Finance Industry Development Council

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

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Way Forward For NBFC Sector

We all know that "change" is the only constant in life. If we look at the changes in the NBFC sector we can see huge promise and potential.

Growth & Potential of the NBFC sector : I will quote two important facts in support of this: 1) Recent study done by one of the leading rating agencies shows that the balance sheets of at least 4 NBFCs have outsized the balance sheets of some of the commercial banks. 2)As per the Financial Stability Report (FSR) dated June 2016 :

- Asset quality of NBFCs improved during the year 2015-16 and is better than the banks (specially PSBs).
- The performance of the NBFC sector in terms of RoE and RoA is much better as compared to that of banks
- NBFCs can support the drive towards promoting inclusive growth by catering to diverse financial needs, specially of MSMEs and individuals.

On the other hand the sector comprises of a large number (almost 90% in numbers) of small and medium sized companies spread across the country. These companies are doing a great job in promoting the govt. agenda on financialinclusionby catering to the unbanked segment. Today, these companies are facing shortage of funds.

While we have had the asset side convergence with banks and other FIs, the same needs to be done on the liability side also.

This is critical for the growth and survival of these small and medium companies.

Regulatory Changes : The Revised Regulatory Framework issued by RBI has brought the asset classifications norms (NPA norms) at par with banks and other FIs.

RBI has relaxed the regulatory norms for non-deposit taking NBFCs to the extent that they need not follow the credit concentration norms.

It is now a stated policy of RBI to switch over to "activity" based regulation from the prevailing "entity" based regulation. This shall largely address some of the concerns that we have had over the years in matters relating to taxation.

Further, measures taken by RBI like CDR or SDR mechanism to address NPA issues are welcome, more so because NBFCs have been treated at par with banks and FIs.

Legislative Changes : Last year's Union Budget (2015-16) granted coverage to NBFCs, with asset size of Rs. 500 cr. and above, under the SARFAESI Act. Currently we are at the door step of a land mark legal change which is The Insolvency and Bankruptcy Code which for the first time in Indian history will recognize business failures and prescribe procedures and systems to exit.

Taxation : This year's Union Budget (2016-17) has given relief to NBFCs by allowing them deduction to the tune of 5% against the provisions made on NPAs. We all look forward to GST which shall do away with the issue of dual taxation (VAT and Service Tax) on the rentals of leasing and hire purchase transactions.However, we still grapple with the issues of income recognition on NPAs and TDS deduction on interest component of every EMI paid by our corporate borrowers.

Innovative Changes : There have been few interesting developments in the sector. One such innovation is the "Alternate Credit Scoring model". This model talks about taking a credit call based on the borrowers online payment behaviour and his posts and behavior on the social media like Twitter, Facebook and Instagram.

We also have a new kid on the block in the form of P2P lenders who are already doing a tremendous job. RBI has issued a discussion paper on P2P lending and the final guidelines are expected to be issued soon.

RBI has issued final guidelines on what are known as NBFC aggregators. The important point to note in all these developments is that RBI is showing great flexibility to the extent of even changing the criteria to define a NBFC. The prevailing criteria of 50% assets and income are not applicable in the case of aggregators and P2P lenders. The message from the regulator seems to be that it is time for all of us to think out of the box to create new opportunities and avenues in future. ■

Raman Aggarwal, chairman, FIDC

AT A GLANCE

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REGULATORY PERIMETER

RBI NOTIFICATIONS & CIRCULARS : Guidelines for Relief Measures by NBFCs in areas affected by Natural Calamities: RBI/2016-17/28; DNBR (PD) CC.No.083/03.10.001/2016-17; July 28, 2016 [All NBFCs]

Master Direction - Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016: RBI/DNBR/2016-17/38; Master Direction DNBR.PD.002/03.10.119/2016-17; August 25, 2016

Master Direction - Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 2016: RBI/DNBR/2016-17/41; Master Direction DNBR. PD. 005/03.10.119/2016-17; August 25, 2016

Master Direction - Core Investment Companies (Reserve Bank) Directions, 2016: RBI/DNBR/2016-17/39; Master Direction DNBR. PD. 003/03.10.119/2016-17; August 25, 2016

Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016: RBI/DNBR/2016-17/45; Master Direction DNBR. PD. 008/03.10.119/2016-17; Sept 01, 2016

Master Direction- Non-Banking Financial Company - Account Aggregator (Reserve Bank) Directions, 2016: RBI/DNBR/2016-17/46; Master Direction DNBR.PD.009/03.10.119/2016-17; Sept. 02, 2016

Bigger NBFCs must be inspected regularly: Rajan

Inspection of bigger NBFCs on a more regular basis is among RBI Governor Raghuram Rajan's unfinished agenda. "What we do want to ensure is the bigger NBFCs are inspected regularly and that their asset portfolios are seen with the same kind of caution we see banks', noting, however, that because they are financed usually with longer-term money, that they have a different capital requirement, that we can be a little more liberal on the risk that they take," Rajan said in a television interview. He said the asset portfolios of such NBFCs must be treated on a par of those of banks.

Especially with respect to loan against property, Rajan said what they don't want was the banks being heavily exposed. "Somebody has to finance those loans and those loans aren't easily financed through a bond markets. So NBFCs do take up that kind of lending. What we have to make sure is that they have the full incentive to recover on those loans," Rajan said in the interview. [Business Standard/PTI, Aug. 11]

RBI has simplified KYC

There have been some significant changes in KYC regulations during Rajan's tenure, making it easier to avail banking and other financial services. "First, the underprivileged and unbanked population was allowed to complete the KYC process with just one document, to open the Jan Dhan Yojana accounts. For affluent segments the facility of e-KYC, using only Aadhaar, has been introduced, which has made the process faster for customers and more cost-effective for the banks. According to the RBI website, eKYC is possible only for those with an Aadhaar number.

Another change is that now you can open a bank account in a city where you don't have an address proof. You just need to furnish the permanent address proof of your city, together with a declaration about your local address for communication purposes. But some experts believe there is still some work left to be done for easier access to financial services.

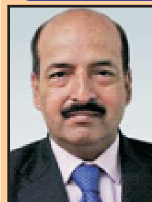
Going forward, initiatives like IndiaStack (which aims to provide a unified platform for electronic identification) and a central repository for KYC data would also help in simplifying the process further. [Live Mint, Aug 10]

Universal bank licenses will now be available on tap

Universal bank licenses will now be available on tap, with the RBI releasing the final set of guidelines for eligible entities to apply for licenses as and when they choose to, and keeping the doors closed to large business houses. NBFCs that are controlled by resident Indians and have a successful track record of at least 10 years, qualified individuals and some private companies will be eligible to apply for licences. NBFCs that are part of large conglomerates with more than 40% of their total assets coming from non-financial businesses will not be eligible. Large industrial houses are excluded as eligible entities but are permitted to invest in the banks up to 10%, said RBI.

Dr. Urjit R. Patel takes over as Governor of the Reserve Bank of India from Sept. 4, 2016 after serving as Deputy Governor since January 2013.

NS Vishwanathan took charge as RBI Deputy Governor



NS Vishwanathan on July 4 took over as Deputy Governor of the Reserve Bank of India. He will look after the Department of Banking Regulation, Department of Co-operative Banking Regulation, Department of Non-Banking Regulation, Deposit Insurance and Credit Guarantee Corporation, Financial Stability Unit, Inspection Department, Risk Monitoring Department and Secretary's Department.

Sudarshan Sen took over as RBI Executive Director

Sudarshan Sen on July 4 took over as the new RBI Executive Director. He will look after the Department of Banking Regulation, Department of Co-operative Bank Regulation and Department of Non-Banking Regulation.

RBI likely to issue draft norms on joint loans by banks, NBFCs

The norms will also look at how these loans will be accounted in priority sector targets and also on books of both entities. RBI Deputy Governor SS Mundra had on Aug. 18 said there was merit in considering joint origination of loans by banks and NBFCs. Mundra said this would help utilise the strengths and reach of the non-bank lenders with the capital and access to low-cost funds of banks.

Prospective buyers should also be given a minimum of two weeks for due diligence and in case the exposure is above Rs 50 crore, then banks need to get at least two external valuation reports. It has also made banks' boards more accountable for stress resolution. [Business Line, 18 Aug.]

RBI tells CICs: Give credit report free to individuals once a year

Given the importance of the credit report in an individual's financial matters, RBI on Sept. 1 directed credit information companies (CICs) to provide access to one free full credit report (FFCR), including credit score, once a year (January-December) to individuals whose credit history is available with the companies. The credit report, which will be in electronic format, will be provided upon request and after due authentication of the requester. The report should also provide an opportunity to the borrower to have the errors, if any, in her/his credit history rectified. [Business Line, Sept, 1]

Reserve Bank widens market for sale of stressed assets

In a bid to improve the sale of bad loans by lenders, the RBI has allowed banks to sell these assets to other banks, NBFCs or FIs who have the necessary capital and expertise in resolving stressed assets. Prospective buyers need not be restricted to securitisation companies/reconstruction companies. The RBI believes this will lead to better price discovery, and to attract more buyers lenders have been asked to follow the e-auction process. [Business Standard, Sept. 2] ■

CHANGING LANDSCAPES OF NBFCs AND DEVELOPMENTAL STANCE IN REGULATION

Inaugural address by
Shri R Gandhi,
Deputy Governor, Reserve Bank of India
at 3rd National Summit on
Non Bank Finance Companies –
"The Changing Landscape"

"You (NBFCs) are not a shadow banks that also is well appreciated from the beginning….. because we have been regulating you right from mid-'60s."

