 Act and Rules framed there under. Further, in capacity of borrower OL is not satisfied with decisions or steps taken by secured creditor or authorized officer, at appropriate stage it has sufficient opportunity to avail right of appeal u/s. 17 of 2002 Act before Tribunal. Further, there is right of further appeal u/s. 18 of 2002 Act before Tribunal. Hence, in view of specific provisions under 2002 Act, there is no reason as to take recourse to any provisions of 1956 Act and permit interference in proceedings under 2002 Act either by Company Judge or OL. Hence, view expressed by Punjab and Haryana HC is not justified and is set aside. Appeal disposed of. ■

SEBI bars wilful defaulters from fund-raising, board positions

In a multi-pronged clampdown on 'wilful loan defaulters', SEBI on March 12 barred them from raising public funds, as also from taking control of listed firms and holding board positions. Besides, such defaulters — including individuals and the companies as well as their promoters and directors — would be debarred from setting up or being associated with the market entities like mutual funds and brokerage firms. SEBI is also mulling making it mandatory for listed companies to disclose their bad loans if they breach certain thresholds set by the banking sector regulator RBI.

SEBI Chairman U K Sinha also announced measures to enhance surveillance actions in the marketplace and to check financial frauds, including by making it mandatory for listed firms to disclose impact of lapses flagged by the auditors. [India/PTI, Mar 12]

Budget 2016: SEBI, IRDA to get service tax exemption for regulatory services

Providing succor to two sectoral watchdogs, the Union Budget for 2016-17 unveiled that they will exempt "regulatory services" provided by SEBI and Insurance Regulatory and Development Authority of India (IRDA) from the service tax ambit with effect from April 1, 2016. Currently, the service tax for these services is 14%. There have been uncertainties on whether SEBI's regulatory services can be taxed, especially after the government moved to negative list for service tax few years back. [Business standard/PTI, Feb. 29]

NBFCs may lose taste for bonds

To safeguard the investor interest, capital markets regulator SEBI, earlier this month notified stricter norms for mutual funds, capping investment limit in bonds of a single company at 10 per cent

NBFCs, particularly housing finance companies (HFCs), may face slowdown in appetite for their bonds on revision of investment rules for debt backed mutual funds, India Ratings and Research (Ind-Ra) said on Feb. 24. To safeguard the investor interest, capital market regulator SEBI, earlier this month notified stricter norms for mutual funds, capping investment limit in bonds of a single company at 10 per cent. [Business Standard/PTI, Feb 24]

SEBI Act lacks clarity, says Supreme Court

The Supreme Court last week stated that the Securities and Exchange Board of India (SEBI) Act and its regulations referring to imposition of penalty for manipulative or fraudulent practices are "somewhat unclear if not a confused picture that emanates from parallel provisions." The procedural regulations including those that prescribe the procedural course, namely, SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations 2002 and the successor Regulation i.e. SEBI (Intermediaries) Regulations 2008 contain identical and parallel provisions with regard to imposition of penalty resulting in myriad provisions dealing with the same situation. A comprehensive legislation can bring about more clarity and certainty on the norms governing the security/capital market and, therefore, would best serve the interest of strengthening and securing the capital market. [Business Standard, Feb. 28]

SEBI seeks powers to conduct direct search

SEBI wants the power to conduct search and seizure operations without needing to first get a court warrant. It has begun informal discussion with the finance ministry to amend the law in this regard, said a person with knowledge of the matter. The markets regulator also wants a single special court in Mumbai for issue of warrants, instead of going to local courts of respective states or different jurisdictions. SEBI feels its operations in this regard are hampered by companies or individuals easily managing to get a stay on a search warrant issued by local courts. [Business Standard, Mar 17]

SEBI clears exit route for dissenting investors at listed cos

SEBI on January 11 approved a new set of norms to provide an exit route to the dissenting shareholders in case of a listed company diverting from its stated objective of raising funds from the public. The move is aimed at helping the shareholders make an exit if they feel dissatisfied with any change in business plan of the company concerned after raising funds through IPOs, FPOs or any other capital-raising exercise involving public investors.

