

SAMPADA

News and views on Non-Banking Financial Services



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Editorial:

Here we are again, with the third issue of **Sampada**, a news and views letter on Non Banking Finance Companies (NBFCs).

NBFCs perform important role in our financial system. We are aware that due to globalization, banking industry and finance sector has undergone significant reforms. The Usha Thorat panel has proposed regulatory changes which may have diverse impact on NBFCs.

This issue contains important articles on the draft Securitisation guidelines of the RBI, which are now awaited for quite sometime. We also give some very informative write-ups on asset finance companies, currencies around the world, etc. This issue also gives a comparative view of the performance of some of the leading NBFCs.

Recently, the RBI has revised the reporting formats for NBFCs – we provide a comparative view of the old and the new formats.

As readers would note, our articles are highly timely, informative and articulate.

Sampada, the newsletter continues to bring you upto speed on what is happening on NBFC sector, not just in India, but globally. So keep reading, preserving and circulating. Please do ask your colleagues to join our mailing list to receive copies of the Newsletter as also other relevant write-ups. See the box on the left to join our group.

We would be pleased to get feedback from you.

The RBI released on 27th September the much awaited revised draft of the securitisation guidelines. The first draft was proposed long time back in April 2010.

By way of quick comments, the revised draft guidelines have reduced the required minimum holding period (MHP) and minimum risk retention (MRR) requirements proposed in the April 2010 draft. In addition, the revised draft has permitted upfront recognition of the cash profit made by the seller in securitisation as well as bilateral sales, thereby the RBI sitting in the capacity, with several conflicts, of an accounting standards body. The revised guidelines have retained the bar in the April 2010 draft in respect of both synthetic transactions as well as revolving securitisation – the basis for which is completely ununderstandable.

The initial feedback of the author is securitisation players in India, armed with the RBI guidelines, will perhaps ignore accounting standards, and use premium structures to book upfront profits in securitisations. It is notable that accounting standards do not go by true sale as the basis for off balance sheet treatment as well as booking of gain on sale, while the RBI seems to have been overwhelmed by so-called true sale requirements. Thus, securitisation market may get a shot in the arm and may be back with a bang. Microfinance securitisations as well as portfolio sales – which have been recognized as priority sector exposures in the hands of the buying banks – will still remain subdued to the impractical MHP requirement, and almost a mindless bar on revolving transactions.

The Minimum risk retention: international and Indian norms:

MRR in securitisations is an international regulatory trend to impose the so-called “skin in the game” requirements on originators. EU regulators have recently enforced the MRR requirements at 5% of economic exposure, though in its details, the exposure can be split in various ways as horizontal piece, vertical piece and L piece. In the USA, the massive Wall Street Reform Act requires Federal regulators to frame rules on the issue – the SEC has come up with draft rules still to be finalized.

In India, the RBI’s April 2010 draft had proposed a 10% MRR requirement. The revised draft guidelines make the MRR requirement far more rational, by laying down a 5% MRR in case of transactions involving loans of original maturity of 24 months or less. In case of loans with original maturity of more than 24 months, the MRR has been set at 10%.

There is, however, a substantial flexibility there. In case of transactions involving tranches, if the first loss tranche is less than 10%, the originator may hold the equity tranche, and make proportional investments in senior tranches. This becomes the kind of L piece acceptable by EU regulators.

Minimum holding period requirements:

It is notable that EU and US regulations do not lay down minimum seasoning or holding period requirements. In India, this is a reaction to the loans that some smart banks had sold to not-so-smart mutual funds, and the loans busted soon after their sale.

The MHP requirements have been rationalized to some extent:

- In case of loans having monthly payments, and having an original maturity of upto 24 months, the MHP will be 6 months from the due of date of the first instalment.
- In case of loans having quarterly payments, and having an original maturity of upto 24 months, the MHP will be 9 months from the due of date of the first instalment.
- In case loans having original maturity of more than 24 months, the MHP will be 12 months.

Microfinance securitisations will still remain affected as 6 months’ seasoning will be too long for microfinance loans. Given the fact that revolving transactions are not permitted, it only leaves a thin tail to be securitized.

Gain on sale:

The so-called profit booking guidelines, known as gain-on-sale under international accounting norms, are the most interesting part of the RBI guidelines. The Feb 2006 Guidelines of the RBI had prohibited booking of profits, but then the easy way out that

Securitisation business will be back with a bang; Microfinance securitisations to still remain subdued

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the market had found to that was that bilateral transactions were not covered by the Feb 2006 guidelines. Now, bilateral transactions are well covered by the revised draft guidelines. However, as an interesting provision, the revised draft guidelines permit upfront profit recognition, however, to the extent of the profit encashed upfront, that is, the sale consideration exceeding the carrying value of the assets. It will always remain intriguing as to what is “cash profit” - whether the securities issued by the SPV as a part of the transaction of securitisation will also form a part of the consideration, and therefore, be called a “cash profit”. It cannot, for example, be insisted that the cash consideration for sale should exceed the carrying value of the loans, because the originator has to perform acquire a stake equal to the MRR, and to that extent, there is no point in the originator paying cash and getting back cash.