"The Reserve Bank all along has recognized this sector's potential to contribute to the development of identified segments of the economy and accordingly has been following a developmental bias in the regulatory framework relating to NBFCs."

"Non-banks channels play an important role in financing the real economy."

I am very glad to be here addressing this forum on growth for NBFCs as we always say the sector has got its own special position within the financial sector of the economy. Before I start, my very quick reaction to Vaidyanathan's comment and suggestions on the nomenclature of NBFCs, I can give you the background. Till mid-'80s these were called finance companies. But in mid-'80s these were redefined as non-banking finance companies because of certain misunderstanding that had been created among the public about its role, whether it is a bank or a non-bank. So it had to be clarified that they are not doing banking services so it was clarified so. That was the reason then but we understand the reason why you make the point. A long time has elapsed since then, we can always revisit the name based on the current levels of regulations, and the circumstances of the day, so I certainly take this suggestion seriously, and we will definitely examine what can be done about it.

Are NBFCs shadow banks?

Again, you are not a shadow banks that also is well appreciated from the beginning. Elsewhere in the world they were called shadow banking or even today continue to be termed as the shadow banking because of the precise reason that you have mentioned that were not regulated.

Shri V Vaidyanathan, Chairman, Capital First Ltd said it is worth thinking if, like the US, we too can call NBFCs simply as Finance Companies, or Lending Institutions, as "Not being something" is not an identity. Better to be known by what the Company does like MFI does Microfinance insurance, HFC does Housing Finance, Life insurance company does life Insurance, and General insurance companies do Insurance of property and cars. He said it is just a proposal, but worth thinking about.

Whereas we did not call you as shadow banking because we have been regulating you right from mid-'60s. So it is a part and parcel of regulated structure there is no need for referring you all as shadow banks. That is certainly acceptable. Okay, anyway right, as I have mentioned in one of my earlier addresses, post the financial crisis of 2008 the non-banking financial sector has continued to attract a lot of attention globally, its state and by its size, growing size and it contribution, significance and risks thereon. This awakening has resulted in enhanced regulation and monitoring of the sector, this coupled with opportunities for growth and diversification both in terms of products and markets operates. The intention to therefore seriously deliberate on the changing landscape and the opportunities and challenges it offers is very apt for the day. While globally the sector is identified as the shadow banking sector as I just mentioned we have been calling it as nonbanking financial sector. Further while the world has, as I said now, sat up and perked its collar to look at this sector intensively, but India had understood the sectors' relevance and the risks that it may pose way back in early 1960s itself when in 1963 chapter 3b dealing with the regulation of the non-banking financial companies was added to the Reserve Bank of India Act. It recognizes that non-banking financial activity is an integral part of the financial system as it complements the commercial banking. Only that appropriate vigilance and due diligence will be needed to regulate this sector.

Changing landscapes for NBFCs

When we are talking about changing landscapes I thought it would be appropriate to take a quick walk through on how the regulatory landscape has changed for the NBFCs which I am sure that you are all well aware. I won't go through the complete details because everyone has complete understanding and this report also fully details the way we have gone ahead and evolved. But very quickly, I will highlight some important points. The micro structure of the NBFC sector in India has evolved as a result of emerging requirements in the market place and regulatory responses to them. NBFCs meet the range of credit needs of the financial sector from financing of vehicles to financing of residential markets also. Finance companies in the early years used to offer a variety of services ranging from personnel to corporate finance under one roof. Today, unlike banks, they tend to specialise over time newer categories got created depending on the nature of financing activity, sector of economy they finance and demands from the industry.

Over the years the NBFC sector has grown its reach and size current data shows that though in absolute terms the number of NBFCs registered has come down to 11,700 as of March 2016, the aggregate assets of systematically important non-deposit taking NBFCs and deposit taking NBFCs have grown from 700 billion at the end of March 1998 today to 15 trillion rupees at the end of December 2015. The current legislative and regulatory structure of NBFCs came into being in 1997 with amendments being made to the RBI Act. The growth in interconnectedness with the banking system raised concerns about the capacity to disturb the systemic stability, the NBFCs were brought under prudential regulatory framework from 2006 onwards.

Developmental stance in regulation of NBFCs

The Reserve Bank all along has recognized this sectors potential to contribute to the development of identified segments of the economy and accordingly has been following a developmental bias in the regulatory framework relating to NBFCs. This would be better appreciated when you look at some of the changes to the regulations with reference to the NBFCs sector that we brought on in the recent past. The process of collapsing the multiple categories of NBFCs has been initiated. In this direction ECB regulations has been harmonised across NBFCs, all NBFCs which are coming under the regulatory purview of the Reserve Bank are now permitted to raise the ECB under track three and can on line to for any activity including infrastructure. The issue of differential amount of bank finance available to different categories of NBFCs is also being examined from banking sector side to move closer to the objective. These coupled with the revised regulatory framework of NBFCs announced in November 2014 have to a great extent removed differential dispensation between AFCs, loan companies and investment companies which instantly account for nearly 94 percent of the registered NBFCs. The Bank would be actively taking forward this agenda to reduce complexities and make

regulations simple and easy to follow and harmonise regulations within the sector to the extent possible. While moving ahead on this agenda the Reserve Bank is also alive to the developmental needs of the economy and therefore will continue to approve of new type of NBFCs if the situations so warrant. Therefore, careful and continuous monitoring is still required to detect any increases in the systemic risks factors that is maturity and liquidity transformation and leverage that could arise from the rapid expansion of credit provided by the non-banking sector. Reserve Bank has been dynamically making the regulatory framework suitable for the day. Let me now explain something about what are things being examined by the Reserve Bank of India.

Simplification of the process of registration of NBFCs.

We have been often hearing the complaint that the process of obtaining a certificate of registration from the Reserve Bank is very cumbersome. In order to improve the ease of doing business and make the process of registration of new NBFCs smoother and hassle free we are simplifying and rationalising the process of registration. The new application forms will be simpler and the number of documents required to be submitted will be reduced. Going ahead the entire process would be made online for ease, speed and transparency.

Peer to peer lending the activity of P2P lending has been engaging the attention of the financial sectors for quite some time now globally. Thus far the growth of such activity in India was at a low level. P2P lending has shown accelerated growth over the last one year, yes Vaidyanathan had given some figures on what is happening elsewhere in the world in this space. While encouraging innovations the Reserve Bank has to be conscious to the risks posed by such institutions to the system. A concept note on P2P lending will be put up on the Reserve Bank's website for public comments shortly and based on the feedback the contours of the regulating P2P lending will be decided in consultation with SEBI.

Growth prospects in various sectors of NBFCs

Going forward in my opinion the prospects for the sector in the medium term may not be uniform, for example, the NBFC, MFI segment is going to shrink heavily as the big ten of them convert themselves into small finance banks. I will hasten to add that this can yet bring higher impetus for the other NBFCs-MFIs to grow not just because of the availability of space vacated by the big ten but also because the capital will be released when many of the converting NBFC- MFIs pay off the current investors as a part of capital restructuring and because of renewed interest by such venture capital aiming growth prospects in such conversions in the future.

NBFCs lending for infrastructure will have a greater scope in the coming years both because the economic growth will bring forth new projects and banks having learnt lessons in the recent past will have a restrained approach towards such projects. As large exposure norms for the banks will apply by 2018, NBFCs will have space for market funding or loan funding of big corporate financing in the medium term. Make in India and start up business could offer fresh opportunities for the sector to grow. Loan companies will face an enhanced consumer protection measures. They will be required to appropriately educate their work force to in selling right. Investment companies will have bright prospects as the equity and corporate bonds markets expand along with economic growth and careful recalibration of bank finance in the wake of Basel III.

Some outstanding issues

There are several issues relating to this sector which are periodically raised. Though we have been reiterating our regulatory stance relating to these issues, Reserve Bank has a time tested practice of reviewing of its policies periodically. We do make changes, our adjustments to our stance based on considered analysis of the situation factoring dynamic developments and always keeping public policy perspective. However, when situation do not demand such changes or adjustments we continue with the extant policy, keeping this in the background let me now discuss certain outstanding issues of interest to you.

Regulating small NBFCs: There has been an argument about why we want to regulate all NBFCs and why small NBFCs cannot be let off regulatory purview. We do recognise that small NBFCs do not pose financial stability risks. We also recognise that the NBFCs which do not depend on public funds either directly or indirectly do not pose risks to depositors. However, they do deal with customers and customer protection issues still will remain and that will need regulation. That is why we have simplified regulatory framework for these small NBFCs.

