FIDC

Finance Industry Development Council

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

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9th May, 2019

Shri Shaktikanta Das
Governor
Reserve Bank of India
Central Office Building
Shahid Bhagat Singh Marg
Fort, Mumbai – 400 001

Respected Sir,

Reg: Key Concerns of the NBFC Sector That Need Urgent Attention

Non-Banking Finance Companies continue to feel the liquidity crunch which is affecting their growth. The total disbursements during Q3 (Oct-Dec, 2018) figures indicate a drop of around 19% (Y-o-Y). This has had an impact on important sectors of the economy like automobiles and MSMEs.

We take this opportunity to draw your kind attention to the three important issues that need immediate redressal:

1. **Request to Amend Securitization Guidelines - MHP & MRR to be Done Away With**

   Over the years NBFCs have mastered the art of funding the unfunded. Better understanding of the ground realities, flexibility in operations to match the needs of the borrowers, providing a personal touch has enabled them to develop a niche market for themselves where the relationship has been stretched beyond the ambit of a simple lender-borrower relationship. As a result the borrowers are wedded to them even at the cost of paying a comparatively higher interest rate.

   On the other hand banks have always struggled to meet the priority sector lending targets prescribed by the regulator. Therefore, securitization by way of bilateral assignments / buying NBFC portfolios have been a practice which has evolved to the benefit of both. While it provides immediate liquidity to NBFCs, it also enables banks to build their loan books aggressively in addition to meet the PSL targets. This has been one of the modes of fund raising for NBFCs over the years and has enabled building of strong linkages between banks and NBFCs.

However, RBI vide its circular no. DNBS. PD. No. 301/3.10.01/2012-13 dated 21st August, 2012 prescribed a Minimum Holding Period (MHP) and Minimum Retention Requirement (MRR) for various tenures and repayment frequency. This was done in order to prevent unhealthy practices surrounding securitization viz; origination of loans for the sole purpose of securitization and in order to align the interest of the originator with that of the investors and with a view to redistribute credit risk to a wide spectrum of investors, it was felt necessary that originators should retain a portion of each securitization originated and ensure more effective screening of loans. In addition, a minimum period of retention of loans prior to securitization was also considered desirable, to give comfort to the investors regarding the due diligence exercised by the originator.

However, since then, the entire regulatory framework for NBFCs has undergone a overhaul, and the markets have also evolved and matured. NBFCs have displayed a healthy growth which reflects in better asset quality. Further, banks follow an elaborate due diligence process including a detailed audit of the pool to ensure that only the best performing (i.e nil default) cases are cherry picked.

Further, with NBFCs having to follow Ind AS accounting system w.e.f 1st April, 2018, the requirement of MHP and MRR denies the benefit of a true sale and thus is resulting in additional capital requirement.

In the light of above said developments coupled with the crying need to provide immediate liquidity to the NBFC sector, It is perhaps time to review the need for the MHP and MRR norms as they are now being seen as restrictive in nature. Moreover, with the prevailing liquidity crunch, such restrictions are affecting NBFCs' ability to generate liquidity.

Suggestion:

In the light of the prevailing scenario, it is hereby requested that the Securitization Guidelines may be amended so as to do away with the prescribed Minimum Holding Period (MHP) and Minimum Retention Requirement (MRR).

As an immediate relief, the MHP for loans with maturity of 2-5 years should be reduced from 6 months to 3 months

2. Challenges from New Working Capital Norms

In India, the working capital (WC) finance has been provided by banks to its customers in the form of fund-based facilities [like WC term loan (WCTL), WC demand loan (WCDL) and cash credit (CC)] and non-fund based facilities [like letter of credit (LC) and bank guarantee (BG)]. RBI had earlier kept the bifurcation of fund-based WC finance facilities in the form of loan and cash credit at the discretion of the banks. This loan component within WC finance, proposed by the Prakash Tandon Committee in 1975, was in the form of WCDL. This WCDL had tenors of 7-90 days, ideal for meeting the needs of the manufacturing sector, and was available at an interest rate less than that of CC. RBI had stipulated a loan component of 80%, but that was optional. Banks then had the freedom to increase the CC component beyond 20% and reduce the loan component below 80%.