It is interesting to see the RBI sitting in the position of an accounting standard setter – the role could have been best left to accounting standard bodies. There is already an elaborate accounting standard IndAS 39 on the issue – which is at par with international accounting standard. That standard is far more conservative and far more mature than what the RBI has laid down. As per international rules, off-balance sheet treatment and booking of gain/loss on sale both go hand in hand, and both are independent of legal true sales. A transaction may or may not be a legal sale, and yet profit may or may not be booked. The determination is based on retention of risks and rewards, and surrender of control by the seller. Given the fact that most regulators now impose minimum risk retention requirements, it is generally felt that off balance sheet as well as gain-booking will not be permissible for most securitisation transactions.

While these accounting standards are still intended to be mandatory in India, it is strange to see the RBI writing its own rule on profit-booking. The RBI's version of the accounting standard is that profits can be booked to the extent of cash profit, and from this cash profit, losses attributable to the seller, including mark to market losses, will be debited against the profit so booked.

References to mark-to-market losses may be taken as implying that the originator will continue to fair value the value of the retained risk, and evaluate how much loss may be attributed to the seller.

Synthetic and revolving transactions not permitted:

In a market which is increasingly using credit derivatives, it is quite strange to find the RBI not permitting synthetic securitisations.

Also, revolving transactions are the norm in case of short-tenure transactions like microfinance receivables. Strangely enough, the RBI has prohibited revolving transactions altogether.

Neither are re-securitisation transactions permitted.

Conclusion

The securitisation market in India has been shaped by regulations – the Feb 2006 made the market primitive by forcing it into the bilateral mode. That party existed for years – till last year, when the RBI came with revised draft of the guidelines. The present draft guidelines are a great improvement on the draft that came in last April; however, there is a substantial scope for rationalization, particularly on the so-called re-set of credit enhancements. The term re-set of credit enhancements has been wrongly understood by the standard-setters. If the MRR is 5%, the percentage is to be applied not to the initial value of the pool, but the-then outstanding value. Clearly, what may be default is the-then value of the pool, and not what has already been paid down. Therefore, repaying subordinated securities proportionally is not a case of re-set of credit enhancements at all.

Also, the bar on revolving and synthetic transactions is completely without any rationale.

Click on this link to view the same article-

<http://www.microfinancefocus.com/securitisation-business-will-be-back-bang-microfinance-securitisations-still-remain-subdued>

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The screenshot shows the top of a web page for 'microfinance focus'. The article title is 'Securitisation business will be back with a bang; Microfinance securitisations to still remain subdued'. Below the title, there are social media sharing options for Facebook, Twitter, and LinkedIn. The author is listed as 'By Vinod Kotbani'. The article text begins with 'Microfinance Focus, September 27, 2011. The RBI released on 27th September the much awaited revised draft of the securitisation guidelines. The first draft was proposed long time back in April 2010. By way of quick comments, the revised draft guidelines have reduced the required minimum holding period (MHP) and minimum risk retention (MRR) requirements proposed in the April 2010 draft. In addition, the revised draft has permitted upfront recognition of the cash profit made by the seller in securitisation as well as bilateral sales, thereby the RBI sitting in the capacity, with several confidants, of an accounting standards body. The revised guidelines have retained the bar in the April 2010 draft in respect of both synthetic transactions as well as revolving securitisation – the basis for which is completely understandable. The initial feedback of the author is securitisation players in India, armed with the RBI guidelines, will perhaps ignore accounting standards, and use premium structures to book upfront profits in securitisations. It is notable that accounting standards do not go by true sale as the basis for off balance sheet treatment as well as booking of gain on sale, while the RBI seems to have been overwhelmed by so-called true sale requirements. Thus, securitisation market may get a shot in the arm and may be back with a bang. Microfinance securitisations as well as portfolio sales – which have been recognised as priority sector exposures in the hands of the buying banks – will still remain subdued to the impractical MHP requirement, and almost a mindless bar on revolving transactions. The Minimum risk retention: International and Indian norms: MRR in securitisations is an international regulatory trend to impose the so-called 'skin in the game' requirements on originators. EU regulators have recently enforced the MRR requirements at 5% of economic exposure, though in its details, the exposure can be split in various ways as



RBI on 27th October, 2011, released the revised draft for the much awaited securitization guidelines. The draft guidelines have reduced the minimum risk retention requirement and have altered the minimum holding period requirement from what was proposed in the April, 2010 draft guidelines. In case of loans having monthly payments, and having an original maturity of upto 24 months, as in case of microfinance loans, the MHP will be 6 months from the due of date of the first installment.

Further, in case of eligibility of assets for securitization, securitization with revolving structures (with or without early amortization) is not eligible for securitization by the originators. Section C of the revised draft that talks about securitization activities that are not permitted includes, Securitisation with Revolving Structures, and states as below –

These involve exposures where the borrower is permitted to vary the drawn amount and repayments within an agreed limit under a line of credit (e.g. credit card receivables and cash credit facilities). Typically, revolving structures will have non-amortising assets such as credit card receivables, trade receivables, dealer floor-plan loans and some leases that would support non-amortising structures, unless these are designed to include early amortization features. xxx

The extract above indicates that only typical revolving structures are barred; specifically in cases which involve exposures where the borrower is under a line of credit, such as credit card receivables and cash credit facilities. In case of microfinance pools, there is no line of credit being provided and hence are not barred.