Harmonisation of regulation: – Many of you have raised questions about the current policy of harmonisation of regulations for the NBFC sector with the commercial banking sector. Let me clarify that our stand is to harmonise not to equalise the regulation. That is similar activities should be subject to similar regulation, this is driven primarily to remove arbitrage, for example, while we do require that the hierarch norms will apply, Basel III norms we don't apply on you. We will continue to keep in mind materiality and proportionality in determining harmonisation, allowing deposit taking activity. Deposit taking is primarily a banking activity though some people argue that NBFCs will take only fixed deposits and not current or demand deposit. There is no risk the argument goes like that. However, this is a precious argument because maturity transformation automatically runs the risks of assets liability mismatches and non-banks runs a much higher liquidity risks. Hence it will be prudent to let only banks accept deposits.

To conclude, the Reserve Bank is alive to the developmental needs of the economy and has been dynamically making the regulatory frameworks suitable for the day. Non-banks channels play an important role in financing the real economy but are also a source of systemic risks especially when a highly interconnected with the banking system. Appropriate monitoring of the sector and the application of appropriate policy responses were necessary helps to mitigate the build-up of systemic risks. Reserve Bank remains committed to such an approach. ***(Source : Assocham. Title and subtitles were given to facilitate reading.)***

LET US BE READY FOR STRONG ROLE OF SELF REGULATION

Shri K V Srinivasan
CEO, Reliance Commercial Finance

What we are really seeing is that the finance industry just like every other industry that we have currently, is going through a huge change a change is coming in to a very large extent because business models are changing, the times are changing, technology is changing. So you have a huge impact that the e-commerce kind of companies are bringing across to the entire industry. Similarly, digital explosion we are talking about Fintech companies which are technology companies which are doing finance business, actually coming into the picture. Small companies, the large companies, the whole environment is under in a stage of flux plus the RBI's efforts that broad basing the entire banking system in terms of allowing the payments banks and the small finance banks to come across has actually brought in a regime which has got probably no parallel anywhere in the world. I don't think this kind of diversity among the finance industry participants is available anywhere in the larger economies.

So given that regulations obviously have to follow from what sort of entities do we need, do we really need all kinds of NBFCs, do we need a certain types of NBFCs only. What is the kind of market needs that each of these segments cover and therefore regulation effectively flows from that reality. So over a period of time the RBI obviously has been at the forefront in terms of creating new regulations to may be not just satisfy the current requirements but also to anticipate what is really happening in the market and what trends are emerging and to have regulations being written up on a proactive basis.

Now, the regulations are becoming tougher and more complicated as the business environment also becomes complicated. Probably it is time for the participants like us, the NBFCs also to realise that only regulations coming in from the regulator is not good enough, we may actually look at very strong role being played by self-regulation itself. So the entire environment is something which is really coming to a state where there is a need to seriously relook at what we have been doing so far and past regulations may not always hold water for the future. [Source: Assocham proceedings of 3rd National summit of NBFCs]

Financial Stability Report, June 2016

Overview

Non-banking financial companies

Non-banking financial companies (NBFCs) have been playing an important role in the Indian financial sector and this role assumes even greater significance at a time when banking institutions are focusing on cleaning up their balance sheets. In the current context, NBFCs can support the drive towards promoting inclusive growth, by catering to diverse financial needs, especially of MSMEs and individuals.

NBFCs: Soundness and Resilience - Stress Test

Table-1 : Consolidated balance sheet of the NBFC sector : y-o-y growth

(Per cent)

Item	Mar-15	Mar-16
1. Share capital	6.3	4.8
2. Reserves and surplus	13.5	14.3
3. Total borrowings	16.9	15.3
4. Current liabilities and provisions	14.1	31.8
Total Liabilities and provisions	15.7	15.5
1. Loans & advances	17.1	16.6
2. Investments	11.5	10.8
3. Other assets	10.6	12.7
Income/Expenditure		
1. Total income	15.3	15.8
2. Total expenditure	15.5	15.8
3. Net profit	15.0	15.6

Source : RBI supervisory returns.

Stress tests for non-banking financial companies (NBFCs) show that the CRAR at the system level was only marginally affected and remained well above the regulatory minimum required level of 15 per cent. However, the CRAR of a few NBFCs may fall below minimum required level, under the extreme scenario of GNPAs increasing by 3 standard deviation.

NBFC Universe

As of March 31, 2016, there were 11,682 non-banking financial companies (NBFCs) registered with the Reserve Bank, of which 202 were deposit-accepting (NBFCs-D) and 11,480 were non-deposit accepting NBFCs (NBFCs-ND). There were 220 systemically important non-deposit accepting NBFCs (NBFCs-ND-SI). All NBFCs-D and NBFCs-ND-SI are subject to prudential regulations such as capital adequacy requirements and provisioning norms along with reporting requirements.

Table-2 : Financial performance of the NBFC sector

(Per cent)

Item	Mar-15	Mar-16
1. Captial market exposure(CME) to total assets	7.4	8.5
2. Leverage ratio	3.7	3.9
3. Net profit to total income	18.3	18.3
4. RoA	2.2	2.2
5. RoE	10.3	10.6

Source : RBI supervisory returns.

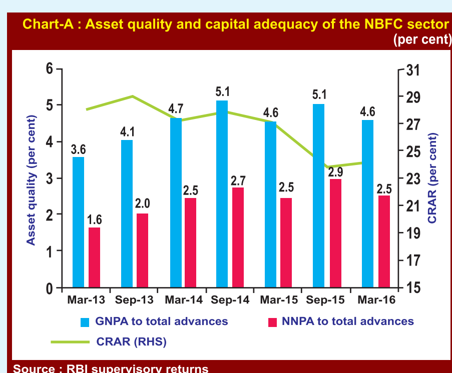


Chart-A : Asset quality and capital adequacy of the NBFC sector

Source : RBI supervisory returns

Financial Performance of NBFC Sector

The aggregated balance sheet of the NBFC sector expanded by 15.5 per cent on a y-o-y basis in March 2016 as compared to 15.7 per cent in the previous year. Loans and advances increased by 16.6 per cent, while, total borrowings increased by 15.3 per cent in March 2016 (Table -1).

The financial performance of NBFC sector has remained unchanged for the last two years. Net profit as a percentage to total income remained at 18.3 per cent between March 2015 and March 2016 and RoA stood at 2.2 per cent during the same period. RoE increased to 10.6 per cent from 10.3 per cent (Table - 2). While the regulatory norms for the NBFC sector are sought to be brought closer to those applicable to SCBs, the performance of this sector (RoE and RoA) seems to be much better as compared to that of banks.

Asset quality and capital adequacy of NBFCs

GNPAs of the NBFC sector as a percentage of total advances declined to 4.6 per cent in March 2016 from 5.1 per cent in September 2015. NNPAs as a percentage of total advances also declined to 2.5 per cent from 2.9 per cent during the same period (Chart- A).

As per extant guidelines, NBFCs are required to maintain a minimum capital consisting of Tier-I and Tier-II capital, of not less than 15 per cent of their aggregate risk-weighted assets. The CRAR of NBFCs increased to 24.3 per cent as of March 2016 from 23.8 per cent as of September 2015 (Chart-B). At the disaggregated level, seven NBFCs were unable to meet the regulatory required minimum CRAR of 15 per cent as of March 2016.

Resilience - Stress tests

System level

Stress test on credit risk for the NBFC sector as a whole for the period ended March 2016 was carried out under three scenarios: (i) GNPA increase by 0.5 SD, (ii) GNPA increase by 1 SD and (iii) GNPA increase by 3 SD. The results indicate that in the first and second scenarios, the CRAR of the sector was marginally affected while in the third scenario, it declined to 23.3 per cent from 24.3 per cent. This however, was much above the regulatory minimum required level of 15 per cent.

Individual NBFCs

Stress test on credit risk for individual NBFCs was also conducted for the same period under the same three scenarios. The results indicate that under scenarios (i) and (ii), around 5 per cent of the companies, will not be able to comply with the minimum regulatory capital requirements, while 8 per cent of the companies will not be able to comply under the third scenario.

Network of the financial system

From the perspective of the larger financial system, the flow of funds between the SCBs, asset management companies managing mutual funds (AMC-MFs), insurance companies, NBFCs, urban co-operative banks (UCBs) and other all India financial institutions (AFIs) assume importance. The AMC-MFs followed by insurance companies are the biggest fund providers in the system, while SCBs followed by NBFCs are the biggest receiver of funds. Within SCBs, however, both PSBs and FBs have a net receivable position vis-à-vis the entire financial sector, whereas PVBs have a net payable position. Further, the four AFIs included in the analysis are significant participants in the financial system.

Changing landscape of Finance Sector

With the introduction of differentiated banking licenses for setting up of payments banks (PBs) and small finance banks (SFBs) along with the push for an on-tap licencing regime for universal banks, the landscape of the banking industry is expected to undergo significant changes, going forward. While the impact of these changes will begin to emerge only after some of the newly licensed entities including PBs and SFBs start operating, the process itself is heralding a churning in various categories of financial entities, mainly NBFCs including the micro finance institutions (MFIs). Alongside these changes, the revised regulatory framework for NBFCs is also being phased in, which seeks to tighten the prudential norms applicable to deposit-accepting NBFCs (NBFC-D) and systemically important non-deposit accepting NBFCs (NBFC-ND-SI) and aligning asset classification norms with those applicable to banks. Thus, while focusing supervisory attention on entities which accept deposits and/or access public funds as also those that are systemically important, the regulations have been rationalised and liberalised to allow a greater operational freedom for other NBFCs.

