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NON-BANKING FINANCIAL COMPANIES

THE BIG SQUEEZE

A new set of draft guidelines from the central bank threatens to drastically shrink the industry

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Reining In NBFCs

NOBODY CAN SAY WITH any accuracy exactly how many non-banking financial companies (NBFCs) operate in India. At the end of March 2012, there were 12,385 NBFCs that had a certificate of registration (CoR) from the Reserve Bank of India. However, not all NBFCs are registered with the central bank.

NBFC itself is a bit of a catch-all term. It encompasses a wide variety of market players. At one end are chit fund companies. Then there are NBFCs that focus on a single line of business — say vehicle finance, or gold loans, or something else. And then there are huge financial companies with multiple lines of business — everything from vehicle leasing to broking to wealth management. There are NBFCs that have revenues bigger than many small banks. And then there are small, mom-and-pop shops which have a balance sheet size of less than Rs 1 crore.

For some time now, the RBI has been trying to figure out how to regulate and monitor NBFCs better. The issue is that while the top 10 or 20 NBFCs are pretty well regulated, hundreds of the smaller NBFCs raise money and lend out money with hardly any regulatory oversight. The RBI simply does not have the resources to keep a close watch on them.

In September 2010, the RBI constituted a committee headed by deputy governor Usha Thorat (she was just about to retire) to look at how to better regulate NBFCs. The Thorat committee submitted its report, and the RBI has now sent its draft guidelines based on it to the finance ministry. If all the recommendations in the RBI draft are accepted, the NBFC universe will see a shakeout and lots of exits. In fact, over 70 per cent of NBFCs may have to deregister from the RBI.

The Thorat committee recommendations and the RBI draft have drawn howls of protest from NBFCs, especially the smaller ones. Even some of the biggest NBFCs are unhappy because they think that the proposed guidelines force them to take on all the burdens of a commercial bank, but without the licence or privileges of a real bank. There are other issues as well.

Senior associate editor Raghu Mohan talked to Usha Thorat, to RBI officials, big and small NBFCs, and to finance ministry officials to understand the full implications for our cover story.

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BRACE FOR A

RBI's draft guidelines threaten to shake up the NBFC universe

by Raghu Mohan

KILLER PAIN

The RBI draft norms make life tough for NBFCs over various points. A snapshot:

The Change: To be an RBI registered entity, an NBFC needs to have Rs 25 crore in assets, and 75 per cent assets and income have to come from financial activities
The Pain: This will push almost 70 per cent of the 12,000-odd NBFCs out of the boat

The Change: Risk weights on vehicle, home and gold loans higher for NBFCs, which anyway do not have a diversified book
The Pain: They lose out in these businesses to banks, which have lower risk weights

The Change: The norm for non-performing assets (NPA) has been cut to 120 days from 1 April 2014, and to 90 days from 1 April 2015. Earlier, it was 180 days
The Pain: Usually, NPAs in the 90-day bucket are twice of that in the 180-day one. Gross NPAs will shoot up; and NBFCs will need more to cover bad loans, which will affect growth

IT was close of business hours on Thursday, 23 October 1997 — exactly a week before Diwali. The fax machine on the news floor groaned as it spat out a shocker from Crisil, the rating agency. In one fell swoop the debt plans of 14 non-banking finance companies (NBFCs) stood downgraded; they cried "foul". If the festival of lights was around the corner, the blast of crackers couldn't be far behind.

"It (downgrade) is uncalled for. It is not due to any fault of theirs that NBFCs were doing badly," was the reaction of an irate Mahesh Thakkar then. Thakkar was the executive director of Association of Leasing & Finance Companies (ALFC). Some marquee names got grime stains: Kotak Mahindra Finance, Anagram Finance, Alpic Finance, 20th Century Finance, Ashok Leyland Finance, and Cholamandalam Investment & Finance.

