FIDC

Finance Industry Development Council

(A Representative Body of Asset and Loan Financing NBFCs)

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

Tel: 022 21027324/9820035553 ● E-mail: directorgeneral@fidcindia.org, website: www.fidcindia.org

14th November, 2019

Smt. Nirmala Sitharamanji
Minister of Finance
North Block
Government of India
New Delhi 110 001

Respected Madam,

SUB: <u>KEY ISSUES BEING FACED BY NBFCs – MEETING HELD ON 11TH NOVEMBER 2019</u>

We sincerely thank you for sparing your valuable time and giving a patient hearing to the important issues raised by our Managing Committee members during the meeting held in your office on 11th November, 2019.

Finance Industry Development Council (FIDC) is a Representative Body of Asset and Loan Financing of the NBFCs registered with the Reserve Bank of India. FIDC was formed 15 years ago and is the recognized face of the NBFC sector. We have been engaged in regular interaction both with Reserve Bank of India and Govt. of India, which include pre-budget meetings and also important policy related meetings with RBI. Almost all the leading NBFCs and a large number of small and medium sized NBFCs are our members.

We appreciate the measures taken by Ministry of Finance to address the liquidity crunch faced by NBFCs. However, the sector continues to grapple with availablity of funding at reasonable cost.

Following are the key issues and our suggestions thereon:

1. **Heterogeneity in the NBFC Sector – Need to Distinguish Between Long Term and Short Term Financing NBFCs**

   The Non-Banking Finance Companies (NBFC) sector is a heterogeneous mix of companies engaged in long term financing (minimum 10 years) in the infrastructure

and housing sectors, and companies following the typical NBFC model of retail small ticket size short term lending (1-5 years). A vast majority of NBFCs are engaged in the short term retail lending, focused on asset creation (other than real estate) and MSME financing.

The core issue in the recent developments post IL&FS default, relates to the asset liability mismatch. While this may be an inherent problem for the long term financing players, asset liability mismatch is not an issue for the short term retail lending NBFCs.

Two major instances of default by NBFCs in the last one year relate to infrastructure financing NBFC and housing finance company – both of whom are long term financers and therefore, were faced by an asset liability mismatch. However, the entire NBFC sector was viewed and projected to have an asset liability mismatch which resulted in banks and mutual funds suddenly becoming risk averse.

Suggestion:

It is of prime importance to clearly differentiate the short term retail financing NBFCs from the long term financing players, to ensure that all are not painted by the same brush and perceived to be high risk.

2. Banks Continue to be Risk Averse in Lending to NBFCs

In spite of the steps taken by Ministry of Finance and RBI, banks continue to be risk averse in lending to the NBFC sector. While banks are willing to buy out NBFCs' portfolio (pool of assets) they have restricted the credit lines to the NBFCs. Buying out of NBFC pool of assets can at best be a band aid solution which does not lead to the growth of NBFCs. Moreover banks undertake a 100% audit of the asset pool and cherry pick the best performing pool of assets in case of a buyout.

The actual credit flow from banks to NBFCs has declined since October 2018 and is primarily available for highly rated NBFCs. It is an established fact that the rating model which is followed by all the accredited credit rating agencies, entails "size" as

an important parameter. This prevents small and medium sized NBFC from getting the desired level of credit rating in spite of sound financials. Thus, small and medium sized NBFCs continue to grapple for bank funding.

All banks prescribe a minimum "bank loan rating" as one of the eligibility criteria for any NBFC to avail credit (by way of term loans or cash credit limits). World over credit rating is
used as a guiding tool to the investor and thus cannot take the shape of Quasi regulatory parameter.

Suggestion:

Minimum prescribed credit rating should not be a barrier for NBFCs to avail credit from banks and bank funding to NBFCs should primarily be based on the financials and overall strength of NBFCs, irrespective of their size and credit rating

3. Encourage Bank Lending to NBFCs for On-Lending to Priority Sector to be Treated as Priority Sector Lending for Banks

Since 1999, RBI had allowed all bank lending to NBFCs for on-lending to the priority sector, to be treated as priority sector lending by banks. This gave a huge incentive to banks to lend to NBFCs. While it ensured sufficient bank funding to NBFCs at a reasonable cost, it also facilitated banks to meet their PSL targets. This was abruptly withdrawn in 2011.

However, RBI re-started this arrangement recently, but only upto 31st March, 2020 and on a very limited scale (only up to 5% of PSL by banks).

Suggestion:

This arrangement of treating bank lending to NBFCs for on-lending to Priority sector to be treated as PSL for banks, should be made permanent and the limit needs to be increased to at least 10% of total priority sector lending (PSL) by banks.

101/103, Sunflower, 1st Floor, Rajawadi Road No.2, Ghatkopar (East), Mumbai – 400 077 (India)
Tel: 022 21027324/9820035553 • E-mail: directorgeneral@fidcindia.org, website: www.fidcindia.org

4. Need for Refinance Mechanism for NBFCs

All the measures to address the liquidity crunch of NBFCs announced by RBI and Ministry of Finance are aimed at nudging/ incentivizing/ advising banks to lend more to NBFCs. Thus, the channel for funding NBFCs is routed through the banks only.

The regulatory regime for NBFCs has evolved to a stage where the regulation relating to the asset side of the balance sheet has been harmonized with that for banks. However, on the liability side NBFCs continue to depend largely on banks. In September 2018, one single default by one NBFC created such a negative sentiment that banks suddenly became very apprehensive and reluctant to lend to NBFCs. This risk averse approach of banks created a liquidity crunch for the entire NBFC sector which in turn had a multiplier effect on the important sector like automobiles, MSMEs and consumer goods.