There is a difference between reinstating structures and revolving structures. In reinstating structures, the repayment of the loan is by way of EMIs, but these loans are sold on regular basis, whereas in case of revolving structures as used in credit card receivables, repayments are within an agreed limit under a line of credit and the exposure varies. The intent of the RBI, it so seems is to put a bar on the revolving type structures and not against reinstating structures.

Hence in case of microfinance securitization, the MFIs would have to hold the loans in their books for 6 months and then can securitise. As the microfinance securitisations as well as portfolio sales have been recognized as priority sector exposures in the hands of the buying banks, it so seems that refinancing facilities for microfinance entities would be reviving and so would the securitization market in India.

The revised draft guidelines permit upfront profit recognition, however, to the extent of the profit encashed upfront, that is, the sale consideration exceeding the carrying value of the assets. The Feb 2006 Guidelines of the RBI had prohibited booking of profits, but the same was not extended to bilateral transactions. However, bilateral transactions are well covered by the revised draft guidelines. Upfront recognition of cash profits is favorable and is in line with the international practices.

While the revised draft guidelines have relaxed the MRR and MHP requirements, trying to bring them in line with international practices, the draft indicates that RBI is only concerned with banks as originators to the securitization transactions and the entire draft is revolving around banks undertaking securitization transactions only. However we are assuming that the same would be extended to NBFCs mutis mutandis in the final version.

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New Draft Securitisation Guidelines: Impact on Microfinance Industry

- Nidhi Bothra

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New Draft Securitisation Guidelines: Impact on Microfinance Industry

in Asia India microfinance securitisation top

By Nidhi Bothra,

Microfinance Focus, September 28, 2011: RBI on 27th October, 2011, released the revised draft for the much awaited securitization guidelines. The draft guidelines have reduced the minimum risk retention requirement and have altered the minimum holding period requirement from what was proposed in the April, 2010 draft guidelines. In case of loans having monthly payments, and having an original maturity of upto 24 months, as in case of microfinance loans, the MHP will be 6 months from the due of date of the first installment.

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Broad parameters for banks and NBFCs to set up Infrastructure Debt Funds (IDFs)

The Union Finance Minister, Pranab Mukherjee, in his budget speech for 2011-12 had announced setting up of IDFs in order to accelerate and enhance the flow of long term debt in infrastructure projects for funding the Government's ambitious programme of infrastructure development.

Accordingly, the Reserve Bank had announced on 23rd September 2011 that banks and Non Banking Financial Companies (NBFCs) would be eligible to sponsor Infrastructure Debt Funds (IDFs), to be set up as Mutual Funds (MFs) and NBFCs. The Securities and Exchange Board of India (SEBI) has amended the (Mutual Funds) Regulations to provide regulatory framework for IDF-MFs by inserting Chapter VI – B to the MF Regulations.

The broad parameters for setting up of IDFs as MF and IDF-NBFC by banks and NBFCs were laid down.

I. Parameters for setting up of IDFs as MFs by banks and NBFCs

Banks and NBFCs would be eligible to sponsor IDFs as Mutual Funds with prior approval of RBI subject to the following conditions in addition to those prescribed by SEBI

II. Parameters for setting up IDF – NBFC by banks and NBFCs

Sponsors of NBFC- IDFs will have to contribute a minimum equity of 30% and a maximum equity of 49% of the IDF-NBFC. Banks and NBFC Infrastructure Finance Company (NBFC-IFCs) may sponsor IDFs as NBFCs with prior approval by RBI subject to few conditions.



The state owned Corporation Bank had always asked for approval to set up Infrastructure Debt Fund (IDF). Now when the guidelines have finally come, they are defiantly interested to float one. It will soon draw up plans to float such fund and approach its board for approval.

While the bank would like to partner with other interested players for floating such an infra fund, they too will try to collaborate with players like IDBI, IIFCL, IDFC, who have already evinced interest for such a fund.

<http://www.moneycontrol.com/news/business/corporation-bank-plans-to-float-infra-debt-fund-591234.html>

Returns to be submitted by NBFCs - Revised Formats –Abhijit Nagee

The Reserve Bank of India vide [notification](#) DNBS(PD).CC. No.243 /03.02.02 /2011-12 dated 22nd September, 2011 revised the formats of the returns to be submitted by NBFCs. NBFCs are required to file various returns related to deposit acceptance, Prudential Norms, Capital Market exposure, etc. It amended the:

- A. Returns to be submitted by deposit taking NBFCs
- B. Returns to be submitted by NBFCs-ND-SI
- C. Returns on important financial parameters of non-deposit taking NBFCs having asset size of ` 50 crore and above but less than ` 100 crore

Given below is a table showing the major amendments in the revised format as compared to the earlier ones.