BLOWOUT

The Change: An NBFC will have to be rated to take on deposits. And it can raise deposits only up to 2.5 times its net owned funds, not four times as it is now

The Pain: An unrated NBFC cannot take or renew deposits. And the amount that the rated ones can take is reduced. NBFCs will have to re-think funding options

The Change: No recourse to Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (2002)

The Pain: If a loan goes bad, the NBFC has to grin and bear

The Change: NBFCs have to be liquid in the up to 30-day timeframe — they must have near liquid assets, bank deposits, and investments in money market instruments that can be liquidated within 30 days

The Pain: Unutilised bank limits to cover mismatches will not count: they need to set aside more funds for this

The angst had its roots in a snafu that happened earlier in June that year. Chain Roop Bhansali's CRB Capital had got an in-principal banking licence from Mint Road. But he turned out to be a pied piper who led wide-eyed investors, rats and regulators into the waters off Marine Drive. An ashen-faced Reserve Bank of India (RBI) pulled back the licence. Cox & Kings' (part of the Tata group) plan to set up a bank got shot into pieces in the crossfire. Crisil had played it politically correct with a wholesale ratings downgrade.

Fifteen years on, one gets a sense of déjà vu. Thakkar now fights under a new flag — the Finance Industry Development Council (FIDC), a self-regulatory body of NBFCs — as its secretary-general. The need to prevail on the mandarins to "act in a fair manner" is so high that soon he will have the company of Y.M. Deosthalee, director, L&T Finance, who is to head the in-the-works 'Forum for NBFCs' with PricewaterhouseCoopers (PwC) in the anteroom.

Lights, Camera, Action

On 12 December 2012, RBI told NBFCs: treat bad loans as a bank does. That is, it is a dud loan if it has not been not serviced for 90 days (and not 180 days as NBFCs were doing). Tier-1 capital and risk weights on loans to bourse-denizens, real estate, commodities, commercial vehicles, construction equipment and homes have; you need more capital to be in these businesses.

If you don't have assets of Rs 25 crore, you deregister as an NBFC with RBI; go home, get fat in two years to reach Rs 25 crore in assets and register again. You have to be liquid in the less than 30-day bucket; you can't count unutilised bank limits towards it. The unsaid: access to bank funds will be limited from here on. And here is the salt on the wound — you still get no recourse to the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (2002) if a loan goes dud. Under such rules, one would have to be foolhardy to be an NBFC.

The font of all the heartburn is the Report of the Working Group on NBFCs, headed by Usha Thorat, a former deputy governor (DG) of RBI. Since the report was made public on 29 August 2011, it is being seen as a torturer of the damned. Arun Duggal, chairman of Shriram Capital, is blunt: "It is not right to have uniform regulations between banks and NBFCs." In one of his past avatars, as BankAm's (India) boss, he inhaled the rarefied air at India Inc's summit; he now bats for the have-nots, and may even make it as a vocalist for Foo Fighters at a concert organised by Global Poverty Project. "NBFCs that serve small businesses and individuals need to grow substantially to achieve financial inclusion."

An unfazed Thorat broke her silence to *BW*. "Yes, it will not be business as usual. What made you think it will be?" You argue with the avid bird-watcher and yoga buff that NBFCs play a complementary role to banks, and she replies with a pithy "I agree. It is recognised by the RBI". But NBFCs may not be able to grow as in the past! "That is the idea. Don't grow at 27 per cent; grow at 15 (per cent)," she says. *Usha* in Sanskrit means sunrise, but a few NBFC honchos may well call her *sandhya* (sunset).

FIDC's Thakkar feels Thorat has turned an argument on its head. "It is perhaps a one-of-its-kind scenario where smaller players want to be registered and regulated, but the regulator

NBFC

BOXED IN Usha thorat, for the first time, sought to define the "principal business" of an NBFC. In terms of section 45I(c) of the RBI Act (1934), an NBFC is defined as one engaged in granting loans, advances or in the acquisition of shares, securities, or hire-purchase finance or insurance or chit fund activities or lending in any manner. And provided the principal business does not constitute any non-financial activities such as (a) agricultural operations, (b) industrial activity, (c) trading in goods (other than securities), (d) providing services, (e) purchase, construction or sale of immovable property. In terms of Section 45I (f) (ii) of the Act, an entity is an NBFC if its principal business is that of receiving deposits under any scheme or arrangement. But the Act was silent on the definition of 'principal business'; it conferred on the regulator the discretion to define it.

