FIDC

Finance Industry Development Council

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

13 January 2009

The Joint Secretary
Banking
Ministry of Finance
Government of India
Parliament Street
New Delhi 110 001.

Dear Sir:

At the outset, on behalf of the Asset Financing Non-Banking Finance Companies (NBFC-AFCs) we express our gratitude and compliment the Ministry of finance (MOF) for taking a unique initiative of creating a platform for bringing together leading NBFC-AFCs and leading Commercial Banks with a view to boosting credit flow to the Commercial Vehicle (CV) sector..

We, as financiers, are very much concerned about recent trends in the sale of commercial vehicles. Sales of CVs registered a steep fall of 70% in December, 2008, compared to the same month in 2007 and by 50% in the month of Nov.'08, compared to the previous year. This is obviously a clear reflection of the overall slowing down of the economy in general and the slump in sectors such as mining, manufacturing, cement and infrastructure.

While the various measures taken by RBI and Govt. of India to infuse liquidity and boost the economy are laudable, there is a compelling need to boost vehicle sales through infusion of funds at affordable cost.

We, on behalf of Asset financing NBFCs, would like to put forth a few points for your consideration so that expectations of the Government can be effectively met.

1. Total Bank Credit to the NBFC sector as of date is estimated at Rs. 66,000 crores, out of which not more than Rs.15,000 crores can be attributed to Asset Finance companies, i.e. those which are predominantly engaged in funding commercial vehicles. In percentage terms, therefore, Banks' credit to NBFC-AFCs forms a very miniscule proportion. Historical data would only support our contention that Asset financing NBFCs have been a good quality risk for the banking sector, apart from the fact that they are engaged in financing a Priority Sector.

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2. A majority of NBFC-AFCs faced severe liquidity constraints during October-December 2008 thereby seriously hampering their lending operations. Even where funds were available to NBFCs, the cost was unaffordable and out of sync with those offered to other sectors. Bank's direct lending to end borrowers is generally 50 – 100 bp below their PLR, whereas, lending to NBFCs for their on-lending to customers is usually 50 – 100 bp over and above their PLR. Therefore, even with such funds NBFCs become uncompetitive. There is, thus, a need to correct the pricing situation. Historically Banks have been considering NBFCs as their competitors in identical areas of lending.

3. Time is now ripe where ideally the relationship between Banks and NBFCs should be accepted as that of wholesaler and retailer rather than as competitors, to better reflect the ground realities. Banks, with their strong financial resources can and should support NBFCs to reach the remotest corners and enable financial inclusion of the credit starved sections of the economy. The change in the relationship between Banks and NBFCs will be economically beneficial to the society at large. While much has been written and spoken about the need for last mile credit delivery, very little has been done to harness the knowledge and strengths of NBFC-AFCs to this end.

It may not be out of place to mention that most of the NBFC- AFCs are also rated by the rating agencies under Basel II norms for their borrowings from banks, whereby the requirement of risk capital for the banks' on-lending to NBFC-AFCs goes down significantly, thereby increasing their return on equity.

4. In terms of the number of players, more than 90% of the NBFC-AFC sector comprises of small and medium sized companies (having Net Owned Funds up to Rs. 25 crores) who have been playing an equally important role in the growth and development of the Road Transport sector. This fact has been acknowledged by various expert committees / task forces setup by the Government and RBI over the years.

Most crucially, we draw your attention to the fact that NBFC-AFCs are subject to bank like regulatory rigour in terms of Capital Adequacy, prudential norms pertaining to asset classification, provisioning, income recognition, as well as credit concentration norms, Know Your Customer guidelines, Fair Practices code and Asset Liability Management guidelines as prescribed by RBI. In other words the sector is today well regulated (almost at par with banks) and as such has the inherent strength.

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While the overall bank exposure to this sector might have shown growth, it is the small and medium AFCs which have faced the crunch. The need therefore is *to increase the spread of banks' exposure to AFCs by catering to more and more number of companies operating in different parts of the country. This would be in line with the govt's agenda on financial inclusion.*

In view of the foregoing, we urge the Finance Ministry and the banks to consider the following:-

- A clear acceptance of the wholesaler-retailer relationship between banks and NBFC-AFCs. This also needs to be blessed by RBI, the common regulator for both.

- Allowing differential Rate of Interest for NBFCs; 80% of the funding in commercial vehicle segment is for funding to SRTO segment which qualifies for priority sector lending by the commercial banks. Therefore, there should be a lower interest rate for funding to SRTOs in order to stimulate demand in the commercial vehicle segment.

- A separate Line of Credit to the extent of Rs.5000 crores should be made available to NBFC–AFCs Irrespective of their size but based on their performance and track record.

- Funding for Commercial Vehicles under the special Line of Credit should include trucks, buses, loaders, dumpers, tempos, Three Wheelers and multi utility vehicles (both new and second hand).

- Similarly, the proposed line of credit should also extend to machinery/equipment such as excavators, material handling equipment, heavy duty dumpers/loaders and other such equipment used in the infrastructure sector.

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We sincerely hope that our submissions would receive the favourable consideration of both MOF and the Banks. We would be more than happy to provide any further details or clarifications, if required.

We look forward to meeting you within a fortnight to review and carry forward this important initiative.

Regards,

Sincerely,

T.T.Srinivasaraghavan
Chairman

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