Of the board meeting in which the proposal to change the objects is approved and those who cast their vote against the resolution would be eligible to avail the exit offer.The exit price would be based on the pricing parameters applicable in case of the exit offer given to the existing shareholders in terms of SEBI's takeover regulations. [Business standard/PTI, Jan 11]

SEBI clears new norms for issuance, listing of green bonds

To help companies raise funds through green bonds for investment in renewable energy space, regulator SEBI approved new norms for issuance and listing of such securities in the stock market. The move is aimed at helping meet the huge financing requirements worth $2.5 trillion for climate change actions in India by 2030. SEBI said the financing needs of renewable energy space in the country require new channels to be explored which can also help in reducing the cost of the capital. SEBI also said that an escrow account would not be mandatory for issuance of such bonds, but issuer will have to provide the details of the systems and procedures to be employed for tracking the proceeds of the issue, including the investments made and earmarked for eligible projects. The same would need to be verified by the external auditors. [Business standard/PTI, Jan 11]

SEBI eases delisting norms for small companies

To weed out a large number of illiquid stocks, markets regulator the SEBI has relaxed norms for small companies with thinly traded shares to delist from the stock exchanges. Now, small listed firms where trading has been less than 10% of the total shares in the last 12 months can get delisted from the stock exchanges. At present, SEBI norms allow only those companies whose shares have not been traded for the preceding one year to get delisted. There are more than 1,000 small companies where trading has been negligible for several years. However, the exit price for such delisting should not lower than the floor price determined through reverse book building process. [PTI/Live Mint, Jan. 14]

SEBI issues consultation paper for public issue of REITs

SEBI following the guidelines for public issue of Infrastructure Investment Trusts [InviTs] issued similar guidelines for the Real Estate Investment Trusts [REITs]. In the consultation paper SEBI has proposed that disclosures in the offer documents and draft papers be kept in the public domain for at least 21 days. The allocation in the public issue to qualified institutional buyers (QIBs) is proposed to be capped at 75 per cent. An investment manager can allocate up to 60 per cent of the portion available for allocation to QIBs to anchor investors.

"An anchor investor shall make an application of a value of at least Rs. 10 crore in the public issue… allocation to anchor investors shall be on a discretionary basis and subject to the minimum of 2 investors for allocation up to Rs. 250 crore and 5 such investors for allocation more than Rs. 250 crore," said SEBI in the consultation paper. The issue would need to be kept open for at least three working days but not more than 30 days. [BS Reporter, Jan 1]

SEBI nod to make e-book mandatory for private placement issues

SEBI on January 11 approved new norms to make electronic book mandatory for all private placement issues on debt basis, having a threshold of more than Rs 500 crore. The electronic book mechanism would be mandatory for private placement of bonds above Rs 500 crore. However, the mechanism would be voluntary for private placement issues where there is a single investor.

The issuer would provide the draft private placement memorandum to the bidders without incorporating coupon details. Such an electronic book may be created by entities to be named as Electronic Book Providers (EBPs) that would provide all bids/ application to the issuer after end of bidding. Further, EBP would disclose aggregate volume data on anonymous basis to avoid any speculation. Recognised stock exchanges would be eligible to act as EBP.

According to an estimate, issuances through private placement bonds have increased from Rs 1.73 lakh crore in 2008-09 to Rs. 4.04 lakh crore in 2014-15. In 2014-15, private placement accounted for 98 per cent of debt securities issuances that have been subsequently listed. [Business Standard/PTI, Jan 11]

NBFC retail credit to grow 18 per cent this fiscal: Study

The retail credit of NBFCs is expected to grow 16-18 per cent in the current fiscal on the back of rising demand in the new commercial vehicle segment and also given the general pick-up in business environment, says a report. The retail credit had witnessed a growth of 14.5 per cent in the previous financial year.

According to credit rating agency, ICRA, the tractor segment could witness a dampening of growth as lenders remain cautious in light of the weak rainfalls over the past three crop cycles.