Therefore, the need of the hour is to develop funding sources for NBFCs outside the banking system.

Suggestion:

1. *Now that the Regulatory function of National Housing Banks (NHB) has been transferred to RBI. NHB may now become the apex refinancing body for the entire NBFC sector and not only HFCs.*
2. *MUDRA (which has the mandate) can play an important role in refinancing large number of Small and Medium NBFCs*

5. "On-Tap" Issuance of Secured Debentures

NBFCs have access to Non-Convertible Debentures ("NCDs") having flexible tenure and rates, both through the private placement (with restrictions) and public issue. While private placements have severe restrictions on the number of investors, the frequency of issue etc., public issue of bonds tends to be very expensive, laborious and inflexible.

101/103, Sunflower, 1st Floor, Rajawadi Road No.2, Ghatkopar (East), Mumbai – 400 077 (India)
Tel: 022 21027324/9820035553 • E-mail: directorgeneral@fidcindia.org, website: www.fidcindia.org

The recent liquidity crunch faced by NBFCs has necessitated diversification of funding sources for NBFCs. Further, Government of India and Economists have all voiced the need for promoting and strengthening the Corporate Bond Market. It is time to think beyond the traditional modes of bond issuances to make them more flexible, acceptable and cost effective.

It is therefore proposed that NBFCs be allowed an **on-tap facility for issuance of NCDs** to the retail market by making the offering of NCDs through an easy- to-operate and less costly procedure, but with proper governance to provide investor protection and comfort. The features proposed are:

- Bonds/NCDs to be rated minimum BBB- (minimum investment grade). Instruments must be secured and should not fall under the definition of "deposit"
- Company to file umbrella prospectus (valid for one year) with quarterly financial updates. In no event, can the financials be older than 4 months. This document would lay down the overall limits and the type of NCDs to be issued (deep discount/interest bearing etc.)
- Under this, NBFC to be allowed to issue as many NCDs as they wish in whatever frequency they wish to. There should be no need to file an updated prospectus – only updated financials may need to be filed as an addendum.
- There should be no need for a specific issue closure date and issue allotment date. The allotment of bonds to be similar to acceptance of deposits – with tenure being determined from the date of the application.
- NCDs to be marketed similar to deposits. Intermediaries may be allowed
- Tenure may be long term say, 2 or 3 years and upwards
- Given that these are secured instruments, there should be no need to maintain SLR.
- Governance under SEBI guidelines, with overall borrowing cap being permitted by RBI.
- Lead Manager to have responsibility of reporting to SEBI & RBI on quarterly basis
- Grievance redressal mechanism similar to deposit acceptance regime; access for investors to SEBI and RBI Ombudsman
- Minimum investment amount could be low – say, Rs 10,000/- so that greater retail participation is possible.

- Instruments would be listed and tradeable on a recognised stock exchange to provide liquidity to retail investors.

The idea is to make bond issuance an on-going process, with increased Reporting, more so, since NBFCs are already subject to stringent supervision, both “on site” and “off site”.

6. Co-origination of Loans- Request to allow Deposit taking NBFCs

The concept of co-origination of loans by banks and NBFCs has been an excellent initiative taken by RBI. It has been heartily welcome and highly appreciated by banks and NBFCs, as it combines the strength of the two financial entities.

However, this is currently restricted to Systemically Important Non Deposit Taking NBFCs (NBFCs-ND-SI) only. Deposit Taking NBFCs (NBFCs-D), especially the larger ones, have built a large retail investor base which are also the target segment of borrowers under the co-origination of loan scheme.(since many of them fall under the priority sector category). Moreover, the prevailing regulatory frame work for NBFCs is equally stringent for both NBFCs-ND-SI and NBFCs-D.

Suggestion:

It is therefore prudent and the need of the hour to extend the Co-origination of Loan Scheme to Deposit Taking NBFCs (NBFC -D).

7. Reporting of Data on Bank Lending to NBFCs by RBI

RBI publishes data on sectorial deployment of bank credit periodically. Under this, the data on bank credit to NBFCs currently includes bank lending to Government owned NBFCs also. Since Government owned NBFCs are largely engaged in big ticket sized and long term funding, bank lending to these Government owned NBFCs forms a significant portion. In the current scenario, where it is an accepted fact that banks have become risk averse in lending to NBFCs, the RBI data does not reflect the true

picture (obviously because of the fact that bank lending to the Government owned NBFCs is not impacted)

Suggestion:

We therefore request that the data on bank credit to NBFCs may be split into Government owned and Private NBFCs. This shall not only present the factual position but also facilitate policy formulation.

8. Meeting with FIDC on a Periodical Basis

While Department of financial Services, Ministry of Finance holds regular interaction with the banking sector, there is no such mechanism of regular meeting with the NBFC sector. In a fast changing scenario, a structured dialogue on a regular basis with the regulator is of utmost importance. This acts as two way flow of information and areas of concern and thus facilitates effective regulation and policy formulation for the healthy growth of the sector.

Suggestion:

Department of Financial, Ministry of Finance under your chairmanship should organize regular meetings (once every quarter) with FIDC.

We look forward to receiving a positive reply from your end. Assuring you of our full cooperation always and thanking in you in anticipation

Yours Faithfully
For **FINANCE INDUSTRY DEVELOPMENT COUNCIL**

RAMAN AGGARWAL
Co-Chairman