India: How to Navigate the Equipment Finance Marketplace
The Foundation is the only research organization dedicated solely to the equipment finance industry.

The Foundation accomplishes its mission through development of future-focused studies and reports identifying critical issues that could impact the industry.

The Foundation research is independent, predictive and peer-reviewed by industry experts. The Foundation is funded solely through contributions. Contributions to the Foundation are tax deductible.
The securitization of first-lien mortgage loans gives rise to a special class of ABS known as mortgage-backed securities.

For simplicity we have not specified the relationship between Niece and AAA-SPE. If Niece were one of the larger leasing companies it would both originate and securitize its own leases.

Alternatively, Niece might act as a conduit for smaller, regional leasing companies by acquiring their equipment leases and loans and including these assets in its securitized pool.
Preface

Members of the equipment finance industry have shown an increasing interest in expanding their leasing and financing activities beyond the US. India, with the second largest population in the world and fifth largest economy, is an enticing market in that expansion. It also has the benefit of Anglicized legal concepts and a large English speaking population.

The Equipment Leasing & Finance Foundation has commissioned a series of White Papers to assist with the international expansion efforts of industry members. Recognizing the need for significantly better information about equipment leasing and finance activities in India, the Foundation has commissioned this, the fifth report in the series, on the Indian equipment leasing and financing market. Backed by the experience of others, and armed with data regarding the environment, unique risks, and entering the market, US equipment financiers can make informed decisions as to how, or if, they should pursue this opportunity.

Principals of The Alta Group, from our offices throughout the world, and with experience in the Indian market, participated in the research and analysis for this White Paper. Lessors with leasing and financing experience in India also provided valuable assistance. It is hoped that this information will assist the industry members in gaining an important “first-mover” advantage into this growing market.

John C. Deane
Managing Principal
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Executive Summary

India, with the world’s second-largest population (1.15 billion people) and fifth-biggest economy (at US$2.99 trillion purchase power parity), represents one of the largest opportunities in the world for manufacturers, financial institutions and services companies. However, the challenges are large for companies considering an entrance into the Indian equipment financing market.

Although equipment financing has been available in India for many years, financing volumes and penetration rates are low for a market of this size. This is due to a high purchase propensity among Indian businesses, the preponderance of banks competing for the financing business of larger companies, and the existence of a pervasive “underground” financing system that provides off-the-books financing to a large number of small and medium-sized businesses.

Challenges to new market entrants include high paid-up capital requirements (as much as $50 million, in some cases), limited availability of western-style credit information, low acceptance of operating leases (with a resultant small used equipment market), and a dividend distribution tax (DDT) that makes profit repatriation expensive. India boasts a large and well-educated work force, but there are limited numbers of people with equipment financing experience. Salaries have escalated dramatically in recent years, and experienced financing professionals in the larger cities in India are expensive to hire.

India’s tax system is one of the most complex in the world. In addition to withholding tax and the DDT, equipment financing firms must contend with VAT, the Central Sales Tax, a services tax on certain types of assets, a cross border lease tax, local taxes, and a variety of other taxes that vary from state to state and year to year. There is not a central repository of tax information in India, so companies are on their own to ensure that they comply with payment of all taxes – and government enforcement of compliance is strict.

To be sure, there are many western equipment financing firms that have been successful in the Indian equipment financing market for several years, including some that have been in India since the 1990s. But, given the relatively low acceptance of equipment financing services in India, the high degree of competition, the high paid up capital requirements, the low availability of experienced equipment financing personnel and the extremely complex tax system, India is not a country for the “build it and they will come” approach. Equipment financing firms should follow their vendor partners into India. Those without pre-existing client relationships there, however, should consider a wait-and-see approach before thinking about entering this market.
Introduction

This is the fifth report in a series of White Papers commissioned by the Equipment Leasing and Finance Foundation to assist with the international expansion efforts of industry members. In addition to following their vendors and customers overseas, or supporting their parents’ products, US leasing and finance companies are pursuing market expansion strategies because of today’s highly competitive US leasing and financing market.

These standard motivations are being reinforced by the fact that, with the US in a time of extreme economic turbulence, emerging markets may be a safe haven and strategic balance in bad times. This thought process is being driven by the widely-mentioned economic theory of “decoupling” that recently has emerged.

Under the theory of decoupling, economists have advocated that emerging economies have broadened and deepened to the point that they no longer depend on the US for growth, thereby leaving them insulated from a severe US slowdown or recession. According to the Economist:

“Decoupling does not mean that an American recession will have no impact on developing countries. That would be daft. The point is that their GDP-growth rates will slow by much less than in previous American downturns. Most enjoyed strong growth during the fourth quarter of last year, and some speeded up, even as America’s economy ground to a virtual halt and its non-oil imports fell.

One reason is that while exports to America have stumbled, those to other emerging economies have surged….China’s growth in exports to America slowed to only 5% (in dollar terms) in the year to January [2008], but exports to Brazil, India and Russia were up by more than 60%, and those to oil exporters by 45%. Half of China’s exports now go to other emerging economies. Likewise, South Korea’s exports to the United States tumbled by 20% in the year to February [2008], but its total exports rose by 20%, thanks to trade with other developing nations.

A second supporting factor is that in many emerging markets domestic consumption and investment quickened during 2007. Their consumer spending rose almost three times as fast as in the developed world. Investment seems to be holding up even better: according to HSBC real capital spending rose by a staggering 17% in emerging economies last year, compared with only 1.2% in rich economies.”

Although the US still leads the world in the volume of equipment leasing, it also is a very mature industry. This maturity includes product commoditization, slowing growth, and static market share. This, added to the slowdown in economic activity, leads many US lessors to seek opportunities in new markets and channels to sustain asset growth and maintain profitability. The Indian leasing market certainly is one such opportunity.

India is not entirely counter-cyclical. Its economy had begun to slow down in early 2008, in concert with the US economy: “The [Indian] manufacturing sector, which grew at double digits the past two years, grew at just 5.3% in January [2008]. During the same month, core-sector growth – defined as power, steel, cement and oil – has halved since January 2007 to 4.2%... Finance Minister Palaniappan Chidambaram admitted that gross domestic product would be less than 9% in the coming years. About a year ago, 9% growth was the benchmark for the Indian economy. Although this may not take away India’s tag as an exciting investment destination, it will certainly impact business plans for domestic players and foreign investors as projections are reworked.”

2The US originates 34.75% of the global leasing volume worldwide, according to the World Leasing Yearbook, 2008, Euromoney Institutional Investor, PLC, England
Still, India offers ample opportunities for growth and investment. “Foreign investors will continue to find India an attractive destination for investment. The government’s commitment to reform and the country’s strong and growing economy will stimulate growth of industries in the years to come. If international leasing firms are able to carve out a niche in the potentially new areas of the leasing market, navigate through the business environment, profit from the [government] incentives, and take good advantage of information, they can gain from leasing as well as asset and project financing opportunities in India.”

**Establishing leasing and finance operations outside the US**

Being a successful lessor is a challenge even in one’s own country – the task becomes even greater in another jurisdiction, especially when it is governed by a different legal, social and business culture such as in India. There are many structural, legal, accounting, tax, and cultural differences that must be addressed.

One such difference is the inherent instability of the economic cycle in all emerging markets. Such instability demands that investors pay close attention and gain insights into the social, cultural, and economic fundamentals of the country and, by corollary, its leasing and financing industry. This assertion is illustrated by Pacek and Thorniley (regarding the emerging market in Mexico) in their book, *Emerging Markets: Lessons for Business Success and the Outlook of Different Markets*:

> “Foreign investors fell in love with Mexico in the late 1980s and early 1990s. The country’s debt crisis was resolved. Mexico, the United States and Canada started to negotiate a North American Free Trade Agreement (NAFTA). The Mexican government was run by economists who were trained at leading American universities. Optimism and enthusiasm spread in the multinational business community as policies grew more liberal and macroeconomic stability seemed impossible to shatter.

