FIDC

Finance Industry Development Council

(A Representative Body of NBFCs in India)

101/103, Sunflower, 1st Floor, Rajawadi Road No.2, Ghatkopar (East), Mumbai – 400 077

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Smt. Nirmala Sitharaman ji 27th December, 2024
Minister of Finance,
North Block,
Government of India,
New Delhi 110 001

Hon'ble Finance Minister Madam,

SUB: PRE-BUDGET MEMORANDUM 2025-26 – CONCERNS & SUGGESTIONS FOR AN ENHANCED ROLE OF NON-BANKING FINANCE COMPANIES (NBFCs)

Finance Industry Development Council (FIDC) is a Representative Body of the NBFCs including Housing Finance Companies registered with the Reserve Bank of India. FIDC was formed 20 years ago and is the recognized face of the NBFC sector. Almost all the leading NBFCs and a large number of small and medium sized NBFCs are our members. FIDC has submitted its application to RBI to be recognized as the Self-Regulatory Organization (SRO)for the NBFC sector.

On behalf of the Board of Directors and the members of FIDC, I would like to convey our sincere Thanks for providing us the opportunity to share our concerns and suggestions thereon. The NBFC sector stands committed to play an important role in meeting the increased demand for credit by the unbanked and under banked segment of the society, as we work towards building a "Viksit Bharat" by 2047.

Important Developments in the NBFC Sector

Enhanced Contribution

- As per an SBI Report dt. June, 2024 the NBFC sector in India has grown to become the 3rd largest in the world, next to US and UK
- Credit growth by NBFCs to the MSME sector was more than three times that of banks.
- The sector has shown a healthy and robust growth despite challenges

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Foreign Borrowings by NBFCs have Surged due to Reduced Bank Borrowings

As per the data released by RBI on External Commercial Borrowings (ECBs), NBFCs have borrowed $16 billion during 2024 (January - October) with $5.5 billion in October alone. This isa significant increase as compared to previous years. This is primarily due to the reduction in bank borrowings. This also shows the increased interest and confidence among foreign investors.

NBFCs are Leaders in Green Financing

Recent press reports have confirmed that NBFCs are the leaders when it comes to financing clean environment initiatives like electric vehicles (EVs) and solar rooftops. This reflects the higher risk-taking appetite of NBFCs and their commitment to building a clean and green Bharat.

Harmonization of Regulations of NBFCs with Banks

RBI has harmonized the regulation of NBFCs with that for banks and FIs, especially, the prudential norms on income recognition, asset classification and provisioning. Commensurate harmonization in provisions relating to Recovery and Taxation are still pending for long.

Concerns of the NBFC Sector

We seek your kind attention to the major concerns of the NBFC sector, some of which have been pending for a long time, that need urgent attention and remedial action.

Details of Specific Issues and our Suggestions thereon, related to:

- ***Diversification of Funding Sources & Tools for Recovery are given in Annexure – A***
- ***Financing of MSMEs are given in Annexure - B and***
- ***Taxation are given in Annexure – C.***

The concerns raised are of prime importance to ensure a healthy growth of NBFCs and enhance their contribution to the growth of India's economy. We shall be glad to provide any clarification or further information in this regard.

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Thanking you,

Yours Faithfully,

For FINANCE INDUSTRY DEVELOPMENT COUNCIL

MAHESH THAKKER
DIRECTOR GENERAL

Encl.: Annexures – A, B & C

Annexure – A: Diversification of Funding Sources and Tools for Recovery

1. Funding Sources to be Diversified - Need for a Refinance Window for NBFCs

In order to diversify their funding and reduce dependence on banks, Indian NBFCs are opting for foreign borrowings for on-lending in the domestic market. Going by the spirit of building an "Atmanirbhar Bharat" it is not only prudent but important that Indian NBFCs must have diversified funding sources within the country.

As financial intermediaries, the demand for funding of NBFCs has increased proportionately to the increase in credit demand in the country. Moreover, as explained earlier, NBFCs have enhanced their contribution in the credit to the of small borrowers, MSMEs and the climate change related initiatives like Electric vehicles (EVs) and Solar Rooftops.

However, the supply of funding to NBFCs has not increased commensurately over the years which has resulted in liquidity being a recurring challenge. With RBI expressing their concern on over dependence of NBFCs on bank funding, bank borrowings have also shown a decline which has resulted in large NBFCS to look for foreign borrowings and a large number of small and medium sized NBFCs, who are majorly dependent on bank borrowings, have to borrow from their larger peers at a higher cost.