The Thorat Working Group was also of the view the 'part' of the business (referred to in section 45I(c) of the RBI Act) of a company which has to be financial in nature in order for the company to be treated as a financial institution must form a significant part of the company's overall business. And so the minimum share of financial assets, and the income derived from it, was upped to 75 per cent (from 50 per cent). Existing non-deposit taking NBFCs have been given three years to comply with the revised definition of principal business. If they fail to do so, they will have to deregister as an NBFC. Deposit-taking NBFCs cannot accept fresh or renewed deposits, and must prepay deposits (within a timeframe) and convert to non-banking non-financial companies.

THE NBFC EVOLUTION

Pre-1996: NBFCs could be all things to all people; even raise deposits up to 10 times their net owned fund (NOF)

1996: A.C. Shah Committee says NBFCs with Rs 50 lakh NOF with credit rating can raise unlimited deposits; for others, up to 5 times NOF

1997: CRB Capital goes belly up. RBI Act amended; mandatory registration for NBFCs with Rs 50 lakh in assets. Later made Rs 25 lakh by Parliament to protect SMEs

1998: NBFCs categorised into deposit and non-deposit taking. A limit of 1.5 times NOF capped at Rs 10 crore for un-rated desposit takers; 4 times NOF for the rated ones

1999: Entry norms for new NBFCs upped to Rs 2 crore from Rs 25 lakh; bar on deposits for first 2 years

2005: Asset finance companies (hire-purchase, leasing & hypothecation) NBFC sub-segment created

2008: Deposit-taking AFCs leverage cut to 1 time NOF from 1.5 times for those with NOF less than Rs 2 crore

wants them to be outside the ambit of regulation. We are back to pre-1997 when such entities mushroomed."

The irony is that Thorat feels the RBI has diluted her committee's views in its draft! *BW* learned from sources that Thorat wrote to RBI governor Duvvuri Subbarao last month that the idea behind exemption from a certificate of registration (CoR) was to ensure these NBFCs were not robbed of their legitimacy, but would not have a CoR to misuse. If you are on RBI's radar, play off the reputation it confers you. The RBI's draft says NBFCs will have the option to surrender the CoR on a voluntary basis and also be out of its regulatory radar (RBI Act 1934, except Section 45N). She raised the existential with Subbarao: "Is it legally possible to say that the law dealing with NBFCs is not applicable to such companies? Maybe this needs to be clarified." As for going back in time to CRB Capital days as Thakkar complains, Thorat clarifies: "All NBFCs accepting deposits have to be registered and regulated by RBI. The new guideline of Rs 25 crore is only for those not accepting deposits. There is no question of going back to the pre-1998 (1997-98) situation; no NBFC can accept deposits from public without a registration from RBI."

A legal challenge is on the cards nevertheless. The Punjab and Haryana Finance Companies Association's secretary general, Alok Sondhi, points out that the stipulation of a minimum asset size of Rs 25 crore and a capital adequacy of 15 per cent is an indirect way to stipulate net-owned funds (NoF) of Rs 4 crore (presently Rs 25 lakh for existing NBFCs and Rs 2 crore for the new ones). "It would be an indirect attempt to modify section 45-IA(1)(b), which, we feel, can only be done by Parliament." It is worth a recall that an act of Parliament set the NoF at Rs 25 lakh in 1997; the RBI wanted it at Rs 50 lakh.