But the seeds of instability were already being sown. The inflation rate stayed relatively high and, with a stable exchange rate, there was continuous real appreciation of the currency. As a result, Mexican exports gradually became less competitive. At the same time, as long-standing import barriers were dismantled and more multinationals started to push sales more aggressively (to buyers who felt richer because their currency had in effect become stronger), an import boom was inevitable. To add fuel to the fire, banks started to loan more and more money, which further encouraged demand for imports.

Economists started to worry that the situation was unsustainable and argued for a devaluation to restore competitiveness and push GDP growth higher than population growth. With foreign reserves decreasing, Mexico decided to devalue. But as Paul Krugman, a professor of economics at Princeton University, argued in his book *The Return of Depression Economics*, the authorities made several mistakes and failed to follow the golden rules. First, if a country decides to devalue, the devaluation has to be big enough to prevent speculators from betting on a further decline. Mexico devalued much less than economists and (nervous) markets expected. Second, after the devaluation, the authorities must appear fully in control of economic policies, or nervous investors might start to panic. As well as not following the golden rules, it emerged that certain Mexican businessmen were given inside information about the devaluation and that they profited from it. Soon foreign investors panicked, prompting a large flight of capital out of the country.”

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Beyond these factors, a US lessor seeking to establish an international presence also must consider the developmental stage of the leasing industry it is entering. Many emerging leasing industries, for instance, follow similar developmental patterns. They start out small and then grow very rapidly, as multiple lessors enter the market. After a relatively short period of growth and prosperity, however, there is an economic adjustment, usually in the form of a major contraction or, in some cases, a collapse. As illustrated later in this paper, the Indian leasing industry appears to be undergoing a period of retrenchment after a period of rapid growth in the 1990s.

**Key differences**

On a more granular level, US lessors must make decisions such as whether to act on a cross-border basis, or establish a permanent presence in the Indian market. Although a permanent presence generally proves to be the best formula for a sustainable strategy, due to its operational flexibility, there are many issues that need to be assessed in order to define the right structure.

It goes without saying that a lessor operating internationally will face differing tax, accounting, and legal rules and regulations. These differences can be reduced to a set of common differences. As an example, although legal systems differ between countries, they generally may be classified as either common law or civil law systems. Common law systems are present in all former British colonies and protectorates such as Canada, India, and Australia. Civil law systems, on the other hand, are present in countries colonized or influenced by Continental European cultures, e.g., Spain, Portugal, France, and Germany.

Accounting regulations are always an issue in any international expansion, but there is not much divergence in the accounting for leases between countries. Many countries now follow International Financial Reporting Standard No. 17 (IFRS 17) or a local lease accounting standard based on IFRS 17 or FASB 13, which is the case in India. And, although accounting systems still may be different, in line with the local legal systems and business cultures, there is a continuing trend towards unification.

The tax systems amongst the various countries of the world also share common threads. The particulars will differ, but each country has a tax on income, some form of cost recovery, and a tax on consumption. US lessors must still be cognizant of the differences in application of the tax laws, nonetheless, particularly in India’s complex tax environment.

Cultural differences also must be assessed and then addressed if the enterprise is to be successful. Special attention needs to be paid to languages, technological and physical environment, social organization, labor issues, country history, the concept of authority and political organization, religion, and even the prevailing business and social approach towards time. The many things that are taken for granted in the US business environment now become critical factors for success in an international environment.

**Regulatory guidance**

The number and nature of the regulations and rules represent a major difference between the US and other leasing industries. Most countries outside the US consider equipment leasing and financing as financial activities, so they regulate such activities with the aim of ensuring transparency, professional reliability, and minimum damage to the public interest. Consequently, regulatory agencies, generally those that supervise banks and insurance companies, also have oversight of leasing companies.

In many countries, leasing is a regulated activity that requires a license from, and reporting to, a government agency. In India, this body is the Reserve
Bank of India (RBI), which is the Indian central bank. As discussed later in this paper, there currently is coexistence between de-regulation and certain regulatory controls that shape the business environment for equipment leasing in India.

**Risk management**

As previously mentioned, being a successful lessor is a challenge even in one's own country and even more so internationally. An international expansion strategy, therefore, also must be supported by a very solid risk management culture and organization. The strategy must assess unique market risks, including country, operating, currency, and funding risks. Lastly, a prudent lessor will analyze and define a sound exit strategy. Managing the risks of doing business in India is discussed in more detail later in the study.

**Core Market Research**

A full understanding of the competitive landscape and unique challenges of a new market is the key to any successful expansion strategy. The balance of this paper addresses the factors to be considered and analyses to be performed by US lessors contemplating conducting leasing business in India.

**Equipment leasing in India**

The history of equipment leasing in India is reflective of its political and economic history. Prior to 1947, when India was still a British colony, equipment financing used to take place in the traditional British form of the hire purchase agreement. After India gained its independence in 1947, the country adopted an economic model based upon central planning and investment mainly directed by government initiatives. These government efforts were supplemented by investments made by wealthy, prominent families (the Tatas, Birlas, Ambanis, and others). However, there was not an environment that favored large demand for investments in the form of equipment leasing. The hire purchase agreement was widely used to finance motor vehicles and household appliances.

It was in 1973, during the economic period when central planning was the one and only driver of investment, that the first leasing company was established. According to Indian leasing specialist Vinod Kothari, “the first leasing company of India, named First Leasing Company of India Ltd., was set up in that year by Farouk Irani, with industrialist A C Muthia”6. The World Bank’s private arm, the International Finance Corporation (IFC), subsequently sponsored a program in the 1980s in order to work with the Indian government in helping to develop and expand India’s leasing industry.

The IFC helped establish four leasing companies that function as operational models in the four major regions of India. These companies include IEL in South India, India Leasing Development Ltd. in North India, Nicco Uco Financial Services Ltd. in Kolkata, and Twentieth Century Finance Corporation Ltd. in Mumbai. IFC also invested in Infrastructure Leasing and Financial Services Ltd., a financial services company that specializes in infrastructure finance.

These IFC-assisted projects were designed to counterbalance the state’s domination of the financial sector in India. IFC, the largest source of financing for private sector projects in developing countries, is a founding shareholder of IEL. The other founding shareholders are Sundaram Finance Ltd. and the State Bank of India. (30)”7. It is clear that the purpose of establishing these leasing companies, as part of the then current Five-year Plan, was aimed at developing capital formation in certain strategic regions of India. This was important, for, at the time, the country was still living in a challenging economic environment.

In 1991, a new economic plan, which incentivized extensive privatization and foreign investment in India, was announced. This caused a boom in the...
creation of new leasing companies, many of which were created through foreign investment. Largely through the effects of this initiative, by the late 1990s there were approximately 400 lessors licensed and operating in the Indian equipment financing marketplace.

It is important to mention that equipment financing in India currently is driven by two basic legal structures: the hire purchase agreement, and equipment leasing. In terms of volume, hire purchase represents the vast majority of equipment financing in India. This hire purchase activity is concentrated in motor vehicles and transportation equipment, while equipment leasing has been widely used for industrial equipment and information technology financing. While the introduction of equipment leasing was mainly driven by tax allowances that were later phased out, the legal and accounting differences between hire purchase and finance leasing agreements are minimal.

Since the inception of the first leasing companies, the RBI has subjected all such companies to its supervision and regulation, and designated each as a Non-Banking Financial Company (“NBFC”). Some Europeans and North American multinationals, such as GE Capital (now GE Commercial Finance), Cisco Capital, AIG Capital, Cargill Capital, and ABB have established operations in India. Interestingly, all these foreign controlled equipment leasing and finance companies have taken the form of non deposit taking NBFCs.

**Market size**

India is the second-most populated country in the world, after China, with approximately 1.15 billion people as of July, 2008. India is a federal republic, and its current government was established in 1947 following its independence from the United Kingdom. The country is comprised of 28 states and seven union territories.

