

Update

Nachiket Mor Committee recommends Bank - NBFC convergence



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NBFCs recommendations by Nachiket Mor Committee

Update

The RBI, in September, 2013 had set up a 'Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households', under the Chairmanship of Dr. Nachiket Mor, Member on RBI's Central Board of Directors. The main objective of the Committee was to prepare a detailed report on India's vision for financial inclusion and financial deepening and to review existing strategies and develop new ones to achieve the objective of financial inclusion and financial deepening.

The RBI on 7th January, 2014 released the Report of the Committee on Comprehensive Financial Services for Small Business and Low Income Households¹ for public comments on or before 24th January, 2014.

The Committee advocated convergence of certain regulatory aspects between banks and NBFCs based on the principle of neutrality in lines of the Usha Thorat Committee recommendations.

Convergence Recommendations of the Committee

The Committee, while giving rationale for the convergence of banks and NBFCs, noted the regulatory similarities between them in terms of capital adequacy rules on credit risks, risk-weighting of assets, provisioning & NPA norms and the applicability of fair practices code. They pictured a scenario where NBFCs operate not merely as Shadow Banks but as an integral part of the large banking system. It gave example of the French banking legislation where irrespective of how credit institutions fund themselves, they are considered banks, and, as such, subject to all banking regulation.

The Committee suggested that the priority sector lending norms and the lender of last resort facility should not be made applicable to NBFCs.

The following table gives an overview of the regulations for which convergence is suggested between NBFC and Bank:

Regulations	Banks	NBFC	Recommendation
Duration to qualify for NPA	Non-repayment for 90 days	Non-repayment for 180 days	Case for convergence. Risk-based approaches to be followed for both types of institutions.
Definition of sub-	NPA for a period	NPA for a period	Case for convergence.

¹ <http://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/CFS070114RFL.pdf>



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Regulations	Banks	NBFC	Recommendation
standard asset	not exceeding 12 months	not exceeding 18 months	Risk-based approaches to be followed for both types of institutions.
Definition of doubtful asset	Remaining sub-standard asset for a period of 12 months	Remaining sub-standard asset for a period of 12 months	Case for convergence. Risk-based approaches to be followed for both types of institutions.
Quantum of provisioning for Standard Assets	0.40% ² For direct advances to agricultural and Small and Micro Enterprises (SMEs) sectors at 0.25%	0.25%	Case for convergence. Risk-based approaches to be followed for both types of institutions. For agricultural advances, this would imply at least 0.40%.
SARFAESI eligibility	Yes	No	Case for convergence subject to strong customer protection

As can be seen from the above, the Committee has suggested convergence of the regulatory norms with regard to classification of non-performing assets and the eligibility under SARFAESI Act, 2002.

Summary of the recommendations:

1. **NPA recognition and provisioning requirements:** As in the case of banks, different customer-asset combinations behave very differently from each other and it is recommended that the regulator specify NPA recognition and provisioning rules, including for standard assets, at the level of each asset-class and require that all NBFCs conform to these mandates. Similar to banks, the Committee suggested that on standard assets provisioning levels as well as asset classification guidelines specified by RBI would need to reflect the underlying level of riskiness of each asset class (combination of customer segment, product design, and collateral) and not be uniform across all the asset classes.
2. **SARFAESI Act, 2002:** At present only 'secured creditors', which includes banks and public financial institutions, can approach the Debt Recovery

² http://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=8128#55



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Tribunal (DRT) for recovery of its debts. NBFCs have not been notified by the Central Government to fall within the definition of secured creditors under SARFAESI Act and accordingly were not eligible to make an application to the DRT for recovery.

In view of the parity between banks and NBFCs, the Committee suggested that NBFCs be notified as 'secured creditors' under the SARFAESI Act as to allow them access to the DRT Forum for recovery of their debts.

Other general recommendations of the Committee

In addition to the convergence of certain regulatory aspects of banks and NBFCs the Committee has also put forth certain other suggestions with respect to NBFCs.

