BOMBAY CHAMBER
Bombay Chamber
of Commerce & Industry

Bombay Chamber's Presentation before
Deputy Governors of Reserve Bank of India
at the
Pre-Policy Consultation Meeting on NBFC issues
April 3, 2012

RBI's Pre-policy Consultation Meeting – Some Suggestions

Monetary & Credit Policy Issues

(1) **Infrastructure Financing**:

(a) Given the current state of debt market development, Bank finance and External Funding are critical for Infrastructure Sector. Few suggestions in this regard are:

(b) Bank Finance:

(i) It is understood that Core Investment Companies (CIC-ND-SI) are eligible for bank finance (within the allowed leverage of 2.5 times the Adjusted Net worth). Banks are awaiting clarifications from RBI in this regard.

(ii) As per the current regulations, Bank Finance to NBFCs is not available for investment in Shares and Debentures. It is submitted that non-convertible debentures are straight-forward credit substitutes and should be treated on par with loans and advances to be considered eligible for bank finance.

(c)ECBs & FII Rupee-Debt:

(i) At present, access to ECBs & FII-Rupee Debt is restricted to operating project companies and infrastructure finance companies.

(ii) It is submitted that many project companies and SPVs are unable to attract investors in view of typical project risks and the current risk aversion that is prevalent in the markets. However, the companies sponsoring these projects usually command higher credit rating and are in a position to raise foreign funds for infrastructure. The current regulation however excludes such borrowers from the purview of ECB and FII-Rupee Debt (Infrastructure-limit).

(iii) It is therefore strongly recommended that eligibility to avail ECB/ FII-Rupee Debt (Infrastructure-limit) only by an Infrastructure Finance Company or an operating

Project Company should be dispensed with. Other CICs and NBFCs should be allowed to access these markets with suitable end-use restrictions.

(iv) At present, sponsor participation in a project SPV through any form of share capital is considered as a capital market exposure and is not eligible for being financed through ECB. Considering that Lenders and Rating Agencies closely look at risk exposures and overall leverage in a holistic manner, it is suggested that unlisted equity and mezzanine finance structures in the Infrastructure Sector not being short term or speculative in nature be removed from the definition of capital market exposure for the end-use of ECB proceeds.

(2) **Corporate Yield Curve:**

(a)RBI's regulations do not permit issuance of NCDs of less than one year and with Call/Put of less than 3 months. It is submitted that 3 months is considered as too long for money market investors such as mutual funds, ruling out access to a large market segment.

(b) For access to funds with less than 3 months, NBFCs have to resort to either CPs or ICDs. While ICDs have decreased in popularity, short term CP issuance is inefficient in view of the stamp duty implications. For instance, if a CP were to be issued on a weekly rolling basis for 3 months, the effective cost goes up by 0.6%p.a. only on account of stamp duty.

(c)In order to provide efficient short term instruments for NBFCs as also to improve monetary transmission of repo rate, it is imperative that a market linkage be established between inter-bank rates and corporate rates. This can be achieved by allowing NCD issuance with call/ put of, say, not less than one week (to be in sync with CP regulation).

(d) Base Rate System: In addition, implementation of a single base rate by banks has resulted in the corporate borrowing costs going up significantly as there is no flexibility of multiple rates across the time-yield spectrum. In the interests of development of efficient and integrated money market and market price based monetary transmission, it is submitted that Banks should be encouraged to introduce separate base rates for short tenor loans.

(3) **Capital Adequacy Norms - Risk Weights**:

(a)Under Basel II Norms, Banks assign Risk Weights in proportion to the credit risk associated with the counter party. NBFCs however are required to assign 100% risk weight to all assets. It is suggested that this requirement be aligned.

(b)Bank loans to NBFCs attract 100% risk weight irrespective of Credit rating. It is suggested that this be aligned.

(c)Securitized Paper pertaining to Infrastructure facility attracts risk weight of 50% subject to certain conditions. It is suggested that this provision be extended to infrastructure facility for other instruments as well viz., term loans, debentures etc.

(d)It is suggested that credit conversion factor for Performance Guarantees be based on the objective assessment of the Guarantee.

Other Regulatory Issues:

(1) LLPs: In view of the special advantages of the Limited Liability Partnership (LLP) structure as a SPV for domiciling of Infrastructure Projects, it is suggested that RBI should consider registered LLPs in addition to Companies under Companies Act for the purpose of reckoning 90% of investment in Group Companies by CICs.

(2) Participation in Currency Markets**:** At present NBFCs are allowed to transact in currency futures market only for hedging specific risks. This restriction is not present for any other entity. Individuals and all types of bodies corporate can deal freely in this market. In the light of increasing global linkages, need for integrated approach in management including management of indirect risks within the group entities, NBFCs and CICs should be allowed to transact in currency futures market subject to an internal risk management framework.

(3) The Income-tax Act allows Banks and FIs a deduction of 7.5% of total income for provision of bad and doubtful debts made in accordance with RBI regulation. It is suggested that RBI recommends similar treatment for NBFCs.

(4) CICs - Investment in Government Securities: Since G-secs carry nil risk weight, and as they are considered as efficient in managing structural liquidity, RBI is requested to clarify that the definition of Money Market instruments for calculation of Net Assets of CICs, includes Government Securities. Accordingly CICs should also be allowed to transact in CBLO and Repo markets.

(5) The definition of “fair value” as per the NBFC Prudential Norms is restrictive. It is suggested that fair value may also include valuation as arrived by an Independent valuer such as Category I Merchant Banker registered with SEBI or an Independent Chartered Accountant.

(6) It is suggested that the definition of “Owned Funds” as per the Prudential Norms should include Bonds and Debentures that are compulsorily convertible into equity shares within a specified period.

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