

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.in



www.fidcindia.org.in

16th December, 2021

Smt. Nirmala Sitharaman ji

Minister of Finance
North Block
Government of India
New Delhi 110 001

Hon'ble Finance Minister Madam,

SUB: PRE-BUDGET MEMORANDUM – SUGGESTIONS FOR FACILITATING AN ENHANCED ROLE OF NBFCs

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 17 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 thank you for giving us an opportunity to present the concerns of the NBFC sector and our suggestions thereon, as part of your Pre-budget consultations.

Contribution of NBFCs in Building an “Atmanirbhar Bharat”

NBFC sector stands committed to building an “Atmanirbhar Bharat” by providing need based credit to the unbanked / underbanked segment of the society.

- (1) NBFCs clientele include Small Businesses, Small Road Transport Operators (SRTOs) and self employed persons (activities like running a small shop, cable TV operator, milkman/ fisherman, construction worker etc.), which fall within the broad category of MSMEs. Also the NBFCs cater to the Tier 3/Tier 6 segments, where in many of the cases, the banks do not venture.
- (2) NBFCs have also helped banks use their network to reach out and provide loans to the priority sector areas. Govt. has also recognized, by prescribing the co-lending guidelines, the complementarity of the role of NBFCs to banks to source borrowers and further contribute to the economic development of the country.
- (3) Last year, The World Bank had sanctioned a \$ 750 million Development Policy Loan to



twitter.com/FidcIndia



facebook.com/fidcindia/



linkedin.com/company/fidc-india



instagram.com/fidcindia/

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.in



www.fidcindia.org.in

Govt of India for supporting the MSME sector. In their report on the same, they have identified “Strengthening NBFCs” as one of the 3 Key pillars in this venture.

- (4) Govt of India and RBI have also appreciated at various fora that the NBFCs have better survived the recent pandemic and despite the fact that many of the MSMEs (main clients of NBFCs) are still recovering from the delayed offtake of their services and sales, NBFCs have ensured to clear their dues to retain their credit worthiness and maintain the credit scores resulting into improvement in collections.

Harmonization of Regulation of NBFCs with Banks – Need to Bring Harmonization in Taxation and Recovery Related Provisions

Lately, RBI has reworked the regulatory framework for NBFCs with the prime objective of harmonizing it with that for banks. Regulation and Development must go hand in hand, and so there is an urgent need to bring harmonization in provisions related to taxation and recovery too.

Regulating NBFCs like Banks Shall Impair the Typical NBFC Model of Lending

If NBFCs are to be regulated like banks, then the typical NBFC model of lending shall suffer which shall impact lending to the unbanked / underbanked segment of the society. “Flexibility” is the key that is required primarily from these borrower’s perspective.

SECTION-I: FINANCING OF MSMEs / SMALL BUSINESSES BY NBFCs

Over the past few years, NBFCs have assumed an increasingly important role in ensuring credit flow to the MSMEs. NBFCs are committed to furthering this role and be a prime mover in the growth and development of MSMEs. We at FIDC have been advocating certain measures to improve credit flow to MSMEs through NBFCs. While many of our suggestions (including the addition of retail and wholesale trade under the definition of MSME) have been addressed, there are a few important issues which remain to be addressed. These include:

(1) Retail Loans to Individuals / Small Businesses Need to be Treated Differently as Compared to Large Corporate Loans

RBI vide its circular dt. 12th November, 2021 on Prudential Norms has clarified that:

- the date of SMA/NPA classification of borrower accounts applicable to all loans, including retail loans, irrespective of size of exposure of the lending institution, shall reflect the asset classification status of an account at the day-end of that calendar date;



twitter.com/FidcIndia



facebook.com/fidcindia/



linkedin.com/company/fidc-india



instagram.com/fidcindia/

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.in



www.fidcindia.org.in

- the upgradation of accounts classified as NPA needs to be done only when the entire arrears of interest and principal is paid by the borrower.

The clarification on upgradation from NPA to Standard is a new provision to be complied with by NBFCs, vide the above said circular.

In this context we would like to draw your kind attention to the following:

(i) The delay, if any, in repayment of loans by the borrowers from the unbanked / under banked segment are due to genuine business reasons and are primarily driven by the uncertainties in their cash flows and not by their intent. These borrowers are neither financially as strong nor as sophisticated in their financial acumen as the large corporates; the MSMEs are totally dependent upon the cycle of payment from users of their services or buyers of their products and hence suffer from fluctuating cash flows.

