FIDC

Finance Industry Development Council

(A body incorporated as a Self Regulatory Organisation for Registered NBFCs – AFCs)
101/103, Sunflower, 1st Floor, Rajawadi Road No.2, Ghatkopar (East), Mumbai – 400 077 (India)
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26th February, 2014.

To

Mr. H R Khan
The Deputy Governor,
Reserve Bank of India,
Central Office, 19th Floor,
Central Office Building,
Shahid Bhagat Singh Road,
MUMBAI 400 001.

Respected Sir,

Reg: Classification of Asset Financing NBFCs – Stand being taken by RBI's Local offices
Ref: Our Representation dated 4th October, 2012 on the subject

We invite your kind attention to a serious issue affecting some of our member Asset Finance Companies on account of a very narrow view taken by inspecting officials of Regional Offices of the Reserve Bank of India, side-tracking the reality on ground in a vast and diverse country like ours and ignoring the innovativeness of a large number of users/buyers of two wheelers and passenger cars being put to several business and productive uses, which are financed by AFCs. Your regional offices have contended that:

"Financing of two wheelers cannot be reckoned for computation of asset-income pattern for determining the AFC status." [Ref. Letter dated 10 September, 2012 of RBI, Chennai- copy enclosed herewith].

The RBI circular of 6th December 2006 facilitating creation of separate class of NBFCs-AFCs has defined AFCs: " AFC would be defined as any company which is a financial institution carrying on as its Principal business, the financing of Physical Assets supporting productive/economic activity, such as, Automobiles, Tractors, Lathe machines, generator sets, earth moving and material handling equipment moving on own power and general purpose industrial machines."

The said circular defines Principal Business of AFCs: "Principal business for this purpose is defined as aggregate of financing real/physical assets supporting economic activity and income arising therefrom is not less than 60% of its total assets and total income respectively".

Three criteria are thus prescribed for AFCs' Principal Business:

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1. Financing of real/physical assets,
2. Supports economic activity, and
3. 'Income arising therefrom is not less than 60% of its total assets and total income respectively.'

The objection of regional offices of RBI, presumably were:

[a]Two wheelers and passenger cars are not assets that support economic activity,
[b]The Assets referred above are for the personal use of the borrowers and do not generate any income,
[c]Such Assets should be excluded while calculating the percentage of Income and Assets for the 60% norm prescribed for determining the status as an AFC.

Let us examine veracity of these contentions:

1. **ARE NOT TWO WHEELERS AND PASSENGER CARS ASSEtS THAT SUPPORT ECONOMIC ACTIVITY?**

The circular providing for Reclassification of the NBFCs to carve out new class of NBFCs-AFCs accepts automobiles as real/physical asset. However, it qualifies that it must support productive/economic activity. Whether do two wheelers and passenger/private cars meet these demands?

At the outset, we reiterate that the definition of 'Asset Finance Company' is an inclusive definition which includes within its ambit 'automobiles' which are treated as Assets by the RBI Circular supporting productive/economic activity. Two wheelers are necessarily automobiles. When the definition itself includes a particular item it has to be read and applied as such. We humbly believe that it is not subject to further test.

It is, however, evident that two wheelers and private [so called] cars are being put to many business and productive uses, which support diverse economic activities in the country as can be seen in the pictures placed in this representation. These are not means of luxury or showpieces for their owners as media projection of auto marketing may lead one to believe. In fact, as one of the financiers in Banaskantha district [Gujarat State] said that well over 80 percent of the cars financed are meant for business or agricultural uses or for dairying. It is their hard calculation of how much they will save on transport cost and/or expand their operations with help of auto [i.e. two wheelers and cars] purchase before they decide to buy. Just to amplify this statement business uses of the vehicles in rural/semi-urban and even in urban areas are stated here under:

[i] Dairy and Agri-business: Many families supply milk daily to the dairy or to its collection centres in cans which are being loaded on two wheelers attached with hooks. Young sons and daughters use two wheelers instead of earlier practice of carrying milk on head by their mothers.

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Side cars attached with two wheelers and cars [four wheeler] are used to carry cattle feed as also seeds, fertilisers, pesticides and other inputs for farms; and when needed small farm equipments. Farm workers are also carried to the farms on the vehicle in sawing and harvesting seasons, a reflection of shortage of farm workers.

Milk vending–home to home-in the morning has become a familiar scene as is the supply of morning news papers has become. Following is one of such cases that is seen in innumerable places in various areas of Gujarat.

1. **Name:-** Laxmanbhai. M. Bharvad
Cust Code:- 471899 – Two wheeler
Centre :- **Anand**

Description:-Customer is having milk business; he uses his bike for door to door selling.