Anand Natarajan, chief operating officer at Fullerton (India), says, "The (proposed norms) will not affect us. We have nearly Rs 2,000 crore in capital." Fullerton (India) is a fully-owned step-down subsidiary of Fullerton Financial Holdings, which, in turn, is a 100-per cent arm of Temasek Holdings of Singapore. But it too had faced pain in 2009-10, when it suffered nearly Rs 1,000 crore in losses. Mainly on its Rs 3,000-crore personal loan book, and due to a cut back of branches to 300 from 800. It now has an equity base of Rs 1,850 crore

"WHEN YOU SAY NBFCs ARE 13 PER CENT OF THE BANKING SYSTEM, YOU HAVE AN HDFC IN IT... AN IDFC, AND ASSET RECONSTRUCTION COMPANIES"

MUNISH DAYAL
Partner, Barings Private Equity

SANJAY SAKARIA

"YES, IT WILL NOT BE BUSINESS AS USUAL"

Usha Thorat, head, working group on NBFCs, and former deputy governor, RBI

SUBHABRATA DAS

and a book size of Rs 4,600 crore. It hawks two-wheeler and commercial vehicle loans, and loans against property, but 65 per cent of its business is still personal loans. The Temasek pedigree helped it weather the storm, but Natarajan agrees we are set to witness an "NBFC cull".

Explains N. Sivaraman, wholetime director at L&T Finance Holdings: "You have to understand we lend to people with volatile cash flows. You can't have (accounting) norms like when you lend to a large company. Here, some even confuse business and personal cash flow. But the 'asset' is all they have and pay up somehow even after 180 days. If you insist on 90 days and attach the assets (trucks, for instance), they will go into a tailspin." He also says, "If you are to treat us like a bank, gives us all the facilities a bank gets — to borrow from the RBI and call (money) markets."

It is a point that Ajay Srinivasan, CEO of Aditya Birla Financial Services Group (ABFSG), which has ambitions to own a bank, seconds. "The key is funding. If you don't get it, you can't grow beyond a point." ABFSG has seven companies under its banner — Birla Sun Life Insurance, Birla Sun Life Asset Management, Aditya Birla Finance, Aditya Birla Capital Advisors, Aditya Birla Money, Aditya Birla Money Mart, and Aditya Birla Insurance Brokers. It has 5.5 million customers with assets of nearly $20 billion, and 15,000 employees. "Other than a savings or current account, we have everything," notes Srinivasan. It remains to be seen how ABFSG will play the game from now on.

"An NBFC is an NBFC; a bank is a bank," says George Alexander Muthoot, managing director of the Kochi-based (Kerala) Muthoot Finance. It gives out Rs 100 crore every day in gold loans ranging between Rs 2,500 and Rs 75,000. "We save people who can't get bank loans, from money lenders." But the RBI doesn't see it quite that way. It feels gold loans favour Shylocks "who offer gold loans at very high interest rates, and then pledge the gold to borrow from gold loan NBFCs at a lower rate". Munish Dayal, partner at Barings Private Equity, which holds a 3 per cent stake in Muthoot, drips sarcasm: "You (NBFCs) are doing a great job, keep it up, but we will not allow you to grow."

The *tamasha* is set to get bigger. Finance minister P. Chidambaram has been buzzed by the political constituency. NBFCs serve the unbanked, which includes truck operators and small businessmen. The 90-day bad loan norm,

KNOW YOUR NBFC

TIER-1 CAPITAL: A measure of financial strength from the regulator's standpoint; it is composed of core capital — primarily common stock and disclosed reserves

OWNED AND NET OWNED FUND (NOF): Owned fund means the total of paid-up capital and free reserves. NOF is owned fund minus investments

RISK WEIGHT: The amount a lender needs to set aside for loans based on the risk perception of the sector it lends to

SUBHABRATA DAS

"THE (PROPOSED NORMS) WILL NOT AFFECT US. WE HAVE NEARLY Rs 2,000 CRORE IN CAPITAL"

ANAND NATARAJAN
COO, Fullerton (India)

for one, will throw them off gear. "Unlike banks, which take three years to repossess Kingfisher's aircraft, NBFCs will not wait that long for a truck," quips Shriram Capital's Duggal. Can UPA-2 afford to ignore the *aam aadmi*? Thakkar met Yashwant Sinha, chairman of the Parliamentary Standing Committee of Finance in Mumbai (on 17 January 2013), and requested the issue be put on its agenda. Watch out for the engagement in the Budget session.