While benign operating environment is positive for NBFCs asset quality, reversal is expected in FY17. Asset quality of NBFCs is expected to benefit from the stronger economic outlook, it said.

Ninety-plus day delinquencies have stabilised at around 5.4 per cent in first half of 2016, although these remain higher compared with 4.7 per cent in March 2014. Overall in FY16, with delinquency forward flows stabilising and economic prospects in general improving, ICRA expects delinquency indicators for retail focused NBFCs could see some reversal towards the latter part of the year.

ICRA expects the lifetime losses of retail-focused NBFCs to remain at manageable levels, considering the secured nature of most of the asset classes. Further, at a consolidated level, retail-focused NBFCs should have an adequate buffer to absorb losses, given their provisioning cover of around 49 per cent and un-provided NPAs-to-networth being low at 10-11 per cent.

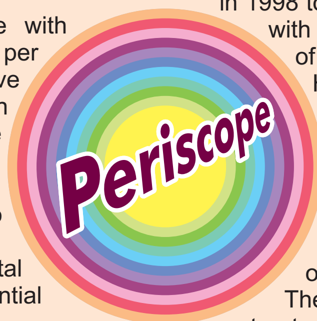
Furthermore, the Budget for FY16 had announced that NBFCs with an asset size in excess of Rs 5 billion would be permitted access to the provisions of the Sarfaesi Act, which once implemented would improve NBFC ability to make recoveries from immovable asset financing, such financing constitutes around 18 per cent of NBFC retail credit, largely in the mortgage segment, it said.

Reported gross NPAs, however, would increase with migration to tighter NPA recognition norm-gross NPA per cent of retail focused NBFCs, excluding captive financiers, have stabilised at 4.2 per cent in September 2015 compared with 4.1 per cent in June 2015.

This, however, is higher than 3.4 per cent in March 2015 largely on account of migration of NBFCs to tighter NPA recognition norms.

NBFC could witness some hardening incremental funding cost in H2-16 with tightening of prudential investment limits of mutual funds, the report said.

The profitability of NBFCs to remain under pressure with migration to more stringent NPA recognitions. However, capitalisation for NBFCs is expected to remain adequate notwithstanding expected pickup in credit growth and compression in internal accruals, the report said. [Economic Times/PTI, Jan 27]



Remove service tax for loans given to poor

Financial inclusion is a national priority for the government, whose commitment to inclusive growth is commendable. Economically weaker section (EWS) is below the tax bracket or not equipped to file a return. Then service tax on financial services extended to them becomes a poverty premium.

"We would request the FM to consider waiving the service tax on any fee payable on all micro loans (less than Rs.50,000) extended by NBFC-MFIs and on micro insurance (sum insured of less than Rs. 50,000) premium paid. A waiver of service tax on Rupay card will be helpful," said S Dilli Raj, president, SKS Microfinance Ltd. Moreover," A blanket waiver of stamp duty on all deeds of hypothecation and assignment deeds executed by NBFC-MFIs will reduce the transaction cost," he added.

The provision for bad and doubtful assets made by banks and FIs are allowed as a tax deduction. But not NBFC-MFIs who are also subjected to prudential norms like capital adequacy, provisioning, mark to market, ALM (asset liability management) and so on. Therefore, NBFC-MFIs should be allowed to treat provisioning made on credit assets as a tax deductible expenditure.

The amendment in Section 36 (1) (Vii a) of the Income-Tax Act should be cross referenced to all applicable sections including Sec 115 JB. [Business Line, Feb. 11]

RuPay cards gaining currency among the poor

More than half the 20.19 crore people who have opened basic bank accounts under the Prime Minister Jan Dhan Yojana have activated their RuPay cards and are using them regularly. About 90 million RuPay cards – envisaged as a home-grown debit card for the economically weaker sections – are being used in the interoperable system of ATM network facilitated by the National Financial Switch alone, "which is a significant indicator for transactions in these accounts," AP Hota, Managing Director and Chief Executive Officer, National Payments Corporation of India (NPCI), told Business Line. So far, 170 million cards have been issued to all eligible accountholders.