There is therefore an urgent need to create a dedicated Refinance window for NBFCs to ensure a smooth and sustainable flow of funds that would also help address the concerns relating to asset liability mismatch. Funds raised through this mechanism may be exclusively used to finance MSMEs, priority sector and green initiatives.

The Parliamentary Standing Committee on Finance in their 45th Report dt. June, 2003 had also recommended setting up of a Refinance Institution for NBFCs on the lines of National Housing Bank for HFCs.

Suggestion:

DFIs like SIDBI should provide refinance to NBFCs for on-lending to the MSME and the priority sector, with special fund allocation from the Govt. During our interaction, the Management at SIDBI have conveyed their willingness to take up this role.

2. Widening and Deepening of the bond market:

A thriving bond market (especially for bonds rated BBB+ to AA) would help in expanding alternate sources of funding for NBFCs and help reduce dependence on banks. At present the primary as well as the secondary market for corporate bonds is limited largely to AAA and AA+ bonds, and even for such bonds there is no organised market making mechanism and so these bonds tend be largely illiquid.

Suggestion:
We request that a suitable mechanism of market making (perhaps on the lines of the Primary Dealers with suitable modifications) be implemented to assist the corporate sector to access public funds in an organised manner with ready retail liquidity.

3. Loan Amount Threshold for Enforcing Security Interest under The SARFAESI Act to be Reduced from 20 Lakhs to Rs. 1 Lakh for NBFCs

NBFCs have faced challenges due to this limit being set at Rs. 20 lakhs as it takes abnormally longer time for resolution of stressed account in absence of SARFAESI which goes as high as 5 years which not only increases the number of stressed accounts on NBFCs balance sheet but

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also increases the legal and litigation cost of NBFCs. This cost gets unnecessarily loaded on the good MSME borrowers which are standard and making timely servicing.

The RBI has vide its notification dated November 12, 2021 implemented a key change of recognising delinquencies on a daily basis instead of on a monthly basis, irrespective of the loan size. This would have a significant impact on the level of systemic NPAs reported by the NBFCs. The recognition norms are thus harmonised across banks and NBFCs. Provision of speedier and effective recovery mechanism in the form of SARFAESI Act is critical to manage this additional burden.

It may be relevant to mention here that the average size of loans sanctioned by NBFCs is far lower at about Rs 5 lakhs, implying that most of the customers of NBFCs are out of the present threshold of Rs 20 lakhs. This effectively places the NBFCs at a disadvantage by preventing NBFCs from usage of a legally valid recovery tool available to banks, creating a piquant situation that in respect of the same customer a bank may resort to the provisions of the SARFAESI Act, while an NBFC cannot. There would be another dichotomy in the case of co-lending and it is not clear as to whether the participating bank can invoke the SARFAESI Act for its own share but the partner NBFC is not permitted to do so.

NBFCs are also subject to a fair practice code and other safeguards to prevent misuse of such provisions to harass customers. NBFC ombudsmen have also been appointed to address any customer grievance in this matter, thus minimising risk of recalcitration.

Suggestion:
In view of the above submissions, the said threshold should be reduced from Rs. 20 lakhs to Rs. 1 lakh in order to bring NBFCs at par with HFCs, Banks, SFBs and other financial institutions. The same was also recommended by the Expert Committee on MSMEs setup by RBI under the Chairmanship of Sh. U.K. Sinha.

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Annexure – B: Financing of MSMEs by NBFCs

1. NBFCs Registration under The Factoring Regulation Act – Request for Harmonisation of Regulations with the Factoring (Amendment) Act, 2021

We invite a kind reference to Paragraph 5 (ii) of the Statement of Objects and Reasons of Factoring (Amendment) Act, 2021, which reads as under:
"(ii) amend section 3 to widen the scope of financiers and to permit other nonbanking finance companies also to undertake factoring business and participate on the Trade Receivables Discounting System platform for discounting the invoices of micro, small and medium enterprises;"

The essence of objects and reasons for the amendments to the Factoring Act, in our bona fide opinion, was to widen the number of financiers and to permit other NBFCs, in whatever proportion of their assets and income to do factoring business, except that the assignment of receivables has to be registered through and on the TReDS platform (under payment system) However, as per RBI Notification No. DOR.FIN.080/CGM(JPS)– 2022 dated January 14, 2022 the eligible NBFCs (classified as Investment and Credit companies – NBFCs-ICC and whose principal business is lending) need to seek fresh registration with RBI for undertaking factoring business. Thus, they have to carry dual registration – both as an NBFC (ICC) and an NBFC (Factor).