[Excerpts from Financial Stability Report, June 2016]

An Innovative Roadmap

Shri Anand Sinha,
Former Deputy Governor,
Reserve Bank of India

The USP of NBFCs is to go into the areas to get into that segment of clientele which for various reasons are not able to have a very fruitful relationship with banking systems. And there are many reasons for that. And this segment does not necessarily have the kind of credit data that is required for making an informed credit decision and therefore innovation in this area is certainly very important and lots of things are happening in this space essentially spurred by innovation and digital space.

Now these are the financial intermediaries who are just like banks, of course there are other varieties also and they carry out the same kind of maturity and liquidity transformation which banks do they build up leverage also. But the problem is that they do not have the safety net which the banking systems have. That is you don't have deposit insurance, you don't have lender of last resort facilities and that is what makes this segment very special. On one hand they are very important component of the financial systems on the other hand they don't have the kind of safety net which is available to the banking system at the same time this allows us some amount of trade off in terms of innovation.

The USP of NBFCs is basically they are free footedness, their innovative capacity and thereby the ability to address the credit needs of the segments that do not have easy access to banks for various reasons. This diversity in the financial system is to be cherished celebrated and encouraged. Of course while being alive to the need to address risks which any innovation is bound to have. Innovations taking place in the digital space provide an enormous opportunities to NBFCs to design newer products, create algorithms for credit assessments something we had in detail just a while ago and particularly for NBFCs this is extremely important because of the kind of clientele that they have, because of the fact that they can go into the space where banks would find difficult or would be diffident about going into and that is a business opportunity. And the new alternative credit assessments which are developing is essentially combining the credit usual credit data with non- credit information or sometime supplemented completely if you don't have any data, a usual credit related data. NBFCs going into deeper and deeper into this segments which is not bank or it is difficult to be banked, it is also extremely important from the perspective of economic development if we are going to make the make in India or the make for India successful. So as I said the number of innovations has happened would keep on happening, the practitioners have to be alive to the risks and the regulators would certainly intervene wherever they feel that a product should be managed in a better way. In fact if you look at regulatory intervention it happens, it is usually of two kinds one is the market proactive is ahead of the regulatory instructions and then the regulator comes in intervenes puts it into the order.. the way is where the regulators himself leads certain products which is felt to be necessary but doesn't have a market. So I think that as far as NBFCs are concerned we are in the first category and the inunctions done by NBFCs would certainly be most welcome. ***[Source: Assocham. Address as a chairman at Technical Session-1 of 3rd National Summit on NBFCs-the Changing Landscape. Title was given to facilitate reading.]***

SOURCES FOR FUNDING FOR NBFCs

Shri Jiji Mammen,
CEO, Mudra Bank

We have heard from Mr. Satyen David what is the sources of various funding in an NBFCs, mostly it is in the form of borrowings or raising NCDs, some could be in the form of capital or majority could be in the form of capital and some in the form of ECBs. So apart from these what is the other source of fund raising that is question which is posed to us. Since I am from a refinance institution for me the first option I would like to say is about the possibility of refinance.

REFINANCE: Three organisations are providing refinance support to NBFCs especially in the recent days. Let me start with Mudra. Mudra has sanctioned more than Rs. 1000 crores mostly it is for MFIs as Mahesh said, it is mostly to MFIs, but a small portions was also sanctioned to NBFC but the fact is that it was not utilised.[2] SIDBI has also sanctioned closely around Rs. 2000 crore for NBFCs plus another Rs. 2000 crores for MFIs.[3] NABARD has opened up a window for refinance, for NBFCs, both for MFIs as well as for the other NBFCs. And I am told that around Rs. 2500 crores was sanctioned during the last year, which is going to definitely grow bigger this year. The beauty of refinance is it is much easier to tap. It is much less cumbersome to tap.

SECURITISATION: The second source is the securitization. Of course it is mostly when you talk about the priority sector funding where the securitisation can play a role especially for the MFI sector. Even Mudra has taken a decision to support that securitisation. Securitisation [by providing credit enhancement providing directly getting involved into the investments], is another area which is a viable area for the NBFCs or for the MFIs specially to raise the funds. The beauty of securitisation is that you can raise more and more funds and without having leverage to your capital.

ECBs : Of course the third one which Dr. Satyen David also talked about the ECBs? So these are the three areas I feel probably the NBFCs can go forward when you look at talking about raising funds are concerned.

Courtesy call by FIDC key Managing Committee Members with the newly appointed Executive Director of Reserve Bank of India Shri Sudarshan Sen on 20th July 2016 : Present (from left to right) : Shri Alok Sondhi, Shri K V Srinivasan, Shri Sudarshan Sen, Shri Mahesh Thakkar, Shri Raman Aggarwal and Shri T T Srinivasaraghavan.

Courtesy call by FIDC key Managing Committee Members with the newly appointed Deputy Governor of Reserve Bank of India Shri N S Vishwanathan on 20th July 2016 : Present (from left to right) : Shri T T Srinivasaraghavan, Shri Raman Aggarwal, Shri K V Srinivasan, Shri N S Vishwanathan, Shri Mahesh Thakkar and Shri Alok Sondhi.

Fund Raising by NBFCs– Diversification and Innovation

Dr. Sathyan David,
Chief General Manager, DNBS, RBI

To NBFC sector we have issued 37 new licenses last year and there is a growing demand for new entities in the segment. Of these, 19 companies have 23 wholly owned subsidiaries abroad with assets of Rs. 22,000 crore. So this is obviously a growing sector.

Only one issue of concern is that the small segment accounts for less than Rs.50 crore assets for over 11,000 companies and out of these a majority, 70-80 percent are those which are around some Rs. 10 to 15 crore or so total assets. RBI has laid down capital requirements norms the - NOF norms - increased from Rs. one crore to two crores. But the majority of these are falling within less than that in this segment. So we expect FIDC to go ahead especially in certain centres like Delhi and Calcutta where there is large number of such small companies. So you have to sensitise them to come into the fold, raise that capital and become a bit more active because this is one segment where we don't have data also and we are trying to capture data but segment is not coming forward for data capture. They may respond better to the peer groups, so we have to have joint efforts through that. We even don't get inputs in terms of auditor's certificates from these companies. So I think we have to have a tripartite effort-ICAI and Industry have to see that we bring these companies within our fold.

Healthy growth of NBFC Sector: If we cut off the Andhra affected MFIs from here then the net NPA ratios look much better and profitability is extremely resilient, return on assets of 1.9 and Nims of 6.6 is I must say very satisfactory and return on equity ranges from 12 to 15 percent.

NBFC sector shows a very healthy growth. All NBFCs have been growing at 24.5 percent in 2014-15. The previous year it was a bit of an aberration because Andhra MFIs and certain other segments and that was the year the entire growth was hit very badly. So compared to banking sector which is hardly growing at 8.7 percent, NBFC sector has been growing at a very rapid pace mainly led by MFIs which have grown by almost 50 percent and then loan companies, infrastructure finance companies and assets finance companies. Gross NPA ratios we have already seen are 4.1 percent as compared to the earlier years of 4.6 percent; in banks it is 4.6 percent. 4.1 percent is still not showing a very good sign because it was 3.9 and 3.2 in the earlier years. What we find that there are growing concerns in the companies which are financing commercial vehicles. So that is an area of concern which you must clamp down upon, we had a recent meeting and the concerned companies assured us that this is actually now plateau out and will improve over the years.

Total assets to total credit are again showing a very healthy growth rate. NBFCs show 17.1 percent growth of credit during the year 2014-15. Banks: public sector banks have been hardly growing at less than 10 percent they have been pulled up by private sector banks which grows slightly more than 10 or 11 percent and so average has come to around 9 percent in terms of growth of credit. So in this field also NBFCs are doing quite fine in the market and again led by MFIs which have been growing in leaps and bounds.

Profitability of NBFCs is higher than Banks: Profitability again traditionally has been higher for NBFCs vis-à-vis banks although they are less leveraged. It is mainly contributed because here no priority sector, no 25 percent SLR - CRR the entire amount that you raise through liabilities can be immediately sanctioned as in your assets portfolio. And again for the branch network basically fixed frozen costs of the entire banking sector and certain rigidities of the banking sector are not there. NBFCs are innovative they are nimble on their feet. They can expand rapidly and when the things are not going too well can also contract rapidly because you are not frozen by some wage agreements and other inefficiencies and rigidities and what we call as restrictive work practices of the banking sector at large. So this is the one segment which can penetrate to all nooks and corners of the country. As you are nimble on your feet whenever you find business is not coming or certain segments are drying up you can also wind up the business rapidly and close down the rental branches and get out and control your costs also. So the operations were simpler less costly and because of your inbuilt flexibilities we have certain inbuilt advantages and profitability showing because some moderation off late because of build-up of NPAs but still doing quite well.

Funding sources: Let us see what your loan assets profile composition is. Funding sources: 34 percent is NCDs another the grey area, 18 percent is bank borrowings, 23 percent large segment is capital, others is 25 percent and deposits have of course contracted to barely 1.7 percent. NBFCs' segment wise breakup of funding sources tells us that one important source of investors for NCDs, and CPs are: the mutual funds, and insurance companies. Some 34 percent of NCD issues during 2014-15 had been taken up by mutual funds and insurance companies also are participating increasingly in investments in instruments issued by NBFCs. So these are your traditional funding sources so far.