- 1) Multiple definitions of NBFCs should be consolidated into two categories – CICs and another category for all other NBFCs. However it specified that benefits available to specific types of NBFCs to continue even after consolidation, on a pro-rata asset basis. The Committee believes that having a number of categories of NBFCs creates room for regulatory arbitrage, and hinders the evolution and growth of NBFCs.
- 2) Addressing of wholesale funding constraints faced by NBFCs in a systematic manner by:
 - a. Developing a clear framework by RBI and SEBI for QIBs and Accredited Individual Investors to participate in the debt market issuances of NBFCs so as to deepen capital market access for NBFCs. It also suggested that investors such as mutual funds, insurance companies, provident and pension funds and private accredited investors could complement bank funding to this sector.
 - b. Providing benefits of 'shelf prospectus' for 1 year to all issuers including NBFCs. Presently SEBI (Issue and Listing of Debt Securities) (Amendment) Regulations, 2012 prescribes a limit of 180 days for any issuer going for private placement of debt and the Companies Act, 1956 provides that only public sector banks, scheduled banks and public financial institutions are eligible to avail the facility of shelf prospectus. Such a recommendation will be in line with Companies Act, 2013 which provides that entities as approved by SEBI are eligible to take advantage of 'shelf prospectus.'
 - c. Permission for raising ECB in Rupees for all institutions. For non-rupee ECB funding, eligibility should be linked to size and capacity to absorb foreign exchange risk rather than specific NBFC categories. Presently



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norms on ECBs are rigidly defined and eligibility varies across different categories of NBFCs.

- d. The criteria for availing refinance from NABARD, NHB, SIDBI and credit guarantee facilities should be based on nature / area of activity rather than the institution type. Currently such refinance schemes are restricted by institution type rather than activity, thus violating the Neutrality principle as far as NBFCs are concerned.
 - e. Current capitalisation slabs on foreign equity funding should be relaxed and money laundering concerns should be mitigated by levying additional reporting requirements on Banks/Authorised Dealers (AD).
- 3) For better on-going risk measures, NBFCs shall disclose their stress test results both at an overall balance sheet level as well as at a segmental level at least annually.
 - 4) NBFCs should adopt core banking systems so as to enable better off-site supervision.

Comparison with Usha Thorat Committee

The RBI on 12th December, 2012 placed the draft guidelines on the recommendations made by the Working Group on the Issues and Concerns³ chaired by Smt. Usha Thorat, former Deputy Governor, Reserve Bank of India, on its website for public comments. Though the draft guidelines are yet to be notified, they are in line with the recommendations made by the Nachiket Mor Committee with respect to asset classification and provisioning norms. The following table will give an overview of both the recommendations:

Particulars	Usha Thorat Committee	Nachiket Mor Committee
Classification of NBFCs	NBFCs should be classified under 2 categories – (1) Exempted NBFCs (based on asset size); and (2) Registered NBFCs	Suggests consolidation of NBFCs into 2 categories: (1) CICs; and (2) All other NBFCs

³ http://www.rbi.org.in/scripts/bs_viewcontent.aspx?Id=2620



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Particulars	Usha Thorat Committee	Nachiket Mor Committee
Liquidity Management	<p>Recommends all registered NBFCs maintain high quality liquid assets in cash, bank deposits available within 30 days, money market instruments maturing within 30 days, investment in actively traded debt securities equal to the gap between total net cash inflows and outflows over the 1 to 30 day time bucket as the liquidity coverage requirement.</p> <p>SLR requirement for deposit taking NBFCs to continue.</p>	Recommends the SLR requirement to be done away with.
Asset classification	<p>Classification of loans to NPA should be brought in line with that of banks i.e. within 90 days of default – for all registered NBFCs.</p> <p>To be implemented in a phased manner.</p>	Asset classification of doubtful assets, sub-standard assets and NPA should be brought in line with banks, as provided above.
Provisioning of Standard Assets	Raise the provisioning for standard assets from 0.25% to 0.40% w.e.f. 31st March, 2014	Should be brought in line with that of banks. However for agricultural advances the provisioning requirements at 0.40%.

While some of the recommendations of the Nachiket Mor Committee are similar to those of Usha Thorat Committee recommendations, the key would be to see how many of these come to effect and get implemented.

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