28th March, 2017

To,
N S Vishwanathan
Deputy Governor
Department of Non-Banking Regulation
Reserve Bank of India
Central Office, Centre I, World Trade Centre
Cuffe Parade, Colaba,
Mumbai 400 005

Sub: Representation for clarification on the position of NBFCs carrying factoring activities as non-principal business activity

Dear Sir,

On behalf of the Indian Securitisation Foundation (ISF), which is a not-for-profit entity representing the securitisation industry in India, I hereby submit our representation seeking clarity about NBFCs, other than NBFC-Factors, in carrying on the business of factoring in India.

ISF performs a pivotal role in promoting and representing the industry to government, regulators, the public, investors and others who have an interest or potential interest both in India and overseas, regarding the benefits of securitisation in India and aspects of the securitisation industry. Our members include banks, NBFCs, microfinance institutions.

This representation is based on the ambiguity created the Reserve Bank of India's FAQs on NBFC-Factors which was brought out on 3rd April, 2013.

Please find attached our representation on the subject matter for your perusal and further action. In case you need any further clarification, we would be glad to provide the same.

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Corporate Identity Number: U65923MH2013NPL242178

In case there is a discussion required on the matter, we will be happy to come down to your office.

Thanking You,

For Indian Securitisation Foundation

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(Director)

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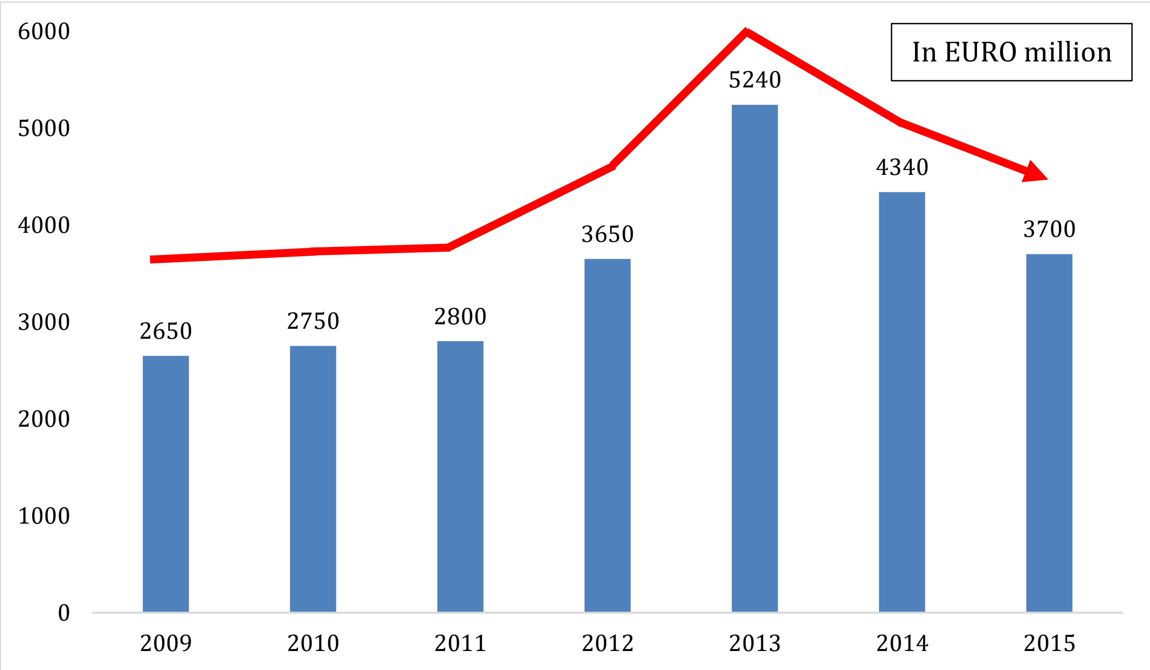
Representation

Factoring in India has been growing constantly during 2009 – 2013, however, there was a sharp decline in the factoring volumes reported by the factoring companies in India. As per the annual review of factoring business across the world by Factors Chain International for the year 2016[1], during 2013 the factoring volumes reached the maximum at Euro 5240 million, however, in the very next year the volume was dropped to Euro 4340 million and there was a further decline in 2015 to Euro 3700 million.