Now, let us see where these funds are going. Loans and advances is 76 percent, you have SLR process only for deposit taking companies that is also at a lower level. So 76 percent is being deployed in loans and advances and 16 percent in investments. So evidently your entire amount is being deployed very profitably [not in fixed interest or low interest rate investments] plus with your combined lower NPAs, larger segment of earning advances automatically of course your DIMs and ROIs and ROEs are also well preserved and doing quite better than the banking segment. ***[Excerpts from Technical Session-II Chairman - Dr. Sathyan David, Chief General Manager, DNBS, RBI. Title and sub-titles were given to facilitate reading.]*** ■

"Cyber incidents are increasingly shifting towards targeting of financial institutions instead of end users." ***S S Mundra, Dy. Gov. RBI***

IMPACT OF GST ON BUSINESS OF NBFCs AND BANKS

India finally seems to be on the cusp of implementing the much-awaited tax reform of Goods and Services Tax (GST). With the release of the Model GST Law on 14 June 2016, we crossed a major milestone and have certainly moved a step closer to GST.

It is noteworthy that the Model GST Law has been released on the final day of meeting of the Empowered Committee of the State Finance Ministers and reflects a determined intent on the part of the Government to pass the Constitution (122nd Amendment) Bill in the Parliament. The Bill is passed by both the houses of Parliament and over 50 % of the state assemblies accorded approval as also the accent of President is received.

Globally the trend for the Financial Services (FS) sector has been either complete exemption or partially subject to GST. In jurisdictions where it is partially taxed, the approach has largely been to tax Fee-based activities with restricted input tax credits, while keeping the Fund based-activities outside the tax net.

In the GST regime, the FS sector is expecting the partial basis of taxation, as prevailing in the present regime, to continue, with clarity on place of supply of services and seamless credits across the country.

GST for the FS sector would be a major transformation as it would have an impact on the financial products, the IT system, processes and a shift from centralised compliance to State-wise compliance. The industry would need to analyze the provisions of the Model GST Law and its impact on their business. This is essential to ensure that timely representations are made to the Government, and to identify implementation requirements for smooth transition to GST regime.

In the ensuing paragraphs, we have sought to identify the key aspects of the Model GST Law as may be relevant for the FS sector.

A. Banks and NBFCs

1 Place of supply of FS Products

Presently, the place of provision of services provided by Banks/ NBFCs to account holders is the location of the service provider. Thus, notwithstanding the fact that the customer may be outside India, service tax is payable.

The Model GST Law specifies the place of supply of services for banking and other financial services (BOFS) as:

- in cases where the services are linked to the account of the receiver, the location of the service receiver on the records of the service provider; and
- where the service is not linked to the account of the receiver, the location of the service provider.

Under the present regime, where there

is a concept of 'intermediary services'; the Model GST Law does not provide anything specific under the Place of Supply provisions. Hence, if Banks/ NBFC's are providing cross-border intermediary services, e.g. branch of a foreign bank providing intermediary services for trade finance transactions, the place of supply could be outside India.

The following issues arise, on which clarifications should be sought from the Government:

- Determining 'location of service recipient' in the digital world, where banks are now endorsing anywhere or everywhere banking concept;
- The terms, 'banking and other financial services' and 'account' are not defined. Hence, it is not clear which activities would be covered under this rule;
- Whether permanent or communication address would be considered to determine the location of service recipient; and
- Determining place of supply for B2B Customers with multiple offices.

2 Interest Income

Presently, services provided by way of extending deposits, loans or advances, where consideration is represented by way of interest or discount, is covered by the negative list of services. Thus, such income is not subject to service tax.

The Model GST Law does not specifically exclude applicability of GST on income by way of interest or discount. However, it is expected that such income by way of interest and discount would continue to be non-taxable, and it will be covered by the negative list of supplies.

3 Free Supply of services

Presently, as per the definition of the term, 'service', only those activities which have a consideration are liable to service tax.

However, the Model GST Law also proposes to tax services by a taxable person to another person in the course of furtherance of business, without any consideration. This proposal could have far reaching implications, as identification and value attribution for such supplies could be challenging. For example, customers maintaining minimum account balance are eligible for certain benefits and such free services could be subject to GST.

Hence, the industry should represent that the instances of free supply of services should be specified in the GST legislation.

4. Sale of securities

Presently, under the State VAT laws, the definition of the term, 'goods' specifically excludes securities. Hence, VAT is not payable on sale of securities.

Under the Model GST Law, the term, 'goods' includes securities. However, it is expected that such a transaction would be covered by the negative list of supplies.

5. Securitisation transactions

Presently, the definition of the term, 'service' specifically excludes actionable claim, whereas under the Model GST Law, the term, 'service' specifically includes actionable claim.

The BOFS sector is facing significant NPA challenges, and securitisation is critical to address the NPA issue. It seems that by including actionable claim, transactions such as securitisation could be subjected to GST. However, it is possible that securitisation could get covered in the negative list.

6. Finance Lease

Presently, finance lease transactions are liable to both, VAT and Service Tax, and ordinarily operating lease transactions attract VAT. Further, VAT is not payable on import of assets on lease basis.

Under the Model GST Law, a finance lease would be considered as supply of goods, and an operating lease would be considered as a service. Further, leasing of an asset from outside India, will be liable to IGST.

7. Sale of Repossessed Assets

Under the VAT laws, taxability of sale of repossessed assets in the hands of Banks/ NBFCs has been a contentious matter. Various courts have confirmed the applicability of VAT on Banks/ NBFCs and the matter is now pending before the Supreme Court.

In the Model GST Law, if Banks/ NBFCs are treated as suppliers of such assets, the overall cost of operations for Banks/ NBFC's would go up, as it is expected that the rate of GST would be higher than the present VAT rate.

8. Input Tax Credit – Proportionate vis-à-vis fixed reversal ratio

Presently, as per CENVAT Credit Rules, Banks/ NBFCs have options to reverse CENVAT credit either to the extent of 50%, or on proportionate basis to the extent of exempt turnover.

Under the Model GST Law, there is no such provision for availment of 50% credit. If such option is not available, then Banks/ NBFCs would be required to reverse input tax credit to the extent attributable to non-taxable supplies. Proportionate basis of reversal has scope for alternative interpretations and/ or verification from authorities. Hence, it should be represented that the option of reversal on the basis of a fixed ratio should also be available. ■

TAKEAWAYS FROM RBI ANNUAL REPORT 2015-16

NBFCs: Department of Non-Banking Regulation (DNBR)

NBFCs play a critical role in catering to under-served niche sectors. An orderly development of NBFCs has been a priority for the Reserve Bank as shadow banking operations have a bearing on the stability of the financial system. In 2015-16, the focus of DNBR was to take forward the process of harmonisation of regulations across NBFCs and banks and move towards activity-based regulation.

Agenda for 2015-16: Implementation Status

Continued Harmonisation of Prudential Regulations

During the year, harmonisation of the following prudential regulations pertaining to NBFCs was undertaken: early recognition of financial distress; prompt steps for resolution and fair recovery for lenders, including guidelines on the formation of JLF and corrective action plan (CAP); factoring activities by banks and those for NBFC-factors; risk weights assigned to exposures to central/state government/s and claims guaranteed by state governments; risk weights with respect to investments in corporate bonds by standalone primary dealers; and strategic debt restructuring and refinancing of project loans.

NBFC-Account Aggregator and P2P Lending

Towards a consolidated view of financial assets, a new category of NBFC, viz., NBFC-AA was proposed. In addition, a consultation paper for designing a suitable regulatory framework for P2P lending was also released.

Simplification of the Registration Process

The process of issuing certificates of registration (CoRs) for NBFCs was simplified and rationalised. Accordingly, the number of documents to be submitted for CoR were reduced from 45 to about eight. Furthermore, NBFCs were divided into two categories for the purpose of CoR, viz., Type I and Type II. It was also decided to fast track applications of Type I NBFCs, which do not access public funds and do not have customer interface.

Agenda for 2016-17

As in the past, the process of regulatory convergence between NBFCs and banks will be carried forward in 2016-17. Furthermore, the year will also witness policy measures towards grouping NBFCs into fewer categories. As part of public consultation process, the feedback from stakeholders and public on the draft directions for NBFC-AA and the consultation paper on P2P lending has been received. The feedback is being examined to finalise the directions and initiate the process of granting in-principle approval for NBFCAA and also to finalise the contours of regulation of P2P platforms.

NBFCs: Department of Non-Banking Supervision (DNBS)

DNBS – the Reserve Bank's supervisory department for NBFCs – focuses on ensuring an enabling environment for a healthy NBFC sector. Recent years have witnessed a significant growth of the NBFC sector as also the introduction of newer types of NBFCs imparting a critical role to this Department.

Agenda for 2015-16: Implementation Status

For ensuring better coordination among various regulators and gathering market intelligence, a website, hosted by the Reserve Bank was operationalised during the year for use by state-level coordination committees (chaired by the chief secretaries of state governments). A CRILC platform to furnish information on large borrowers was made active during the year for eligible NBFCs. A consultative approach involving regular interaction with participants from the NBFC sector was formalised and meetings were organised accordingly. During the year, a simplified annual return was prescribed for small NBFCs.

