FIDC NEWS

Finance Industry Development Council

(A Self-Regulatory Organisation for Non-Banking Finance Companies (NBFCs) registered with RBI)

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Segregate the exposure on HFCs and NBFCs for debt mutual funds

It is appreciable that SEBI has endeavoured to strengthen the mutual fund industry and introduced Prudential Limits on portfolio concentration risk in debt oriented mutual fund schemes. 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. The guidelines imposes 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 with exception of Public Sector Financial Institutions and Banks which are specifically provided as exceptions, 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.

We would like to point out that due to the nature of their business, both these kinds of entities, i.e. NBFC-AFCs and HFCs 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. But by clubbing exposure to these two kinds of entities with different risk profiles under a single limit, the ability of debt mutual fund schemes to lend to these different kinds of entities is severely constrained. If these schemes are 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 fund deploying of these entities can get impacted thereby, adversely impacting other beneficiary sectors of the economy. The FIDC feels strongly that the HFCs may be treated as a separate sector, thereby delineating it from other NBFCs i.e. the exposure on HFCs should not be clubbed along with exposure on NBFCs.

R Sridhar, Chairman, FIDC

REGULATORY PERIMETER

RBI NOTIFICATIONS & CIRCULARS :

1.Implementation of Section 51-A of UAPA, 1967-Updates of the UNSCR 1988 (2011) Sanctions List : RBI/2012-2013/231; DNBS(PD).CC. No 305/03.10.42/2012-13- Oct. 3.

2.Foreign investment in NBFC Sector - Amendment to the Foreign Direct Investment (FDI) Scheme - RBI/2012-13/241; A. P. (DIR Series) Circular No. 41, Oct. 10.

3.NBFCs/RNBCs - Uploading of Reports in 'Test Mode' on FINnet Gateway Reporting - RBI/2012-13/252; DNBS(PD).CC. No307/03.10.42/2012-13-Oct. 16.

4.PRIORITY SECTOR LENDING –TARGETS AND CLASSIFICATION : RBI/2012-13/253 -RPCD. CO. Plan. BC 37 /04.09.01/ 2012-13 October 17.

5.Name of Fitch Ratings changed to India Ratings and Research Private Limited (India Ratings) : RBI/2012-13/278, DBOD.No.BP.BC. 54 /21.06.007/2012-13- Nov. 5.

6.Standardisation and Enhancement of

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MICRO LOANS TO AFFORDABLE & RURAL HOUSING LOANS

Security Features in Cheque Forms - Migrating to CTS 2010 Standards : RBI/2012-13/280; DNBS.PD/ CC.NO.308 /03.10.001/2012-13-November 6, 2012

7.Readiness of major service providers to migrate from IPv4 to IPv6 : RBI/2012-13/289; DNBS(Inf.).CC. No 309/24.01.022/2012-13-Nov. 8.

8.National Telecom Policy, 2012 Migration of current version of Internet Protocol IPv4 to IPv6 : RBI/2012-13/292; UBD.BPD.(PCB) Cir No.24 /09.18.300/2012-13- Nov. 9.

9.Definition of 'Infrastructure Lending' : RBI/2012-13/297 DBOD.BP.BC.No. 58 / 08.12.014 /2012-13- Nov. 20.

10.NBFCs/RNBCs - Implementation of Section 51-A of UAPA, 1967-Updates of the UNSCR 1988 (2011) Sanctions List : RBI/2012-13/305; DNBS(PD).CC. No /03.10.42 /2012-13-Nov. 22.

11.Core Investment Companies - Overseas Investment (Reserve Bank) Directions, 2012- RBI/2012-13/314; DNBS (PD) CC.No.311/03.10.001/2012-13; December 06 , 2012

12. Checklist for apllication form for NBFCs, NBFC-MFIs, NBFC-Factors and Core Investment Companies (CICs)- RBI/2012-13/319 ; DNBS.CC.PD.No. 312 /03.10.01/2012-13- December 07, 2012

13.Implementation of Section 51-A of UAPA, 1967 - Updates of the UNSCR 1267 (1999) /1989 (2011) Committee's Al Qaida Sanctions List- RBI/2012-13/321; DNBS(PD).CC. No 313/03.10.42 /2012-13; Dec. 10.