He is having his own 4 buffalos & 2 Cows.
Gets 20 litres of milk in the morning as well as in the evening.

[ii] Marketing: Products/kirana supply-home to home- by traders for their regular customers and senior citizens' families in order to have customer loyalty has picked up well with increasing use of two wheelers for the purpose. Bicycles are being replaced by automotive two wheelers with improvement in road conditions and well developed road net work even in villages/towns.

Bigger companies use persons with two wheelers for introducing new products and penetration in new far-flung areas. Availability of finance has considerably facilitated use of two wheelers/cars for deepening market access, especially when shortage of manpower for such kind of jobs is increasing. Students, in order to support their studies and to supplement the family income do undertake such jobs.

Innovative uses of two wheelers for different kinds of product marketing/selling are taking place in several areas by budding entrepreneurs. Few examples are shown hereunder:

2] Fish Marketing:
Name:- Dalpatbhai. A. Vasava
Cust Code:- 695438
Segment:- Two Wheeler
Centre :- **Surat**

Description:-Customer of AFC does his business of selling of fish locally on his bike.
Daily covers 15 to 20 kms

3] Food items marketing:

Name:- Harilal. V. Baghel
Cust Code:- 785092
Segment:- Two Wheeler
Centre :- **Ahmedabad**

Description:- Bike is used by Customer of AFC for his business of Pani Puri

4] Plastic & Misc. products selling:

Name:- Sonabhai. J. Bajaniya
Cust Code:- 776780
Segment:- Two Wheeler
Centre :- **Mehsana**

Description:-Customer's son Vipulbhai is doing door to door selling of household plastic item.

Daily covers the area of 20 km to 100 kms.

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Many traders who prefer to stay in their villages and run shop or business in nearby city also take the products [being prepared at their village home, i.e. sweets, other items and fast food] daily in their own vehicle to the shop. They also bring raw material required by them in their vehicle on return journey. Some of them also take their employees to the shop regularly in car. Besides, shop owners of precious products/jewellery etc. also need secured vehicles.

In urban and city areas and where the manufacturing units are set up by the owners of small and tiny sector in Industrial estates [these are generally quite away from cities and not connected with any public transportation facility] need for vehicle[s] is imperative not only for commuting but also for purchase of raw materials, sale of their products, customer contacts and recovery of dues.

[III] Services Marketing: Services sector in India is expanding fast and competition in this sector increasing. As a result, providers of such services and their agents are required to meet challenging demands of their customers, needing frequent contacts. This is being met by the increased use of two wheelers and many a times cars for high-end users/customers. This increased mobility has considerably helped expand insurance, share broking, internet and electronic/electrical products' repair/ servicing, construction, to name a few.

Use of cars for catering food for parties, serving fast foods at a fixed point/place near gardens or commercial places is also found growing. That saves them the cost of rented premises that makes it a viable proposition.

It is also noteworthy that in the rural areas where AFCs finance cars, Doctors, Lawyers, Small contractors, Architects use the same for rendering professional services like visiting hospitals, patients, courts, clients, construction sites etc

[iv] Commutation: With fast expansion of cities/growing urbanisation and increased inter-connection of villages with cities, the commutation for traders, business men, petty shop/galla owners as well as blue and white colour workers/employees', government servants' need for two wheelers/cars to reach their place of work in time has become a must, as reliable public transport system has not come up. Their vehicles are also used for shopping of merchandise, carrying their workers to the work place as well. The cost of leased/rented vehicles for such regular commutation is taken into account by such persons and when it is economical to buy a vehicle it is acquired, not otherwise.

Let us assume that such groups of traders, businessmen, petty shop/galla owners as well as blue and white colour workers/employees organise a unit of drivers or have informal understanding with potential drivers and such drivers get finance for cars from AFC. Would that not become finance for business? Instead of having such contrived arrangement if the real-end users get cars/two wheelers for their business uses/commuting to work place, why should those assets be excluded? How can we say that they are not "supporting economic activities"?

Moreover, they will be saving cost of transport on alternative means on one hand and would expand their business, thereby generating more income.

Even students engaged in higher studies do require two wheelers to reach their place of studies in time and pursue field work assigned to them. Alternative mode of transport may be either costly or unreliable for them. Why should their cost saved not be considered a part of income generation for their families? Moreover these vehicles are put to other productive uses in spare time by their family.

