FIDC

Finance Industry Development Council

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

October 08, 2012

To

Mr Parag Basu
General Manager,
Securities and Exchange Board of India
Plot No. C4-A, G Block,
Bandra Kurla Complex, Bandra (East),
Mumbai 400 051.

Respected Sir,

Sub: FIDC Representation – To consider NBFCs and HFCs separately for calculating 'Sectoral Exposure' of Debt Mutual Funds

Asset Financing NBFCs, (NBFC-AFC) registered with Reserve Bank of India, have joined hands and formed a Self Regulatory Organization (SRO) under the name of Finance Industry Development Council (**FIDC**). Please permit us to refer to ourselves as NBFC-AFC for the purpose of this note.

Securities and Exchange Board of India (SEBI), vide its circular no. CIR/IMD/DF/21/2012 dated 13/09/12 has taken various steps to re-energise mutual funds and has also introduced Prudential Limits on portfolio concentration risk in debt oriented mutual fund schemes.

This representation intends to focus on the prudential limits on portfolios of debt mutual fund schemes imposed under the above mentioned circular. The relevant extract of the circular is reproduced below:

Prudential limits and disclosures on portfolio concentration risk in debt-oriented mutual fund schemes

> ***1. Mutual Funds/AMCs shall ensure that total exposure of debt schemes of mutual funds in a particular sector (excluding investments in Bank CDs, CBLO, G-Secs, T-Bills and AAA rated securities issued by Public Financial Institutions and Public Sector Banks) shall not exceed 30% of the net assets of the scheme.***
>
> ***2. Existing schemes shall comply with the aforementioned requirement within a period of one year from the date of issue of this circular. During this one year, total exposure of existing debt schemes of mutual funds in a particular sector should not increase from the levels existing (if above 30%) as on the date of issuance of this circular.***

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3. Appropriate disclosures shall be made in Scheme Information Document (SID) and Key Information Memorandum (KIM) of debt schemes.

FIDC View:

We would like to place on record our sincere appreciation to SEBI for its efforts to strengthen the mutual fund industry. However, the limits imposed for portfolio concentration risk on debt mutual fund schemes, as are being interpreted at the moment, are expected to have a significant impact on the fund raising of NBFCs as described below.

The guidelines have imposed a sectoral limit of 30% for a particular debt mutual fund scheme. However, for calculating limits applicable for Finance Sector, a whole host of companies, though having very different kinds of business, are getting clubbed together.

Currently, the **Finance Sector** definition is all encompassing and includes almost every entity in the business of lending (other than AAA rated securities by Public Sector Financial Institutions and Banks which are specifically provided as exceptions by SEBI), and hence includes all Housing Finance Companies, Asset Finance Companies, Stock Broking, Core Investment Companies and Capital Market Financing entities. This therefore comprises a widely disparate group of entities, which have totally different risk profiles. e.g. Asset financing NBFCs are largely involved in financing machinery, commercial vehicles, cars, construction equipment etc while Housing Finance companies are involved in financing of homes. Factors which would impact commercial vehicle or construction equipment industry would typically be very different from those that would impact mortgage industry. Both kinds of companies are therefore, focused on very different sectors having very different risk profiles.

We would also like to point out that due to the nature of their business, both these kinds of entities are prolific issuers of debt securities through which they raise funds and deploy them further – NBFCs being the front runners in the 'financial inclusion' agenda of the government by lending to the people in rural and semi-rural areas while HFCs help in fulfilling people's dream of owning their own home. By providing finance focussed on various sectors of economy, these entities also play an important role in economic growth of the country. By clubbing exposure to these two kinds of entities under a single limit, the ability of debt mutual fund schemes to lend to these different kinds of entities is severely constrained. Considering these schemes were active investors in these kind of securities wherein they were investing in highly rated debt instruments of NBFC-AFCs and HFCs, the fund raising (and therefore, fund deploying) of these entities can get impacted thereby, further impacting other sectors of the economy negatively.

It is, therefore, suggested as below:

- ***Treat the housing finance sector i.e. HFCs as a separate sector, thereby delineating it from other NBFCs. In terms of the underlying asset, asset quality parameters, tenor, regulatory framework (Regulated by NHB) and the importance of housing finance in the development of the housing and many allied industries, this sector stands out distinctly. As such, the exposure on HFCs should not be clubbed along with exposure on NBFCs.***

The matter needs to be addressed expeditiously so as to prevent disruptions in the funding availability of various companies operating in the finance sector.

We hope the above receives your favourable consideration. We are ready to offer our views on the above, should you deem it necessary.

Thanking You

Yours sincerely,

For **FINANCE INDUSTRY DEVELOPMENT COUNCIL**

MAHESH THAKKAR
Director General