14.Issuance of rupee denominated co-branded pre-paid cards- RBI/2012-13/325; DBOD.No.FSD.BC. 67/24.01.019/2012-13; Dec.12.

15. Progress report on frauds-RBI/2012-13/328; DNBS.PD.CC. No. 314 /03.10.042 / 2012-13; Dec. 13.

16.Frauds-Classification and Reporting -RBI/2012-13/329; DNBS (PD).CC.No.315/03.10.42/2012-13; Dec. 13

Migrating to CTS 2010 standards cheques-time extended

RBI has extended the time up to March 31, 2013 for banks to ensure withdrawal of non-CTS 2010 Standard cheques and replace them with CTS-2010 Standard cheques, taking into account representations of stake holders. Earlier, RBI had asked all banks to arrange to issue only multi-city/payable at par CTS-2010 standard cheques not later than September 30, 2012 and to withdraw the non-CTS-2010 Standard cheques in circulation before December 31, 2012 by creating customer awareness. Further, banks holding post-dated EMI cheques (received either on their own behalf or on behalf of their NBFC clients) were advised by a circular on 3 Sept. to ensure the replacement of non-CTS-2010 Standard cheques with CTS-2010 standard cheques before December 31, 2012.

RBI has further said that the residual non-CTS-2010 Standard cheques that get presented in the clearing system beyond this extended period will continue to be accepted for the clearing but will be cleared at less frequent intervals. The modalities, charges applicable if any, etc. are being discussed with stakeholders and a separate communication will follow in this regard, adds RBI circular issued on 20 Dec.

NBFCs open to both organic and inorganic route to set up banks

With the Parliament passing the Banking Laws (Amendment) Bill, paving the way for the RBI for issuing final guidelines and inviting applications to set up new banks, NBFCs are considering entry to the sector through the inorganic route by mergers and acquisitions (M&As). Some of the NBFCs, however, said they would prefer organic growth to inorganic growth. If permitted by the RBI, the NBFCs are likely to consider banks at the holding company level and may not convert the NBFC into a bank, according to brokerages. In its draft guidelines, the banking regulator has proposed initial capital requirement of Rs 500 crores and foreign share holding is capped at 25 per cent for the first five years. [Business Standard, Dec 20]

Readiness of major service providers to migrate from IPv4 to IPv6

The RBI has advised that as the current version of Internet Protocol (IPv4) has almost run out of addresses, the broadband revolution has to ride on next generation Internet Protocol (IPv6). The NTP-2012 recognizes the futuristic role of IPv6 and aims to achieve substantial transition to IPv6 in the country. Since migration to IPv6 is an eventuality that has to be accepted and in order to manage migration to IPv6 proactively, it is to be done in a planned way. The migration of all payment gateways, banks, financial institutions, insurance companies etc. including their web sites should be completed preferably by December 2012. RBI has asked to initiate necessary action by constituting a special team to complete the migration within the stipulated time.

Registration of NBFC-Factors

Following the notification by the Central Government of the Factoring Regulation Act, 2011, the Reserve Bank has put in place a detailed regulatory framework for NBFC-Factors on July 23, 2012. NBFC-Factors shall have a minimum Net Owned Fund of Rs.50 million for registration; factoring activity should constitute at least 75 percent of total assets; and income derived from factoring business should not be less than 75 percent of gross income. NBFC-Factors intending to deal in forex through export/import factoring will need an authorisation under FEMA, 1999 from the Reserve Bank."[RBI Website]

RBI harmonies definition for Infrastructure lending

The RBI has harmonises the definition of infrastructure lending for financing by banks and financial institutions to avoid confusion. The definition has been aligned with the master list of Infrastructure sub-sectors notified by the Government on March 27, 2012. The revised definition will be effective from the date of this circular, RBI said in statement. The exposure to projects included under old definition but are excluded from the revised definition, will continue to get benefits under 'infrastructure lending' till the completion of the projects. However, fresh lending to those sub-sectors will not qualify as 'infrastructure lending'. [Busi. Standard, Nov 20/RBI circular Dec. 28]