The number of RuPay transactions, too, has been increasing steadily. For example, from 20 lakh transactions a day about two-and-a-half months ago, the number has gone up to about 27 lakh, according to NPCI data. The average transaction value is about Rs.2,000. In the last three months, about three crore new accounts were added across the country. Government data show that as on January 13, the total balance in these accounts has crossed Rs. 30,000 crore. [Business Line, Jan. 21]

Spur growth, give some tax sops

The NBFCs are now in the thick of action with many opportunities and challenges. What tops their wishlist is a growth-oriented Budget which spurs business in areas served directly and indirectly by NBFCs.

The importance of NBFCs to the economy is significant. There are 11,769 NBFCs with an asset size of Rs. 16,10,729 crore at end September 2015. The share of NBFC assets as a percentage of scheduled commercial banks' assets has increased from 7 per cent in 1998 to 14.8 per cent in March 2015. There are 202 entities with assets of Rs. 500 crore or more, with a total asset size of Rs.14,126 billion, according to RBI data.

However, what these NBFCs want now is revival of growth which automatically boosts business for them. V Vaidyanathan, who founded Capital First with Rs. 800 crore equity support from Warburg Pincus, told BusinessLine that he has no specific Budget wishlist as he feels that if the economy grows, the businesses will also grow. "I am only hoping for a great growth-oriented Budget and bold reforms," he said.

The long-pending demand of ending 'step-motherly treatment' to NBFCs in comparison with banks and creation of a level playing field, special focus on finance to small business where NBFC can play a better role than the banks also figure in the expectations. For NBFC-MFIs (microfinance institutions), the business environment is both promising and challenging. [Business Line, Feb. 11]

[Continued from page-7]

Expedite payment data capture in information bureaus to bring large number of customers in the net of formal finance

- Eg. Utility bill payments

Government departments involved in hypothecation of vehicles, creation and recording of mortgages need to digitize their systems to permit NBFC to offer end to end digital experience to their customers, reduce costs, and reduce frauds and operations risks

There is significant innovation taking place in the FinTech space in form of new business models like peer to peer lending. RBI should consider regulatory guidelines to encourage further innovation

Consider a regulatory architecture which permits large ticket deposits from HNI customers to be place with NBFCs directly. This will help with NBFCs funding and a wealth management instrument in HNI banking. ***[Extract from Confederation of Industry [CII]-Boston Consulting Group [BCG] whitepaper on the NBFC sector released at the CII's 1st NBFCs Summit with the theme 'Regulatory Paradigm & Contours of Growth– Vision 2020' which was organised on 21st.Dec.2015 at Mumbai]***

> **"A slow and complex legal system may be thwarting the effort of public sector banks to recover their dues and clean up their balance sheet."**
>
> *Arun Jaitley, Finance Minister*

Union Budget 2016 – One of the Long Standing Demands of the NBFC Sector Accepted

Union Finance Minister has accepted one of the long standing demands of the NBFC sector while presenting the Budget for FY 2016-17. NBFCs have been included in clause (c) of Section 36(1) (viia) so as to provide deduction from total income (computed before making any deduction under this clause and Chapter-VIA) on account of provision for bad and doubtful debts to the extent of five per cent of the total income in the case of NBFCs, Mr. Raman Aggarwal, chairman, FIDC said

During the Pre-Budget Meeting held with the Finance Minister and his team in January this year, FIDC had demanded harmonization of income tax provisions with that for banks and FIs, in the light of the regulatory framework for NBFCs has been harmonized with those of banks by RBI in November 2014, specially, in matters relating Asset Classification (NPA) norms, Mr. Aggarwal added.

While bringing forth the pending issues, he stated: "However, the associated demands for income recognition norms on NPAs and exemption from TDS provisions on interest component of EMIs, also being harmonized with banks and FIs still remain pending".

He also added that "We also look forward to an early issue of the notification giving coverage to NBFCs with Asset base of Rs. 500 crores and above, under the SARFAESI Act, which was announced in the last year's budget".