A few of the examples are given hereunder:

- (a) Despite MSMED Act of 2006, the credit cycle of MSMEs is still about 2 months and their payments are invariably delayed for a few days or weeks.
- (b) SMEs typically suffer from variable delays in payments of the larger companies in terms of their sales realisation. In the absence of penalties on large entities, which do not pay their SME suppliers on time, stipulating a day-based SMA/NPA reporting would be unfair to MSMEs.
- (c) We may also point out that Farmers' cash flow depends on crop being bought by Mandis and release of payment. Similarly, tractors engaged in contracting segment depend on Govt. payments.
- (d) NBFCs are also serving a segment of borrowers with an average family income of around Rs 15000-20000 per month and it would become difficult to collect all the arrears in a single go; the option of repossession is also not an ideal situation as that will hamper the Company-Customer relationships. Most of the retail customers pay a few EMIs and promise to pay remaining in next months.
- (e) It takes some time ranging from 5-7 days to update customer receipts collected at remote locations in the system. Even if the NBFCs calculate daily DPD, the same would be far away from reality and will result in erroneous reporting of standard accounts as NPA.



twitter.com/FidcIndia



facebook.com/fidcindia/



linkedin.com/company/fidc-india



instagram.com/fidcindia/

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.in



www.fidcindia.org.in

- (f) Historically, most of the collection is done during the last 2 weeks of a month. As with retail customers of rural areas, it's many times difficult due to accessibility issues to make payment on or before the due date warranting some grace days post Due date.
- (g) Many driver-cum-owners of trucks or construction equipment spend most of their time in the field and may not be available to pay EMIs on the due date. They would typically pay as soon as they return, but clearly before the end of the month. Insistence on a daily EOD based NPA recognition and SMA reporting would be too harsh on these borrowers.
- (ii) The requirement to upgrade the account only on the receipt of total arrears will cause that the "NPA" tag for prolonged period thus adversely impacting their credit history, which these borrowers try assiduously to avoid, even under challenging circumstances as being seen now.
- (iii) If an account goes into NPA and the customer pays back an amount enough to push the account out of NPA, NBFCs must be allowed to classify the account as standard. SRTOs, MSMEs etc. cannot pay all the dues in one go and to apply the same norms of corporate sector on such small borrowers would be harsh and may be counter-productive.

It may be observed from the above submissions that the grounds of justification for distinction between the class of borrowers of large corporate loans and retail loans, particularly in the case of borrowers upto Rs. 2.00 Crs remain valid even today and hence the NPA/SMA norms for them should NOT be the same across the board.

Request:

Based on the facts explained above, it shall be prudent to bring some element of “flexibility” in case of retail loans given to individuals / small businesses :

- (i) Smaller loans (retail and MSME) upto Rs. 2.00 Crs may be permitted to be marked as SMA / NPAs as on month end.
- (ii) Upgradation in respect of the above loans (i.e., up to Rs. 2.00 Crs.) from NPA to Standard category, may be allowed to continue, as hitherto (i.e., by partial repayment of arrears)

(2)Extension of CGTMSE coverage to loans given to Educational Institutions:

Educational Institutions are covered under the definition of MSMEs under the MSME Ministry Circular No. 5(6)/2/2009-MSME POL dated July 21, 2009. However, CGTMSE coverage is not available for loans given by NBFCs to educational institutions. NBFCs provide term loans to



twitter.com/FidcIndia



facebook.com/fidcindia/



linkedin.com/company/fidc-india



instagram.com/fidcindia/

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.in



www.fidcindia.org.in

schools and colleges for expansion of classroom facilities and for working capital. Most educational institutions have been under lockdown for the past 18 months owing to the pandemic.

Request:

Given that these institutions are now being slowly opened in many states, there is a considerable need to provide adequate financing for the restoration of normalcy and for growth of the institutions. Covering these loans under the CGTMSE scheme would facilitate greater flow of funds to this critical and socially important sector.