RBI panel to resolve stress in financial conglomerates

The RBI and the Centre will develop a framework to deal with systemically important financial institutions (SIFI) which came under stress and might require quick resolution of problems. The central bank will set up a high-level working panel (inter-regulatory forum), to recommend a comprehensive resolution regime for all types of financial institutions in India, RBI said in its second quarter review of monetary policy. This inter-regulatory forum, to be headed by RBI's deputy governor (banking supervision), will institutionalise the framework for supervision of financial conglomerates (FCs). It will also develop framework to monitor and for management of systemic risks emanating from their activities. This forum will assist the Financial Stability and Development Council (FSDC) for monitoring the functioning of SIFIs. The forum will be responsible for framing policies for FCs such as identification, group-wide risk management, and corporate governance. The forum would also seek to strengthen the supervisory co-ordination/cooperation mechanism amongst domestic supervisors for effective supervision, the RBI said in its policy announcement. [Business Standard, Oct 31]

RBI sets up panel to speed up financial inclusion

Amid slow progress in bringing the entire population under banking network, the RBI announced setting up of a high level committee to "spearhead" efforts to ensure accessible financial services in the country. The Financial Inclusion Advisory Committee (FIAC) under RBI Deputy Governor Dr. K C Chakrabarty is expected to suggest appropriate regulatory framework to ensure that financial inclusion and financial stability move in tandem, the RBI said in a statement. Stating that there has been significant, "albeit slow", progress towards greater financial Inclusion, the RBI said ensuring accessible and affordable financial services in all the six lakh villages is a "herculean task" and given the enormity of the task, "a lot of ground still needs to be covered". "This calls for a partnership of all the stakeholders," it said. The stakeholders include, RBI, SEBI, IRDA, PFRDA, NABARD, governments, civil society and NGOs, among others, the central bank said. [Moneycontrol.com, Oct 11]

Securitisation market adapting well to revised norms: CRISIL

India's securitisation market is adjusting well to the revised securitisation guidelines issued by the Reserve Bank of India (RBI) in May 2012, according to rating agency CRISIL. After a brief lull following the new guidelines, market activity has resumed, CRISIL said in a statement.The total market volumes from May to mid-October 2012 were stable at Rs 3,400 crores involving 38 transactions. These were Rs 3,500 crores with 38 transactions during the corresponding period last year, CRISIL noted. The dampener in the guidelines is that credit enhancement in direct assignments is not allowed, leading to a shift to the pass through certificate (PTC) route.

The volumes have remained stable despite two of the revised regulatory norms reducing the availability of assets eligible for securitisation. First, the provision on minimum holding period that requires originators to hold assets longer to increase their seasoning. Secondly, the assets should conform to a maximum interest rate of 8 per cent above the investing banks' base rate to receive priority sector status.Transactions through the PTC route have accounted for over 85 per cent of the total issuances since the guidelines were issued, as against less than 20 per cent in 2011-12. In a PTC, banks and NBFCs can go less than the base rate. Clarity on the income-tax liability of the trust set up for the PTC route will

enhance confidence of investors. In addition, guidelines for resetting of credit enhancement will reduce the overall cost of securitisation for issuers, without necessarily reducing the protection for investors. said Pawan Agrawal, Senior Director, Crisil Ratings. [BS Reporter, Oct 19]

RBI changes definition of sickness for assessing MSE viability

The RBI has modified the definition of sickness and a procedure for assessing the viability of sick micro and small enterprises (MSEs). According to a notification issued by RBI on Nov. 1, "An MSE is considered sick when any of the borrowal accounts of the enterprise remains NPA for three months or more or there is erosion in the net worth due to accumulated losses to the extent of 50 per cent of its net worth." Earlier, an MSE was considered sick if any of the borrowal accounts of the unit remained substandard for more than six months. The stipulation that the unit should have been in commercial production for at least two years has been removed by the RBI. RBI has also laid down the procedure for declaring a unit unviable. [BS Reporter, Nov 02]

