FIDC

Finance Industry Development Council

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

6th July 12

To
Shri. Anand Sinha
The Hon Dy Governor
Reserve Bank of India
Mumbai

Sub: RBI guidelines vide DBOD .No.BP.BC-103/21.04.177/2011-12 dated May 07, 2012

Dear Sir,

This is with reference to the recent Guidelines on Securitization issued by Reserve Bank of India vide DBOD.No.BP.BC-103/21.04.177/2011-12 dated May 07, 2012. Even though the subject Guidelines apply to Scheduled Commercial Banks at this point in time, Finance Industry Development Council (FIDC) thinks it appropriate to highlight a few issues that, if not considered and addressed appropriately by the RBI, will have an adverse impact on the NBFC-AFCs.

Presently there are essentially two main sources of funding by the Banks to the NBFC-AFCs.

(a) Direct lending by banks to the NBFC-AFCs for non-priority sector assets and

(b) Direct assignment / securitisation transactions focussed completely at the Priority sector assets.

NBFC AFCs have been recognized for their role in credit delivery in remote corners of India and have carved a niche for themselves in the semi-rural and rural segments of the country. NBFC-AFCs are also playing a vital role in furthering the cause of Financial Inclusion and in credit dispensation to the poor states/credit starved areas for over 5 decades. They specialize in financing to productive assets in the Transportation, Agricultural, infrastructure and SME segments and their customer segments include , First time buyers, SRTOs, Agricultural and Weaker sections of the society, involving people who normally either cannot approach banks for their credit requirements or are unable to provide appropriate documentary proofs of their creditworthiness to the banks. Considering that such are the customers being catered to by the NBFC-AFCs, it is acknowledged time and again that they are thus playing a vital role in enabling the informal segment customers move away from the Money lenders to an Organised financier and over a period of time move them into the formal segment which enables these customers to be recognised and serviced by the Banking segment as well.

222, Ashoka Shopping Centre, 2nd Floor, L. T. Road, Near G. T. Hospital, Mumbai – 400 001 (India)
Tel: 022 2267 5500/98200 35553 • E-mail: maheshthakka45@yahoo.in website : www.fidcindia.org

In this background, Direct Assignment transactions vide which the Banks buy Priority Sector assets from the NBFC-AFCs, have formed an important source of funding for NBFC AFCs and have also ensured the furtherance of the principle of Financial inclusion. Such a partnership between banks and NBFC AFCs has not only supported in fulfilling the banks' statutory compliance of Priority Sector Lending but has also provided NBFC AFCs a regular source of funds – primarily by assigning the loans originated by NBFC-AFCs.

The continuance of this source for funding is critical for sustenance of NBFC-AFCs since the corporate debt market is non-existent and the mutual fund industry is stagnant and has almost reached its ceiling in terms of exposure on NBFC sector. Any restriction on the above sources will choke the availability of funds from NBFC-AFCs to the needy segment of the society. These are the segments where Banks are still trying to reach directly and which has larger issues of NPAs and increased cost of credit delivery. However, NBFC-AFCs have, over several decades of catering to this customer segment, been adept at lending to these customers based on local understanding and ensure that the portfolio quality remains robust, by handling the recoveries through a method of direct contact with these rural/semi-rural customers having uncertain cash flows and fiscal discipline.

It will be appropriate to mention that for the past four financial years, the Direct Assignment route has been the most chosen method of transacting both by the buyers and the sellers. About 80% of the total volume of Asset backed securitisation(ABS) transactions, which is around **Rs.83000 Cr**, has been in the nature of the Direct Assignment transactions. We are confident that your good self will appreciate that none of these pools have been downgraded by the Rating Agencies even during the peak of the Economic recession during FY 09 or FY 10. The buyers include all types of large Banks in the Public sector and Private Sector including Foreign Banks and the sellers have invariably been the NBFC-AFCs. It will be interesting to observe that since FY 09 almost all transactions done through the direct assignment route were of Priority Sector assets, this segment of customers being the niche area of the NBFC-AFCs over the past four decades.

As a consequence of the Guidelines cited above, there are two specific issues which are hindering the flow of credit to the niche segments of the NBFC-AFCs:

I. (a) The Originators can't provide credit enhancement on Direct Assignment transactions
(b) The requirement for 100% audit of underlying pool of assets and their documents is duplicating an already complied item, considering that ever since the RBI published the KYC guidelines for Banks and Non banks, NBFC-AFCs have been applying uniform KYC norms on its customers as well

II. The pending Income Tax dispute on Securitisation Income for the transactions of a Pass through certificate nature.

Given the prohibition on credit enhancement on Direct assignment transactions, the investing banks will be exposed to the entire credit risk on the assigned portfolio. Hence transactions through the Direct Assignment route are unlikely to be carried out by the Buyers. As a result there is bound to be a complete reliance on securitisation as a mode of conducting transactions, by the Investors.

On securitisation transactions we understand that there are existing Income tax litigations that are pending through the Pass through certificate route wherein the Special purpose Vehicle (SPV) have been demanded Income tax by the authorities concerned. Considering that the SPV is a mere pass through entity, its contention that it is not liable to tax is the subject matter of the litigation. In the background of such a pending litigation, the Investors are wary of transacting through the Securitisation route as well.

As will be clear from the above, while on the one hand, the Direct Assignments transactions forming an essential source of funding the Priority sector segments by the NBFC-AFCs, are expected to be severely affected because of non availability of credit enhancement, on the other hand, the unresolved issue of the Income Tax authorities' claim of taxing the Special Purpose Vehicle (SPV) involved in securitisation transactions as a separate entity will constrain the transaction through the securitisation route as well.

It will be also appropriate to mention that, the RBI vide its Master circular no RPCD. CO.Plan. BC 10 /04.09.01/ 2011-12 _ Dtd 1st July 2011, had withdrawn the facility of PSL benefit for direct lending by Banks to NBFC-AFCs.

As a consequence most routes of making available appropriate finance facilities to the NBFC-AFCs involved in furthering the avowed cause of Financial Inclusion is restricted, however un- intended on behalf of the RBI, is a reality today.

In the light of above it is requested as follows:

1. Allow a transition of two years for Direct Assignments so that it can continue in its existing structure, i.e. with Credit Enhancement, i.e. atleast until the Income tax issue is resolved on the Securitization transactions.

2. Rely on the KYC documents collected by the NBFCs as these NBFCs are also regulated by RBI and have been collecting and verifying the KYC documents as a Bank would do.

We hope the above receives your favourable consideration. It will be our pleasure to be present in person and offer our views on the above should your honourable self deem it necessary.

Thanking You,

For **FINANCE INDUSTRY DEVELOPMENT COUNCIL**

MAHESH THAKKAR
Director General

Cc:

The CGM-In-Charge
Reserve Bank of India
DNBS
Mumbai.