(3)Acceptance of Arbitration as a valid legal step taken for debt recovery under the ECLGS scheme:

Arbitration is the most cost effective, quick and popular means adopted by NBFCs for recovery/settlement of NPAs. This avoids lengthy and costlier civil law and suits and helps unclog the legal system. Most defaulters do so due to business constraints or cash flow mismatches and not due to mal intention and hence usage of softer tools such as arbitration would be most appropriate. The Arbitration and Conciliation Act has adequate controls and safeguards to ensure a fair procedure. In fact, the FAQs released by the Government include arbitration as a sufficient step for claiming relief under the ECLGS scheme. However, the NCGTC has taken a stand to the contrary. We sincerely request that this anomaly be removed.

Further, the High Courts in the country also prefer and advise the litigating parties to explore arbitration as per the 1996 Act before reaching the judicial forum. The arbitration process has been bestowed quasi-judicial powers accordingly and award passed by the arbitrator is converted in to decree and the same is enforceable in the court having jurisdiction on the property of the judgment debtor.

Request:

The entire process mentioned above is legally valid and takes at times more than a year and should be recognised as valid legal remedies for delinquent accounts while processing claims under CGSMSE program.

(4)Refinance mechanism for NBFCs:

Most NBFCs (except the very highly rated NBFCs) depend upon banks for their funding needs since the money markets and other institutional sources of funding are shallow or are restricted



twitter.com/FidcIndia



facebook.com/fidcindia/



linkedin.com/company/fidc-india



instagram.com/fidcindia/

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.in



www.fidcindia.org.in

to highly rated NBFCs. This has resulted in inadequate and erratic flow of funds to NBFCs and increased concentration risk at a systemic level. There is a dire need for an effective refinance mechanism (on similar lines as the NHB refinance or any other effective method) to ensure diversity and greater regularity in sources of funds to NBFCs.

Request:

We believe that SIDBI is most suited as an institution to provide a refinance facility to NBFCs for onward lending to MSMEs and other appropriate sectors.

SECTION- II: DIRECT TAX

(1) TDS On Interest (Sec 194A) – Request For Exemption

As per section 194A of the Act, any person making payment of interest is required to deduct tax at source ('TDS') @ of 10%. There are certain exemptions given under this section wherein the person making payment to various institutions like Banking Company, Life Insurance Companies and UTI etc., is not required to deduct TDS. Accordingly, any person making payment of interest to Banks is not required to deduct tax.

However, no such exemption has been provided to NBFCs from the applicability of section 194A. Accordingly, tax is required to be deducted at the rate of 10 percent from interest paid to NBFCs. This creates severe cash flow constraints since NBFCs operate on a thin spread/ margin on interest which at times is even lesser than the TDS on the gross interest. Further, due to enormous transactions, NBFCs have to face severe administrative hardship in terms of collection of TDS certificates from their thousands of customers.

RBI has allowed banks and NBFCs to engage in Co-Lending to the priority sector. As per this, a single borrower may be co-funded by bank and a NBFC in a pre-determined ratio. Both bank and NBFC may price the loan independently. However, the borrower shall be offered a single blended rate of interest. All the repayments made by the borrower (including the interest) by way of EMIs shall be made to an escrow account from where the amounts shall be credited to the bank and NBFC in respective proportion.

In such a scenario, the borrower shall not be in a position to split the EMI and determine the exact interest component of the NBFC portion and hence TDS deduction shall be practically impossible. It is therefore important to bring both bank and NBFC at par on the TDS provisions.



twitter.com/FidcIndia



facebook.com/fidcindia/



linkedin.com/company/fidc-india



instagram.com/fidcindia/

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.in



www.fidcindia.org.in

Request:

Exemption May be Granted to Non-Deposit Taking Systemically Important NBFCs (NBFC-ND-SI) and Deposit Taking NBFCs (NBFC-D) As per the prevailing Regulatory Framework of RBI, the following two categories of NBFCs are subject to the most stringent regulations:

1. All Deposit Taking NBFCs (NBFC – D) irrespective of their size –there are total 52 NBFCs-D as on 30th September, 2021
2. Non-Deposit Taking Systemically Important NBFCs (NBFC-ND-SI) i.e., NBFCs which do not accept public deposits and have an asset base of Rs 500 crores and above – there are total 319 NBFCs –ND-SI as on 30th September, 2021