RBI tweaks priority sector lending norms

Heeding the demand of bankers, the Reserve Bank of India on Oct. 17 revised priority sector lending norms . Loans up to Rs 2 crore to companies involved in farming and allied activities will be treated as lending for direct agriculture under priority sector lending (PSL) status. Also, credit to housing finance companies for onward lending for rehabilitation of slum dwellers and economically weaker sections will enjoy PSL status . The cap on such loans will be Rs 10 lakh per borrower. The limit on loans to SMEs in services sector under PSL stands doubled to Rs 2 crore. RBI said the eligibility under PSL (for HFC exposure) is capped at five per cent of total priority sector lending. The maturity of bank loans should be coterminous with average maturity of loans given by housing finance companies. Banks should maintain necessary borrower-wise details of underlying portfolio. [BS Reporter, Oct 18]

Priority sector lending: No relief to NBFC-AFCs

The RBI, in response to a representation made on August 9 by FIDC in regard to revised guidelines issued by RBI on priority sector lending said that the "request to include other entities involved in transportation of farm products under direct finance to agriculture under priority sector lending cannot be acceded to." The revised RBI guidelines have restricted the loans to farmers for transportation of their own farm produce only as the eligible category. FIDC had stated that it is unviable for the farmers owning smaller land to buy a truck for their own usage. RBI, in its letter dated September 11, also reiterated that "with effect from 1 April, 2011 loans to Non Banking Financial Companies except MFIs, which satisfy eligibility criteria, are not eligible for classification under priority sector." However, when the FIDC team met RBI Governor on Oct. 17 for pre-policy consultation for second quarter review of monetary policy 2012-13 this issue was raised again.

Core Investment Companies [CICs] -Overseas Investment

Being holding companies CICs may need to invest in both financial and non-financial activities. The RBI has issued a separate set of Directions on Dec. 6 to CICs with regard to their overseas investments. CICs, currently exempted from registration, desiring to make overseas investments in financial sector, would require a Certificate of Registration [CoR] from RBI and shall have to comply with all the regulations applicable to registered CICs. However exempted CICs do not require to be registered with RBI for making investments in non-financial sector.

All CICs investing in joint ventures/subsidiaries/representative offices overseas in financial sector will now require prior approval from the Reserve Bank. The approval will be subject to the CIC fulfilling the conditions enumerated in directions issued by Reserve Bank on December 6, 2012. This modifies earlier RBI directions for overseas investment by NBFCs issued on June 14, 2011. [RBIwebsite]

RBI allows Aadhaar as banking address proof

RBI has expanded the know-your-customer (KYC) norms for opening an account. Accordingly, it has advised banks to use Aadhaar cards as well as job cards issued under Mahatma Gandhi National Employment Rural Employment Guarantee Scheme as a valid address proof for opening of accounts. RBI has also scrapped the requirement of introduction from an existing account holder in a bank for opening new accounts. [Financial Express, Dec. 12]

RBI direction on fraud cases of NBFCs

RBI has asked NBFCs not to close fraud cases until their final disposal by investigating authorities. RBI wants the NBFCs to pursue cases until the examination of staff accountability has been completed, the amount of fraud has been recovered or written off and insurance claim, wherever applicable, has been settled. [Economic Times, 14 Dec.]

Stringent capital provisioning to put many NBFCs out of business

Interview of Mr. Umesh Revankar, Managing Director and CEO, Shriram Transport Finance Company Ltd.

Are NBFCs going through a difficult time, given the regulatory changes?

There was a similar crisis in 1998-99. We were dependent on retail deposits and the RBI came down on us. We started building banks' portfolio. From 2002 onwards, NBFCs started securitisation and another source of raising resources came to us. There were similar situations in the past.

How do NBFCs plan to go about securitisation?

