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

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18th September, 2020

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

Hon'ble Finance Minister Madam,

SUB: <u>LIQUIDITY CONCERNS FOR SMALL AND MEDIUM SIZED NBFCS – THE WAY FORWARD</u>

The important role being played by NBFCs in funding the unfunded, including the MSMEs, has been duly recognized by the Govt. This has led to several measures taken by Ministry of Finance and RBI to provide liquidity support to NBFCs, especially, during the last 2 years after the IL&FS debacle. Post the COVID driven lockdown further steps were taken in this direction under the "Atmanirbhar Bharat" package. The World Bank has recently sanctioned a $ 750 million Development Policy Loan to 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. NBFCs, including the small and medium NBFCs play a significant complementary role in the credit supply chain.

<u>Importance of Small and Medium Sized NBFCs</u>

i) They play a significant role in reaching credit to the deeper pockets, and bring customers to the formal mainstream credit system, thereby playing a significant role in financial inclusion.
ii) They have last mile Connectivity and have phenomenal knowledge and understanding of the local market dynamics. Hence, they have been able to maintain a high asset quality.
iii) They are focused in providing livelihood product financing support to customers who are not normally getting credit from formal credit system.
iv) They have excellent track record in servicing their debts to Banks and other lending institutions in the past.

They help give employment to local rural youth.

The Ministry of Finance as well as the RBI have expressed willingness and alacrity to address the issue of providing more liquidity to the smaller NBFCs. Several schemes with specific carve-outs have been announced in this regard, including TLTRO 2.0 and Partial Credit Guarantee Scheme.

We thank the Ministry and the RBI for these initiatives and take this opportunity to make following request for consideration which would help in funding of small and medium sized NBFCs, and suggest the way forward:

A. Issues Related to Funding at the Policy Level

1. Mode of Borrowing

The small and medium sized NBFCs, generally do not access capital market due to the complexities in compliances to various rules and regulations. As such, they do not issue bonds / debentures (NCDs) / CPs and instead borrow by way of "term loans" secured against their receivables, from banks and FIs like SIDBI and NABARD (including its subsidiaries like NABKISAN & NABSAMRUDDHI).

This single factor has ruled these companies out of contention for availing funding under the TLTRO 1.0 & TLRO 2.0 of RBI and PCG 2.0, SPL (Special Liquidity Scheme) of Ministry of Finance as all these schemes entailed investment by banks and SPV in bonds / CPs issued by NBFCs.

2. Tenure

A vast majority of loans given by NBFC to MSMEs and individuals are for average tenure of 24 to 48 months. Therefore, it is imperative that NBFCs need to borrow for a commensurate period in order to maintain a healthy asset liability match.

Currently, funding under the PCG 2.0 (including the Govt guarantee), SPL and the Refinancing being done by SIDBI, are all for a short tenure of 6 months to 18 months only. We request if the tenure could kindly be increased to at least 36 months for a healthy liability profile.

3. Need to Have a Refinancing Body

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Bank funding of small and medium NBFCs has been a challenge due to various reasons, especially, during the last 2 years. The tepid response to the TLTRO 2.0, which mandated banks to invest at least 50% of the stipulated amount in small and medium NBFCs, was a clear example of this. The need therefore, is to reduce the over-reliance on banks and have a dedicated refinancing body.

Parliamentary Standing Committee on Finance in their 45th report of June, 2003 had recommended setting up of a refinance institution for NBFCs on the lines of National Housing Bank for HFCs.

More recently, The World Bank Report of June, 2020, on the Development Policy Loan for $750 million, also suggests:

"The post Global Financial Crisis (GFC) experience with large volumes of liquidity provision to the financial system by central banks is important. It is critical to ensure that liquidity is not hoarded by banks which have the broadest access to the central bank liquidity windows and is spread widely throughout the financial system, including both to financial intermediaries (such as NBFCs) and ultimate users of finance (such as MSMEs). Public DFIs serving as quasi-lenders of last resort to NBFCs (e.g., Landesbanken in Germany) can serve as highly relevant examples for India due to its large NBFC sector without a dedicated lender-of-last-resort (LOLR) window."

Under the circumstances, we feel SIDBI and NABARD may be assigned this role.

Request:

Based on the facts explained above:

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

B. Issues Related to Bank Funding of Small and Medium NBFCs

1. **Need for a Carve Out for Small and Mid-Sized NBFCs, Within the Sectoral Cap**

While NBFCs account for 20% of total credit in the economy, most banks have capped the exposure to the sector at 8-9%.

Due to drying up of other avenues post IL&FS and DHFL crisis, banks are the only source of borrowing for most NBFCS and certainly for small and medium ones and they get crowded out by the large ones. Most if not all, small n mid-sized NBFCs cater to the most under-served/credit starved customers in rural and semi-rural markets and new to credit (NTC) customers and they don't get enough support from banks owing to lack of credit rating.

Request:

A Special carve out within overall sectoral cap, for small n mid-sized NBFCs, should be prescribed, like the way RBI has done for several sub-sectors within overall 40% Priority Sector Lending.

2. **Encourage Bank Lending to NBFCs for On-Lending to Priority Sector to be Treated as Priority Sector Lending for Banks**

Since 1999, RBI had allowed all bank lending to NBFCs for on-lending to the priority sector, to be treated as priority sector lending by banks. This gave a huge incentive to banks to lend to NBFCs. While it ensured sufficient bank funding to NBFCs at a reasonable cost, it also facilitated banks to meet their PSL targets. This was withdrawn in 2011.

However, RBI re-started this arrangement recently, but only up to 31st March, 2020 and on a very limited scale (only up to 5% of PSL by banks). There is also an artificial cap of Rs 20 lakhs per loan put on such on-lending transactions which may kindly be done away with.

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The arrangement of treating bank lending to NBFCs for on-lending to Priority sector to be treated as PSL for banks, should be made permanent and the limit needs to be increased to at least 10% of total priority sector lending (PSL) by banks.

Kind regards

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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