Sr. No.	Returns to be submitted by deposit taking NBFCs	OLD FORMAT			REVISED FORMAT		
		Periodicity	Reference Date	Due on	Periodicity	Reference Date	Due on
1	NBS-1 Annual Returns on deposits in First Schedule	Annually	31st March	30th Sept	Quarterly	31st March/ 30th June/ 30th Sept/ 31st Dec	15th April/15th July/ 15th Oct/ 15th Jan
2	NBS-2 Half-yearly return on Prudential Norms is required to be submitted by NBFC accepting public deposits	Half-yearly	31st March / 30th Sept	30th June/ 31st Dec	Quarterly	31st March/ 30th June/ 30th Sept/ 31st Dec	15th April/15th July/ 15th Oct/ 15th Jan
3	NBS-3 Quarterly return on Liquid Assets by deposit taking NBFC	Quarterly	31st March/ 30th June/ 30th Sept/ 31st Dec	15th April/15th July/ 15th Oct/ 15th Jan	Quarterly	31st March/ 30th June/ 30th Sept/ 31st Dec	15th April/15th July/ 15th Oct/ 15th Jan
4	NBS-4 Yearly return of critical parameters by a rejected company holding public deposits	Yearly	31st March	to be submitted within 30 days from the close of the financial year	Yearly	31st March	to be submitted within 30 days from the close of the financial year
5	NBS-5 Monetary and supervisory return by NBFC having public deposits of Rs. 20 crore and above	Quarterly	31st March/ 30th June/ 30th Sept/ 31st Dec	10th April/10th July/ 10th Oct/ 10th Jan	Withdrawn as submission of NBS-1 has been made quarterly	N.A	N.A

6	NBS-6 Monthly return on exposure to capital market by deposit taking NBFC with total assets of Rs 100 crore and above	Monthly	As at the end of the month	7th day of next month	Monthly	As at the end of the month	7th day of next month
7	NBS-7 Annual Return of Capital Funds, Risk-Asset Ratio from NBFCs-ND-SI (Supervisory Return)	Annually	31st March	30th June	Quarterly	31st March/ 30th June/ 30th Sept/ 31st Dec	15th April/15th July/ 15th Oct/ 15th Jan
8	Asset-Liability Management (ALM) Return	Half-yearly	31st March/ 30th Sept	30th April/ 30th Oct	Half-yearly	31st March/ 30th Sept	30th April/ 30th Oct
9	A Statement of short term dynamic liquidity in format ALM - NBS-ALM1	Monthly	As at end of the month	10th day of next month	Monthly	As at end of the month	10th day of next month
10	Statement of structural liquidity in format ALM – NBS-ALM2	Half-yearly	31st March/ 30th Sept	20th April/ 20th Oct	Half-yearly	31st March/ 30th Sept	20th April/ 20th Oct
11	Statement of Interest Rate Sensitivity in format ALM-NBS-ALM3	Half yearly	31st March/ 30th Sept	20th April/ 20th Oct	Half-yearly	31st March/ 30th Sept	20th April/ 20th Oct
12	Monthly Return on Important Financial Parameters of NBFCs not accepting/holding public deposits and having asset size of Rs.100 crore and above	Monthly	end of every month	7th of next month	Monthly	end of every month	7th of next month
13	Quarterly return to be submitted by non-deposit taking NBFCs with asset size of Rs 50 crore and above but less than Rs 100 crore,	Quarterly	31st March/ 30th June/ 30th Sept/ 31st Dec	within a period of one month from the close of the quarter	Quarterly	31st March/ 30th June/ 30th Sept/ 31st Dec	within a period of one month from the close of the quarter
14	Quarterly Return to be submitted by NBFCs having overseas investment	Quarterly	31st March/ 30th June/ 30th Sept/ 31st Dec	within a period of one month from the close of the quarter	Quarterly	31st March/ 30th June/ 30th Sept/ 31st Dec	within a period of one month from the close of the quarter



Central Bank's new discussion paper on draft guidelines for NBFCs is facing opposition from the REC (Rural Electrification Corporation) regarding crucial issues such as higher capital adequacy ratio for Tier-I capital and on tightening the exposure limit. The RBI working group on NBFCs had earlier proposed that the capital adequacy ratio should be 12 per cent for Tier I capital against 7.5 per cent at present. Second, it has suggested the exposure limit be reduced by five per cent. However the REC has written in to the Ministry of Power for onward submission to the RBI demanding the current (not proposed) guidelines to be followed. REC along with Power Finance Corporation, another state-run lender for the power sector has also written a letter seeking clarifications from RBI on the draft banking guidelines. Both these Corporations planning to promote a bank were restricted by draft guidelines in two major ways: Firstly it restricts the setting up of banks to private sector players and secondly it requires the transfer of all the assets to the bank. Both conditions are unfavorable to the REC which is a state run corporation and does not wish to convert to a bank by transfer of assets; as compliance with the SLR and CRR rates may constrict the net interest margins of the corporation. It is seeking the opportunity to become a promoter by collaborating with foreign and infrastructure banks. Another demand from the REC's side is the classifying loans as NPA issue where it wants a two quarter norm or a leeway of 180 days to declare an asset bad or non-performing.

Sporadic changes in the bank credit with regard to various sectors are posing threats to the stability and consistency of the bank credit policy. While the commercial real estate sector or the CRE saw a significant moderation from 17.1% y-o-y to 15.8 y-o-y in August 2011, the NBFC sector experienced a sharp rise in bank lending by 55.2% y-o-y on the back of a similar 55.6% y-o-y growth in July. With the NBFCs now borrowing both from banks and markets, the probability of them being overleveraged and being exposed to high systemic risks increases to a great extent. Growth in the service sector also moderated slightly from 20.6% y-o-y in August from 21.3% in July while the sectors like infrastructure, metal and agriculture showed small to moderate growth rates as compared to the previous months. Studies also show that the overall non-food credit grew at a healthy growth rate of 19.8% in August, a shade higher than 19.7% growth posted during August 2010.



