FIDC

Finance Industry Development Council

(A body incorporated as a Self RegulatoryOrganisation for Registered NBFCs – AFCs)

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

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December 31, 2014

To
Mr. R. Gandhi,
The Deputy Governor,
Reserve Bank of India,
Central Office, 19th Floor,
Central Office Building,
ShahidBhagat Singh Road,
MUMBAI 400 001.

Sir,

We ***thank you*** very much for the courtesy extended to FIDC key Managing Committee Members when they met yourself at your office at Mumbai on November 28, 2014.

As discussed, we submit herein below some of the issues concerning NBFC Sector for your kind consideration.

1. **RISK WEIGHTAGE FOR PRODUCTIVE ASSETS**

Under the present dispensation, all the assets financed by NBFCs, regardless of whether they are secured or unsecured and regardless of the risks associated with different assets, carry a uniform risk weightage of 100%. It is a well documented fact, based on the detailed analysis undertaken by credit rating agencies that commercial vehicles, cars and construction equipments have a much lower risk profile, as compared to other categories of assets. By their very nature, they are easily saleable and realise significant residual values.

In light of the above, we submit that the risk weightage for assets financed by NBFC-AFCs to be revised as under

- ***For Commercial vehicles, Cars & Multi Utility Vehicles = 50%***
- ***For Construction & Material Handling Equipment & Tractors = 50%***
- ***Loans against Gold and Silver Jewelry uptoRs. 1 Lakh = 50%***
- ***Loans for plant & machinery/equipmentfor SMEs = 50%***
- ***Three Wheelers, Two Wheelers and Industrial Equipment = 75%***

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It is our submission that this would duly reflect the appropriate levels of risk inherent in the respective asset classes and provide NBFC-AFCs a degree of capital relief. This is also in consonance with the Base III requirement for Banks.

2. RECOVERY MECHANISM – COVERAGE UNDER THE SARFAESI ACT

We reiterate our demand that in spite of the fact that NBFCs are today regulated almost at par with banks, they have been denied the benefit of any defined recovery mechanisms which are available not only to banks but also non bank entities like Housing Finance Companies.

Recently, RBI has amended the NBFC norms based on the recommendations made by the Working Group on NBFCs (Usha Thorat Committee) and the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households (Nachiket Mor Committee). The genesis of these amendments is to bring parity with banks when it comes to NPA classification norms. As such, it is all the more important to bring total parity with banks by giving NBFCs tools for recovery, as available to banks. Without adequate tools for recovery, expecting NBFCs to comply to the new NPA classification norms shall be like thrusting a soldier to fight a battle without giving him adequate arms/protection.

RBI had issued a “Framework for Revitalizing of Distressed Assets in the Economy” in order to check the growing menace of NPAs. This framework is equally applicable to banks and Systemically Important NBFCs and has recommended coverage of these NBFCs under the SARFAESI Act.

Since the new framework has already been enforced, coverage of Systemically Important NBFCs (NBFC- ND – SI) and Deposit taking NBFCs (NBFC – D) under SARFAESI Act needs to be given top priority. Moreover, both the expert committees, mentioned above, had also recommended the same.

3. ISSUES PERTAINING TO SMALL NBFCs ARISING OUT OFRBI NOTIFICATION DATED 10TH NOVEMBER 2014

3.1 Separate Category for small NBFCs: 90% NBFCs today are small. They can not be treated at par with large NBFCs. When small banks have been allowed with Net Owned

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Fund of 100 crores and SME Exchange has already started working, then small NBFCs should also be declared as a separate category on the basis of Net Owned Funds. So all small NBFCs including Deposit taking having NOF upto Rs.10 crores should be declared as separate **Small NBFC category** to fulfill objective of **FINANCIAL INCLUSION**.

3.2 Credit Rating should be made Accessible and Affordable for small NBFCs (AFCs): Out of total existing 241 deposit taking NBFC (AFC), 184 are small, having deposits less than Rs. 10 crores. It is an accepted fact that credit rating agencies follow the same model to rate NBFCs irrespective of their size. As a result, obtaining the minimum Investment grade rating has become practically impossible and unaffordable for small NBFCs, simply due to their small size and inspite of their financial performance. We therefore request that a joint meeting with all the approved Rating Agencies should be called, to ensure that the “small size” should not be a hurdle for obtaining investment grade rating.

Till such time, these existing small Deposit-taking NBFCs should be allowed to raise Deposits without rating requirement, from their relatives, friends and close associates, without any public advertisement/agent and also other affordable debt instruments.

3.3 More time required to increase capital for small NBFCs: At present, though the minimum requirement of NOF for registering new NBFCs is Rs. 2 crores, RBI had allowed existing NBFCs with NOF below Rs. 2 crores and above Rs. 25 Lacs, who had obtained RBI registration as per RBI Amendment Act (1997), to continue operations. Now, these companies have also been asked to increase their NOF to Rs. 2 crores, giving only 2 years time. It is our submission that time should be given 5 years instead of 2 years. Similarly, more time may be granted for rated NBFCs to reduce deposits to the prescribed level.