During 2015-16, ARCs continued to be active in the takeover of stressed assets from banks.

Agenda for 2016-17

During the year, it is proposed to review the role of statutory auditors in the certification process so as to have a wider supervisory oversight of a large number of small NBFCs. The process of leveraging IT for processing of necessary approvals by the Reserve Bank, which has been initiated, will be taken forward during the year. Furthermore, compliance of NBFCs with the Fair Practices Code is set to be improved through enhanced supervision. A formal PCA framework will be developed for NBFCs. *[Source: RBI Annual Report released on 29th Aug. 2016]* ■

Rediscovering the role of NBFCs

Shri Sunil Kanoria
President, ASSOCHAM

NBFCs have always been an integral part of the Indian financial system. They have been complementing and supplementing the banking sector in reaching out credit to the un-banked segments of the society thus promoting financial inclusion, and over the years their gamut of activity has kept on expanding, so much so, that the exclusiveness between the banks and NBFCs has somewhat blurred. Expanding into areas like infrastructure financing and housing financing, NBFCs now actively contribute in nation building too. The biggest contribution of NBFCs is their ability to cater to the needs of the Micro, Small & Medium Enterprises (MSMEs) which form the cradle of entrepreneurship and innovation in India. After all, it is these MSMEs, scattered throughout the country, account for nearly 40% of India's total employment and form the backbone of the India Growth Story. NBFCs, because of their ground level understanding of customers' profile and their credit needs and their ability to innovate and customise products as per their clients' needs, are the perfect conduit for credit delivery to MSMEs.

The NBFC sector is maturing in India and over the years it has witnessed continuous consolidation. As on September 2015, there were 11,769 NBFCs with an asset size of more than Rs. 16 lakh crore. There are 202 NBFCs each with asset size of Rs. 500 crore or more, with a total asset size of around Rs. 14 lakh crore.

Government of India is pursuing growth, at the same time the banking sector is saddled with huge amount of stressed assets which severely limits their lending ability. In this backdrop, NBFCs assume even more importance. Earlier the bank-NBFC equation was more akin to that of a wholesaler-retailer. However, that is undergoing a change. Many NBFCs have resorted to borrowing by selling commercial paper and short-term bonds. Recently, the norms for accessing ■

[Extract from welcome address at the 3rd National Summit on NBFCs.]

REGULATING NBFC SECTOR-LEVERAGING TECHNOLOGY IS THE WAY FORWARD

Shri C D Srinivasan,
Chief General Manager,
DNBR, RBI

More categories of NBFCs are in queue: RBI felt there was an absolute need for regulating this NBFCs sector in a much better more friendly, more facilitating sort of way. So that is why a department was carved out, out of the then existing department of non-banking supervision, which I lead. It is more than a year old now. That shows the importance which RBI attaches to the regulation aspects of these wide financial entities called non banking financial companies. On the one end of the spectrum, there are primary dealers and on the other end of the spectrum are those account aggregators, and there is also another one which might come up anytime now, peer to peer; and then custodian banking is in queue. So there is a wide family which we have to administer, regulate and obviously one cap fits all policy will be very difficult for us to follow. But then there is also this need to harmonise. So most of the time I struggle where I need to harmonise and where I need to specialise and as our family keeps growing every day the task is getting tougher. Nevertheless if we go by the net owned fund concept then probably there is some sort of uniformity because above Rs. five hundred crore companies, I can say that there is no specialisation there as all NBFCs above this threshold follow the same rule have to file the same returns and there is no classification. Now probably we can start from that and go down from Rs. 500 crores; you may go to 250 crore then may be to 100 crore and try to bring harmony because I have to talk of the road ahead also, that is why I am thinking that if we try to go, drill down and bring in harmony from the regulatory perspective keep minimum returns, standardise the returns formats which need to be filed. Make the process of getting a registration easy, make the process of dying out also, you see it is not just the registration, it is also dying out. People keep cancelling also, many companies are cancelled you might be hearing in the papers. Unfortunately they all come bunched up together so it gives an impression as if we have gone and cancelled it. It is not so. Please don't be misunderstood. Many companies come to us willingly offering to get out of this sphere and we allow them.

We have simplified many returns, especially when you want to become an NBFC, we have made it as simple as possible, we have made it as easy for you to start the process without coming to us. What I mean is we are leveraging on technology. we are slowly trying to make it as transparent as possible so that you anywhere in the world you are able to log onto a portal of RBI and then you get the information which you want and also whatever information, whatever processes you want to start as the contributor to the Indian economy by say starting an NBFC company, if possible, we will be able to provide you all the details and also make you enter into the domain without having to use paper.

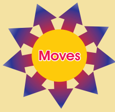
A minimum NOF of one crore by 31st March 2016 to remain NBFC: There were some questions raised as to how to ensure that the net owned funds of the entities that we register or whom we regulate should be beyond a particular point, beyond a particular level. As of now the rule is that the entities should have a minimum NOF of Rs. one crore by 31st March 2016. Only then they will be allowed to be an NBFC. And by 31st March 2017 they should scale up to Rs. two crore. We are committed to ensuring that this rule is followed in letter and spirit because you have all agreed and it is understood that how better it would be to manage this entire family with a minimum threshold of net owned funds. On that we are all committed. If you have any issues how to achieve it we will definitely help you out the process of you achieving this or you going out of this sector will be a smooth one. It will not be a bloody war that much definitely I can assure you. That will be one of our challenges going forward.

P2P are to be just like that marriage broker: P2P as days go by will play a big role in ensuring MSME credit flow, apart from what is coming through the informal sector. But I only wish and pray god that the MSME sector credit which is coming from the informal sector now doesn't get converted to P2P, we will have to be very careful there. That is one of the challenges which we will face as somebody was explaining that the earlier money lender may suddenly become a P2P man. We have to understand that P2P is only going to be a platform, it will only bring the lender and the borrower together on one platform and then those two will sort of find out for themselves what is the best bargain for themselves and the electronic platform, online platform fellow which is the P2P will only get his commission from both the lender and the borrower and that is going to be his business. He will be just like that marriage broker where he will bring and the boy and girls' people together.

Consolidation to ease Regulation: The other thing is there are 11000 odd companies NBFCs at this moment of time. It is definitely the biggest number of entities which RBI is trying to regulate and to supervise. Again here as we saw there is about 80 percent of the NBFC money, NBFC assets, NBFC owned funds are with hardly five to ten percent of the NBFCs in total. The rest are all the smaller ones. That doesn't mean that RBI is not going to look at the smaller ones. Please don't misunderstand that this one crore NOF is not with the intention to get the smaller ones out of the domain. It is not so, it is only to make them healthier. So out of 11,000 after this consolidation takes place we hope that there will be a number which will be manageable for us to supervise and also to regulate.

Regulation in that sense will be easier, supervision is going to be a difficult part because ensuring that everybody gives the returns in time, ensuring that they are audited, ensuring that all the rules of the game are obeyed by the companies whom we supervise is going to be difficult, we have only 17 offices and only 17 department of non-banking financial companies are there which will have to oversee the entire country. There are even now some states which doesn't have an office to which it is attached in that state itself it is attached to some other state, nearby state. It is a big challenge for us. So we have no option but to leverage on technology to ensure that we do the best possible supervision and we act as a very good facilitator as regards regulation making for the sector to develop and to play its important role in the Indian economy.

[Excerpts from the speech delivered at 3rd National Summit on NBFCs. Title and sub-titles were given to facilitate reading.] ■



Govt exempts masala bonds from certain norms under Companies Act

A senior Ministry official said the move would provide clarity on the applicability of the rules on such bond issues as well as help in the ease of doing business. Issuance of these bonds to overseas investors is regulated by the RBI as part of External Commercial Borrowing (ECB) policy framework. [Financial Express/PTI, Aug. 16]

FSB asks India to examine costs of NBFCs raising public money

Indian authorities need to examine "benefits and costs" of NBFCs being permitted to raise funds from public in the context of financial stability, global body FSB said. The Financial Stability Board (FSB) also said Corporate Affairs Ministry, which is currently the oversight authority for non-financial companies, sees "its role mainly as a repository of corporate information rather than a regulator per se".

While these companies' deposit-taking activities are subject to a number of restrictions, information on the extent and nature of those activities is limited, it noted. Noting that not all deposit-taking activities are regulated by RBI, the report said industrial, manufacturing and other non-financial companies are allowed to take deposits — both from their employees and others under the Companies Act 2013 which is overseen by the Corporate Affairs Ministry. According to FSB, the practice appears prima facie inconsistent with RBIs policy to discourage deposit mobilisation activities outside banks. "It may therefore be useful for the authorities to examine the benefits and costs of this activity from a financial stability perspective," FSB said in its peer review report of India. [PTI/India Today, Aug. 21]

SNIPPETS:

NPCI launches Bharat Bill Payment System pilot project: National Payments Corporation of India on Aug. 31 said it has launched the pilot project for Bharat Bill Payment System (BBPS) with 26 Bharat Bill Payment Operating Units. In the first phase, BBPS will cover repetitive payments for everyday utility services such as electricity, water, gas, telephone and direct-to-home (DTH), etc.