The figure below shows the trend of factoring volumes in India during 2009-2015.



Source: Annual Review 2016[2]

We had initially carry out a market research in 2013 and from the inferences it was understood that there was substantial interest from the banks and financial institutions in India for engaging into factoring business, however, looking at the decline in the

[1] https://fci.nl/downloads/annual-review-2016.pdf
[2] ibid

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factoring volume over the period of time, the interest seems to have fizzled out and one of the strong reasons for the same is the current regulatory framework which has a created a confusion on whether factoring can be carried out as a non-principal activity.

The relevance of factoring becomes particularly important for promoting MSMEs in the country. This was appropriately captured by the Hon'ble Deputy Governor of the RBI in his opening address on '*Welcome to India: State of the Indian economy, banking sector and factoring services*' at International Factors Group's Annual Conference on October 7, 2013. The following is a quote from his address, emphasising the contribution of MSMEs to India's GDP and the role factoring companies can play in its development:

> *"The critical role and place of the MSME sector in employment generation, exports and economic empowerment of a vast section of the population in the Indian economy cannot be overemphasized. As per estimates released by the Ministry of MSME, there are about 36.1 million enterprises in this sector employing nearly 80.52 million people. The sector accounts for 45 per cent of manufactured output and 8 per cent of the GDP. MSMEs contributed close to 40 per cent of all exports from the country.*
>
> *Timely payments from customers will help SMEs in reducing their working capital requirements leading to lower interest costs, improved profitability and a positive impact on the long-term health and sustainability of India's SME sector. Delays in settlement of dues adversely affect the recycling of funds and business operations of the SME units.* ***It is, therefore, critical to ensure that the small entities are able to raise liquidity against their receivables. This problem can be institutionally tackled by factoring, which provides liquidity to SMEs against their receivables and can be an alternative source of working capital (emphasis ours).*** *World over, factoring is a preferred route of accessing working capital for SMEs and even larger organisations. Some banks and financial institutions in India have already launched factoring services and I would urge more banks to offer such services, particularly for the MSMEs. To provide a legislative framework for factoring services, the Parliament has recently passed the Factoring Regulation Bill that would address delays in payment and liquidity problems of micro and small enterprises."*

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To provide a facilitating regulatory environment for the factoring business to develop, the Factoring Regulation Act, 2011 ('the Act') was enacted on 22nd January, 2012. Section 3 of the Act provides that every factor has to be registered with the RBI.

Section 3 also provides that a registered Non-Banking Financial Company ("NBFC") engaged in factoring business as its *principal business* shall make an application for registration as a factor to the RBI within 6 months from the date of commencement of the Act. The test provided to determine whether the 'principal business' of the NBFC is that of factoring is as follows:

(i) *If its financial assets in the factoring business are more than 50% of its total assets* ***or such percent as may be stipulated by the RBI****; and*

(ii) *If its income from factoring business is more than 50% of the gross income* ***or such percent as may be stipulated by the RBI****.*

It is clear from the proviso to section 3 (2) that the application for registration was to be made by an NBFC only if factoring constituted the principal business of the NBFC, that is to say, 50% or more its income and assets.

