

# FIDC

## Finance Industry Development Council

*(A Representative Body of Assets and Loan Financing NBFCs)*

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

Tel: 022 21029898/9820035553 • E-mail: [directorgeneral@fidcindia.org](mailto:directorgeneral@fidcindia.org) Website: [www.fidcindia.org](http://www.fidcindia.org)

**Shri Injeti Srinivas**

**Secretary**

**Ministry of Corporate Affairs**

5<sup>th</sup> Floor, Shastri Bhawan

New Delhi - 110001

Email: [secy.mca@nic.in](mailto:secy.mca@nic.in)

May 14, 2020

Dear Sir,

### **NOTE ON PROVISIONING REQUIREMENTS UNDER RBI CIRCULAR DT 27<sup>TH</sup> MARCH & 17<sup>TH</sup> APRIL, 2020 AND THE ICAI ADVISORY**

In view of Covid-19 induced lock down and its consequential impact on the livelihood of millions of people particularly MSMEs and truck/taxi drivers and unorganized labour who are most vulnerable and earn and pay their instalments, RBI has permitted NBFCs to allow moratorium to their customers for instalments falling due between March and May, 2020 and also allowed standstill on asset classification during this period. In other words, all standard accounts (0-90 dpd contracts) as on 1<sup>st</sup> March 2020 can be frozen during this period of 3 months till 31<sup>st</sup> May20.

RBI has also specified provisioning guidelines applicable in respect of these accounts and advised NBFCs to comply with Ind AS in line with duly approved Board policies and the advisories issued by ICAI for recognition of impairment.

We list out the key issues of concerns for NBFCs:

1. The RBI has vide its asset classification and provisioning notification dated April 17, 2020 laid down that the moratorium granted even to standard assets as at February 29, 2020 shall be excluded by lending institutions from the number of days past-due for the purpose of asset classification under IRAC norms. The RBI has accordingly laid down that for lending institutions,



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the asset classification shall stand frozen even for the standard assets that have been granted moratorium.

We are aware that Banks follow Indian GAAP and the IRAC norms while NBFCs follow the Ind-AS. Hence, Banks shall adopt this notification as laid out. The RBI notification dated April 17, 2020 also says that NBFCs shall be guided by guidelines as approved by their Boards and as per ICAI advisories.

### **Request:**

***It is therefore submitted that NBFCs shall be able to adopt the above RBI notification only after a specific notification from the ICAI or the MCA that even in the IndAS framework, this RBI notification is superior as it is a regulatory override and should be adhered to for treatment in the financial statements of NBFCs. We request the MCA/ICAI to issue such a notification***

Just like as has been recommended for the Banks, this temporary revision (freezing) in the classification (staging) requirements would ease out the current precipitated Covid-19 related credit weakness for NBFCs, which will in turn support the NBFC business, the financial sector and the economy as a whole, so as to continue our journey in coming out from such difficult financial times.

2. The SARFAESI Act was enacted in 2002 to provide inter alia, a mechanism by which banks and NBFCs could sell/transfer stressed assets to an asset reconstruction company (“ARC”) in order to clear their balance sheets of non-performing loans and to ensure that the economic value of these loans could be effectively realised in a focussed and time-bound manner. ARCs are expected to have the necessary skills to ensure better recovery of such assets and hence aid in reducing the incidence of bad loans at the systemic level.

By the general model, Banks and NBFCs subscribe to Security Receipts (SR) of the trusts that hold the transferred distressed assets. These SRs are accounted for as investments under the Indian GAAP. With the implementation of Indian Accounting Standard (Ind-AS) for NBFCs, the entire accounting paradigm has undergone a significant change. We refer to the requirements under Ind AS 109, “Financial Instruments” with regard to derecognition of financial assets from the balance sheet of a transferor. We note that the said requirements contain a strict ‘risk and



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rewards test’ which needs to be tested in order for a transferred financial asset to be derecognized from the balance sheet of the transferor. In addition, there is also a ‘control test’, which needs to be applied but only in case where the transferor neither transfers nor retains substantially all the risks and rewards. Thus, in effect, the risk and rewards test precedes the control test. A plain reading of the newer norms would suggest that the stressed loans that are transferred to an ARC cannot be derecognised on the books of the NBFC and would have to continue to be accounted for as if no such transfer took place. By implication, impairment of each such loan would have to be recognised by the NBFC in line with the expected credit losses. By implication as well, investments in SRs issued by the ARC/SPV cannot be held as investment by the said NBFC.

This creates a strange situation where the NBFC is forced to account for an asset it does not have, but not account for an investment, actually which is legally held by it.

Being mandated under the Ind-AS to continue to show the stressed assets on the balance sheet also effectively defeats the purpose of sale of such assets under the SARFAESI Act.