There are two ways of securitising - PTC (pass through certificates) and bilateral. In PTC's case, credit enhancement has to be done from the reserves. We don't have further dilution on capital adequacy. Second is bilateral on which RBI has clarified that banks cannot take credit enhancement on securitisation. Now, banks have the option to factor in the risk premium into the rate. For NBFCs, this portfolio is risk free and we do not have to make any provision and comes with zero capital. Earlier, the minimum period was not mentioned. If the loan agreement is three years or more, six months have to be completed and then banks can take it.

Will it affect fund raising?

Existing NBFCs pool performance is known, so they will not face any problem. It will be difficult for the new NBFCs. As far as raising resources is concerned, there should be no difficulty. There are other options for raising funds like NCDs also.

What is the biggest challenge now?

The biggest challenge for NBFC-AFC is to build a team that manages bigger volume. As they grow 10-15% on a big base, they need a team that has culture, and that is a challenge. Making him work with small operators is a challenge. His behaviour could be stressful. There is a generation gap and building attitude among staff and customer is difficult.

How will the Usha Thorat panel recommendations affect NBFC business?

The proposed provisioning norm will affect NBFCs' profitability. For NBFCs, moving from 180 days to 90 days would be difficult. There will be pressure on NBFCs to behave like a bank. NBFCs' customers are completely different from a bank's customers. NBFCs' customers are non-bankable and cash flows are not smooth... When you try to push customer hard, he will go to moneylenders or he may not become the owner (of a truck) and remain a driver. It may not result in financial inclusion.

Another suggestion is to increase capital requirement, for example from 7.5% to 12% for tier-I. Will it lead to consolidation?

Capital adequacy could have an impact. Now, tier-I is at 7.5% and another 7.5% for tier-II. The committee has recommended 12% and 3%. With this, the private equity players may not find it attractive. If you have stringent capital adequacy and provisioning norms, many NBFCs in the business for two generations with Rs.50 or Rs.100 crore would go out.

[In an interview to Shilpy Sinha, Economic Times on 29 October, MD and CEO Umesh Revankar talks about the challenges faced by NBFCs amid regulatory intervention.]

PERFORMANCE OF NBFC SECTOR IN 2011-12

NBFCs: Categories and Classifications

1.Three new categories of NBFCs have been created – Infrastructure Debt Funds (NBFC-IDF), Micro Finance Institution (NBFC-MFI) and NBFC-Factors

2.NBFCs are classified into two categories, based on the liability structure, viz., Category 'A' companies (NBFCs accepting public deposits or NBFCs-D), and Category 'B' companies (NBFCs not raising public deposits or NBFCs-ND). NBFCs-D are subject to requirements of capital adequacy, liquid assets maintenance, exposure norms (including restrictions on exposure to investments in land, building and unquoted shares), ALM discipline and reporting requirements; in contrast, until 2006 NBFCs-ND were subject to minimal regulation. Since April 1, 2007, non-deposit taking NBFCs with assets of Rs.1 billion and above are being classified as Systemically Important Non-Deposit taking NBFCs (NBFCs-ND-SI), and prudential regulations, such as capital adequacy requirements and exposure norms along with reporting requirements, have been made applicable to them. The asset liability management (ALM) reporting and disclosure norms have also been made applicable to them at different points of time.

3.NBFCs are also classified in terms of activities into Asset Finance Companies (AFC), Investment Companies (IC), Loan Companies (LC), Infrastructure Finance Companies (IFC), Core Investment Companies (CIC), Infrastructure Debt Fund - Non-Banking Financial Companies (IDF-NBFC), Non-Banking Financial Company– Micro Finance Institutions (NBFC-MFI) and NBFC-Factors. During 2011-12, two new categories of NBFCs, viz., Infrastructure Debt Funds – NBFC (NBFC-IDF) and Micro Finance Institution (NBFC-MFI) – were created and brought under separate regulatory framework. In addition, a new category called NBFC-Factors was introduced in September 2012. Earlier in April 2010, a regulatory framework for Systemically Important Core Investment Companies (CIC NDSI) was created for companies with an asset size of Rs.1 billion and above, whose business is investment for the sole purpose of holding stakes in group concerns, who are not trading in these securities and are accepting public funds. Prudential requirements in the form of Adjusted Net Worth and leverage were also prescribed for CIC-ND-SIs as they were given exemption from NOF, capital adequacy and exposure norms.

