KNBFC
KERALA NON-BANKING FINANCE COMPANIES
WELFARE ASSOCIATION

July 10, 2013.

Shri N. S. Vishwanathan
Principal Chief General Manager
Reserve Bank of India,
Department of Non-Banking Supervision,
Central Office, World Trade Centre, Cuffe Parade,
MUMBAI 400 005

Dear Sir,

Sub: Secured Non-Convertible debentures issued by NBFCs under private placement.

Ref; RBI Circular No. DNBD (PD) CC No. 330 dated 27.06.2013 & No. DNBS (PD) CC No. 349 dated 02.07.2013.

We, the members of the Kerala Non-banking Finance Companies Welfare Association, aggrieved over some of the harsh and sudden restrictions brought in by the RBI vide the above circulars wish to submit as under for kind re-examination and consideration of the RBI.

As financial intermediaries perform the function of being a link between the savers in the society and the users of these savings, the need to develop a wide range of such entities in the economy has been well recognized. NBFCs have become an accepted and integral part of the Indian financial system in view of their complementary as well as competitive role; they have displayed their intrinsic capacity as purveyors of credit, to have a larger reach and greater flexibility in meeting the credit needs of sectors like consumer finance, retail loans, retail investments etc. It is well recognized that NBFCs are performing a significant and important role in the Country's financial sector. We, therefore, believe that for development of a healthy integrated financial system, there is need to foster close linkages between Commercial Banks and the NBFCs so that the two can complement the efforts of each other. We are sure that the RBI accepts that NBFCs play an equal if not much higher role in financial inclusion than banks because of the very nature of their business operations. It would, therefore, not be judicious to introduce every conceivable restriction on NBFCs in sourcing resources.

The new restrictions brought in by RBI are given below:

Terms of issue	Existing practice	Revised RBI guidelines
Offer document	No offer document issued at present	Should be issued within six months from the date of authorization of the issue
Opening/closing dates of issue	No prefixed closure date	Should be incorporated in the offer document
End use of funds	No specific restrictions	To be used only for own balance sheet
No of subscribers	No limit	Limited to 49 investors identified up front
Minimum subscription	Rs. 1,000/- and in multiples of Rs. 1,000/- thereafter	Rs. 25 lacs and in multiples of Rs. 10 lacs thereafter
Loans against security of own debentures	Permitted	Prohibited

The main sources of funds for the NBFCs have been their paid-up capital, borrowings from Banks and Financial Institutions, issue of Debentures etc. It needs no saying that with every adverse comment and/or restriction brought in by RBI, banks further squeeze the supply of funds to NBFCs almost choking many of them out of life. NBFCs have been raising working capital finance by the issue of Secured Non-Convertible Debentures in conformity with the provisions of the Companies Act, 1956 and as per the guidelines on private placement.

The major reasons for raising funds though secured non-convertible debentures by way of private placement can be summed as under:

1) NBFCs raise resources for onward lending.
2) Unlike other industries where long term funds are secured for specific purposes and for specific time schedules, funds are required by NBFCs on an on-going basis.
3) These debentures are subscribed mostly by individual investors of small or medium means.
4) It can also be verified that NBFCs have been paying the periodical interest as well as repaying the principal on maturity without delay and there have been no complaint of non-payment till date.
5) The lead time required for sourcing funds through public issue of secured debentures and lines of credits from banks is anywhere over six months.
6) Hence NBFCs have to depend upon secured non-convertible debentures by way of private placement while lines of credit from banks and listed debentures are used only for meeting the deficit.
7) At present 50-80% of the resources of NBFCs are met through issuing secured non-convertible debentures by way of private placement.
8) Barring funds required for operational requirements, rest of the funds are deployed by NBFCs for onward lending for periods ranging from 12 months onwards.

Denying this access to funds will have a cascading effect on NBFCs carrying on their irreplaceable service to retail investors and borrowers; all the initiatives taken by the Government in fostering the NBFCs as an integral part of the Indian financial system will be stymied; it will have catastrophic systemic impact on the society and economy.