Apparently, the prescriptions regarding requirements of separate registration as NBFC (Factor), except for the purpose of eligibility to participate on the TReDS platform are incongruent and inconsistent with the Factoring Regulation (Amendment) Act, 2021.

Suggestion:

(1) For the existing registered NBFCs, factoring should be subsumed by the classification of NBFC (ICC) meaning thereby that the separate classification of NBFC (Factor) should be done away with.

(2) In such cases, all the registered NBFCs may be authorized to commence or carry on the business of factoring under the Factoring Regulation Act by registering itself on TReDS platform. The Certificate of Registration held by the applicant NBFC may also be considered as

<u>the certificate of registration under the provisions of Section 3 of The Factoring Regulation Act.</u>

2. Bank Lending to NBFCs for On-lending to Priority Sector Treated as PSL by Banks – Need to Re-look at the Caps Imposed

Since 1999, RBI had allowed all bank lending to NBFCs for on-lending to the priority sector, to be treated as priority sector lending by banks. This gave a huge incentive to banks to lend to NBFCs. While it ensured sufficient bank funding to NBFCs at a reasonable cost, it also facilitated banks to meet their PSL targets. This was withdrawn in 2011 and subsequently re-started by RBI but has been restricted to only 5% of total Priority Sector Lending done by banks. This limit of 5% has been there for more than 5 years now.
Further, there is a cap of Rs. 10 lakhs per borrower for Agri loans and Rs 20 lakhs per borrower for non-Agri loans given to the priority sector. However, no such caps exist for direct lending by banks to these sectors. Further, RBI norms on Credit Concentration have prescribed limits on the total quantum that NBFCs can lend to any single borrower. Thus, these caps seem to have no relevance and simply restrict lending to the priority sector.

<u>Suggestion:</u>

<u>- The cap of 5% should be increased to at least 10% of the total priority sector lending done by banks, in order to ensure a better flow of credit to the priority sector by ensuring a greater portion of bank funding to NBFCs going towards priority sector lending</u>
<u>- The caps of Rs. 10 lakhs per borrower in Agri and Rs. 20 lakhs per borrower in Non-Agri priority sector lending, have lost their relevance. They should therefore be done away with.</u>

<u>Annexure – C: Taxation</u>

1. TDS On Interest (Section 194A) – Request for Exemption

As per section 194A of the Act, any person making payment of interest is required to deduct tax at source ('TDS') @ of 10%. There are certain exemptions given under this section wherein the person making payment to various institutions like Banking Company, Life Insurance Companies

and UTI etc., is not required to deduct TDS. Accordingly, any person making payment of interest to Banks is not required to deduct tax.
However, no such exemption has been provided to NBFCs from the applicability of section 194A. Accordingly, tax is required to be deducted at the rate of 10 percent from interest paid to NBFCs. This creates severe cash flow constraints since NBFCs operate on a thin spread/ margin on interest which at times is even lesser than the TDS on the gross interest. Further, due to enormous transactions running into thousands, NBFCs have to face severe administrative hardship.

RBI has allowed banks and NBFCs to engage in Co-Lending to the priority sector. As per this, a single borrower may be co-funded by bank and a NBFC in a pre-determined ratio. Both bank and NBFC may price the loan independently. However, the borrower shall be offered a single blended rate of interest. All the repayments made by the borrower (including the interest) by way of EMIs shall be made to an escrow account from where the amounts shall be credited to the bank and NBFC in respective proportion. In such a scenario, the borrower shall not be in a position to split the EMI and determine the exact interest component of the NBFC portion and hence TDS deduction shall be practically impossible. It is therefore important to bring both bank and NBFC at par on the TDS provisions.

<u>Suggestion:</u>
<u>There is an urgent need to exempt NBFCs from TDS Deduction u/s 194A in order to ensure harmonization and remove the ambiguity in Co-lending. The same may be done by way of a Notification to be issued u/s 194A (3)(iii)(f).</u>

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