2. ARE VEHICLES FINANCED FOR PERSONAL USE AND DO NOT GENERATE INCOME FOR BORROWERS?

Majority of the vehicles [both two wheelers and *so called private* cars] financed by AFCs are put to business uses as may be seen from above stated actual uses of the vehicles. Personal use of them is only a fraction of it. It is well understood that before buying any auto, cost of alternatives, i.e. leased/rented vehicles, public transport system is being generally calculated by the customers, apart from convenience and potential of increase in business. Although, they don't put their figures on paper, but they do their home work well, as they are required to meet the obligations of paying not only the principal amount but interest thereon as well. Whether the vehicle so bought with borrowed funds is compensating them adequately or not as compared to their daily/monthly cash outgo on other alternatives is taken into account. For them thus *saving cost is synonym of income generation*. Auto vehicle is for most of them an instrument which helps them running their business/ trade/ vocation/service and an earning proposition through increased mobility. That either makes/spares/generates income for payment of principal and interest on borrowing for vehicle. Had this not been the case, the exceedingly well repayment record for such borrowing and negligible NPAs in this segment of assets class would not have become possible and would not remain sustainable for several years.

3. WHOSE INCOME GENERATION IS NEEDED TO BE THE BASIS FOR QUALIFYING TO BECOME OR REMAIN AFC?

The objection of the inspecting officials of some of the RBI regional offices that "the Assets are for the personal use of the borrowers and do not generate any income," needs to be examined more closely.

The definition of Principal business given in circular of 2006 of RBI for AFC referred above says: "Principal business for this purpose is defined as aggregate of financing real/physical assets supporting economic activity and *income arising therefrom*...." What is implied here is the income of AFC and *not of the borrower*. Conditionality for AFCs is satisfied when AFC [1] finances for real/physical assets supporting economic activity and [2] [interest] income arising therefrom [such assets] is not less than 60% of its total assets and total income respectively". Here *income* [of 60%] stipulated by the RBI *is the income of AFC and not the borrower* [from the vehicle acquired from borrowing] as is being presumed by the Inspecting officials saying that such vehicles "are for the personal use of the borrowers and *do not generate any income*."The inspecting officials' expectation of vehicle generating income is unfounded and uncalled for and does not arise from the definition of AFC or their 'Principal Business'.

It is to be noted that the differentiation of use of vehicles either for personal or business purpose is difficult to make with objectivity. It is also quite difficult to identify the vehicles that may be put to ONLY PERSONAL use [except the luxury cars or high-end two wheelers like super bikes which have not yet come up in India]. Here the real issue is why AFC as a financier and RBI as a regulator indulge in such exercise of differentiation of use of vehicles financed in the country? Are banks going to be debarred from financing these categories of vehicles on such imaginary and subjective grounds of *personal uses/not income generating*?

The details given above clearly show various business uses of the vehicles in question, which also amplifies that uses of those vehicles supports several economic activities in the country.

We, therefore, urge you to kindly have a fresh look at the issue of financing of two wheelers and cars by branding them all as not "supporting economic activity." As we have clarified that the questions/objections raised on the basis of 'personal use' and 'not generating income' are also without any basis in terms of circular of 2006 paving way for creation of AFCs.

4. OTHER IMPLICATIONS:

This issue is not merely that of defining AFCs business. It has far wider implications to the economy of the country that is experiencing down turn. The automobile sector is suffering a severe slump. SIAM data shows that passenger car sales fell by 9.59% and poor market condition has compelled companies to cut production. Overall sales of two wheelers also fell by 1.21 %. Data for manufacturing sector also continue to show negative trends.

Major part of the vehicle sales in our country is covered with financing. Curtailing effect of above RBI measure will fuel the fire of slump already damaging and dampening the economy. It is quite known fact that deceleration in automobile sector has a cascading effect on several sectors of the economy. Such a negative measure by the regulatory authority will depress the automobile and other sectors quite adversely.

Notwithstanding the above, whether Two Wheelers support economic activity and contribute to the economic growth of the Country:

a. The automobiles sector in India is divided into four segments – two-wheelers (mopeds, scooters, motorcycles, electric two-wheelers), passenger vehicles (passenger cars, utility vehicles, multi-purpose vehicles), commercial vehicles (light and medium-heavy vehicles), and three wheelers (passenger carriers and good carriers).

b. Further, two-wheelers occupy more than 75 % of the segment-wise market share of the Automobile Industry.

c. It is also noteworthy that all the regulations pertaining to road transportation like Motor Vehicle Act, 1988 etc. apply to two wheelers as such and no distinctions have been made between two wheelers and other automobiles by any of the governing laws.

d. Further, the economic viability of two-wheelers as a part of automobile industry is also highlighted by **Investment and Technology Promotion Division of Ministry of External Affairs, Govt. of India, the extracts of which are produced below:**