4 . Reduction in NPA Provisioning Norms (Para-8):

Overdue period for classification of an Asset as Non-Performing Asset has been brought down to 3 months in a phased manner with the justification “In the interest of harmonization, the asset classification norms for NBFCs-ND-SI and NBFCs-D are being brought in line with the Banks in a phased manner”.

Ground realities of AFCs is totally different from Banks as they deal mainly with rural/illiterate/ un-banked segment of society which is mainly self employed besides deprived of the benefits of SARFESI & Debts Recovery Tribunal (DRTs). Instalments are normally delayed due to the

peculiar circumstances of the borrowers. Even Nachiket Mor committee recommended 365 days for some sectors of AFCs stating that "one size fits all" approach for provisioning is not desirable.

Realization of default amounts through legal re-course takes years, making NPA norms more stringent will only harm the cause of 'Financial Inclusion' as AFCs would be very selective in lending thus forcing small borrowers to go to un-regulated sector/Money Lenders making them vulnerable. The need of the hour is to introduce measures to expedite recovery in the present times. We request that overdue period for classification as an NPA be kept at 6 months.

Asset classification

The asset classification norms for NBFCs are sought to be brought in line with those of banks, in a phased manner and accordingly 90-day NPA classification is prescribed by March 2018. While this would bring the asset classification norms in line with the banks, the disparity in respect of the tax treatment in respect of NPA provisions and Recognition of Income on NPA assets has not been addressed. **It is relevant here to quote from the recommendations of the Usha Thorat Committee. "Banks and NBFCs are in similar businesses of lending and investing. Since the assets of the two financial entities are similar, it is necessary that they be subject to similar prudential norms for asset classification, income recognition and provisioning. However, the tax treatments for provisions are not similar. It is therefore proposed that the tax treatment for provisions made by NBFCs for regulatory purposes should be similar to that for banks."** It is our humble submission that unless suitable amendments to the Income Tax Act are carried out in respect of allowability of provisions and income deferment, the objective of 'Harmonisation' would not be met. On the other hand, NBFCs would be further disadvantaged by this move.

5. Corporate Governance

Recently SEBI has announced changes in the listing agreement guidelines in order to bring them in line with the new Companies Act 2013. The revised RBI framework contains several provisions which are more stringent than similar provisions covered under the Companies Act, 2013 and revised SEBI guidelines. We suggest that the following norms which are in variance with the provisions of Companies Act 2013 and the Listing Agreement be brought in line with the above.

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(i) Fit and Proper criteria for Directors

As per clause 2 (g) of Annex-1, covering 'Fit and Proper' criteria for Directors of NBFCs, Independent/non-executive Directors nominated to the board of NBFC should be between 35 and 70 years of age, whereas, there is no age limit prescribed under Companies Act, 2013 or under Listing Agreement, for Independent/non-executive Directors.

In view of this, it is suggested that the restriction on the age limit for Independent/non-executive Directors be removed from the regulatory framework for NBFCs. The age restriction, if any, maybe applied only for the whole-time Directors of NBFCs.

(ii) Declaration and Undertaking by Director/ Deed of Covenants with a Director (Annex-3)

Para II (a) to Annex 2 requires the Director to declare the list of relatives who are connected with the NBFC. For this purpose, the definition of relatives is as given in Sec 6 and Schedule 1A of the Companies Act. It would be a challenge for the Directors to provide details of all transactions, of their relatives, with the NBFC in different capacities namely depositors, borrowers, shareholders and employees. Several such transactions with the NBFC may happen in the normal course of business, without the knowledge of the Director. Hence, the requirement may be restricted to "dependent relatives" as provided under the Listing Agreement.

The regulations prescribe that in addition to a declaration and undertaking obtained from the Directors, the Directors shall sign a Deed of Covenants as given in Annex-3.

As per Section 149 (8) of the Companies Act 2013, every Independent Director shall abide by the provisions specified in Schedule IV to the Companies Act, 2013. Schedule IV prescribes the Code of Conduct for Independent Director which inter alia prescribes (a) Guidelines of Professional Conduct, (b) Role and functions, (c) Duties (d) Evaluation mechanism etc.

Further, Section 166 of the Companies Act, 2013 stipulates duties for all Directors covering several of the clauses in the suggested deed of Covenant. The well laid out regulations in the Companies Act 2013 exhaustively cover the duties and responsibilities of a Director. The Independent Directors are bound by additional code, besides evaluation mechanism. Where any Director contravenes these regulations he / she is subject to penal provisions as well. Thus

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it can be appreciated that in the interest of various stakeholders, the appointment of Directors has been exhaustively covered by the new Companies Act 2013. Hence, subjecting them to further covenants does not seem appropriate.
Pursuant to the above, a deed of covenant as specified in the Regulatory Framework for NBFCs may be dropped.

Disclosures in Financial statements
We submit that considering the sensitive and confidential nature of the information sought, this should not form part of the Annual report/ public disclosure. Instead, we suggest that this may be made part of the Annual information provided to the inspecting officers from RBI or furnished as a return to RBI.

We earnestly hope that above suggestions will be considered favourably and sympathetically by the RBI.

Thanking you,

Yours sincerely,

For **FINANCE INDUSTRY DEVELOPMENT COUNCIL**

MAHESH THAKKAR
Director General