It is also to be noted that Banks have currently not transitioned to IndAS. Accordingly, currently if a portfolio with similar characteristics is sold by a bank to an ARC where “True Sale” criterion is met, the bank would be able to derecognize the loans (Financial Assets) under RBI guidance, while NBFCs cannot do so given that IndAS does not allow it. It is evident that this is not a fair treatment for NBFCs, given that both the legal entities (NBFCs and Banks) are covered by the same provisions of the SARFAESI Act. We request that the anomaly be please be considered for a suitable resolution.

Also, under US GAAP guidance, derecognition of financial assets occurs when effective control over the financial asset has been surrendered. Thus, if internationally as per US GAAP, control is assessed for derecognition and not the risk and reward, this principle may also be followed in case of securitisation transactions in India. Considering the aforesaid arguments, we believe, that when a specific law is available which requires certain accounting treatment to support the industry and economy as a whole, IndAS guidance cannot override it to provide an absolutely differing picture to readers. Business model and result reading and presentation and accounting presentation cannot look in opposite directions.

- Thus, we request your honourable office to allow banks (whenever they transition to Ind AS) and NBFCs to recognize Investment in SRs and derecognize the financial asset (loans), if



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control has been transferred to an ARC. As we mentioned, this does not affect true and fair view, given that Expected Credit Loss would continue to be provided on such SRs, and the fair value of SRs would reflect the expected credit loss.

- We have observed that regulators in the past (such as in the case of Para 46 & 46A of AS 11, carve out in FCCB, Ind AS 101 transition to allow Indian GAAP carrying cost for PP&E, Bargain purchase gain to recognize in equity, Appendix C to Ind AS 103, Dividend distribution tax to be recognized in equity) have supported and stood for our country's legal and economic condition which prevails and have more weightage than the global standard guidance (IFRS) or Ind AS. Thus, we would request you to suggest suitable amendments to the accounting standard.

### **Request:**

***We would request the MCA (and the ICAI) to suitably amend the norms under IndAS in respect of the aforesaid stressed loans to***

***a) enable these to be derecognised as assets by the transferor NBFC (in standalone and consolidated financial statements) and,***

***b) account for investments in SRs on a fair value basis as "Investments" (in standalone and consolidated financial statements)***

3. The lockdown prescribed by various authorities have wide-ranging effects on all aspects of business and commerce. Various transactions, including acquisition, divesture, security creation/perfection/enforcement, registration, etc., which in all substantive manners may have been consummated, would be awaiting closure purely due to administrative reasons. The lockdown would result in incorrect reporting of transactions that are pending only administrative filings/approvals or otherwise pending for administrative reasons.

### **Request:**

***The Institute of Chartered Accountants of India along with suitable authorities/departments from Ministry of Corporate Affairs and Ministry of Law &***



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***Justice should develop a suitable guide to assist corporates, banks, chartered accountants etc., on matters which can be considered as adjusting post-balance sheet events (even without formal closures or formal closures post-March 31, 2020).***

4. In terms of Clause VI of the circular dated March 24, 2020 issued by the MCA, Corporates have been granted time till June 30, 2020 to comply with the requirement to invest or deposit at least 15% of amount of debentures maturing in specified methods of investments or deposits [Requirement under rule 18 of the Companies (Share Capital & Debentures) Rules, 2014]

The above measure has provided liquidity in the hands of corporates to manage their cash-flows including redemption obligations which in normal course would have been held as investment in the form of Fixed Deposit, etc.

Given the current financial conditions, it is expected that the uncertainty around normalisation of business activities will get extended to the following next quarter and cash-flow management would continue to remain a challenge.

**Request:**

***In view of the foregoing, you are humbly requested to please consider extending the timeline to comply with the said requirement to invest or deposit at least 15% of the amount of debentures maturing in specified methods of investments or deposits to September 30, 2020 versus the current requirement of June 30, 2020.***

The above measure would help corporates to continue to have the much-needed additional liquidity to deal with their cash-flow challenges including meeting their payment obligations / debenture redemption obligations.

**We sincerely appeal to the MCA & the ICAI to consider these measures to help NBFCs manage the current situation and to enable them to play a due role in the rebuilding efforts.**



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**Sir, we, some of the Directors of FIDC seek an audience with yourself and your officials, either by audio or video con-call, on behalf of our members and seek your sympathetic consideration of our request and positive response.**

Thanking you,

Yours faithfully,

**For FINANCE INDUSTRY DEVELOPMENT COUNCIL**

**MAHESH THAKKAR  
DIRECTOR GENERAL  
98200 35553**

**Cc to:**

**1. CA Atul Kumar Gupta,  
President,  
The Institute Of Chartered Accountants of India,  
ICAI Bhawan, Indraprastha Estate,  
New Delhi 110002.**

**2. Shri Manoranjan Mishra,  
Chief General Manager,  
Reserve Bank of India  
Department of Regulation (NBFCs),  
Main Building 1<sup>st</sup> Floor,  
Shahid Bhagat Singh Road, Fort,  
Mumbai 400 001.**



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