India boasts the fifth-largest economy in the world, with a 2007 gross domestic product (purchasing power parity) of $2.99 trillion. This places it ahead of all individual European countries, and behind only the European Union, the US, China, and Japan. Although its economy slowed in 2008, it has maintained an annual growth rate of more than 7% in the decade since 1997, including 8.5% GDP growth in both 2006 and 2007.8

India’s economy is driven by agriculture, services, and manufacturing. Approximately 60% of the workforce is in agriculture, and a major initiative of the United Progressive Alliance government is an economic reform program aimed at developing basic infrastructure to improve conditions for the country’s rural poor. However, “services are the major source of economic growth, accounting for more than half of India’s output with less than one-third of its labor force.”9

The size of India’s equipment financing market is extremely difficult to gauge. The 2008 World Leasing Yearbook (WLY) reports that the number of Indian leasing companies has declined dramatically, from an estimated 375 lessors in 2000 to 62 in 2006. Similarly, gross leased assets declined from US$2.2 billion in 2000 to US$364 million in 2006, according to the WLY.10

However, these statistics are based only on deposit-taking NBFCs that reported data to the RBI. There is a sizeable number of non-deposit taking NBFCs that do not report data. Among multinationals, GE Commercial Finance alone generated approximately US$2.5 billion in financing originations in India in 2006.11 Additionally, many other US technology captives, such as IBM Global Financing, Hewlett-Packard Financial Services, and Cisco Systems Capital have had financing operations in India for several years.

Among domestic companies, the RBI lists almost 12,000 NBFCs (those not accepting public deposits) on its web site.12 Most of these NBFCs are extremely small companies focused on automobile and other small-ticket financing. When these firms, as well as the multinationals and the deposit-taking

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9 Ibid.
10 2008 World Leasing Yearbook; Euromoney Publications, p. 245.
12 At http://www.rbi.org.in/scripts/nbfcpublication_new.aspx
NBFCs are considered, it is reasonable to estimate that equipment financing volumes are in the range of at least US$3 billion per year.

**Lease taxation**

Lease taxation in India is exceptionally complex, in part because there are so many different taxes and in part because the tax system is in a state of constant flux, particularly with regard to VAT and the central sales tax. Any lessor contemplating the creation of a leasing entity in India should consider it mandatory to enlist the services of an Indian lease taxation specialist, and to retain such services following the creation of the entity.

“…Taxes in India are levied by the Central Government and the State Governments. Some minor taxes are also levied by the local authorities such as the Municipality or the Local council. The authority to levy a tax is derived from the Constitution of India which allows the power to levy various taxes between the Center and the State. An important restriction on this power is Article 265 of the Constitution which states that ‘No tax shall be levied or collected except by the authority of law.’ Therefore each tax levied or collected has to be backed by an accompanying law, passed either by Parliament or the State Legislature.”

This section provides an overview of the pertinent taxes in effect at the time of the writing of this paper. The relevant taxes include:

- Corporate income tax
- Central sales tax (CST) and Value added tax (VAT)
- Service tax
- Cross border lease tax
- Other taxes

The corporate income tax rate in India is 33.66%, which is comprised of a base rate of 30%, a 10% surcharge on all taxable income in excess of Rs1 million (approximately US$24,000), and an educational “cess”, or assessment, of 2%.

If a lease is qualified as a true lease, the lessor is entitled to tax depreciation benefits. Several factors must be considered in determining whether a lease is a true lease or not. Three of the most important of these factors are beneficial ownership, right of reversion, and use of the asset:

“The tax-payer claiming depreciation should own the asset…but…it is not legal ownership alone that is sufficient; the lessor must establish himself to be the beneficial owner as well. [For example,] it is on the failure of the condition of beneficial ownership that the legal owner in case of hire-purchase is not allowed depreciation.

The lessor’s beneficial ownership of the leased asset is proved essentially by the right of reversion of the asset at the end of the lease period – this highlights the significance of proving that the lessor has a substantive and not merely a notional or technical right of reversion of the asset…”

Thus, if, in the opinion of the tax authorities, the lessee has the option to acquire the asset at a bargain price at lease-end, or is considered likely to acquire the asset based on terms of the lease, the lease is unlikely to qualify as a true lease for tax purposes. Lessors must take care to word lease agreements carefully with this provision in mind.

Regarding use of the leased asset:

“The other condition for depreciation is that the tax payer should be using the asset. It is understood clearly that the tax payer uses the asset in the business of leasing; hence, it is on the strength of the
lessor’s use that depreciation is claimed and not on the strength of the lessee’s use. Use or its absence by the lessee should not, therefore, cast any implication on the lessor’s depreciation claim.”

Lessors in India must be prepared to show the tax authorities that leasing is a core business, and that use of the asset as an incoming-earning asset is an integral part of their business. This is essential to ensuring their ability to qualify for the depreciation benefits of leased assets. Depreciation rates on some of the more commonly-leased assets in India are shown in Table One.

<table>
<thead>
<tr>
<th>Asset</th>
<th>Annual Depreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Automobiles</td>
<td>20%</td>
</tr>
<tr>
<td>General plant or machinery</td>
<td>25%</td>
</tr>
<tr>
<td>Trucks/busses/taxis for hire; aircraft</td>
<td>40%</td>
</tr>
<tr>
<td>Crates</td>
<td>50%</td>
</tr>
<tr>
<td>Computers</td>
<td>60%</td>
</tr>
<tr>
<td>Pollution control and energy-saving devices</td>
<td>100%</td>
</tr>
</tbody>
</table>

Central Sales Tax (CST) and Value Added Tax (VAT)

For many years, the Central Sales Tax, or CST, was imposed on a wide variety of transactions, including leases. In addition, each state maintained its own rate schedules and list of transactions to be taxed, and there was little standardization between states. Inter-state transactions generally were taxed both in the state of the lessor and in the state of the lessee, which made inter-state leasing both complicated and quite expensive. For this reason, many larger lessors simply registered offices in each state in which they originated significant leasing business volumes.

On April 1, 2005, India began a transition away from the state sales tax system, and instituted a value-added tax system. With VAT, tax is paid on the incremental value added on each step of manufacturing a product. A reseller, which buys a product for the express purpose of reselling it, will pay VAT when acquiring the product, but recovers that tax upon resale. For example, if a reseller acquires a product for $100 from a manufacturer, it would pay VAT on the $100; if it resells the product for $110, it will charge the customer VAT on the $110 and hence recovers the VAT it had paid originally.

Lessors pay VAT in a way similar to resellers:

“The goods that a leasing company purchases for the purpose of lease or hire purchase are not ‘capital goods’…the goods bought for the purpose of a lease are actually goods bought for resale. Hence, in every case…the leasing company will be able to claim set off of the input-tax paid by it.”

There is one very important caveat in this regard. Interstate transactions, from a lessor in one state to a lessee in another state, are treated differently for VAT purposes and the input tax cannot be reclaimed. Therefore, as before, larger lessors have registered offices in the largest states, and, in many cases, in all 28 states. This does not require a permanent presence, and simply can be the office of an accountant or auditor for whom the lessor is a client.

VAT rates in India generally are 4%, although they may be as high as 12.5%, depending on the type and source of the asset. Some users/lessees are “zero-rated”, and, hence, exempt from paying VAT. VAT is recovered from the lessee through the periodic lessee receivables payments, and so is spread out over the term of the financing period (which must be considered when pricing the financing transaction).

At the time of this writing, nearly all of the 28 states have converted from the CST to the VAT (20 of the 28 adopted VAT at its inception in April, 2005). Lessors should verify which states have not...
yet adopted the VAT prior to entering into and pricing leasing transactions in those states.

Service Tax
In budget year 2007-08, the Indian government proposed a service tax of 12.24% on the “renting of immovable property for use in commerce or business”20 (the service tax was reported as 12.36% in some other publications). This caused howls of protest from those in the real estate and retail sectors, and it is unclear if the tax increase was implemented, deferred or withdrawn. This would not be unusual, as the Indian government has a history of implementing and then temporarily withdrawing the implementation of taxes in the past. Market entrants in the real estate-related and structured finance sectors will need to verify whether this tax is actually in effect at the time they choose to enter the Indian market.