Recently, using the newly amended guidelines, some Non-Banking Financial Companies (NBFCs) have found their way to the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI), 2002 as some have been notified as Public Financial Institution (PFI). The SARFAESI Act is not applicable to NBFCs, however it is applicable to PFIs.

The Ministry of Corporate Affairs has laid down guidelines for declaring financial institution as Public Financial Institution under Section 4A of the Companies Act, 1956 vide [General circular no. 34/2011 dated 2-06-2011](#). Hence every financial institution applying for declaration as PFI shall fulfill the following criteria:

- It should be established under a Special Act or Companies Act being Central Act
- The net worth of the Company should be rupees one thousand crore
- Their main business should be infrastructural or industrial financing
- It must be in existence for at least 3 years also their income from industrial/infrastructure financing should be exceeding 50% of their income
- The company is registered as Infrastructure Finance Company with Reserve Bank of India(RBI) or as an Housing Finance Company with National Housing Bank(NHB)

While issuing the guidelines, the Ministry laid down that in case of Central Public Sector Undertakings (CPSUs) and State Public Sector Undertakings (SPSUs), the restriction with respect to financing specific sectors and net worth shall not be applicable.

Prior to the amendment, the Central Government notified institutions as PFIs if it satisfied any of the following conditions stated under 4A(2) of the Companies Act, 1956:

- It has been established or constituted by or under any Central Act;
- Not less than 50% of the paid up share capital of such institution is held or controlled by the Central Government.

Section 4A(1) of the Companies Act, 1956 defines Public Financial Institutions as:

“(1) Each of the financial institutions specified in this sub-section shall be regarded, for the purposes of this Act, as a public financial institution, namely:-

- the Industrial Credit and Investment Corporation of India Limited, a company formed and registered under the Indian Companies Act, 1913 (7 of 1913);*
- the Industrial Finance Corporation of India, established under section 3 of the Industrial Finance Corporation Act, 1948 (15 of 1948);*
- the Industrial Development Bank of India, established under section 3 of the Industrial Development Bank of India Act, 1964 (18 of 1964);*
- the Life Insurance Corporation of India, established under section 3 of the Life Insurance Corporation Act, 1956 (31 of 1956);*
- the Unit Trust of India, established under section 3 of the Unit Trust of India Act, 1963 (52 of 1963);*
- the Infrastructure Development Finance Company Limited, a company formed and registered under this Act.”*

Impact of the amendment

The recent guidelines for PFI were amended by the Central Government permitting private companies, principally engaged in infrastructure funding, to be categorized as PFIs, vide [Notification No. S.O.1355 \(E\), dated 10-6-2011](#). Pursuant to this notification, L&T Infrastructure Company Limited, being one of the private NBFC, has attained the status of a PFI under section 4A(2) of the Companies Act, 1956.

Other NBFCs falling under this category are as follows:

- Sicom Limited
- Gujarat Industrial Investment Corporation Limited

NBFCs find the PFI way to SARFAESI Act

--By Monica Chandak

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- Andhra Pradesh Industrial Development Corporation Limited
- Karnataka Urban Infrastructure Development and Finance Corporation Limited

Implications of being a PFI

It is discernible that NBFCs are not covered under the SARFAESI Act. However, by virtue of being classified as a PFI u/s 4A of the Companies Act, 1956, they get covered under the definition of financial institution for the purpose of the SARFAESI Act. Consequently upon getting the status of PFI, they have found a way to recover debts and to foreclose the security. Hence, these developments will further strengthen the recovery capabilities of the company. It is only a few among the total number of NBFCs that have been covered under the SARFAESI Act, 2002. Most of the NBFC are unable to recover bad debts. Hence, the working group of RBI, headed by Smt. Usha Thorat rightly recommends that the Act should be extended so as to cover the NBFCs within its ambit.

Besides the aforementioned implications, NBFCs notified as PFIs, will now enjoy certain benefits under the Companies Act, 1956, Income Tax Act, 1961 and Recovery of Debts due to Banks and Financial Institution Act, 1993.

As per the Companies Act, 1956, a PFI may issue Shelf Prospectus (Section 60A). Also under Section 224A, incase not less than 25% of the subscribed share capital is held by PFIs, they are required to appoint auditor of the company by special resolution.

There are several important implications of being a PFI under of the Income Tax Act, 1961 as well.

Under Section 43B Clause (d), in case the borrower defaults in the payment of interest on any loan or borrowing, borrowed from a PFI, a deduction shall not be allowed to the borrower in respect of delayed payment of interest. This becomes a very significant demotivator for a borrower who has borrowed from a PFI in defaulting, and will ensure timely payments of dues to PFIs.

