FIDC

Finance Industry Development Council

(A Representative Body of Assets and Loan Financing NBFCs)

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The Chief General Manager,
Reserve Bank of India, Department of Regulation (NBFCs),
2nd Floor, Main Office Building, Shahid Bhagat Singh Marg,
Fort, Mumbai – 400001

LIST OF COMMENTS/ SUGGESTIONS ON THE RBI DRAFT CIRCULAR ON DECLARATION OF DIVIDENDS BY NBFCS (*"DRAFT CIRCULAR"*)

A. Arguments for why the restriction should not apply to NBFC-ND-SI

1. Non-banking financial companies ("**NBFCs**") are anyway bound by the Companies Act, 2013 ("**Act**") which has sufficient guard rails on declaration of dividend including sources from where it can be declared and quantum of distributable profits. Hence, a further restriction in this regard is not needed.

2. An NBFC-ND-SI has no retail depositors and its creditors are largely bank lenders and debt security holders. Thus, NBFC-ND-SI lenders are usually institutional and sophisticated which already impose their own restrictions on dividend payments contractually. Additionally, debenture holders are also protected, as a prohibition to pay dividend, until the company has paid or has made satisfactory provision for the payment of the instalments of principal and interest due on the debentures, is mandatorily required to be included in all debenture trust deeds in terms of Form No. SH-12 prescribed by the Act read with Companies (Share Capital and Debentures) Rules, 2014.

3. NBFC-ND-SIs perform an important role in delivery of last mile credit and require capital to continue to grow. The proposed restrictions on dividend payments by NBFCs over and above those prescribed by the Act could seriously jeopardise investor interest and capital raising ability of the NBFCs.

B. Requirement for declaration of dividend only from current year profits

1. Under the Act, dividend can be declared from free reserves, undistributed accumulated profits for previous financial year(s) as well as current year profits. The Draft Circular by restricting the source of dividend only to current year profits, fundamentally changes the basic fabric of the distribution of profits by a company to its shareholders and in effect makes it impossible for an NBFC-ND-SI to distribute dividend from other sources from which such declaration is permitted under the Act.

2. Many core investment companies and investment NBFCs recognise gains arising out of sale of investments through Other Comprehensive Income (a Reserve Item) not through the Profit and Loss Account. However, presently for the purposes of paying dividends such amounts would under the Act be available for payment of dividend. In the current form, the Draft Circular which permits declaration of dividend only from 'current year profits' would prevent declaration of dividend from such gains which are taken to reserves.

C. NPA ratio determining dividend payment ratio

The presence of non-performing assets ("**NPAs**") and the provision taken as per Indian Accounting Standards (Ind AS) in any case adjusts profits downwards and reduces the distributable profits available. A further cap based on NPAs being a certain percentage is not necessary or desirable. Further, given the heterogeneity of NBFCs it is not feasible to have a "desired" level of NPAs – the NPA levels of a wholesale lending NBFC and a small ticket consumer lending NBFC cannot be compared. Profitability alone should be a criterion

D. Retrospective application

1. The Draft Circular is proposed to take effect from the financial year beginning April 1, 2020 (financial year 2020-21) onwards which would in effect impact the declaration of dividend for the current financial year as well in which interim dividend may already have been

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declared – this will be akin to giving retrospective effect to the guidelines and hence the request should be for the guidelines to take effect only from April 1, 2021, i.e. for dividend from financial year 2021-2022 onwards.

2. Moreover, for preference shares which have already been issued with a certain promised rate of dividend, the proposed guidelines could in effect bar the NBFC-ND-SI from making payment of the same despite having sufficient distributable profits in terms of the Act. All such existing instruments should be grandfathered.

E. Specific risk on preference shares

The circular should be explicitly limited to dividend on only Equity Shares. Companies often issue Redeemable Preference Shares carrying fixed rates of Dividend which need to be treated differently. Without prejudice to this suggestion, furthermore, we have to state that under Section 47 (*Voting Rights*) of the Act, failure to pay dividend for a period of two years or more gives preference shareholders voting rights at par with equity shareholders. If the proposed guidelines under the Draft Circular are introduced, such a situation could be triggered despite the NBFC-ND-SI having distributable profits available for honouring the promised preference share dividend. The Act should be amended as a pre-cursor to the Draft Circular to ensure that the voting rights would not trigger if the non-payment of the preference share dividend for a period of two years or more is due to the RBI stipulation.

We request your kind and favourable consideration of these requests.

We seek an audience with your kind-self and seek your sympathetic consideration of our request and positive response.

Thanking you,

Yours Faithfully,

For FINANCE INDUSTRY DEVELOPMENT COUNCIL

MAHESH THAKKAR
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