Cross border lease tax
Indian tax law requires that any financing payment to a non-resident, subject to tax, requires a deduction of tax at the source of the payment.21 Also, “a disturbing wrinkle in this is the Finance Ministry’s insistence on imposing a withholding tax ranging from 20% to 40% of rentals paid to offshore lessors.”22

Other tax-related issues
Several states and municipalities impose taxes on leasing transactions. For example, some states charge a lease development tax of 1%. Others, at various times, have proposed sales taxes on general leasing activities or on the leasing of specific assets, such as software.

Lease accounting
Accounting practices in India are overseen by the Institute of Chartered Accountants of India (ICAI), which is a statutory body created under an act of the Indian Parliament. The rules of lease accounting in India closely resemble those in both the US and Europe. Accounting Standard (AS) 19, enacted on April 1, 2001, contains most of the key regulations regarding accounting for leasing in India (a copy of AS 19 can be found in Appendix One).

Among the provisions included in AS 19 are definitions of operating and finance leases, lessee and lessor accounting for both types of leases (as well as hire-purchases), and financial statement disclosure requirements. Other important Accounting Standards pertinent to NBFCs are shown in Table Two.

<table>
<thead>
<tr>
<th>Standard</th>
<th>Description</th>
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<tbody>
<tr>
<td>AS 1:</td>
<td>Disclosure of Accounting Policies</td>
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<tr>
<td>AS 3:</td>
<td>Cash Flow Statements (revised)</td>
</tr>
<tr>
<td>AS 4:</td>
<td>Contingencies and Events Occurring after the Balance Sheet Date (revised)</td>
</tr>
<tr>
<td>AS 6:</td>
<td>Depreciation Accounting (revised)</td>
</tr>
<tr>
<td>AS 10:</td>
<td>Accounting for Fixed Assets</td>
</tr>
<tr>
<td>AS 11:</td>
<td>Accounting for the Effects of Changes in Foreign Exchange Rates (revised)</td>
</tr>
<tr>
<td>AS 13:</td>
<td>Accounting for Investments (revised)</td>
</tr>
<tr>
<td>AS 17:</td>
<td>Segment Reporting</td>
</tr>
<tr>
<td>AS 18:</td>
<td>Related Party Disclosures</td>
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<tr>
<td>AS 20:</td>
<td>Earnings Per Share</td>
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<tr>
<td>AS 22:</td>
<td>Accounting for Taxes on Income</td>
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<td>AS 25:</td>
<td>Interim Financial Reporting</td>
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<tr>
<td>AS 26:</td>
<td>Intangible Assets</td>
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<tr>
<td>AS 28:</td>
<td>Impairment of Assets</td>
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<tr>
<td>AS 29:</td>
<td>Provisions, Contingent Liabilities and Contingent Assets23</td>
</tr>
</tbody>
</table>

The operating lease test in India is very similar to that defined in both International Accounting Standard (IAS) 17, and Financial Accounting Standards Board Statement No.13 (FAS 13) in the US. A lease is considered a finance lease under AS 19 if:

- There is a transfer of ownership at the end of the lease term;

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22Farouk Irani, World Leasing Yearbook 2008, Euromoney Institutional Investor PLC, pp. 244-5
23Accounting and Taxation – NBFCs, presentation given by R. Anand, Vice President (Corporate Affairs), Sundaram Finance Limited, August 5, 2004; at http://fidcindia.com/members/presentations.asp, which is the web site of the Finance Industry Development Council
There is a lessee purchase option which is expected to be significantly lower than fair market value at the date the option is exercised such that, at lease inception, it is reasonably certain that the lessee will exercise the purchase option;

The lease term is for the predominant part of the economic life of the asset, whether or not title is transferred at lease-end;

At lease inception, the present value of the minimum lease payments amounts to substantially all of the fair value of the leased asset;

The leased asset is of a highly-specialized nature, such that only the lessee could use the asset without extensive modifications.  

### Leasing Associations

The Finance Industry Development Council (FIDC) is the major professional leasing association in India for NBFCs. It was formed in 2004, and represented the coming together of three prominent, predecessor organizations: the Equipment Leasing Association of India, the Federation of Indian Hire Purchase Association, and the Association of Leasing and Financial Services Companies.

The FIDC’s stated mission is to develop and maintain a code of conduct for small-to-medium NBFCs (although with the participation of larger NBFCs), compilation of industry data, development of a defaulters’ list in tandem with the India Banks’ Association, and image-building for the industry.  

### Establishing a Leasing Company in India

A license is required to establish an equipment leasing and financing company in India. Banks choosing to offer leasing must obtain a bank leasing license through the RBI. Non-banks have two options: a Non-Bank Financing Company (NBFC) license that allows the company to accept deposits, and a NBFC license that does not allow acceptance of deposits. The majority of US-based companies with licenses in India that were interviewed as part of this research obtained NBFC licenses without deposit-taking capabilities, as the record-keeping and reporting requirements are less-stringent than for the NBFC deposit-taking license.

“NBFCs operate almost like banks, except for running a checking account, or accounts, where money can be easily withdrawn by writing checks or using a debit card. Although the capital adequacy norm for NBFCs is 10%, compared with 9% for a regular bank, they do not have any statutory liquidity ratio (SLR) – the amount of money banks are required to invest in government bonds - and cash reserve ratio (CRR) – the amount of money banks are required to keep with RBI – requirements. For banks, the SLR and CRR requirements are 25% and 7.5%, respectively.”

There are varying requirements for each category of NBFC (for example, capital adequacy), which can be modified by the RBI as necessary. NBFCs registered with the RBI are categorized as follows:

- Equipment leasing company
- Hire-purchase company
- Loan company
- Investment company

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24 Lease Accounting, presentation given by Dr. T. F. Ghosh, Professor, MDI, Gurgaon; presentation is posted at http://fidcindia.com/members/presentations.asp
25 From the FIDC’s website, at www.fidcindia.com
Procedures and time required

NBFC license applicants must complete the Form of Application for Certificate of Registration to Commence/Carry On The Business of a Non-Banking Financial Institution By a Company. A copy of the current form is available in Appendix Two. The basic application requirements for this license are listed below:27

• Minimum NOF requirement Rs200 lakh (one lakh is a unit of 100,000 so, at an exchange of 50 rupees per dollar, Rs200 lakh equals $US400,000).

• Application to be submitted in two separate sets tied up properly in two separate files

• Annex II to be submitted duly signed by the director/authorized signatory and certified by the statutory auditors.

• Annex III (directors’ profile) to be separately filled up for each director. Care should be taken to give details of bankers in respect of firms/companies/entities in which directors have substantial interest.

• In case the directors are associated or have substantial interest in other companies, indicate clearly the activity of the companies (whether NBFC or not).

• Board Resolution specifically approving the submission of the application and its contents and authorising signatory.

• Board Resolution to the effect that the company has not accepted any public deposit, in the past (specify period)/does not hold any public deposit as on the date and will not accept the same in future without the prior approval of Reserve Bank of India in writing.

• Board resolution stating that the company is not carrying on any NBFC activity/stopped NBFC activity and will not carry on/commence the same before getting registration from RBI.

• Auditors Certificate certifying that the company is/does not accept/is not holding Public Deposit.

• Auditors Certificate certifying that the company is not carrying on any NBFC activity.

• Net owned fund as on date.

• Certifying compliance with section 45S of Chapter IIIC of the RBI Act, 1934 in which director/s of the company has substantial interest.

• Details of changes in the Memorandum and Articles of Association duly certified.

• Last three years Audited balance sheet along with directors & auditors report.

• Details of clauses in the memorandum relating to financial business.

• Details of change in the management of the company during last financial year till date if any and reasons thereof.

• Details of acquisitions, mergers of other companies if any together with supporting documents.

• Details of group companies/associate concerns/subsidiaries/holding companies.

• Details of infusion of capital if any during last financial year together with the copy of return of allotment filed with Registrar of Companies.

• Details of the bank balances/bank accounts/complete postal address of the branch/bank, loan/credit facilities etc. availed.

27 Source: Reserve Bank of India
• Business plan for next three years indicating market segment to be covered without any element of public deposits.

• Cash flow statement, asset/income pattern statement for next three years.