The Government will bear MDR: In order to promote less cash economy, the government has said it will bear the transaction cost for all payments made to it through debit or credit cards and net banking. At present, customers bear the transaction cost commonly known as merchant discount rate (MDR) on payments made to the government.

Centralised KYC: To streamline and centralise the KYC process, RBI, SEBI and IRDAI have authorised the Central Registry of Securitisation and Asset Reconstruction and Security interest of India (CERSAI) to come up with a central KYC (C-KYC) registry. With C-KYC, all your KYC details will be stored electronically by CERSAI. You need to submit the details only once. You will be issued a unique C-YKYC number that you can quote for all your KYC requirements.

Union Budget may be advanced by a month to 31 January: It will help Government departments to start spending the money allocated to them right from the beginning of the fiscal year instead of waiting for the budget to be passed by the Parliament. It will also help in resource mobilization as budget proposals can be implemented from 1 April. Railway budget will also be merged with general budget.

CBDT IN ACTION MODE: [1] Keen to bring down the number of tax litigations, the I-T Department will soon write to over 2.59 lakh taxpayers asking them to avail the one-time dispute resolution scheme to settle their cases. The Direct Tax Dispute Resolution Scheme, introduced from June 1, seeks to address the issue of pending litigation before Commissioner of I-T (Appeal). The scheme is open till December 31. [2] CBDT has launched the ambitious 'e-nivaran' facility for online redressal of taxpayers' grievances related to refunds, ITRs and PAN among others. A link has recently been activated on the e-filing portal of the department- www.incometaxindiaefiling.gov.In — where taxpayers can register their complaints through their personal computer systems. ■

SICA prevails over Companies Act

The Supreme Court stated that different situations might arise when a sick company is before both the company court for winding up and before the Board for Industrial and Financial Reconstruction (BIFR) for its revival, "but whatever be the situation, whenever a reference is made to the BIFR under the Sick Industries Act (SICA), the provisions of the latter would come into play and they would prevail over the provisions of the Companies Act and proceedings under the Companies Act must give way to proceedings under the Sick Industries Act." The court reiterated this view after going through the case law on this issue in its judgment in the case, Madura Coats Ltd vs Modi Rubber Ltd. Madura Coats moved the Allahabad High Court for winding up Modi Rubber as its dues were not paid. The company court appointed an official liquidator, against which Modi appealed to the high court. Meanwhile, Modi also moved the BIFR and a rehabilitation package was approved. The high court stayed the company court proceedings. This situation raised the question which law would prevail and the Supreme Court upheld the high court view. The judgment noted that since Madura Coats has already participated in the BIFR proceedings, nothing survived in this case. "Strictly speaking, we have merely undertaken an academic exercise," the three judges observed in this 14-year-old litigation which is still continuing. [Business Standard, July 3]

Time limit starts from first default

The Supreme Court had dismissed the appeal of Sundaram Finance Ltd against the Kerala High Court judgment which stated that its suit against a defaulting borrower, Noorjehan Beevi, was beyond the time limit of three years. In this case, a woman bought a vehicle on hire purchase from the financing firm in 1984 but defaulted after a year. The company took over the vehicle and sold it, though there was no term in the contract empowering the company to sell it. However, the amount recovered was not sufficient to clear the loan and the company sued the woman for the balance. She argued that the suit was filed beyond the limitation period. The company argued that the time started from the sale of the vehicle. The woman contended that the time should be counted from the first default. The trial court, the high court and now the Supreme Court agreed with her. [Business Standard, July 3]

Parliament approves Bill to fast track recovery of bad loans

Parliament approved the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Bill, 2016. It received the assent of the President on the 12th August, 2016 and was notified in Government Gazette on Aug. 16.

Primarily, four existing legislations, namely: i. Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002; ii. Recovery of Debts due to Banks and Financial Institutions (RDDBFI) Act, 1993; iii. Indian Stamp Act, 1899; iv. Depositories Act, 1996 were amended.

Highlights of the Amended Act

- Amendments to the SARFAESI Act, 2002: The SARFAESI Act allows secured creditors to take possession over a collateral, against which a loan had been provided, upon a default in repayment.
- This process is undertaken with the assistance of the District Magistrate, and does not require the intervention of courts or tribunals.
- The Bill provides that this process will have to be completed within 30 days by the District Magistrate.
- In addition, the Bill empowers the District Magistrate to assist banks in taking over the management of a company, in case the company is unable to repay loans.
- This will be done in case the banks convert their outstanding debt into equity shares, and consequently hold a stake of 51 percent or more in the company. [Government Gazette, Aug. 12]

Draft Law for Ponzi schemes

The challenge was how do you deal with Ponzi schemes? First, certain acts have to be declared illegal. Second, if there is a Ponzi scheme there has to be a provision of seizing the assets and returning them to the investors. The third aspect is taking penal action against the perpetrators of this kind of illegal schemes.

The draft Bill on Ponzi schemes addresses all these issues. Some States have enacted laws, but there are a few deficiencies. The Central law will be very robust legal framework, which will address all the issues, said Shaktikanta Das, Secretary of Department of Economic Affairs in an interview to Business Line. ■

SEBI relaxes InvITs, REITs rules; sops to foreign investors

SEBI board meeting held on Sept. 23 amended several regulations as follows:

FPIs allowed to trade directly in corporate bonds : SEBI amended the rules for FPIs to trade directly in corporate bonds. According to the new rules, Category I and Category II FPIs can now access debt markets directly without any brokers, while direct participation for Category III would be allowed only through e-book platform of stock exchanges.

Relaxation in rules for, InvITs and REITs : According to the new regulations, InvITs and REITs can now invest in a two-level special purpose vehicle (SPV) structure through the holding company. The holding company in both vehicles would have to distribute 100 per cent cash flows realised from the underlying SPVs and at least 90 per cent of the remaining cash flows. SEBI also reduced mandatory sponsor holding in InvITs to 15 per cent, removed the limit on the number of sponsors and rationalised the requirements for private placement of InvITs. For REITs, the regulator removed the limit on the number of sponsors, introduced the concept of sponsor group, and allowed investment up to 20 per cent in under-construction assets.

SEBI to float consultation paper on investment advisors : Consultation paper would seek a re-examination of the exemptions provided to mutual fund distributors and also SEBI-registered intermediaries for providing advice, as an incidental activity to their primary business.

More market intermediaries allowed to obtain permanent registration : In another important development, market intermediaries, including merchant bankers, registrars, credit rating agencies, depository participants and portfolio managers, can now obtain permanent registration with SEBI.

Limit for foreign investors' shareholding limit raised to 15 %: The regulator also increased foreign investors' shareholding limit in Indian stock exchanges to 15 per cent from the earlier five per cent. This is in line with the initiative announced by Finance Minister Arun Jaitley in Budget 2016-17.[Business Standard, Sept. 24]

SEBI to beef up cyber security framework for markets

To protect securities markets from cyber threats, SEBI is looking to further beef up its policy framework on this front and plans to appoint a Chief Information Technology Security Officer [CITSO] to head these initiatives. He will be responsible for strengthening its regulatory policy framework in the area of cyber security. He would oversee implementation of these regulatory policies across security markets and also help enhance capacity building at SEBI and various market participants with respect to cyber security. SEBI would also develop stress testing mechanism to mitigate risk arising out of cyber-attacks, while necessary framework would be put in place for taking corrective measures and prudent response in case of cyber attacks at the regulator or market participants [Times of India/PTI, Sept. 25]

SEBI may relax norms for firms eager to list on national bourses

At least 2,000 companies, struggling to stay afloat in the listed space, may finally get a breather. The SEBI is about to introduce norms that will allow companies migrating from defunct regional bourses to raise capital through private stake sales and become eligible to list and trade stocks on national exchanges such as the BSE and the NSE. To be able to list on a national bourse, companies require higher paid-up capital and net worth and need to comply with stricter listing norms. Under the norms, if a company listed on an existing/derecognized stock exchange wants to get directly listed on a national trading platform, it needs a minimum issued and paid-up capital of Rs. 1 crore and a minimum net worth of Rs. 3 crore. [Live Mint, Sept. 2]

SEBI weighs cash benefit distribution via depositories

In an effort to improve investor experience, SEBI is considering a proposal to distribute cash benefits through depositories. A consultation paper in this regard was placed for public comments in April this year. The regulator had sought views of all stakeholders till May 5. The move will help in bringing Indian markets at par with most developed markets where depositories usually distribute cash benefits to investors. [Times of India/PTI, Aug 23] ■

Sound financials place NBFCs to make best of credit demand

Finance companies with better risk management and recovery systems are better placed than banks to take advantage of an upturn in credit demand. Vibha Batra, co-head of ICRA, said finance companies, especially those in the retail space, faced less concerns over asset quality. The tightening of regulatory framework has also given strength to finance companies. The PSBs are facing the highest stress levels and it is because of this that their performance has also been under pressure. In fact, the Financial Stability Report of RBI pointed out that the NBFCs are performing better than the banks. [Business Standard, June, 30]