A well-wisher is Dinesh Kumar Mittal, secretary of department of financial services, finance ministry. "We are to have another meeting of the KYG (key advisory group). We will have to discuss RBI's draft before it is finalised," he told *BW*. At the meeting held on 21 January 2012, a source says the finance ministry agreed that the RBI draft was harsh and that "it will try to prevail on the RBI to go easy in its final guidelines. But then they (RBI) have their own ideas — from interest rates to gold loans".

As per plans hammered out at the meeting, finance ministry officials will fly down to Mumbai within the fortnight to take up the matter with the RBI at the DG or executive director level. Further, Chidambaram has called a separate meeting of NBFCs, and the four key points up for discussion are — to create a separate category of NBFCs that lend to priority sector and small businesses; create a regulatory mechanism to help these grow; maintain the 180-day dud loan-norm and capital adequacy at 7.5 per cent; and leverage for deposit taking NBFCs at four times net owned funds (NoF), not the 2.5 times in the draft. But that's for the future.

It's No Cold Start

Ever since Thorat's report came out, a lot has been spent on trips to New Delhi, and North Block has had to play referee. It set up the KYG under Alok Nigam (joint-secretary), with members drawn from the Indian Banks' Association, the chambers of business, Ernst & Young, Amarchand Mangaldas, Juris Corp, FIDC, and large NBFCs. Thorat may now say part of her submission has been watered down by the RBI, but the RBI had back then said that "their association (with KYG) may not be desirable", to show what some term as "solidarity with her views". Thorat retired as DG on 9 November 2010, but institutional memory did not allow her colleagues to be part of efforts towards a "compromise".

After two rounds of meetings (8 October and 8 November 2011), the KYG sang hosannas in favour of NBFCs. As on end-May 2011, banks had given Rs 5,50,178 crore, or 15 per cent of bank credit, to build roads, ports, landing strips, power and telecom. In comparison, infrastructure NBFCs (like an IDFC) had given out Rs 1,96,158 crore. But "banks' further exposure is hostage to their internal limits (typically at 12-15 per cent) and asset-liability mismatches (long-term assets funded out of shorter-term liabilities)", noted the KYG. And given the projected capital requirement for infrastructure in the 12th Five-year Plan, NBFCs will be key to supply capital.

But North Block's ballast did not have much effect. On 26 December 2012, NBFCs called on the RBI for an informal tete-e-tete to retrieve a no-go. "I did not get the sense (that) they will budge," said a source who was present at the meeting. "For them, it is less by way of headache if scores of NBFCs go out of business." On 7 January 2013, NBFCs wrote to Uma Subramanian, chief general manager of department of non-banking supervision: "The present propositions are patently loaded against NBFCs, and must be reconsidered. RBI may not accept all it hears, but it will certainly benefit from listening to everything that needs to be said."

It is a debate that has been on for one-and-half years; of longer vintage is new bank licences. It is perhaps a coincidence that some of the big NBFCs have a lot at stake in how the latter turns out. Finance ministry's Mittal and the RBI have a history; he had aired views on how state-run banks should function — from bad loans to business targets; all of which is RBI turf. On 9 February 2012, Mittal made it as the ministry's second nominee on the RBI's board (a rare first), a week after the KYG gave its report and a case

NBFC

DID YOU KNOW?

THE SUNDAR COMMITTEE TO REVIEW THE MOTOR VEHICLE ACT (1988) HAS SAID THE LIEN IN THE REGISTRATION CERTIFICATE BE MARKED ONLY IN FAVOUR OF BANKS, AND RBI-REGISTERED NBFCs

MIDGETS AND GIANTS

The size of NBFCs' assets, though not as large as that of banks, is significant enough to be strictly regulated

	FY 2006	FY 2010	FY 2011
No. of NBFCs	13,014	12,630	12,409
Bank credit of all scheduled banks (Rs cr)	15,72,780	33,37,659	40,40,843
NBFC advances as percentage of bank credit	**10.77%**	**12.57%**	**13.20%**
Assets of all scheduled banks (Rs cr)	25,31,462	52,58,495	61,46,590
NBFC assets as percentage of bank assets	**13.06%**	**13.33%**	**13.78%**
Deposits of all scheduled banks (Rs cr)	21,85,809	46,35,224	53,55,160
NBFC deposits as percentage of bank deposits	**1.05%**	**0.37%**	**0.22%**

Source: Finance ministry

was made for it to be a standing committee. Perhaps, this too was a coincidence.