• Brief background note on the activities of the company during the last three years and the reasons for applying for NBFC registration.

• II(b) is the company engaged in any capital market activity? If so, whether there has been any non-compliance with SEBI Regulations? (Statement to be certified by Auditors).

• Whether any prohibitory order was issued in the past to the company or any other NBFC/RNBC with which the directors/promoters etc. were associated? If yes, details there of.

• Whether the company or any of its directors was/is involved in any criminal case including under section 138(1) of the Negotiable Instruments Act? If yes, details thereof.

• Whether the company was granted any permission by ECD to function as Full-fledged Money Changers

• Whether the company was/is authorised by ECD to accept deposits from NRIs.

• Whether “Fit and Proper” Norms for Directors have been fulfilled

The time required for application approval can vary, though it has improved in recent years. In the early part of the new century, approval times could take a year or longer, in part because the list of documentation required was not well-defined, and government staff often was not responsive (or simply did not know what information was required). Recent applicants for NBFC licenses have reported approvals in as little as 90 days, and documentation requirements are much better understood. Applicants are strongly suggested to retain the services of experienced attorneys or other financing specialists to assist in the application process.

**Partnership considerations**

There are several reasons why international equipment finance companies should consider the use of a local partner when entering the Indian market:

- **Local market knowledge** – Experienced Indian financiers are familiar with local businesses and their credit histories. Character is a very important issue in terms of credit risk management in India, and character is better assessed with local knowledge regarding companies, individuals, and their background. An experienced Indian partner will know which prospective lessees are reputable, and those with whom one can safely deal. Given the still limited amount of generally available credit information in India, this sort of knowledge is vital in preventing fraud and building a financing business with a credit-worthy portfolio.

- **Existing business relationships** – India partners may bring an existing portfolio, business relationships, or both, to a partnership. Depending on the desire of the international finance company, this may allow the partnership to begin operations with a critical mass and with a core set of clients.

- **Staffing** – Beginning financing operations with an experienced staff can be an important difference-maker in India. A local partner can provide on the spot knowledge in this regard.

- **Familiarity with the Indian legal system** – The Indian legal system is based on British law, and so is very similar to the legal system in the US (i.e., “rule of law”, versus the “rule of people,” or civil, legal system present in...
many European and Latin American countries). However, the court system in India is notoriously slow and inefficient. According to the World Bank, it takes an average of 1,420 days to resolve legal disputes (compared to 300 days in the US). A partner with local knowledge can be invaluable in speeding up resolution of court cases and repossessions.

- **Speed to market** – An experienced Indian partner can save time through its knowledge of what products are most popular, what marketing and advertising media are effective, which companies may be the best potential customers, and how to get approvals and credit information faster and more effectively.

- **Language** – This is an extremely important issue in India, a country in which Hindi is the official language, but 14 different other “official” languages are in use. English is widely spoken in the business community in most large cities, but its use may be problematic among lessees. Local language capabilities are critical, and a local partner will usually offer this skill.

**Capital requirements**

The paid up capital requirement for a foreign-owned NBFC is US$50 million. This amount can vary, depending on ownership structure, with smaller amounts required depending on the foreign investor’s ownership percentage.

The RBI requires NBFCs to maintain minimum Capital to Risk-weighted Assets Ratio (CRAR) levels, and these recently changed. As a result of the worldwide credit squeeze, on June 8, 2008, the RBI ordered non-deposit taking NBFCs to increase their minimum CRARs from 10% to 12%, with a further requirement to increase it to 15% effective April 1, 2009. As market conditions are changing rapidly, prospective applicants for NBFC licenses should contact the RBI directly to learn the requirements in effect at the time of application.

**Funding and currency considerations**

Funding options for NBFCs in India are reasonably flexible. Most US-owned NBFCs contacted for this paper are self-funded, while some made use, in early 2008, of the small syndication and securitization markets that existed. These markets have since frozen as part of the credit crisis, and interviews with users suggest they are not likely to re-open significantly until at least early, to mid 2009.

Deposit-taking NBFCs have limitations on the levels of deposits they may take, depending on license type, capital adequacy ratio, and RBI-directed rules that are subject to change. The Indian rupee, at the time of this writing, has approached its weakest position vis-à-vis the US dollar in the last 10 years, and is nearing the 50 rupee/dollar threshold at year-end 2008. Currency and interest rate hedging tools are readily available in the Indian market. A history of the exchange rate for the Indian rupee is shown in Figure One.

**Figure One: Indian Exchange Rate History**

- **Staffing**

As in most emerging markets, staffing is a key challenge for entrants to the Indian equipment financing market. On the positive side, India boasts a highly-literate work force. Although the national literacy rate is only 61%, that number is skewed by

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large numbers of rural residents that lack adequate reading and writing skills. The cities are different, where there is ready availability of college-educated professionals with work experience. According to firms interviewed, many of these candidates have core banking and finance skills.

Salary levels for entry-level staff remain fairly low, despite recent inflation. For example, the pay for a junior accountant with two to three years work experience is in the range of US$30,000 annually in the larger cities, and as low as US$10,000 to US$12,000 per year outside of the major metropolitan areas like Mumbai and Chennai.31

However, the availability of experienced senior personnel is a different story. While there are reasonably good numbers of bank-experienced mid- and senior-level managers, their salaries are much higher – in the range of US$75,000 to US$90,000 per year, in the large cities. It is difficult to find people with equipment leasing experience in most capacities – that are not currently employed – in the big cities, and extremely difficult to find in smaller cities and towns.32

Multinationals often choose to bring expatriates to India to oversee the establishment and opening of their financing operations, though they are expensive as well. Ongoing human resources planning is critical for successful operations in India.

**Systems and service providers**

The lease and finance service provider market in India is not well developed. There are not, for instance, many success stories concerning leasing information systems providers. This is due to relatively low demand, the complex and rapidly-changing Indian tax environment, and the preponderance of in-house developed systems among NBFCs.

There are some lease and loan servicing/collections firms and the supply of asset management specialists is growing. Although their skills still need to be developed further, the market is increasingly demanding their services. Tax, accounting, and consulting services also are available from the larger worldwide consultants, and there are a few local firms that specialize in equipment leasing and financing. The same holds true for legal services. There is a large array of well-trained attorneys, but there are few with comprehensive leasing knowledge.

**Geographical considerations**

Geographically, India is slightly greater than one-third the size of the US. It borders Bangladesh, Bhutan, Burma, China, Nepal, and Pakistan, and has ongoing political and, occasionally, military disputes with both Pakistan and China. India consists of 28 states and seven territories, as illustrated on the map in Figure Two.

![Figure Two: Map of India](http://www.citypopulation.de/India-Agglo.html)

India’s population density is startling. It has 35 cities with populations in excess of one million (the US has 9), and another 39 cities with populations between 500,000 and 1,000,000 (versus 25 in the US), according to the 2001 Indian census.33 Its five

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31 Based on Alta research/interviews of US-controlled NBFCs.
32 Ibid.
33 [http://www.citypopulation.de/India-Agglo.html](http://www.citypopulation.de/India-Agglo.html)
largest cities are:

- Mumbai, population 16,434,386
- Kolkata, 13,211,853
- Delhi, 12,877,470
- Chennai, 6,560,242
- Hyderabad, 5,742,036

Bangalore, India’s technology capital, is the sixth largest city with a population of 5,701,456. By way of comparison, New York is the largest US city with slightly more than 8 million people; no other US city has more than 4 million inhabitants (Los Angeles is second-largest at 3.8 million).

Equipment sales and attendant financing operations are heavily concentrated in the largest cities, so, as a result, most US-owned NBFCs are based in or near these cities. Additional NBFC offices and/or representative offices are usually established based on financing volumes, and to a large extent on the interstate VAT charges.

**Risk Considerations**

Any lessor seeking to establish a presence outside the US must carefully consider the unique risks inherent in that jurisdiction. Although the analysis may not be much different than one performs in entering a new market in the US, it is important to remember that the differences in culture, economy, time, and distance magnify the risks, concerns, and operating issues.