*"On the canvas of the Indian economy, automotive industry occupies a prominent place. Due to its deep forward and backward linkages with several key segments of the economy, automotive industry has a strong multiplier effect and is capable of being the driver of **economic growth**. A sound transportation system plays a pivotal role in the country's rapid economic and industrial development. The well-developed Indian automotive industry ably fulfils this catalytic role by producing a wide variety of vehicles: passenger cars, light, medium and heavy commercial vehicles, multi-utility vehicles such as jeeps, **scooters, motorcycles**, mopeds, three wheelers, tractors etc."*

India's Position in World's Production:

- Well-developed, globally competitive auto ancillary industry
- Established automobile testing and R&D centres
- Among one of the lowest cost producers of steel in the world
- World's second largest manufacturer of two wheelers
- Fifth largest manufacturer of commercial vehicles
- Manufactures largest number of tractors in the world
- Ninth largest car manufacturer in world

e. Also according to Society of Indian Automotive Manufacturing (SIAM), majority of Automobiles sold in India are two wheelers.

f. As per Automobile India, a complete automobile Consumer Guide:

*"Some of the features that deserve attention in respect of the **Indian two wheeler segment contributing to the economic growth of the country through increased production, employment generation, exports etc.** are mentioned below:*

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- *The total sale of two wheelers in India has touched a figure of 7.86 million units by March, 2007, up 11.42% from the previous fiscal figures of 7.05 million. Production during the period reached 8.63 million units.*
- *The production of two wheelers in India is expected to reach a staggering 17.85 million units by 2011-12, more than double of the current production level.*
- *The two-wheeler production capacity is to reach 22.31 million units in 2011-12 compared with 10.78 million in 2006-07.*
- ***India is likely to export 1.39 million two-wheelers in 2011-12 compared with 590,000 in 2006-07.***
- ***Total investment for new capacity generation in two-wheeler segment is likely to be more than $2.2 billion (INR 10, 000 crore)."***
- *Hero Honda, Bajaj Auto and TVS Motor remain the leading players in terms of sales and popularity of their two wheelers."*

g. India is the second largest manufacturer of two- wheelers. Two-wheelers contribute 6% of India's GDP. **Therefore, it contributes to the economic growth of the country and generates income in the economy.**

h. In India maximum population belongs to the middle-class and lower-class income group who use two-wheelers as a necessity not a luxury for supporting productive or economic activity.

Two-wheelers occupy more than 75 % of the segment-wise market share of the Automobile Industry Over 80% of all automobiles sold in the country are financed and if the narrow interpretation is taken, which excludes two-wheelers within its purview is considered, it will bring the automobile sales in the country to a grinding halt and also make a considerable number of Asset Finance Companies redundant.

5. FINANCIAL INCLUSION- NEW PERADIEM:

Dr. Raghuram Rajan, Governor of Reserve Bank of India in one of his recent path breaking statement about financial inclusion has said:

"Expanding access to finance for small and medium enterprises, the unorganized sector, the poor and the remote and underserved areas of the country through technology, new business practices, and new organizational structures; that is, we need financial inclusion.

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We have to reach everyone, however remote or small, with financial services. *Financial inclusion does not just mean credit for productive purposes*, it means credit for paying a doctor to heal your child or to pay lumpy school or college fees. It means a safe mode of remunerated savings, and an easy way to make payments and remittances. It means insurance and pensions. It also means financial literacy and consumer protection. We have made great strides in inclusion, but we are still some distance from our goal….We created a frugal Indian model, we need a frugal, trustworthy, and effective Indian model for financial inclusion.

The Dr. Nachiket Mor Committee is helping us think through possible models, and I am hopeful that when we outline measures based on its recommendations*, our fine banks, NBFCs, IT companies and mobile players will rise to the occasion.* The key will be to encourage entities to compete *to serve the customers at the bottom of the pyramid*."[*emphasis added*]."

NBFC sector is one of the pioneers of financial inclusion and has commenced it as back as six decades. The NBFC sector has thus been able to evolve a frugal trustworthy model for financial inclusion over a period of time which has been lauded from time to time by the RBI also.

The Regulatory authorities have to broaden the horizon of concept of 'credit to productive purposes' in order to continue to enable the NBFC- AFCs to help serve the customers at the bottom of pyramid as desired by the Hon'ble Governor of RBI.

We earnestly hope that above request will be considered favourably and sympathetically by the RBI and would not insist on such a broad brush approach that tantamount to exclusion of financing of two wheelers and cars by NBFC-AFCs.

We look forward to an immediate positive response and are confident that we are in the process of a long and beneficial relationship.

Thanking you,

Yours sincerely,

FOR FINANCE INDUSTRY DEVELOPMENT COUNCIL

MAHESH THAKKAR
Director General