What You See, What You Get

The new weltanschauung lies in the suspicion of 'shadow banking', and regulatory arbitrage — wherein banks park riskier activities in vehicles not consolidated with them. So when the last straw breaks, it is not on the camel's back, but on their books. At its height, shadow banking in the US was roughly twice the size its banking system; in others, it equals. No central bank wants a systemically important entity to dribble past its regulatory field.

The latest (consolidated) publicly available figure on NBFC assets — be it of non-deposit taking, deposit-taking or residuary ones — shows it at Rs 8.47 lakh crore at end-March 2011, or 13.78 per cent of the banking system. Five years before that, it was Rs 3.30 lakh crore. In this timeframe, the number of NBFCs have fallen to 12,409 (and to 12,385 at the end of March 2012) from 13,014, but bank loans to them have gone up to Rs 1.84 lakh crore from Rs 62,308 crore. It is this three-fold rise at an annual rate of 24 per cent (and by 37 per cent over 2009-10) that worries the central bank as it creates systemic risks. Bank loans to NBFCs can turn dud, and their links with other parts of the financial mart can lead to an avalanche (NBFCs issued debentures worth Rs 2.05 lakh crore in FY11 to investors which include banks, non-banks and a few corporates, which in turn use bank funds).

The truth hit NBFCs in 2008-09. NBFCs were more leveraged, and more dependent on commercial paper (CP) and short-term bank borrowings. They had little space to manoeuvre when bank credit lines froze; many had to trim balance sheets, rationalise branches and curb growth. Pravin Kadle, managing director and CEO of Tata Capital concedes, "Banks may be exposed to some spill-over risk owing to a borrower NBFC (that has) a large exposure to risky sectors. But banks need to ensure prudent practices to avoid getting exposed to unduly high risk as in any lending arrangement." So if banks neglect hygiene, why blame NBFCs for it?

SUBHABRATA DAS

"YOU (RBI) ALLOWED THEM (NBFCs) TO GROW; NOW YOU SAY YOU HAVE SYSTEMIC RISKS DUE TO THEM"

MAHESH THAKKAR
Secretary general, Finance Industry Development Council

Barings' Dayal contests the composition of the "NBFCs club". "When you say NBFCs account for 13 per cent of the banking system, you have an HDFC in it, a Power Finance Corporation, a Rural Electrification Corporation, an IDFC, and asset reconstruction companies." Adds ABFSG's Srinivasan: "It also shows that these NBFCs play a role complementary to banks." But the RBI has an equally persuasive point. "The regulatory challenge would be to devise a framework to identify systemically important non-banking financial institutions, markets and products, and evolve a framework, for the oversight and, if need be, prudential regulation," notes Anand Sinha, deputy governor of RBI.

The finance ministry quotes RBI's *Report On Trend And Progress Of Banking In India*' (2005-06) that the RBI received 38,244 requests for grant of NBFC certification, and seconds the central bank's worries when it points out that "unregistered entities could be manifold the number of registered NBFCs". Says Shinjini Kumar, director of tax and regulatory services at PwC: "What we are seeing now is a reversal of that process (of licencing)". But why did the

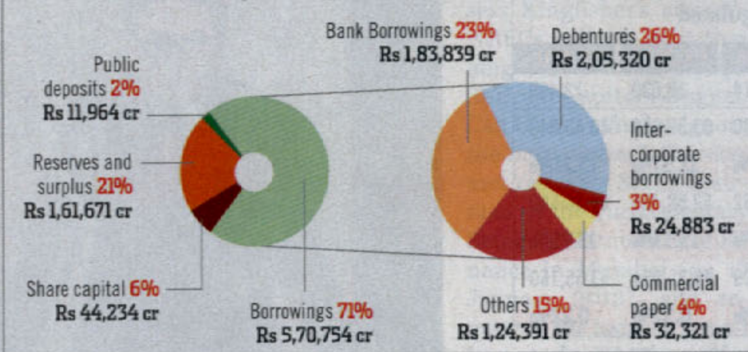
NBFC

DID YOU KNOW?