No let up in share pledging by promoters

There is a marginal increase in the number of companies where promoters have pledged shares in April-June quarter. According to a study by Edelweiss Research, 721 companies (in a universe of 3,098 companies) have reported promoters' pledge holdings during April-June 2016 compared with 699 (among 3,166 firms) in the previous quarter. Pledging of shares does not necessarily imply that a company or a promoter is under financial stress; banks (lenders) could have sought additional security in the form of promoters' shares," said Kotak's Sanjeev Prasad and Sunita Baldawa said. However, value of pledged holding rose to Rs. 2.28 lakh crore in Q1-FY17 compared to Rs.1.85 lakh crore in Q4-FY16. [Business Line, Aug. 8]

Profits of private companies up; sales contract in FY16

Private companies saw their profits rise last fiscal despite contraction in sales, a first in the last 15 years, according to the Reserve Bank data of 2932 listed non-government non-financial listed companies. At the aggregate level, operating profit grew by 10.2 per cent in 2015-16 compared with 5.3 per cent in the previous year, boosted mainly on account of sharp contraction in raw material expenses "Net profit grew by 9.3 per cent in 2015-16 as against Y-o-Y contraction of 0.7 per cent in the previous year mainly on account of higher operating profits and lower tax provisions growth. Y-o-Y growth in net profits improved across all sectors," RBI said. Overall sales totaled Rs 29,898 billion last fiscal, as against Rs 31,191 billion in 2014-15. Net profits, on the other hand, were up at Rs 1,966 billion as against Rs 1,825 billion. [Financial Express/PTI, Sept. 2]

NBFCs offer 6-9 month moratorium on interest to builders

Several builders under severe cash crunch are getting a breather from debt repayments with some lenders, especially NBFC, offering a moratorium on interest repayments over and above moratorium on principal repayments that builders were already enjoying. This breather has been necessitated by the continuing cash flow crunch among builders as home sales remain dry in many areas. "Selectively, we have given interest as well as principal moratorium in projects where immediate cash flows might not be visible but we like the project and the developer and see that cash flows will pick up after the first 12-18 months once potential home buyers see that the project is off the ground and construction is well underway," said Amar Merani, chief executive at Xander Finance.

While principal moratorium can range from 18 to 30 months, interest moratorium usually is between 6 to 9 months with a few NBFCs extending it to 12 months in some cases. [Procomindia/ET, Sept. 02] ■

FIDC Meeting with Shri Kshtrapati Shivaji, CMD, SIDBI at Mumbai on 01 09 16 to discuss modalities of MUDRA re-finance to small NBFCs. Present (from left to right): Shri K V Srinivasan, Shri Mahesh Thakkar, Shri Kshtrapati Shivaji and Shri Raman Aggarwal.

SIGNIFICANT MILESTONES OF FIDC FOR 2015-16

FIDC is contemplating to have Vision and Action Plan for the NBFC Sector and for the purpose it is considering to set up Think Tank/Advisory Council, involving independent financial experts, media leaders, legal luminaries etc. from financial and allied fields, in order to improve the NBFC Sector's image, perception and reputation. FIDC organized last year a "Media Briefing" to announce its vision to reposition NBFCs in the Indian Financial System, notes FIDC Report.

"In order to reposition NBFCs in the Indian Financial System, the Managing Committee members regularly engaged with all the stakeholders at RBI, Ministry of Finance, Ministry of Road Transport & Highways, Indian Banks Association and also the leading Chambers of Commerce and Industry," adds FIDC Report. Healthy discussion held during personal meetings with various authorities followed by persuasive representations, were the key to FIDC achieving greater heights during last year.

Highlighting its achievements FIDC said in its report" Union Budget 2015-16 accepted our demand and allowed NBFCs to avail deduction of 5% in the total income against the provisions made on NPAs".

Moreover FIDC said, to provide a much needed relief to tackle the menace of cheque bouncing, especially in the light of the confusion created by the Supreme Court Order, aggressive representation and suggestions made to Ministry of Finance and Ministry of Law and Justice on the need to amend The Negotiable Instruments Act, 1881, the same were accepted and the Act was subsequently amended so as to redefine that the jurisdiction for filing criminal cases U/S 138 of The Negotiable Instruments Act.

FIDC In Action

Notification for 196 NBFCs with assets above Rs. 500 Cr. under SARFESAI Act issued

The Finance Ministry has notified under sub-clause (iv) of clause (m) of sub-section (1) of section 2 read with section 31A on 5th August 2016 that SARFESAI Act will be applicable to notified 196 NBFCs (as per the list in the gazette notification) having asset of five hundred crore rupees and above as per their last audited balance sheet, as "financial institutions. However there is an exception that Sections 13 to 19 of the Act (Which are Enforcement Sections) will be applicable only to such security interest which is obtained for securing repayment of secured debt with principal amount of rupees Rs.1 crore and above.

This was a significant attainment of FIDC as the cause was relentlessly pursued with the government and regulator.

FIDC took up on Sept. 8 with the Finance Minister the need for removal of this exception made only for NBFCs, saying that "it is the duration of the overdue period of a loan, and not the ticket size, which determines whether the loan (Asset) is to be classified as "nonperforming" or not," according to RBI's prudential norms for all financial entities. Raman Aggarwal, chairman, FIDC said, ' it is imprudent and unjustified to make the ticket size of the loan as a determining factor for use of tools of recovery of that particular loan.'

FIDC Top brass met NS Vishwanathan, RBI Deputy Governor and Sudarshan Sen, ED, RBI

FIDC top brass met NS Vishwanathan, Dy. Governor, RBI and Sudarshan Sen, Executive Director, RBI to greet them after taking over the charge of various departments including Department of Non-Banking Regulation of RBI. They while during discussion brought to fore various issue concerning NBFC sector as under:

- **Risk Weightage for Productive Assets:** instead of uniform risk weightage of 100%

Risk weightage appropriate to different classes of assets be stipulated to provide NBFC-AFCs a degree of capital relief.

- **Need to Promote Leasing:** Requested RBI to take up this matter with Government of India for removal of hurdles to promote leasing which can play a key role in the revival and growth of important sectors like Infrastructure and MSMEs.
- **Acceptance of Public Deposits:** small and medium sized NBFC-AFCs may be allowed to accept public deposit with a minimum ticket size of Rs.50,000/-(Fifty Thousand only) without obtaining an investment grade credit rating.
- **Refinancing By MUDRA as a Substitute to Public Deposits:** The eligibility norms for NBFCs for availing refinance from MUDRA should be made favorable as it will enable small and medium sized NBFCs to shift from acceptance of public deposits and instead avail refinance from MUDRA.

First interactive meeting of SIAM group with FIDC members

A meeting of the Finance, Leasing and Insurance group of Society for Indian Automobile Manufacturers [SIAM] was held under the chairmanship of Mr Ajay Seth, Chairman of the group on 13th July 2016 at SIAM office, New Delhi. A delegation of Finance Industry Development Council (FIDC) members also joined the interactive session to work together in future on mutual issues in a proactive manner regularly. Mr Raman Aggarwal, Chairman, FIDC, raised a few concerns with regards to vehicle financing by NBFCs in the country and requested support from the SIAM group to address those issues.

Among the issues discussed were non-accessibility for NBFCs of the Vahan Database of the government that has details of all the vehicles sold in the country as only banks, insurance companies, transporters are eligible to access the information available. The provision to mark the lien in favour of the financier is only in the machine readable and not in the printable zone of Smartcard which is susceptible to frauds where a vehicle may be sold without the knowledge and consent of the financier. This issue started in Delhi but has now spread in many other states, FIDC said.

Amongst the issues relating to financing of vehicles FIDC brought fore were: [i] two wheeler financing and private cars should also be incorporated under the purview of Asset Finance by RBI as both are assets, [ii] Instead of assigning a uniform risk weight of 100 for all assets RBI should prescribe a system of assigning differential risk weight to financing of different assets, ensuring that low risk carrying assets like vehicles should be assigned a lower risk weight.

Some concerns related to leasing business like leasing being subjected to the levy of both Service Tax and VAT; disallowance of depreciation benefits and problem relating to financial lease etc. were also indicated by FIDC. SIAM expressed interest in promoting leasing business in the country and requested FIDC to share their suggestions on this topic.

Chairman of the SIAM group requested FIDC members to share their views on the proposed GST to be further taken up with the Government.

Meeting with Joint Parliamentary Committee

FIDC Team met Joint Parliamentary Committee on 'The Enforcement of Security Interest And Recovery of Debts Laws And Miscellaneous Provisions (Amendment) Bill, 2016' on June 30 at Mumbai and suggested to amend section 31A. FIDC also represented that the definition of financial lease proposed under Section 2(1) (ma) should be amended so as to clearly specify the nature of the transaction and ownership rights (leading to the right to claim depreciation). It was also pleaded that a single common pool of all the registration records of security interests on any moveable/immoveable property with the Central Registry be integrated.

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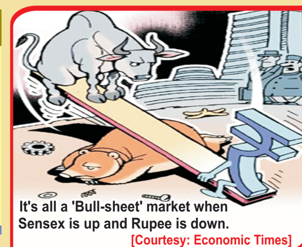
Suggestions and feed-back

We would appreciate your views, suggestions and feed-back to make the **'FIDC News'** more useful and illuminating. Your inputs and contributions too are welcome on : fidcnews@gmail.com

- Editorial Committee



It's all a 'Bull-sheet' market when Sensex is up and Rupee is down.
[Courtesy: Economic Times]

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