4.An NBFC-MFI is defined as a non-deposit-taking NBFC (other than a company licensed under Section 25 of the Indian Companies Act, 1956) that fulfills the following conditions: (i) Minimum Net Owned Funds of Rs.5 crore (Rs.2 crore for the North-eastern Region), (ii) Not less than 85 per cent of its net assets are in the nature of "qualifying assets", (iii) the income it derives from the remaining 15 per cent assets in accordance with the regulations specified in that behalf. An NBFC which does not qualify as an NBFC-MFI shall not extend loans to the micro finance sector, in excess of 10 per cent of its total assets.

> *"Expansion in assets of AFCs [asset finance companies] was noticeable [in 2011-12]."*

NBFC Sector: Consolidation

Non-Banking financial companies' segment is witnessing consolidation. The total number of NBFCs registered with the Reserve Bank declined marginally to 12,385 as at end-June 2012. A similar trend was observed in the case of deposit-taking NBFCs (NBFCs-D) during 2011-12, mainly due to the cancellation of Certificates of Registration (CoR) and their exit from deposit-taking activities. Despite the decline in the number of NBFCs, their total assets as well as net owned funds registered an increase during 2011-12, while public deposits recorded a decline.

The ratio of public deposits of NBFCs to aggregate deposits of Scheduled Commercial Banks (SCBs) in 2011-12 indicates a decline. The ratio of deposits of NBFCs to the broad liquidity aggregate of L3 also declined during the year.

Operations of NBFCs-D

Financial performance of deposit-taking Non-Bank Financial Companies (NBFCs-D) showed improvement. The balance sheet size of NBFCs-D expanded at the rate of 10.8 per cent in 2011-12. The borrowings constituted around two-third of the total liabilities of NBFCs-D. The public deposits of NBFCs-D, which are subject to credit ratings, continued to show an increasing trend during 2011-12. On the assets side, loans and advances remained the most important category for NBFCs-D, constituting about three-fourth of their total assets. The investment constituted the second most important category, which witnessed subdued growth during 2011-12 mainly due to a decline in non-SLR investments. Asset Finance Companies (AFCs) held the largest share in the total assets of NBFCs-D at end-March 2012.

> *"The financial performance of the NBFCs-D segment has witnessed improvement as reflected in the increase in their operating profits mainly emanating from fund based income."*

NBFCs-D: Borrowings

DEPOSITS: A sharp increase was discernible in the share of NBFCs-D with a deposit size of Rs. 500 million and above, accounting for about 93.2 per cent of total deposits at end-March 2012. However, only 7 NBFCs-D belonged to this category, constituting about 3.6 per cent of the total number of NBFCs-D. It indicates that only relatively larger NBFCs-D were able to raise resources through deposits. There was an increase in the share of public deposits in the interest rate range of 10 per cent to 12 per cent during 2011-12. The largest proportion of public deposits raised by NBFCs-D belonged to the short to medium end of the maturity spectrum. In 2011- 12, there was an increase in the shares of deposits for more than 2 years.

BANK & OTHER SOURCES: NBFCs-ND-SI segment continues to rely heavily on bank finance. Banks and financial institutions were the major providers of funds for NBFCs-D, constituting about 50 per cent during 2011-12. This share has come down marginally. Others (which include, inter alia, money borrowed from other companies, commercial paper, borrowings from mutual funds and any other types of funds that were not treated as public deposits) also registered a declining trend.

NBFC-D: Assets

Expansion in assets of AFCs was noticeable. The total assets of NBFCs-D sector registered a moderate growth during 2011-12 mainly due to an increase in the assets of asset finance companies. As at end-March 2012, more than two-third of the total assets of the NBFCs-D sector was held by asset finance companies. Component-wise, advances accounted for the predominant share of total