Under Section 36 (1) (vii) (c), deduction shall be allowed in respect of any provision for bad and doubtful debts made by PFIs, upto an amount not exceeding 5% of the total income (computed after making any deduction under this Section and Chapter VI A). This is quite an important benefit, since in case of NBFCs, deduction for provisions for bad/doubtful debts is not allowed as a deduction. You may refer to Supreme Court judgement in the case of [Southern Technologies limited vs JCIT](#), on 11th January 2010. We are also of the view that the limit of 5% of total income may be sufficient to allow PFIs the benefit of the deduction.

Also under Section 43D, the income by the way of interest in relation to categories such as bad or doubtful debts, based on subsequent recovery, shall be chargeable to tax in the previous year in which it is credited by the PFIs.

There is also a very significant benefit to PFIs in terms of ability to offer bonds and other securities. Bonds issued and certain other liabilities of PFIs are treated as eligible investment for insurance companies, Residuary Non-Banking Finance Companies (RNBCs), Provident Funds (PFs) and Mutual Funds (MFs).

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http://www.india-financing.com/NBFCs_find_the_PFI_way_to_SARFAESI_Act.pdf

NEWS

Recently, MCA vide notification NO. S.O. 2223(E), dated 26-9-2011 has notified SREI Infrastructure Finance Limited, an NBFC, as a public financial institution u/s 4A.

News Article

NBFCs find the PFI way to SARFAESI Act

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What is an Asset Finance Company (AFC)? -compiled by Monica Chandak

“Asset Finance Company (AFC) would be defined as any company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive /economic activity, such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines. Principal business for this purpose is defined as aggregate of financing real/physical assets supporting economic activity and income arising therefrom is not less than 60% of its total assets and total income respectively.”

In 2006, based on a request from the industry, a separate category of NBFCs, termed Asset Finance Companies (AFC) was created to differentiate NBFCs engaged in tangible lending from riskier NBFCs which were either into unsecured lending or were investing in stock markets/real estate and whose assets were subject to greater volatility. NBFCs that were essentially financing hire-purchase and leasing assets were reclassified as AFCs. An AFC was defined as a company where more than 60 percent of its business was in the financing of physical assets supporting productive/economic activity.

Asset Financing companies are now very well regulated and supervised. Just like banks, they are required:

- To be registered with RBI,
- To follow stringent prudential norms set by RBI in the matters of capital adequacy, credit/investment norms, asset-liability management, income recognition, accounting standards, asset classification, provisioning for NPA and several disclosure requirements.
- To follow KYC norms.

DID YOU KNOW?

The market downturn has led to battering of NBFC stock. The valuation of such stock has been lowest in the last five years. A committee headed by former RBI deputy governor Usha Thorat has proposed regulatory changes in terms of increased capital adequacy, liquidity ratio to be introduced for 30 days and tougher provisioning norms. When implemented, they could pose challenges for NBFCs, especially asset financing and infrastructure NBFCs.

Some of them, like REC, PFC and IDFC, seem to have factored in regulatory changes and are now quoting at a price-book value, or P/B, which is nearly half



Profitability Indicators of AFCs, As on Mar 31, 2010

Total number		415
Total Assets		113951
Return on Assets (%)	NBFCs-D	2.8
	ND-SI	1.3
Return on Equity (%)	NBFCs-D	19.8
	ND-SI	8.5
Leverage Ratio Type of (%)	NBFCs-D	14.2
	ND-SI	15.1

Source: [Working Group on the Issues and Concerns in NBFC](#)



STRENGTHS

- Creation of productive national assets through leasing and other modes of financing, creation of assets like financing transportation and infrastructure construction equipments and projects
- Ensure cost-effective delivery of credit to the weaker and the un-banked segments of Indian society
- Act as an intermediary between the banking sector and borrowers in the rural markets, and assist in the creation of real and productive assets, which in turn have a multiplier effect on employment.

WEAKNESS

- Restrictions in accessing ECB
- Most of the AFCs do not have access to SARFAESI act
- No deduction under section Sec.36 (1) (vii) and Sec. 43D of the IT Act. No access to DRTs to enable speedier realization of their dues Provisions made by NBFC-AFCs for Non Performing Assets (NPAs) in line with prudential norms fixed by RBI are disallowed by tax authorities when assessing their income tax liabilities
- No exemption TDS on interest payment to AFCs u/s
- 194A (3) (iii) of the I.T. Act.
- Required to file regular returns with RBI and are subject to inspection on site from RBI

SWOT Analysis of AFCs

OPPORTUNITIES

- An NBFC NDSI which is an AFC can exceed credit concentration norms by 5 percent with the approval of the Board
- Can accept deposits without credit rating;
- Can accept higher level of deposits than LCs/ICs, if holding minimum investment grade rating and in compliance with prudential norms

THREATS

Regulatory changes in the Non-Banking Financial Company (NBFC):

- RBI has recommended maintaining a liquidity ratio of for 30 days. NBFC has to set aside cash balance equivalent to its debt payments due every month. Asset finance companies, especially those with longer repayment cycle, may be impacted.
- Usha Thorat has proposed regulatory changes in terms of increased capital adequacy and tougher provisioning norms. When implemented, they could pose challenges for NBFCs, especially asset financing

**COMPARATIVE ANALYSIS OF SOME LEADING
NBFCs - compiled by Monica Chandak**

Let's make a comparative analysis of the following AFCs:

Sundaram Finance Ltd

Sundaram Finance Ltd incorporated in 1954 has grown today into one of the most trusted financial services groups in India. Today, the activities of the group span savings products like Deposits and Mutual Funds, Car and Commercial Vehicle Finance, Insurance, Home Loans, Software Solutions, Business Process Outsourcing, Tyre Finance, Fleet Cards and Logistics Services. The Sundaram Finance group is a leading Indian Financial Services Group offering a host of Financial Products & Services.