**Market entry risk**

Sovereign risk is a prime example of the type of unique risks that US lessors may face internationally but do not have to contend with at home. This risk can be considered from two different perspectives. One is political risk, which is the likelihood that a country will subject foreign and/or domestic investors to measures that impair the security of enjoyment of life, freedom, and property. In concrete terms, political events consist of political violence and revolution, expropriation, and other factors such as government breach of contracts. The second perspective relates to the timely payment of government sovereign indebtedness.

India’s tremendous growth rate over the last decade has attracted a large amount of foreign investment, and the attendant in-country presence, of most of the larger Fortune 500 countries. Despite this, India maintains the lowest-level investment grade rating, Moody’s BBB-minus, and perhaps for not much longer, according to Reuters:

“India’s hard-won investment-grade foreign-debt rating is in danger of being cut back to junk status as slowing economic growth, rising inflation and growing debt wreak havoc on the country’s finances. The balance is tilting toward a downgrade by at least one of the big three rating companies this year [2008], especially because the Indian government has been weakened by the loss of a coalition partner and will not want to antagonize voters with any fiscal cuts.

In the past four years, the three rating companies have raised India to investment grade on the strength of its external financial ratios, improving budget deficit and robust economic growth. The external position remains strong, but analysts are worried that domestic problems and a flight of capital could combine to bring down the country’s credit standing. Undoubtedly, the downside risks have grown on account of high oil prices and an inadequate reaction from the government,” said Aninda Mitra, a rating analyst with Moody’s Investors Service.”34

Another issue for consideration is India’s history of nationalizing several industries, among them financial services. Since 1949, India has nationalized

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the following groups, firms and industries:

- 1949 The Reserve Bank of India was nationalized. The Reserve Bank of India was state-owned at the time of Indian independence.
- 1953 Air India under the Air Corporations Act 1953.
- 1955 Imperial Bank of India and its subsidiaries (State Bank of India and its subsidiaries)
- 1969 Nationalization of 14 Indian banks.
- 1973 Coal industry and Oil companies
- 1980 Another six banks nationalized

Finally, all but the largest firms will find the paid-in capital requirement of a 100% foreign-owned NBFC to be an impediment.

**Regulatory**

NBFCs are regulated by the RBI. Although the regulations, compliance and reporting requirements are much less-onerous than for banks, NBFCs must maintain capital adequacy ratios and be mindful of other regulations or face strict penalties along with possible revocation of their license.

**Structure**

The NBFC structure is, by far, the most popular structure for foreign equipment leasing and financing firms in India, for all the reasons stated previously.

**Operational risk**

Operational risks also must be considered when entering the Indian market as they have a direct impact on the day-to-day business of the lessor and, hence, its profitability.

**Market Risk**

Market risks in India vary depending on the market each lessor chooses to serve. The domestic Indian market, despite recent economic turbulence, remains strong by Western standards and continues to grow. Yet equipment financing generally, and leasing in particular, remains a relatively small percent of total equipment sales in India, according to those US-run NBFCs interviewed for this paper.

Part of the reason stems from a lack of understanding of the leasing product. Despite its use in India for many decades, equipment leasing remains unknown or not well understood by many prospective lessees – therefore, marketing and training are important prerequisites to a successful financing business in India.

Another reason is the existence of a strong underground financing system in India among smaller firms. In a fascinating paper, Knowledge@Wharton authors suggest that an informal, but well-established, financing network exists that is both self-policing and effective:

“Despite the English common-law origin, a British-style judicial system and a democratic government, Indian firms appear to be beset by weak investor protection in practice and poor legal and government institutions characterized by corruption and inefficiency. With extensive country- and firm-level data sets, including both cross-country and within-India firm samples and our own surveys of small and medium firms, we find that to a large extent Indian firms conduct business outside the formal legal system and do not rely on formal financing channels from markets and banks for most of their financing needs.

Instead, firms across the board, and in particular, small and medium firms, use non-legal methods based on reputation, trust and relationships to settle disputes and enforce contracts, and rely on alternative financing

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channels such as trade credits to finance their growth. The scope, methodologies, and results of our paper paint a more complete picture of the law-finance-growth nexus and how businesses and investors respond to the limitations of legal system and formal financial system than existing studies.”

This may explain, to a large extent, why smaller Indian firms may have limited interest in using formal equipment financing channels for acquisition of equipment, and why this market may be difficult for western lessors to crack.

Funding

The funding risks to be faced in India are similar to many of those in the US, though currency risk is a new factor if lessor’s transactions are denominated in Indian rupees. All NBFCs interviewed for this paper write rupee-denominated financing agreements with their clients, for the most part, and hence must hedge against currency movements to the extent their borrowings are in foreign currency.

This is facilitated by a well-developed hedge market in India, in which futures and options contracts allow investors to fix the price of financial assets (US dollars, Euros, bonds, individual stocks, indices, interest rates) today, to be paid or delivered at a future date. These options allow lessors to plan, hedge, and manage financial risks, as well as to optimize the performance of their portfolios.

The effect of inflation on interest rates also must be considered. Inflation has ranged from approximately 4% to 10% per year over the last decade, and presently is in the range of 10%.

Credit

Credit risk always is of primary concern whenever a lessor enters a new market, and particularly in an emerging market like India. When doing business with listed companies (which, generally, are only the larger companies in India) the best source of information can be found in a firm’s filings with the stock exchange.

Credit reporting agencies are not well-developed in India, particularly for smaller companies, and the quality of the information they provide must not be taken at face value as it is not comparable with the information available in the US. Dun & Bradstreet provides basic company information on approximately 60% of medium and larger Indian companies, according to one subscriber, but there is limited, to no, credit-relevant information.

The system and business environment still leave room for uncertainties in credit performance due to the inefficiency of the courts, and lack of consistent reporting among smaller companies to the public recording systems. Furthermore, character, which plays such a large role in credit in India, is not reported by any credit agency. Most leasing and finance companies rely on informal sources of information and local partner knowledge.

There is some good news, however, in that all NBFCs interviewed reported good performance of their portfolios, with minimal to no losses – at least, in their collective experience to date (and some have financing operations in India dating back to 1993). Collections do take longer in India than in the US, and, as enforcement in the courts can take a prohibitively long time, settlement may prove to be a better option than litigation.

One lessor noted that “our default experience has been excellent – we’ve had minimal defaults. But, it will be interesting to see what happens over the next few years, when growth slows down from 9% a year to 8%, 7%, 6%, or less.”

Residuals

While residuals already represent a primary risk for many lessors in the US, the operating lease market in India is extremely small today, other than for select large ticket assets such as aircraft. One lessor estimated that 95% of their leases were full payout or finance leases, and most other interviewees had similar comments.

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Ibid

Secondary markets for equipment such as I/T and telecommunications were slow to develop in India, in part because of important, prohibitive restrictions that were in place for many years (to encourage consumption of new, India-produced assets). Although some of these barriers have been removed, the used equipment market in India continues to lag well behind those in Europe and the US, which has affected the development of a residual value-based operating lease market.

**Structuring**

Although limited use of residual values for many asset classes has hampered structuring options, India’s ever-changing tax laws have provided periodic opportunities for creative structures. Structuring interstate financing transactions to maximize yield based on tax implications is one way NBFCs have done this over the years. Another recent example was the introduction of India’s VAT, which:

“…brought an unexpected blessing [to] the leasing industry – our calculations demonstrate that [for] most lease and hire purchase transactions, the tax inefficiency involved in sales tax on lease transactions has completely been eliminated.

Leasing companies that have all-India operations will have a peculiar advantage…will [they] rationalise the input tax paid on the purchase of goods? For example, if a leasing company buys a machine having a basic price of Rs100,000, paying a 4% tax thereon, adding up to Rs104000, will it compute rentals on Rs100000 or Rs104000?”

In this example, the author’s calculations showed potential IRR increases of 10% to as much as almost 75%, depending on financing term and VAT rate.

**Legal/documentation**

Documentation also is critical in India. As is well known, good documentation is a very valuable asset for a leasing and finance company. Documentation must be clear, comprehensive, enforceable, and user friendly. Generally speaking, having a good legal counsel with a business mindset is the best solution.