For NBFCs, especially, the Investment & Credit companies (NBFC-ICCs), whose raw material is only money and who provide loans to their customers for tenures of 3-5 years, having such a loan component with 7-90 days tenor in the WC made little sense. This opened up the possibility of a typical mismatch in the availing of the WC and its servicing, but because of the optional nature of the WCDL component, NBFCs could manage just by paying off the interest component and rolling over the principal amount, till they had enough funds to pay off the principal. Under this arrangement, access to liquidity wasn't a concern for the NBFCs.

It is worth noting that RBI had formed various committees in the past to suggest the framework for WC facilities from the banking system. In this respect, Tandon Committee and Chore Committee laid out the framework for calculation of WC and the same was adopted by the banking system. For more than two decades, NBFCs have been following that methodology for calculation of WC done on the basis of two methods as recommended by Tandon Committee. RBI had also suggested a formula to the banks for calculating drawing power (DP) based on the outstanding lease credit where the period of lease was assumed as 5 years and accordingly DP was calculated. All the banks had been following this formula. For asset financing, DP has historically been calculated on the basis of receivables for a period of up to 5 years.

However, the December 5, 2018 circular from RBI has changed the scenario. This circular has introduced a compulsory bifurcation of the WC for borrowers enjoying an aggregate fund-based WC finance of Rs. 150 crore and above from the banks. The sanctioned fund-based WC finance (after excluding the export credit limit and the inland sales bill discounting limit) is to have a compulsory WC loan (WCL) component of minimum 40% w.e.f. 1st April 2019. The minimum tenor for WCL has to be 7 days. This loan component will further go up

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to 60% w.e.f. 1st July 2019. As per the new guidelines, the loan component can be split into multiple loans having different maturities. Banks have also been given the freedom to allow rollover of these loans subject to compliance with income recognition and asset classification (IRAC) norms. While earlier the interest rate for WCDL was lower than the rate for CC, RBI has not provided any guidance on the applicable rate of interest on WCL.

The erstwhile WC calculation was done taking cognisance of the IRAC norms and was based on the premise that an NBFC will be lending for tenures greater than 1 year. But the new requirement of a compulsory loan component within the working capital facility is inappropriate for an NBFC as the tenor of the loan component is shorter than the period over which the receivables accrue to the NBFC. The loan component has to be co-extensive with the underlying receivables given as security for the loan, or else it will result in a dynamic inconsistency in the inflow and outflow of funds making it difficult for the NBFCs to service WC. In this regard it is worth recalling one of the recommendations of the Chore Committee which said that the banks should not bifurcate cash credit accounts into demand loan and cash credit components for NBFCs.

Suggestion:

Keeping in mind the criticality of the NBFC sector for its role of catering to the credit needs of the micro, small and medium enterprise (MSME) class, especially at a time when the sector continues to face a liquidity crunch:

i. *Implementation of the new WC norms for NBFCs may be deferred by one year considering the current situation.*
ii. *Further, following changes are proposed:*
    - *the sub-limit or the loan component within the working capital facility should get re-instated automatically upon maturity thereof, to ensure continuation of the WC facility. This would ensure that just paying the interest on the loan would suffice once the loan matures ; the principal can be paid off when the NBFC collects enough funds from its receivables*
    - *the pricing for the loan component should be based on its tenor linked with respective period MCLR and tenor premium of the bank*

3. Need to have a Structured Dialogue on Regular Basis – As assured in the 9th January Meeting

In the fast changing scenario today, a structured dialogue on a regular basis with the regulator is a must. This acts as a 2 way flow of information and areas of concern. In the past, we at FIDC had the privilege of meeting the RBI Governor at least twice a year (in April and October, just before the Annual Credit Policy and the Mid Term Review).

In addition to this, RBI had constituted an Informal Advisory Group (IAG) on NBFCs which comprised of NBFC representatives and professionals from ICAI and ICSI. IAG meetings were held on a quarterly basis under the Chairmanship of Executive Director / Chief General Manager, Dept. of Non-Banking Regulation / Supervision. All policy changes proposed by RBI were discussed in detail prior to their implementation. This ensured a healthy dialogue and resulted in smooth sailing for the regulatory changes announced by RBI.

Suggestion:

At least 2 Meetings of FIDC Office Bearers with the Governor / Deputy Governor should be held in a year.

During the meeting convened by you on 9th January 2019 this matter was raised by the undersigned and you had assured to have regular interaction with FIDC at least at the Deputy Governor level.

We hope that the issues stated above and the suggestions made thereon shall be favorably considered on priority basis. Assuring of you of our full cooperation always and thanking in you in anticipation

Yours Faithfully
For Finance Industry Development Council

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