It will not be out of context to state that NBFCs have to compete with Banks in the matter of yield and instilling a sense of safety in their retail investors. It may be noted that it was on account of the prohibition on saving deposits or acceptance of public deposits by NBFCs that the restriction to issue NCDs to only 49 investors under Private Placement was first relaxed for NBFCs. At present the major part of their resources are met through issuing NCDs by way of private placement. Here we wish to draw RBI's attention to the legislative history of NCDs which was allowed to NBFCs as an alternative source of fund raising post the RBI Amendment Act in 1997. Now that a significant number of NBFCS have surrendered their deposit taking certificates because of the well meant, persuasive verbal directions of RBI in the past, NCDs are the only source of borrowing for a number of small and medium sized NBFCs. Raising the ticket size of privately placed NCDs to Rs 25 Lakhs will make it impossible for small and medium sized NBFCs to raise money, defeating the very purpose of their registration and existence as an NBFC. There is no cause or justification to suddenly pull the carpet from under the feet. The harsh restrictions on issue of NCDs by way of private placement will not only adversely affect the capacity of the NBFCs to honor the payment of interest and repayment of the Debentures already issued, but will drive them out of business of lending to low and middle income individuals. Recalling loans before the expiry of the loan period in order to raise funds for honoring the claims of Debenture holders will, it needs no mention, be an unethical practice, giving rise to multitude of customer complaints and litigations, severely impacting the industry as a whole, creating a crisis of credibility and confidence. The situation could even lead to a run on the NBFCs. Reputation of these Companies, built over the years by honest dealings, will be at stake as well.

NBFC NCDs are attractive and valuable to pensioners and households as they give positive returns after adjusting for income tax and inflation. Most of the NBFCs presently offer NCDs at the average rate of 13% p.a. which just covers the present Consumer Price Inflation (CPI) in the Country. The rates offered by the Commercial Banks do not cover that. The majority of the investors of the NBFCs are from low and middle income households and they stay away from the capital markets because of uncertain environment. They could easily be dragged into the unorganized sector, comprising mostly of "fly –by –night" operators, promising high returns on investments; they thus run the risk of losing their life time earnings, as history clearly proves.

Further, it is now widely acknowledged that the flight of savings into gold (with all its negative implications for the macro-economy) is largely on account of real interest rates in the banking system that have not kept pace with inflation. With savings getting eroded by high inflation, ordinary people of India have responded by putting their faith in gold. In this situation, the retail NCDs of the NBFCs have been a ray of hope for many, offering returns higher than inflation and also meeting minimum standards of safety and security. With the clampdown on retail NCDs of NBFCs, the choice available to the common man will be further restricted. This can only lead to an increased rush towards gold, and that is likely to be counterproductive.

In view of the above factors, we request Reserve Bank of India to kindly recall the impugned circulars.

If entire recall is not possible, at least consider the following suggestions:

- Please provide at least a five year prorated time frame to implement and bring down the levels.
- Impose a cap on the level of secured non-convertible debentures by way of private placement to be carried by an individual NBFC based on the asset size of the NBFC or the outstanding of such debentures as on 03/07/2013 whichever is higher and NBFCs be permitted to operate issuance of secured non-convertible debentures by way of private placement within this ceiling.
- Future issues of NCDs will be as per revised RBI stipulations to be issued by RBI taking into account this representation.
- The stipulation of a minimum subscription amount to Rs.25 lakhs should be reduced to Rs.25000/- and in multiples of Rs.10000/- to cater to the needs of small and medium investors, like pensioners and retirees who are our main customers and who have no other options of steady and meaningful returns that can sustain them.
- Loans should be permitted for emergent needs of subscribers after completion of one year from the date of the debenture in respect of long term NCDs with maturity beyond 12 months. It would otherwise tantamount to rule without a human face.
- Instead of setting a maximum number of investors for private placement or a minimum amount for ticket size, there has to be a monetary limit on how much debentures an NBFC can raise, based on rational financial paramaters like asset size (say up to a maximum of 90%) or capital adequacy etc..
- Better compliance mechanisms, adequate and relevant scrutiny returns etc. can be brought in.

Incidentally, without diluting our request for minimum Rs.25000/- and multiples of 10,000/- as above, we may mention that the stipulation of minimum multiple of Rs 10 lakhs for amounts beyond the minimum (Rs 25 lakhs) has no special logic to it. What if someone wishes to invest 26/27/28 lakhs etc? Multiples of Rs. 1 lakh each would sound more logical.

We are hopeful, nay certain that the RBI who is our Regulator will listen to our justified angst and provide relief as requested.

We shall be happy to have a personal meeting to discuss.

Yours faithfully,
For Kerala Non-Banking Finance Companies Welfare Association

Thomas George Muthoot
Chairman

KERALA NON-BANKING FINANCE COMPANIES WELFARE ASSOCIATION

Copy to:

The Regional Director,
Reserve Bank of India,
Thiruvanthapuram,
Kerala - with a request to kindly recommend our request to RBI HO, based on the ground realities here and the genuineness of our grievance.