Although documentation can be used to differentiate a lessor from its competition, the market first needs to achieve a certain level of maturity before introducing innovative structures. For example, courts, other authorities, and businesses must be able to understand and navigate on a solid legal basis prior to combining elements of creativity in the transactions.

**Collections**

Interviewees indicated that the collections process in India takes longer than in western countries, and delinquencies are somewhat higher, although overall loss experience has been good. Lessees are aware of the inefficiencies of the court system, and recognize that they may have leverage when it comes to settlement of a past-due account, but lessors interviewed indicated that they have been able to work through most issues with their customers.

The big caveat, of course, is that part of the reason for the above is the continued expansion of India’s economy. Growth across almost all industries has helped ensure adequate funds for business expansion and financing, and defaults have not become a concern.

India has not been through a protracted downturn for many years, and, while it remains to be seen how much the current credit crisis will affect the country, the consensus among NBFCs interviewed was that defaults are likely to begin increasing soon. All those interviewed are taking steps to be proactive with their customers to try to get ahead of any potential problems, and are tightening credit policies to limit future exposures.

**Repossession and recourse**

On paper, lessor’s rights are clear in Indian law, and are similar to those in the US. In practice, these

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40 Ibid.
rights are consistently enforceable in India, but only after considerable time and expense.

“The most striking fact about India’s legal system is the difference between superior investor protection under law as opposed to inferior protection in practice…with the English common-law system, India has strong protection of investors on paper. For example, the scores on both creditor rights (4 on a 0-4 scale in LLSV (1998)\textsuperscript{41}, [4 being high], based on the Company’s Act of 1956, downgraded to 2 in DMS\textsuperscript{42} (2007) based on the Sick Industrial Companies Act of 1985) and shareholder rights (5 on a 0-6 scale in DLLS (2007) [6 being high]) are the highest of any country in the world…

[However,] despite strong protection provided by the law, legal protection is considerably weakened in practice by corruption within the government and an ineffective legal system. While the need for judicial and legal reforms has long been recognized, little legislative action has actually taken place so far (Debroy (2000)). Currently, the government is trying to emulate the success of China by following the Special Economic Zone approach rather than overhauling the entire legal system.”\textsuperscript{43}

NBFCs interviewed indicated that the courts can take 24 to 36 months to resolve collections, repossession and recourse issues. Court workload, judicial process inefficiencies, and corruption were cited as the main issues for the lengthy process.

India is ranked 85th in the world by Transparency International in terms of corruption, based on Transparency International’s Corruption Perception Index.\textsuperscript{44} While this places India numerically in the middle of the world’s country rankings, it ranks below most large industrialized countries, and, notably, China.

**Competition**

Unlike most western countries, the primary competition for most NBFCs is not other financing entities, but customers choosing to purchase their equipment rather than finance it. For those that do choose to finance their purchases, the underground Indian financial system referenced earlier is a formidable competitor among small-to-mid-sized firms. Banks offer strong competition for the financing business of larger companies. “India is incredibly overbanked,” said one NBFC. “There is bank on every corner in India, and several in-between as well! There will have to be consolidation in the industry over the next several years…but banks will continue to be a key competitor for the financing business of our larger customers for a good while.”

Most US-owned NBFCs are in India to support either a manufacturing parent or existing vendor relationships. As such, they are focused primarily on financing only the equipment of their parent or its vendor partners. According to those interviewed for this paper, it was rare for an NBFC to lose a financing transaction to another financing entity.

**Financial risk**

The leasing and financing business, by definition, has a high degree of risk associated with it. Understanding those risks, in the context of the Indian market, is an essential element of expanding into this market.

**Interest rates**

Forward contracts are readily available in India to hedge against interest rate movements for those lessors borrowing in local currency. The two major current issues related to interest rate risk are (1) the gap between interest rates in India and the US and European Union, and (2) the relative strength of the banking system.

The interrelationship between Indian and world capital markets is close, as the current credit market turmoil has demonstrated. For example, the RBI cut
its benchmark repurchase rate twice, from 9% to 7.5%, between October 20 and November 3, 2008, in a move that mirrored those in other major capital markets.45

Currency

The rupee is fully convertible to other currencies, and hedges are readily available. As stated previously in this paper (see the “Funding and currency considerations” section), the rupee has traded in a band of approximately 39 to 50 rupees per dollar between September 1998 and September 2008, which reflects modest volatility over the last decade.

Profit repatriation

Profit repatriation and dividend distribution requires careful planning in India, as there is a Dividend Distribution Tax (DDT) on remitted dividends which is subject to withholding. The legal structure of the financial services entity may have a bearing on whether and how DDT is paid:

“A big consideration associated with structuring is choice of entity structure. For an incorporated entity, the taxation is deferred until the repatriation of dividends from India. However, there could be economic double taxation on repatriation because the dividend is subject to DDT in India and this might not be allowed as a credit from the tax in many countries.

“If the entity structure were a branch, the advantage would be that losses, if any, could be consolidated with head office income. On the other hand, the foreign tax liability on India-sourced income cannot be deferred in a branch structure as is the case with an incorporated entity, because the branch income is likely to be consolidated with the income of the head office. Further, a branch would constitute a permanent establishment (PE) of the head office and would give rise to income attribution issues, which is a concern and is being debated extensively by tax experts around the world.”46

One option new entrants may consider is to create holding structures in specific countries with which India has tax treaties or economic agreements in place:

“Mauritius, Singapore and Cyprus could be considered as jurisdictions when structuring capital investments in India. Mauritius is a preferred destination for many foreign investors investing in India, given the exemption from capital gains provided by the India-Mauritius tax treaty, coupled with a favourable regime for taxation of offshore companies in Mauritius. The India-Mauritius tax treaty has also stood the test of judicial scrutiny. In a recent judgment, the Supreme Court of India upheld the validity of a circular issued under the Indian income tax laws, which enable the investor to enjoy tax treaty benefits, provided the investor obtains a tax residency certificate from the Mauritius Revenue authorities.

A recently concluded Comprehensive Economic Cooperation Agreement (CECA) between India and Singapore has provided an additional favourable jurisdiction for structuring investments into India. The India-Singapore tax treaty now provides for a capital gains exemption in India similar to the capital gains exemption provided under the India-Mauritius

Figure Three: Corruption Propensity Index

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tax treaty. However, the India-Singapore tax treaty also specifies certain conditions (to prevent treaty abuse), the fulfillment of which would need to be examined on a case-to-case basis.

Cyprus is also emerging as a preferred jurisdiction, as the India-Cyprus tax treaty provides for a capital gains exemption, as well as a lower withholding tax rate in India on interest payments from India to Cyprus. Consequently, Cyprus could be an important intermediary jurisdiction if investments in India are structured by way of a shareholders’ loan.

Investment structuring opportunities also exist under India’s tax treaties with a few European countries such as Belgium, France, Denmark and the Netherlands, and Asian countries such as the United Arab Emirates.”

**Conclusion**

US leasing and finance companies considering entering the Indian market face substantial risks and challenges. Significant barriers to entry exist, including the $50 million capital requirement for 100% foreign-owned NBFCs. This amount can be reduced if an Indian partner is used, but, while a local partner can offer numerous benefits, finding an appropriate one and managing the relationship requires time and effort. Other important entry barriers include the shortage of experienced equipment financing personnel, the government’s history of intervention and nationalization, the inefficient court system, and the return sapping DDT.

Other factors beyond entry barriers also exist. For instance, the low acceptance of equipment financing in India is an obstacle to success that must be overcome. Among those choosing to finance equipment, banks (for larger companies) and the underground financing system (for small- and mid-sized companies) pose tough competition. India’s complicated tax system is another issue. The sheer number of different taxes is complex enough, but the Indian government’s heavy hand in enforcement of the tax laws make compliance critical for NBFCs.