Shriram Transport Finance Company Ltd.

Shriram Transport Finance Company Limited is India's largest player in commercial vehicle finance that was established in the year 1979. The company has a network of 488 branches and service centers. It is one of the largest asset financing NBFCs in India with a niche presence in financing pre-owned trucks and Small Truck Owners (STOs).

The "SHRIRAM" conglomerate which has significant presence in financial services viz., commercial vehicle financing business, consumer finance, life and general insurance, stock broking, chit funds and distribution of financial products such as life and general insurance products and units of mutual funds. Apart from these financial services, the group is also present in non-financial services business such as property development, engineering projects and information technology.

Magma Fincorp Ltd.

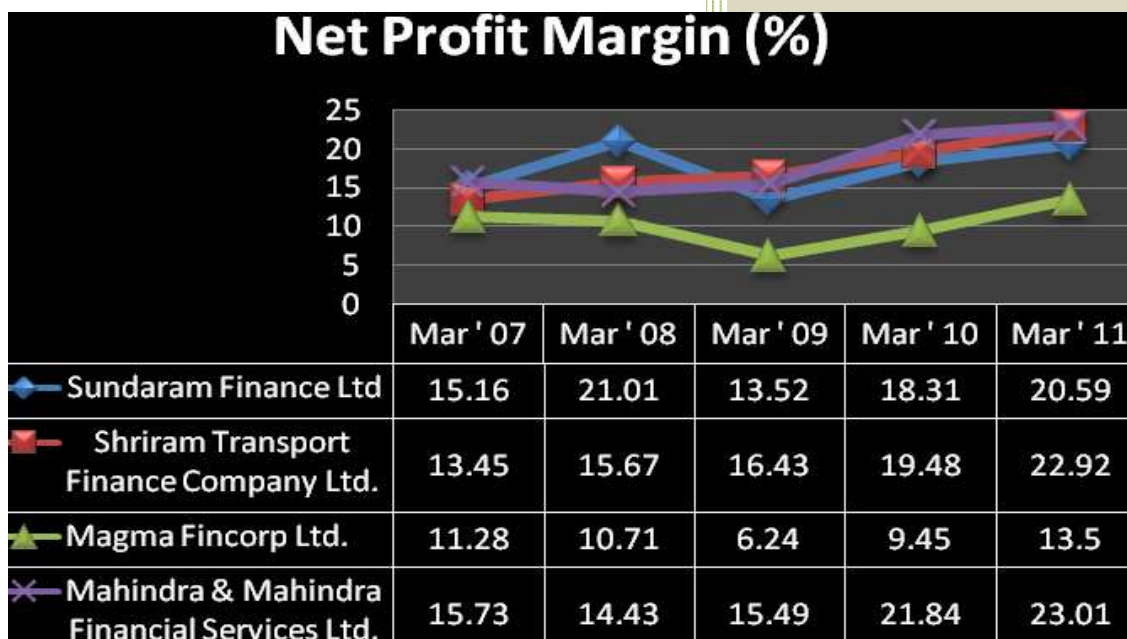
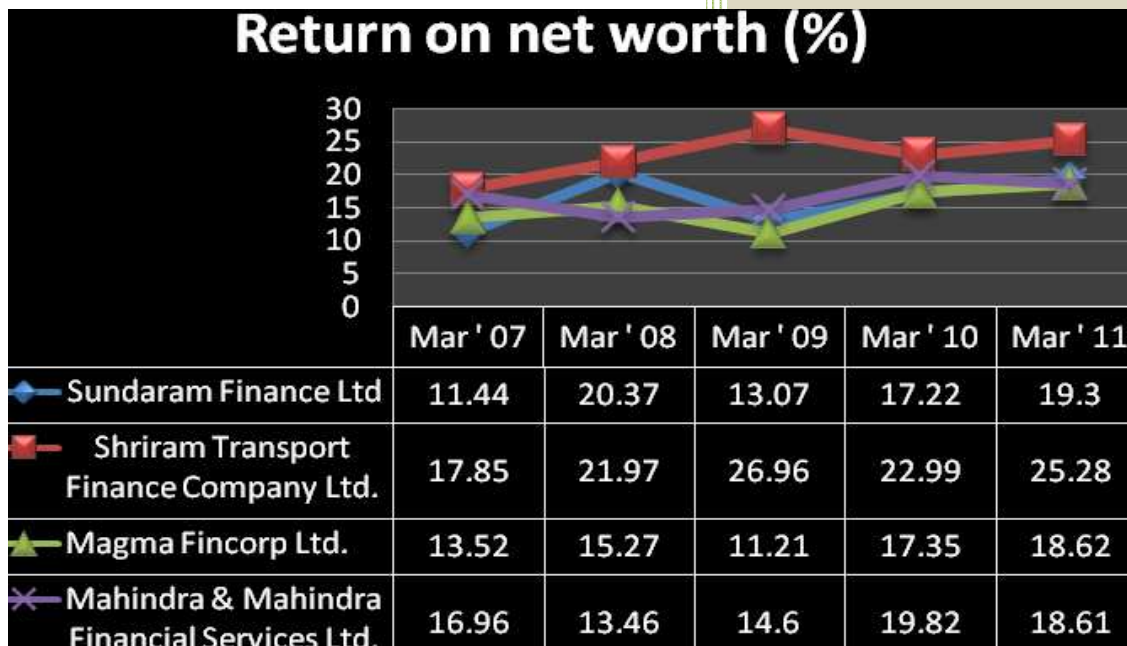
Magma today has a pan India presence with over 185 locations in 21 states and represented by a qualified team of over 5050 Magmites. Over 70% of our branches are located in semi urban and rural areas and about 60% of our customers are from the hinterlands. Magma today is one of the largest asset finance companies and carries an asset base of Rs 10,900 crore. In response to rapidly evolving demand, Magma offers individual and corporate customers a range of financial products and services in: Commercial Vehicle Finance, Construction Equipment Finance, Car and Utility Vehicle Finance, Suvridha Loans (Refinance), Strategic Construction Equipment Finance, Tractor Finance, SME Loans, Insurance

