FIDC

Finance Industry Development Council

(A Representative Body of Assets and Loan Financing NBFCs)

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06th September, 2019

Shri N S Vishwanathan
Deputy Governor
Reserve Bank of India
Central Office Building
Shaheed Bhagat Singh Marg
Fort, Mumbai- 400 001

Respected Sir,

SUB: MEETING HELD ON 22ND AUGUST 2019

We **thank you** for sparing your valuable time and given a patient hearing to various matters discussed during our meeting held in your office 22nd August 2019.

We take this opportunity to convey our most sincere thanks to RBI for not only giving us an opportunity to raise the concerns relating to the liquidity crunch faced by NBFCs, but also some of the encouraging measures taken in this regard. This further strengthens our firm belief in RBI's efforts towards a healthy growth and development of the NBFC sector.

Based on the discussion held we hereby would like state the following:

1. Partial Credit Guarantee Scheme for NBFCs Pool of Assets – Concerns and Clarification

We welcome the announcement made by the Hon'ble Finance Minister in her budget speech this year, whereby Government of India shall provide Partial Credit Guarantee to Public Sector Banks for purchasing pooled assets from NBFCs/ HFCs.

Concern

However, based on the details of the scheme issued by Ministry of Finance vide Circular F.No.1/17/2019-BOA-II dated 10th August 2019, the mandatory requirement of the NBFCs Pool of Assets to have minimum credit rating of AA or equivalent prior to the credit guarantee by GoI, shall reduce the impact significantly. Needless to say, any pool of assets having a credit rating of AA and above is anyway easily purchased by banks even without any credit guarantee. Further, in the prevailing scenario of liquidity crisis obtaining such a high grade credit rating itself is a big challenge, in spite of the financial performance. Some of the recent events have also raised a question mark on dependence on external credit ratings.

Suggestion:

*The requirement of AA credit rating should be applicable **post** the Partial Credit Guarantee by GoI.*

Request for Clarification

All the Credit Rating Agencies registered with SEBI have a prescribed rating scale under which AA scale signifies "High Degree of Safety". However, rating agencies use modifiers "+ (Plus)" or "– (Minus)" along with the rating symbol to reflect the comparative standing of companies within the category (scale). Thus an instrument with AA- rating and an instrument with AA+ rating, both signify "high degree of safety" but in comparison to each other AA+ is placed above AA-

We therefore presume that the condition of minimum AA credit rating shall include AA- (AA minus). You are requested to kindly clarify the same.

2. Request to Redefine Systemically Important (SI) NBFCs

FIDC has been aggressively taking up issues relating to taxation and recovery, where NBFCs have been denied the benefits/ relief available to banks and other financial institutions. During our discussion with Ministry of Finance and other government agencies it is often felt that any such relief/benefit cannot be given to all the 9,600 odd NBFCs in one go. The obvious choice is then a class of NBFCs which are subject to the most stringent regulations. It is here that the RBI defined Non Deposit taking Systemically Important NBFCs (ND-SI) are the first choice. However, the prefix "ND" (Non-Deposit taking) rules out the Deposit taking NBFCs, even if their asset base is more than Rs 500 crores. It requires a herculean effort to convince them that some of the deposit taking NBFCs which have asset base of Rs 500cr and above are also in the same league when it comes to regulation and governance.

Suggestion:

We hereby request that RBI should rephrase the term NDSI to SI, thereby removing the prefix ND (i.e., Non Deposit Taking) so as to ensure that even the Deposit taking (D) NBFCs with asset base of Rs 500crs and above are duly covered in this definition. This shall enable any government agency/ department or any other relevant authority to directly pick the "SI" class of NBFCs when it comes to giving the much desired relief/ benefit, as a first step.

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3. Need for Refinance Mechanism for NBFCs

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:

Refinancing mechanism on the lines of National Housing Banks (which refinances housing finance companies) is the desired solution. Further, MUDRA (which has the mandate) can play an important role in refinancing large number of Small and Medium NBFCs

4. 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 is 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).

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

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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.

6. Challenges from New Working Capital Norms

As per the RBI Circular dt. December 05, 2018, in case of borrowers enjoying an aggregate fund based Working Capital (WC) Finance of Rs 150crs and above from the banks, the sanction WC Finance is to have a compulsory Working Capital Loan (WCL) component of minimum 60% wef 1st July 2019.

As per the new guidelines, the loan component can be split into multiple loans having different maturities. Banks have also been given the freedom to allow rollover of these loans subject to compliance with income recognition and asset classification (IRAC) norms. While earlier the interest rate for WCDL was lower than the rate for CC, RBI has not provided any guidance on the applicable rate of interest on WCL.

The erstwhile WC calculation was done taking cognizance of the IRAC norms and was based on the premise that an NBFC will be lending for tenures greater than 1 year. But the new requirement of a compulsory loan component within the working capital facility is inappropriate for an NBFC as the tenor of the loan component is shorter than the period over which the receivables accrue to the NBFC. The loan component has to be co-extensive with the underlying receivables given as security for the loan, or else it will result in a dynamic inconsistency in the inflow and outflow of funds making it difficult for the NBFCs to service WC. In this regard it is worth recalling one of the recommendations of the Chore Committee said that the banks should not bifurcate cash credit accounts into demand loan and cash credit components for NBFCs.

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Further most of the banks have converted part of CC limits into WCL in compliance to the above said circular. But banks are now asking for repayment of WCL on maturity which is further aggravating the liquidity crunch being faced by NBFCs.

Suggestion:

Keeping in mind the criticality of the NBFC sector for its role of catering to the credit needs of the micro, small and medium enterprise (MSME) class, especially at a time when the sector continues to face a liquidity crunch:

i. *Implementation of the new WC norms for NBFCs may be deferred by one year considering the current situation.*

ii. *Further, following changes are proposed:*
   - *the sub-limit or the loan component within the working capital facility should get re-instated automatically upon maturity thereof, to ensure continuation of the WC facility. This would ensure that just paying the interest on the loan would suffice once the loan matures ; the principal can be paid off when the NBFC collects enough funds from its receivables*
   - *the pricing for the loan component should be based on its tenor linked with respective period MCLR and tenor premium of the bank*

7. Meeting with FIDC on a Periodical Basis

We hereby convey our sincere thanks for accepting our request to hold periodical meetings with FIDC on a regular basis. 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.

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

Chairman