FIDC

Finance Industry Development Council

(A Representative Body of Assets and Loan Financing NBFCs)

101/103, Sunflower, 1st Floor, Rajawadi Road No.2, Ghatkopar (East), Mumbai – 400 077

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The Chief General Manager-in-Charge,
Reserve Bank of India,
Department of Regulation,
2nd Floor, Main Office Building,
Shahid Bhagat Singh Marg,
Fort, Mumbai – 400001

SUB: NOTE ON ACCOUNTING TREATMENT OF ASSIGNMENT TRANSACTION

1. Background of the Assignment Transaction:

1.1 Direct assignment is not only a strategic tool for achieving liquidity but it helps the company to de-risk and conserve the capital.

1.2 Agreements are entered with the bank/FI.

1.3 Assignment is for the balance period of loan over which cash flows were originally agreed with the borrower.

1.4 Assignor performs servicing of a loan wherein Assignor assumes a contractual obligation to pay the cash flows to the Assignee.

1.5 There are no credit enhancements to the assignment transaction.

1.6 As per RBI norms, based on the balance life of the pool, the Assignor is required to retain 5%/10% of the Assignment pool as minimum retention requirement [“**MRR**”] in lines with RBI guidelines. Retention of right to receive MRR portion ranked **pari-passu** with the assigned assets. The pool of loan assigned by the Assignor *does not undertake to make good any losses suffered by the Assignee* due to the non-receipt of the contractual cash flows (i.e. loan principal and interest thereon).

2. Pre – IND AS – Accounting Treatment:

The accounting treatment for the benefits (if any) retained by the assignee in any form post sale of the assets was recognized over the period in the statement of profit and loss, as per RBI circular no. DNBS. PD. No. 301/3.10.01/2012-13 dated 21 August 2012. As per para 1.4.1 of RBI Circular “The amount of profit in cash on direct sale of loans may be held under an accounting head styled as "Cash Profit on Loan

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Transfer Transactions Pending Recognition" maintained on individual transaction basis and amortised over the life of the transaction."

Any income which is **received/to be received** from the sale of the loan exposure is to be recognized over the life of the transaction.

3. Current Regulatory View:

3.1 RBI, vide its Circular dated 13th March, 2020, issued guidance to Non-Banking Financial Companies ('NBFCs') on implementation of IND AS stated that "The responsibility of preparing and ensuring fair presentation of the financial statements of a NBFC/ARC vests primarily with its Board of Directors. Reserve Bank expects a high-quality implementation of IND AS which will require detailed analysis, application of judgment and detailed documentation to support judgments".

3.2 RBI considers upfront booking of income as abnormal profit and hence in the draft comprehensive framework for "**Sale of Loan Exposure**" dated **8th June 2020** suggests **excluding such income from the computation of Tier I capital and net worth**.

4. Accounting Treatment followed under IND AS 109:

4.1 Currently, the following accounting treatment is being followed by the Company under Ind AS – 109:

- Financial assets are derecognized on the date of assignment.

- Any right on interest on assigned portion of asset is required to be recognized as a new financial asset at fair value.

- On de-recognition of a financial asset in its entirety, the difference between the carrying amount (measured at the date of de-recognition) and the consideration received (including any new asset obtained less any new liability assumed) shall be recognized in profit or loss.

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- As and when cash collections are made for interest retained, receivables are reduced to that extent.

4.2 The above accounting is based on the following guidance within IND AS 109. As per para 3.2.4, 3.2.5, 3.2.6 and 3.2.12 of IND AS 109, ***the asset assigned qualifies for the de-recognition*** *and the interest portion retained as MRR is required to be recognized* ***at fair value as new financial asset*** *and the difference* between
  a. the carrying amount (measured at the date of de-recognition) and
  b. the consideration received (including any new asset obtained less any new liability assumed) recognised in the **statement of profit and loss.**

5. Limitation of New accounting Policy post implementation of IND AS:

The current accounting treatment as per IND AS results into abnormal outcome varying with the tenure of the underlying pool:

a. It inflates the income at the time of transaction which is to be received over tenure of the loan. The same has the potentiality to decrease suddenly & substantially if the liability model of the Company changes.
b. Additional revenue can be used for reporting higher Earnings per Share, Higher Dividend Payout or improved CRAR.

The income to be booked in the year of sale of asset as per IND AS and amortization can be demonstrated from the table mentioned below:

Sr. No.	Loan for Sale	Lender ROI	Purchaser (Assignee) ROI	Assignor margin %	Residual Tenure (Months)	As per IND AS	As per Amortization	% Change
1.	100	17%	9%	8%	24	8.70	6.37	36.51%
2.	100	17%	9%	8%	36	12.94	7.01	84.63%
3.	100	15%	9%	6%	60	15.73	5.61	180.32 %
4.	100	13%	9%	4%	120	19.38	3.91	396.04 %
5.	100	13%	9%	4%	180	26.90	3.96	579.49 %

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6. **Appeal:**

Based on the points as discussed above prior to IND AS application, NBFCs, on sale of loan exposure were required to amortize the income over the tenure of the loan. **RBI considers this income as abnormal and from regulatory prospective guided NBFC not to consider such income as it's tantamount to false representation of company's performance.**

We humbly request your good selves to consider the change in accounting policy because of implementation of IND AS which has serious limitations as discussed above and propose the small change to be allowed to NBFC for accounting the income from sale of loan exposure. The details of change proposed are mentioned in para 7 below.

7. **Proposed Accounting Policy as per RBI Guidelines dated 21st August, 2012 before IND AS Implementation.**

7.1 **Gain on direct assignment transactions** wherein the gain will be recognized in non-financial liability as "Unearned income on assigned loans" and will be amortized in the statement of profit and loss over the period of loans assigned instead of recognition of the gain in the statement of profit and loss immediately upon assignment of the loans (that qualify the de-recognition guidance stated above).

7.2 **Upfront Profit:** Gain which was recognized till date as upfront profit has inflated the net worth of the company, so same should be transferred to non-financial liability as ""Unearned income on assigned loans" from the reserves and surplus.

7.3 In our humble view, it will adhere to the basic intent of the accounting standard to project the asset and liabilities at fair value and along with that, it will depict the fair and transparent picture of the statement of profit and loss.

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It is our submission that this would duly reflect the appropriate levels of risk inherent in the respective asset classes and provide NBFCs a degree of capital relief. This is also in consonance with the Basel III requirement for Banks.

We request the RBI to kindly consider our submission. We would be grateful for an opportunity to discuss and present our views to the RBI at a virtual or physical meeting.

Thanking you,

Yours Faithfully,

For FINANCE INDUSTRY DEVELOPMENT COUNCIL

MAHESH THAKKAR
DIRECTOR GENERAL
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