

T T Srinivasaraghavan
Chairman

November 10, 2006

Dr Y V Reddy
Governor
Reserve Bank of India
Central Office Bldg, 18th Floor
Shahid Bhagat Sing Road
Mumbai 400 001

Respected Sir,

Reg: Mid-Term Review of Annual Policy Statement for the year 2006-07 – Financial Regulation of Systemically Important NBFCs and Banks' Relationship with them.

You had been good enough to meet the NBFC representatives for a pre-Mid Term review discussion. In response to the various issues put forth by us, you have responded very positively in your statement by saying that RBI proposes a separate classification for "Asset Financing" NBFCs and that a detailed notification would be issued in this regard. This has sent a very positive signal about the role played by the Asset Financing NBFCs.

While so, the draft guidelines put up by RBI subsequently, under reference DBOD.No.FSD./556/24.01.02/ 2006-07 dated 3/11/06, has sent contrasting signals about the NBFC Sector. While it refers to Para 141 (f) "Banks' Exposures to Systemically Important NBFCs" of your Mid-Term Review of Annual Policy Statement for the year 2006-07 made on 31/10/06, it completely ignores your statement under para 154 about a separate classification for the Asset Financing NBFCs, in the same Mid-Term review of the Annual Policy Statement.

While we share RBI's concern about the regulatory arbitrage enjoyed by the bank promoted NBFCs and the regulatory gaps in respect of NBFCs-ND, stand-alone asset financing NBFCs need to be viewed in a different light.

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The draft guidelines seek to impose serious restrictions on the **entire** NBFC sector vide para 15 B (iv):

1. **Bank funding to NBFCs being restricted to 5% of the Bank's Net Owned Funds:**
 - a) As against usual credit concentration norms of 15% of Bank's NOF for a single party exposure, the prescription of a sharply lower limit of 5% for NBFCs is unduly harsh. This will seriously affect the operations of the large **NBFCs who are not promoted by banks** and who are not a source of concern either to RBI or to the lending banks.
 - b) RBI's concerns on unlimited lending by banks to the NBFCs promoted by them, have been suitably addressed by the introduction of CRAR of 10% for NBFC-NDs in the draft guidelines

2. **The overall exposure of a bank to the NBFC sector has been capped at 40% of their NOF.**
 - a) It has been acknowledged by RBI, time and again, that NBFCs are important financial intermediaries. In fact, we have been discussing with RBI for increased bank funding to the NBFC sector and RBI has also sent some positive signals in the past. In fact, the Sastri Committee on bank funding, appointed by IBA, had also made elaborate recommendations for bank funding to the NBFC sector. Considering the **wholesaler – retailer** relationship between banks and NBFCs, the cap of 40% goes against the very spirit of this relationship.

 - b) The 40% cap is also likely to result in bank funding flowing only to the large NBFCs, leaving the smaller NBFCs starved of a very crucial avenue of funding. As you are well aware, sir, the smaller NBFCs also play a very vital role in the last mile credit delivery in the country.

3. Last year, RBI had written to all deposit taking NBFCs, encouraging them to move away from public deposits and seek alternate sources of funding, which the NBFCs have done, as evidenced by the decline in the quantum of public deposits held by NBFCs, as of 31.3.2006. Traditionally, bank finance has been one of the mainstays of the NBFC sector and the proposed guidelines would seriously cripple the operations of this sector. Together, with the existing restrictions on Securitisation and the embargo on ECBs, the proposed guidelines would have very serious and damaging implications, especially for the stand alone, Asset Financing NBFCs.

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Sir, you had stated very clearly in your Mid-Term Review of Annual Policy Statement for the year 2006-07 made on 31/10/06,

“..Companies engaged in financing real/physical assets supporting economic activity, such as automobiles, general purpose industrial machinery and the like would generally correspond to the classification as asset financing companies. Accordingly, it is proposed to re-group them as asset financing companies. Detailed operational instructions in this regard would be issued separately. “

Such a clear classification will automatically ensure the discipline on the end use of funds on the part of asset financing NBFCs and also plug any diversion of funds to undesirable sectors, like capital markets etc.

We, therefore, earnestly request you to kindly consider our submissions and exempt the asset financing NBFCs from the purview of para 15 B(iv) of the draft guidelines.

With Warm Regards

Yours Sincerely

T.T. Srinivasaraghavan