FIDC

Finance Industry Development Council

(A Representative Body of NBFCs in India)

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

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To
The Secretary,
Department of Financial Services,
Ministry of Finance, Government of India,
New Delhi.

Our response to the two queries raised by you is as under.

1. *What steps to be taken to enable NBFCs to charge lower interest rates from its customers?*
2. *What steps to be taken by the Commercial Banks or the Government of India for better financing avenues of NBFCs?*

NBFCs primarily cater to the credit needs of the self-employed, MSMEs, agriculturists, transporters, contractors and small borrowers who are not adequately served by the banks. Given their financial position and level of financial discipline, they fall under the "higher risk" category. The amount of loan taken by such borrowers are smaller in size, resulting in higher transaction costs for sourcing, managing and collecting such loans. Hence, these loans carry a higher rate of interest. Further, NBFCs today are heavily reliant on funding from banks and hence are constrained by their borrowing cost from banks.
Following steps are suggested for better financing of NBFCs and reducing our borrowing cost:

i) The need of the hour is to diversify funding sources for NBFCs in order to reduce dependence on banks. For this, there has to be a permanent "refinance window" on the lines of that available for Housing Finance Companies from National Housing Bank.

ii) A major chunk of lending done by NBFCs goes to what is categorized as "priority sector" by RBI. As such, all banks lending to NBFCs for on-

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lending to the priority sector should be considered as Priority sector lending for banks. This shall have a direct impact on the reduction of our borrowing cost and also ensure better funding from banks. While this arrangement was in place since 1999, it was withdrawn in 2011. However, the same has been allowed again but only to the extent of 5% of the individual bank's total priority sector lending. There is also an artificial cap of Rs 20 laths per borrower for such on-lending by NBFCs. This may kindly be removed.

iii) More than 90% of the NBFCs (in number) are small and medium sized. For these companies, obtaining even a minimum investment grade credit rating is a major challenge. This is because "size" of operations (which may be expressed as a function of Total Assets under Management / Net Worth / Geographical spread of operations / Diversity of products) is an important parameter when it comes to the ratings assigned by all the approved and accredited rating agencies. Additionally, all avenues of fund raising for NBFCs, including banks, prescribe a minimum external credit rating as the most important criteria. All this put together, not only make fund raising difficult but also increases the cost of borrowing. Banks, Financial Institutions need to depend more on their own risk assessment rather than being dependent on external credit rating assigned by rating agencies.

iv) One of the key elements of prudential norms is risk based accounting. While banks have the benefit of assigning differential risk weights based to various asset classes for NBFCs the risk weights assigned to all asset classes is uniformly prescribed as 100. In fact for high risk assets like real estate and stock markets, the prescribed risk weights are 150. It is therefore pertinent to allow NBFCs to assign lower risk weights to "low risk" assets like automobile loans, equipment loans, tractor loans etc.

This would enable NBFCs to leverage better and operate at lower net interest margins.

v) NBFCs lending rates are also a function of the ability to recover our dues. With NBFC regulations being "harmonized" with that for banks and FIs, it is not only prudent but urgent to ensure harmonization of norms relating to recovery of our dues. Today, NBFCs can enforce security under SARFAESI Act only in cases where the ticket size of loans is more than 20 lakhs. This rider is both imprudent and a major stumbling block to our recoveries. Since, NBFCs are known to offer small loans to small borrowers, we are unable to benefit from the SARFAESI Act. This rider of 20 lakhs should be reduced to 1 lakh, as is the case for banks.

We request you to kindly consider our requests.

We thank you for your kind consideration.

Thanking you,

Yours sincerely,

For FINANCE INDUSTRY DEVELOPMENT COUNCIL

MAHESH THAKKAR
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