THERE WERE OVER 60,000 NBFCs IN 1996; THERE ARE JUST 12,409 OF THEM NOW

THE MONEY TRAIL

NBFCs depend mostly on borrowings for funds



Data for FY11

RBI issue so many licences in the first place? "You should ask RBI that. You allowed them (NBFCs) to grow; now you say you have systemic risks due to them," says FIDC's Thakkar. "It is a retrograde step. The 1997 RBI Amendments made it mandatory for NBFCs so as to properly regulate them," adds Sondhi.

On its part, the RBI has always been wary of NBFCs. In March 2006, it set up an internal group of its top officials from the department of banking operations and development (DBOD), department of supervision (DoS), and department of non-banking supervision (DNBS), when it noticed "asset bubbles" (before the term became famous in financial lexicon). The group noted there were 104 non-deposit taking NBFCs with assets of Rs 100 crore and more. Citigroup, with five NBFCs topped in terms of assets; GE Capital and associates came next. Of these 104 NBFCs, the top 10 held 43.3 per cent of the assets. And of these 10, five entities were foreign-owned and had the lion's share of the bank borrowings, CPs and debentures. "Some mopped up huge bank funds for capital market operations," says a senior RBI official. "The figures were never made public as it was sensitive, based on our inspection reports. It is wrong to say we had no idea of the hot spots."

About 70 per cent of the 12,000-odd NBFCs are paper-weights. "They were set up for all kind of activities, as investment companies, to route promoter holdings," points out PwC's Kumar. Even if you assume four employees at each of the 12,000 NBFCs — one to open and close shutters, a second to run errands and do sundry house-keeping, a third to maintain ledgers, and a fourth as a boss of all three — it means 33,600 resumes will be in search of a job sometime in the near future. But Mint Road does not see it that way. "They have basically said you do whatever with your NoF. *Apne paise se kuchh bhi karo. Zameen ke andar dalo, jala dalo* (Bury your money, burn it)," opines FIDC's Thakkar.

"THE KEY IS FUNDING. IF YOU DON'T GET IT, YOU CAN'T GROW BEYOND A POINT"

AJAY SRINIVASAN
CEO, Aditya Birla Financial Services

What's The Name Game

Ironically, an RBI registration has all along given NBFCs a window to raise leverage to levels not normally available to them. "You can mislead (consumers) by stating that you are regulated by the RBI. It gives you an aura (of credibility), and you can then do what you want," says PwC's Kumar, herself a former RBI official. Given the low financial awareness in the hinterland, a rogue NBFC can promise the moon, offer no deposit insurance cover, and play the money lender's game. If it can swing it, it can then foray into realty, transport, the works and raise still more money. Such risky ventures can impact their balance sheets, and adds to the systemic risk. Apart from the risk factor, the RBI also faces operational issues in monitoring such entities — both off-site and on-site. And any adverse development could result in denting the RBI's reputation. Does Sahara ring a bell?

"The central bank has basically thrown in the towel. It cannot and does not have the wherewithal to supervise thousands of NBFCs. Many are small, spread all over the country; they have little or no corporate governance at all; raise deposits and funds from all kinds of sources", says an official at a leading NBFC. RBI's supervisory workload is set to go up. On the cards is the Financial Holding Company (FHC) model for banks. If you are of any consequence in the financial mart, you will have to put all your businesses under it — be it a bank, insurance company, mortgages or mutual fund. FHC is aimed to do away with the turf battles between Securi-

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DID YOU KNOW?

A DEFENDANT HAS TO BE RBI REGISTERED TO BE HEARD IN CASES FILED UNDER SECTION 138 (BOUNCED CHEQUES) OF THE NEGOTIABLE INSTRUMENTS ACT, AND OTHER SUITS ties and Exchange Board of India (Sebi), Insurance Regulatory and Development Authority (Irda), the RBI and the finance ministry. In 1997, the RBI had said that Sebi had not monitored CRB Capital; that it had given a clean chit when its opinion was sought ahead of granting the banking licence. Within the RBI, the DBOD squared off with the supervision department.