Thereafter the RBI issued directions for regulation factoring companies in India. The NBFC Factor Directions ('Directions'), first issued vide notification of 23rd July, 2012[3], and later amended vide Notification No.DNBR.012/ CGM (CDS)-2015, dated March 27, 2015[4] deal with registration of factoring entities. Direction 6 provides for the "principal business" requirement for an NBFC – Factor, as reproduced below:

> *"An NBFC-Factor shall ensure that its financial assets in the factoring business constitute at least 50 per cent of its total assets and the income derived from factoring business is not less than 50 per cent of its gross income."*

Consequently, from a reading of Section 3 of the Act together with the Directions we are of the view that 2 different categories of NBFCs carrying on factoring business emerged, as is depicted in the following table:

[3] http://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=8159
[4] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=9623&Mode=0#N12

Less than 50% of the asset / income dedicated to factoring business	More than 50% of the asset / income dedicated to factoring business
• Not meeting the principal business criteria. • Accordingly Directions don't apply on such NBFCs. • Therefore no need apply for registration as NBFC-Factor or unwind the business	• Will have to comply with the Directions • Apply to RBI for obtaining Certificate of Registration as an NBFC-Factor

It is quite obvious that the Directions are applicable only to an NBFC – Factor, and an NBFC could not be an NBFC - Factor unless it either achieved *50 percent of its total assets / income from factoring business* or had definitive plans to achieve *50 percent of its total assets / income from factoring business within 2 years from the date of the Notification.*

On 3rd April, 2013, the RBI came out with its FAQs on NBFC-Factors[5], which attempted to provide answers to questions relevant to factoring and NBFC-Factors. It is the FAQs have created ambiguity on which entities can undertake factoring business. Some of the answers from RBI indicate that there is a blanket bar on NBFCs other than NBFC-Factors to undertake factoring business at all. Relevant text of the FAQs are below --

> ***"Q 4. What would happen with the existing companies registered with RBI as NBFCs and conducting factoring business that constitute less than 75 percent of total assets / income?***
>
> *Ans. Such a company shall have to submit to RBI, a letter of its intention either to become a Factor or to unwind the business totally, and a road map to this effect. The company would be granted CoR as NBFC-Factor only after it complies with the twin criteria of financial assets and income. If the company does not comply within the period as specified by the Bank, it would have to unwind the factoring business.*

[5] http://www.rbi.org.in/scripts/FAQView.aspx?Id=88

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Q.6. If a company does not fulfill the principal business criteria for factoring and has no intention of getting itself registered as a Factor with the Bank, can it continue to do factoring activities with its group entities.

Ans: No. As per Section 3 of the Factoring Act 2011, no Factor can commence or carry on the factoring business without a) obtaining a CoR from the Reserve Bank, b) fulfilling the principal business criteria."

If the answer to question 6 above is taken as stating the correct position of law, it will lead to an impossibility, illustrated by the following:

- NBFC, carrying factoring business < 50% of total assets – cannot carry factoring business at all
- NBFC carrying factoring business > 50% of total assets – needs registration as NBFC-Factor, and can carry factoring business.

Even if one were not to restrict to the provisions of law, in terms of policy, there seems no justification for saying that factoring can be done only by NBFC-Factors. If it is a non-principal part of business, both non-financial companies do factoring, as well as NBFCs do factoring. Most of the lending NBFCs in the country has been doing assignment of receivables as a non-principal part of their business.

We are of the view that the RBI's interpretation in the FAQs unreasonably restricts the factoring activity to a handful of companies registered as NBFC-factors. There are only a few banks offering such facility. As a result factoring activity in the country is getting affected.

We also know from market surveys that one of the major reasons for factoring activity not growing in the country is lack of awareness, which itself is caused by an extremely narrow market. We see no reason why from a policy perspective the business of factoring should be constricted to registered factoring companies only. After all the avowed objective of the Factoring Act was not to restrict factoring but to promote it, and the interpretation taken in the FAQs , which we submit for the sake of reiteration, is not in accordance with section 3, and is only restricting business.

Based on the above rationale, we humbly submit that RBI come out with clarification stating that NBFCs whose financial assets and income from factoring business is less

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than 50% of its total assets or gross income may carry out factoring business and will not be required to register as NBFC-Factor.

Should you need any further clarification, we would be glad to provide the same. In case there is a discussion required on the matter, we will be happy to come down to your office.

Kindly look into the matter and oblige.

Thanking You,

Yours truly,

For ***Indian Securitisation Foundation***

(Nidhi Bothra)

Director

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