SECTION- III: ENFORCEMENT OF SECURITY INTEREST UNDER THE SARFAESI ACT COMES WITH A RIDER OF MINIMUM LOAN TICKET SIZE OF Rs. 20 LAKHS

1. The Underlying Need to Bring Parity with Banks, Housing Finance Companies (HFCs) and Other Financial Institutions (FIs) Is Not Fully Addressed

The prime objective of giving NBFCs coverage under the SARFAESI Act was to bring parity with banks, HFCs and other FIs, and providing NBFCs with an important tool of recovery. This has been done in the light of the Revised Regulatory Framework for NBFCs, issued by RBI which is aimed to “address regulatory gaps and arbitrage arising from differential regulations, both within the NBFC sector and vis-a-vis other financial institutions”. As a result, the Asset Classification (NPA classification norms) were brought at par with banks. However, the above said rider of Rs. 20 lacs does not fully justify the objective of bringing parity, since the threshold for enforcing security interest under SARFAESI for HFCs and other FIs is much lower at Rs. 1 lac.

2. Size of The Loan Should Not Be The Criteria

As per the Prudential Norms for Asset Classification (NPA Classification) for banks, HFCs and NBFCs, it is the duration of the overdue period of a loan, and not the ticket size, which

determines whether the loan is to be classified as “non-performing” or not. It is, therefore, imprudent and unjustified to make the ticket size of the loan as a determining factor for use of tools of recovery of that particular loan.



twitter.com/FidcIndia



facebook.com/fidcindia/



linkedin.com/company/fidc-india



instagram.com/fidcindia/

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.in



www.fidcindia.org.in

3. Recovery efforts under Co-lending Model

It is pertinent to note, RBI has given a special thrust by introducing ‘Co-Lending Model’ with a motive to improve the flow of credit to the unserved and underserved sector of the economy and make available funds to the ultimate beneficiary i.e. MSME borrowers at an affordable cost, considering the lower cost of funds from banks and greater reach of the NBFCs.

Pursuant through this model, it is marriage between Banks and NBFCs wherein the origination, customer service and collection are responsibility of NBFC. Now, for recovery of bad loans made under this model, while banks have option to initiate recovery proceedings under SARFAESI Act even for loans under Rs. 20 lacs but the same option is not available for NBFCs who will be acting as recovery agents and hence will not be able to initiate action under SARFAESI Act recovery of co-originated loans up to Rs. 20 lacs which puts partnering banks in disadvantageous position, this in fact is one of the open points for discussions with banks and one of the reason delaying the tie-ups.

4. Reduction in Credit Cost and Litigation Cost

It is not only important to improve credit discipline but also to provide low-cost funds to protect the interest of small borrowers. NBFCs can achieve these by keeping Credit Cost lower.

The Credit Cost can be significantly brought down if the loan recovery mechanism is robust. The average time taken in various recovery methods is detailed herein below:

Arbitration & Conciliation Act, 1996 & Civil Procedure Code, 1908	6 - 9 months (Arbitration) 1-3 years (Execution)
Negotiable Instruments Act, 1881/PASS Act, 2007	2 - 5 years
SARFAESI Act, 2002	6 - 9 months

Micro loans to MSME segment are generally up to Rs. 20 lac ticket size. In case the loan turns NPA and in absence of recovery tools like SARFAESI, the only recourse available is lengthy litigation process. This will not only increase the credit / litigation cost for the NBFC but also these costs will unnecessarily get loaded on to MSME borrowers which are standard and making timely servicing of the loans.

One of the reasons HFCs have been able to provide housing loans at affordable rates is due to their credit cost being lower due to availability of SARFAESI even for loans above Rs. 1 lac.



twitter.com/FidcIndia



facebook.com/fidcindia/



linkedin.com/company/fidc-india



instagram.com/fidcindia/

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.in



www.fidcindia.org.in

Request:

In view of the above submissions, the said threshold should be reduced from Rs. 20 lacs to Rs. 1 lac in order to bring NBFCs at par with HFCs, Banks, SFBs and other financial institutions as asset classification norms are also at par for all the institutions.

We hope that our requests shall receive a favourable consideration.

Thanking you in anticipation

Regards



twitter.com/FidcIndia



facebook.com/fidcindia/



linkedin.com/company/fidc-india



instagram.com/fidcindia/