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

Tel: 022 21029898/9820035553 • E-mail: directorgeneral@fidcindia.org Website: www.fidcindia.org

16th July, 2020

Smt. Nirmala Sitharaman ji
Minister of Finance
Govt of India
North Block
New Delhi – 110 001

Hon'ble Finance Minister Madam,

SUGGESTIONS TO ENSURE LIQUIDITY FOR SMALL AND MEDIUM SIZED NBFCS

NBFCs, especially, a large number of small and medium sized, have been facing a liquidity crunch since 2018, after the IL&FS fiasco. The Covid driven lockdown has aggravated the situation. We sincerely appreciate the measures taken to provide liquidity to NBFCs, which clearly show the concern and intent to support NBFCs as key players in financing MSMEs.

The interventions by the Government through TLTRO 2.0, PCG 2.0, Special Liquidity Scheme etc. targeted to infuse liquidity has provided only a limited relief to small and medium sized NBFCs as most of the money has flowed into a small number of large NBFCs, which are highly rated. Despite the steps taken, the situation for small and medium sized NBFCs has not changed significantly, and these companies continue to face difficulties in raising funds.

It has also been our experience that the lower translation of benefits to mid and small sized NBFCs through TLTRO, PCG and other similar interventions seem to be stemming from the tighter evaluation criteria adopted by the Banks related to the Profit & Loss account, such as interest coverage ratio, credit losses and consequently the profitability. These ratios are obviously under stress due to the headwinds faced by the small and medium sized NBFCs, such as failure of a few large NBFCs such as ILFS, Dewan Housing etc., Economic Slow Down in FY19-20 and now the COVID 19.

Further, due a major withdrawal of mutual funds, insurance companies etc from funding to NBFCs, even large companies have been borrowing mainly from banks and it has left hardly any space for small and medium NBFCs and they have been crowded out and banks have been citing sectoral exposure caps to deny the credit facilities to these NBFCs.

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The Government has announced the ECLGS scheme for funding MSMEs to the extent of 20% of their existing loans backed by Govt. guarantee. The smaller NBFCs may not be able to fully participate in the scheme unless sufficient funding is made available to them.

Following are the key factors that need to be given top priority in order to ensure that liquidity reaches the larger universe of small and medium sized NBFCs, which account for more than 90% of the total number of NBFCs registered with RBI:

1. Mode of Funding Should be Term Loans Only

Small and medium sized NBFCs do not access capital market and thus do not issue bonds / NCDs / CPs etc. They raise funds simply through "Term Loans" from banks and FIs. Almost all the measures announced – TLTRO 1.0 & 2.0, Partial Credit Guarantee Scheme 2.0 and Special Liquidity Scheme, entail funding of NBFCs by investment in their bonds / NCDs / CPs only. Thus, these measures have not provided the desired results.

2. Credit Rating Should Not be an "Eligibility" Criteria

All the measures announced till date have a minimum prescribed credit rating as an eligibility criteria. Any NBFC which does not have the minimum prescribed rating is "not eligible" to take benefit. World over credit rating is used as a guiding tool to the investor and thus cannot take the shape of Quasi regulatory parameter. Recently, reacting to the downgrade of India's Sovereign rating by one of the rating agencies, a very senior official of the Ministry of Finance stated that "credit rating is just a view", which is the norm globally. However, when it comes to funding of NBFCs, it is unfortunate that credit rating is used as an eligibility criterion.

Moreover, 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. All the credit rating agencies use the same scale to rate both large and small NBFCs. In such a scenario, it is practically impossible for a small sized NBFC to get the desired level of credit rating despite a sound Balance Sheet and excellent track record.

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3. Small and Medium NBFCs Should be Funded by FIs / SPV

Govt. of India and RBI have announced several measures in the recent times to provide funding support to NBFCs. All these measures are aimed at routing funds to NBFCs through the banking channels. However, last 2 years have clearly shown the risk averse approach of banks when it comes to funding NBFCs. The Partial Credit Guarantee Scheme 1.0, TLTRO 1.0 & 2.0 could not yield desired results simply due to the risk aversion on part of banks. Thus, it is important to provide funding from sources other than banks also.

The idea of creating a SPV, as part of Special Liquidity Scheme is unique and welcome. Further, FIs like SIDBI, NABARD (along with its subsidiaries NABKISAN & NABSAMRUDDHI) should be allocated funds for on-lending to NBFCs.

4. Financial Ratios Related to Profit & Loss Account Need Relaxation in Extraordinary Circumstances

The Banks/FIs usually look at certain profitability ratios such as Interest Coverage Ratio, Credit Loss ratio and Profitability ratios etc. while granting new facilities to NBFCs. These ratios play an important role in approval of new facilities.

These profitability ratios are usually complied in normal economic conditions. We are living in abnormal times now, hence, it would be in fitness of the situation to relax the profitability ratios and covenants - for the financial years 2019-20 and 2020-21. It would be easier on part of the Banks/FIs to relax conditions for the current year, if the same is backed by a regulatory advice.

Suggestions:

- ***A fund dedicated to Funding Small & Medium NBFCs may be allocated to FIs like SIDBI, NABARD (along with NABKISAN & NABSAMRUDDHI)***

- ***These FIs should fund by way of "Term Loans" for a tenure of 3-5 years***

- ***All NBFCs, irrespective of their size and credit rating (even unrated), should be eligible***

- ***Regulatory forbearance and advice to banks/FIs to show leniency towards the financial covenants related to Profit and Loss account for the financial years 2019-20 & 2020-21, along with a carve out for small and medium NBFCs in the sectoral caps prescribed for NBFC***

- ***Key Balance Sheet parameters such as CRAR, NPAs, Track Record along with Promoters experience and understanding of the market, should be the important consideration***

We are confident that once liquidity concerns of these large number of small and medium NBFCs are addressed, it shall have a multiplier effect when it comes to credit delivery, as these companies have a deep rooted understanding of the local market dynamics and a greater connect with the unbanked and underbanked segment of the society.

Assuring you of our full co-operation always and thanking you in anticipation

Yours Faithfully,
For **FINANCE INDUSTRY DEVELOPMENT COUNCIL**

MAHESH THAKKAR
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