The FHC will report to DNBS; the RBI has had enough of being a slave with two masters. And the last thing it wants is scores of NBFCs scurrying around its feet. "You have no idea how difficult it for us to keep track of them," says a senior RBI official.

Perhaps the biggest dissonance in the RBI draft is the point which states that an entity will be treated as an NBFC if it has assets of worth over Rs 1,000 crore, and if 50 per cent of its assets and income are from the financial world. It unwittingly brings into the RBI net a huge number of companies that are not NBFCs today. Worse, even by these norms, there can still be large companies that are technically not NBFCs (such as Reliance Industries, Tata Group concerns, Indian Oil or ONGC). Thorat, sources say, has raised this point with Subbarao: "There could be concerns of the systemic impact on financial stability of *non*-banking, *non*-financial companies having significant operations in the financial markets and *whose treasuries* have significant share of various financial markets... There is, therefore, a need for market regulation or activity regulation of these activities rather than having definitions which bring them under NBFC regulation. This is a matter for the FSDC (Financial Stability and Development Council) to deliberate." FSDC, headed by Chidambaram, is modelled as a super regulator.

One view is that the current regulatory regime on NBFCs has a link to the FHC. An FHC is nothing, but an NBFC. It will be possible for RBI to classify FHCs as a separate category of NBFCs and issue directions appropriate to the risks involved with them. But as the working group on FHCs, headed by deputy governor Shyamala Gopinath, observed: "The power of RBI (Chapter IIIB of RBI Act) to regulate NBFCs is not on the same footing as the powers exercised by it with respect to banks under the BR Act. For instance, with respect to NBFCs, it is not possible for RBI to remove managerial and other personnel as can be done with respect to banking companies (Sections 36A of the BR Act)." A senior RBI official says, "The problem Shyamala has pointed out is an important one, but hopefully FHCs will all be set up by those who satisfy all our requirements and continue to do so and we can make some of the RBI needs as part of licensing."

Some have read the plot early. Tata Capital, for instance, has converted into a core investment company (CIC), a non-deposit taking entity. It has transferred its loan book to a wholly-owned subsidiary Tata Capital Financial Services. Tata Capital will now serve as a holding company for all financial businesses in the Tata Capital group. "This (structure) will enhance the fund raising capacity of the Tata Capital group as a whole. From the regulator's point of view, this arrangement will lead to better transparency and better corporate governance and compliance culture," explains Kadle, the company's CEO.

In the case of ABFSG, there is a plan to carve it out of the $3.5-billion Aditya Birla Nuvo (which has interests in financial services, telecom, fashion and lifestyle, IT-ITeS and manufacturing) and list it separately as an FHC. You need to have a clean holding structure.

Says Gagan Banga, CEO of Indiabulls Financial Services: "With the reverse merger of Indiabulls Financial Services with its own 100 per cent subsidiary Indiabulls Housing Finance, the whole balance sheet of nearly Rs 37,000 crore is now housed with the latter with effect from December 2012. Thus, the guidelines on NBFCs are not strictly applicable to us." Interestingly, the RBI's draft was released on 12 December 2012.

What now? This is a moot point. Despite reining in Sahara and Peerless, the RBI finds undisciplined entities mushroom in regulatory gaps. It is a tough challenge for the regulator. Thorat is right; it will not be business as usual. NBFCs will have to brace for a blowout if they can't match RBI's logic, which feels June 1997 could be in the offing. Now it is up to the NBFCs to prove this is a myth.

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TRIBHUWAN SHARMA

"IT'S NOT RIGHT TO HAVE UNIFORM REGULATIONS BETWEEN BANKS AND NBFCs"

ARUN DUGGAL
Chairman, Shriram Capital

NBFC

DID YOU KNOW?

IN 1997, IT WAS MADE COMPULSORY FOR NBFCs TO REGISTER. THE RBI, HOWEVER, NOW SAYS THAT THOSE WITH LESS THAN Rs 25 CRORE IN ASSETS NEED NOT DO SO