Pre- Budget Meeting with Union Finance Minister

Raman Aggarwal, Chairman, FIDC attended the Pre-budget Meeting of the Hon'ble Finance Minister and his team with Representatives from Banks and Financial Institutions on January 12, 2016 at North Block, New Delhi.

Mr. Raman Aggarwal, chairman, FIDC presented all tax issues relating to NBFC sector stressing on the fact that these issues need redressal more so in the light of the Revised Regulatory Framework bringing parity with banks, to increase the Ease of doing business and the fact that the focus is now shifting towards activity based and not entity based regulation.

Government approves creation of a Credit Guarantee Fund for MUDRA loans

The Union Cabinet has given its approval for the creation of a Credit Guarantee Fund for Micro Units Development Refinance Agency (MUDRA) loans and to convert MUDRA Ltd. into MUDRA Small Industries Development Bank of India (SIDBI) Bank as a wholly owned subsidiary of SIDBI. This fulfills long standing hope of NBFC sector to make it eligible for such credit guarantee.

The main features of the scheme are:

- Establishment of Credit Guarantee Fund for MUDRA Units(CGFMU) for guaranteeing loans sanctioned under Pradhan Mantri Mudra Yojana with effect from 8th April, 2015 with the objective to reduce the credit risk to Banks / NBFCs / MFIs / other financial intermediaries, who are Member Lending Institutions (MLIs).
- The National Credit Guarantee Trustee Company Ltd. (NCGTC Ltd.), a wholly-owned company of Government of India, constituted under the Companies Act, 1956 (2013) to manage and operate various credit guarantee funds, shall be the Trustee of the Fund.
- The guarantee would be provided on portfolio basis to a maximum extent of 50% of Amount in Default in the portfolio.

FIDC In Action

Allow NBFCs to raise ECB in foreign currency and also under Track 1 & 2: FIDC

FIDC has asked RBI to allow NBFCs to raise External Commercial Borrowing [ECB] in foreign currency as well under Track-1 to NBFC-AFCs and under Track 2 to NBFC-IFCs to enable them to mobilise long-term funds for lending to infra- project so that asset liability mismatch issues may not arise for NBFC-IFCs. It will also enable the currency risk being borne by the NBFCs and not by the lenders, as eligible lenders have a wide portfolio of borrowers from different nations who are willing to bear the foreign exchange risk, but may not have incentive to bear such risk in order to be able to lend to Indian NBFCs.

FIDC, in its representation to RBI on January 11 drew attention of RBI to some of the new provisions in the revised framework issued on Nov. 30th last year so that those stipulations do not affect fund raising through ECBs by NBFCs.

The NBFC-AFCs cater to the credit requirements of the numerous small and medium enterprises (SMEs) in the infrastructure sector which usually provide services like construction, transportation, etc. With the changed conditions, the SMEs stand to suffer as most of them would not be in a position to raise ECB on their own and the NBFC-AFCs' access to ECB also has got severely restricted. Government's objective of inclusive growth will suffer in the process, said Raman Aggarwal, chairman, FIDC.

ASSOCHAM-FIDC NBFC Summit

ASSOCHAM-FIDC NBFC Summit is being organised on April 25, 2016 at Mumbai. RBI Deputy Governor Mr. R Gandhi will be the Chief Guest at the Summit.

Allow small NBFC-D to retain deposits at least 1:1 of net owned funds: FIDC

FIDC pleaded the RBI to allow small NBFC-D to retain deposits at least 1:1 of net owned funds or Rupees 10 crores without credit ratings and defer refund of deposits for at least 2 more years since RBI has prescribed that small NBFC-D not having investment grade rating must return deposits post March 31, 2016. Small NBFC-D unable to get investment grade ratings due to size being small as prescribed by RBI and rating agencies and all banks cite RBI guidelines which require them to insist for credit ratings which are not available. Small NBFC-D caters to small and medium enterprises and fund vehicles which are used for economic growth. They provide valuable last mile connectivity and play a complementary role to banks, since they fund those who are not able to get funds from banks and large NBFC-D, said Mahesh Thakkar, director general, FIDC.

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Suggestions and feed-back

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