Mahindra & Mahindra Financial Services Ltd.

It is one of India's leading non-banking finance companies. Through a vast network of branches, they provide personalised finance for the widest range of utility vehicles, tractors and cars, focusing on the rural and semi-urban sector.

MMFSL's rural financing is considered as the cornerstone of poverty reduction, rural development and inclusive growth in many parts of the country. With a majority of our country's population living in rural India, our loans to over 10,00,000 customers belonging to the low income groups have proved to be a catalyst in helping rural India surge ahead in a big way.

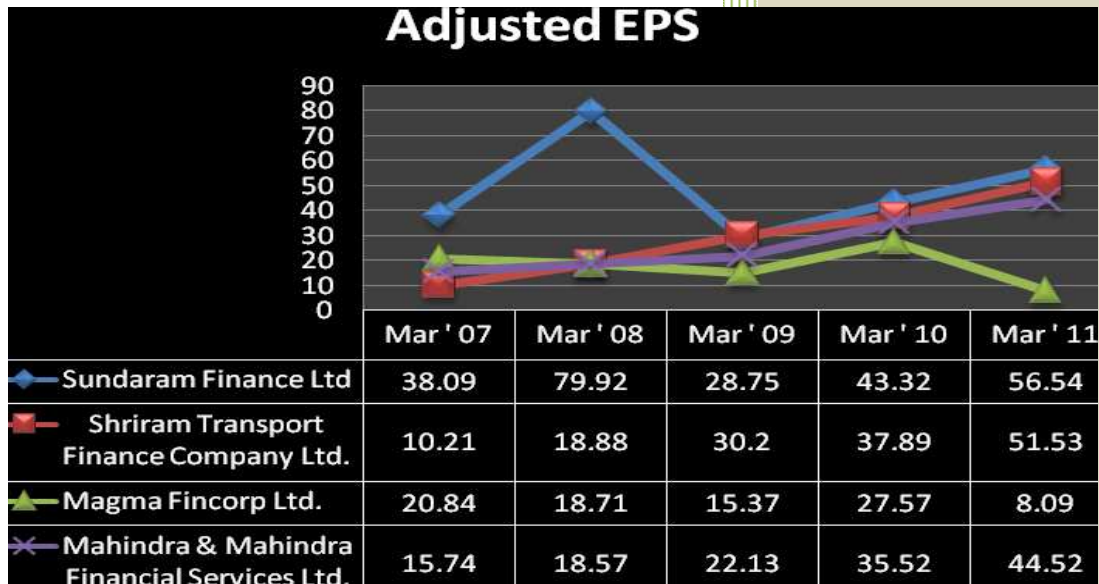




Long term Debt Equity Ratio



Adjusted EPS



CURRENCIES AROUND THE WORLD

- There are only 5 currencies in the world that have unique symbol to represent them. These are US Dollar, Yen, Pound, Euro and Indian Rupee (latest addition). Of these only the pound sterling has its symbol printed on the notes.
- The widely used \$ symbol, which is used to represent US Dollar, doesn't appear on US currency at all.
- In India, Rupee one notes have signature of the Secretary, Ministry of Finance, Government of India, while the notes of Rs.2 and above denominations contain signature of the Governor, Reserve Bank of India.
- When Pakistan was in its infancy after India-Pak separation in 1947, they used Indian currency with "Pakistan" stamped on it for the first few months till there was enough circulation of Pakistani notes.
- It is illegal to take Indian currency (rupees) out of India
- Before 1974, Bhutan didn't have any currency. Instead they followed Barter system, i.e., they traded goods and services in exchange of other goods and services. In 1974 Bhutanese Ngultrum was introduced as a currency.
- Australia introduced polymer notes in 1988 and in 1996 it became the first country in the world to have a complete series of polymer notes.
- 95% of the notes printed each year are used to replace notes already in circulation.



“\$” symbol doesn't appear on US currency



Indian currency with “Pakistan” stamped

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