The ability to manage risk effectively, particularly credit, recourse, currency, and residual risk, is the main issue on the minds of most executives considering expansion into India. Doing so requires local market knowledge, not only of the secondary equipment market, but also to conduct effective due diligence during the credit process. Although the availability of reliable credit information is better now than several years ago, it still lags behind most legal or regulatory issues that would threaten the process. This process involves filing documents with the appropriate government authorities, submitting audited financial statements and bank records, settling with partners, and paying any debts and taxes due.

**Exit strategy risk**

The process of ceasing operations in India is similar to that in most other countries and there are no
American/Canadian and Western European countries. Foreign leasing and finance companies also can use hedges to help manage currency (and interest rate) risk.

Despite India’s size, rapid growth and vast potential, the equipment financing market in India is not for everyone, due to barriers to entry or obstacles, and the level of risk. Firms that have chosen to enter the Indian market have demonstrated ways these risks can be managed by using partners, vendors, product resellers and distributors, and others with local knowledge to help them better understand and manage risks.

Case Studies

In the pages that follow, case studies of two different equipment financing companies provide insight into the decision process as to whether or not to enter the Indian market. Both companies studied are large, international equipment financing companies. The first has been active in the Indian equipment financing market since the 1990s; the second recently put its plans to enter the Indian market on hold. The authors hope these case studies will be useful to readers desiring more practical, experiential information on the Indian equipment financing market.

Company Background

The company (Company A) is a multinational equipment financing firm with operations worldwide. It operates in over twenty countries, and employs in excess of 1,500 people. It provides vendor programs, direct equipment financing, and several other financial services to its customers.

US-Based Multinational Financing Company

Description of Financing Operations in India

- **Organization** – Company A began its financing operations in India in the 1990s. Its main purpose there, and the driver for the establishment of its Indian operations, is to support its many worldwide vendor relationships. However, it now has a thriving direct financing business as well, supported by a dedicated sales force.

  Company A was established as a non-deposit taking NBFC. It has offices, or representative offices, in all 28 states in India. Organizationally, Company A’s Indian operations report to the company’s Asian headquarters office, which, in turn, reports to the president of the corporation.

- **Employees** – The company has over 125 employees in India, supporting in excess of 3,000 customers across the country.

- **Business model** – The company originates business through its own sales force, as well as through the sales forces of its vendors. Most of its vendor relationships are with multinational manufacturers that require financing capabilities in India. However, it also has developed relationships with Indian manufacturers that seek customer financing in both India and in other markets.

  Its direct sales force is focused on infrastructure financing, including project financing and construction equipment, as well as vehicle financing.

- **Credit** – Company A has built a strong credit team over the years it has been in India.

  “With the lack of western-style credit bureaus, we’ve had to rely almost exclusively on our own research to perform credit due diligence and analysis,” said a Company A executive. “We’ve built an extensive database of
Indian companies and clients, and obviously we add to it every year and it gets more and more valuable to us.

“Western lessors need to understand that you’re not going to have the same kind of credit turnaround times that you’re used to in the US or Western Europe. You need to research each company, call references, learn about their reputation – just good, old-fashioned credit research. The days of instant credit approvals on small-ticket transactions are a long ways off in India.”

Another factor in credit and risk management in India is single borrower limits imposed on NBFCs by the RBI. The regulations stipulate that exposure to any single borrower/lessee must be limited to less than US$25 million, and the RBI enforces this rigorously but fairly. “When the single-borrower limits were implemented, we had some relationships in which our total exposure was in excess of the $25 million ceiling. RBI was happy to work with us, though, and allow us to reduce our exposure over time – they didn’t force us to hold a “fire sale”. I’ve found the RBI is fairly reasonable to work with on most issues.”

- **Funding** – Funding is handled by Company A’s corporate treasury. They have made use of the syndication and securitization markets over the years, although at the time of this writing those markets are frozen and Company A largely is self-funding.

**Decision Process to Enter the Indian Leasing Market**

- **Drivers** – Company A’s vendor program relationships were the initial drivers to enter the Indian market. Company A viewed its presence in India as a competitive advantage to the multinational manufacturers that were its target clients.

- **Decision Process** – Company A’s decision process was typical of most large companies. Its vendor programs group developed the business case, and, with India viewed as one of the company’s key long-term markets at the time, the decision was made to enter the market and establish basic operations to support its vendor partners.

  The executive interviewed was not part of the operation at the time, and did not know for sure whether the direct financing opportunities were part of the original business case justification, but was fairly certain that they were.

  The decision to become a non-deposit taking NBFC was fairly easy. At the time, there was little regulation on these types of NBFCs – most of RBI’s regulations, such as reserve and reporting requirements, were aimed only at deposit-taking NBFCs. The Company A executive noted that, today, these differences have narrowed, and new applicants should consider whether the ability to take deposits is an important funding consideration.

**Experiences**

- **Volumes** – Company A’s volumes have grown significantly since its modest start-up in the 1990s. It has financed well into the billions of dollars since inception, and has annual financing originations in excess of $250 million per year.

- **Bad debt and delinquencies** – Company A’s loss and delinquency experiences have been surprisingly good. “We’ve been pleased with our performance,” said the executive. “Fortunately we have not had to go to court too many times over the years to enforce contracts…the few times that we have, it has taken an inordinate time to get a resolution.” While the executive would not share specific numbers, he said losses were not appreciably
higher than in established western markets, though delinquency levels definitely were higher.

“Repossession of movable assets is fairly straightforward and easy in India. Repossessing immovable assets is another matter, though – it usually involves the courts, which means you are talking about years, not months, of litigation in many cases.”

• Personnel – The executive interviewed said, “we have found that our Indian employees are very well-educated and hard working. There is a strong work ethic in India, and finding and hiring motivated employees is not a problem.”

Company A has a well-developed internal education program, and it has a good track record of training and developing its employees. “It’s true that there are not a lot of experienced equipment financing people in the market in India. We tend to look for university-educated people that have relevant asset and/or financing experience, and there are lots of those people available.”

Company Background - The Company (Company B) is a wholly-owned subsidiary of one of the world’s largest banks. It has equipment financing operations in Asia (including Australia), Europe, North America and South America, with managed assets in the multiple billions of dollars. The Company provides a wide range of financial services, including equipment leases and loans, vendor programs, inventory financing, lines of credit, and several other services.

Market Entry Decision Process

• Drivers – The major driver for establishing leasing operations in India is the need to support Company B’s vendor partners. “India is our next ‘line of sight’,” said the Company B executive that led the project to establish operations in India. “Several of our European and our American vendors have asked us to offer equipment financing in India for their customers. We will be there for them, but we need to make sure we can provide the service levels they have come to expect from us while simultaneously making an acceptable risk-rated return for our parent bank.

We had made three extended trips to India over a two year period, and met with banks, NBFCs, clients, and government officials each trip. Each time, the equation simply didn’t close for us; the volumes simply were not big enough to warrant the expense and effort of starting an operation there.”

Decision process – Before it establishes operations in any country, Company B performs extensive research on the market. It determines the nature of the equipment leasing environment, the demand for leasing from its clients and from the market generally, all relevant tax, accounting, legal, and licensing regulations and requirements, and then develops a business case. Approval ultimately must be obtained from the subsidiary’s executive board, which includes executives from the parent bank, before proceeding.

Experiences and Expectations

• Efforts to date – The Company has had plans to expand into India for several years, but, for a variety of reasons, the decision to make the move was never made. “We simply saw greater opportunities in other markets,”
said the executive, “and it was easy to defer a decision on India because our clients were asking for support in other countries first.”

In 2007, Company B decided to make Indian expansion a priority, and dispatched an executive to make a thorough study of the market, assess the opportunity, and recommend when and how to enter the market. The executive leading the project was head of their Asian operations at the time.

As part of the project, the executive gathered and analyzed data on a number of different topics, including:

- Surveys of current and prospective vendor partners, to determine client needs and volume expectations in India
- Indian tax law, accounting practices and general regulatory environment
- License requirements, including paid up capital required, approval process and reporting requirements
- Funding and reserve requirements
- Ease of repatriation of profits
- Assessment of prospective local partners and analysis of wholly-owned versus partnership operations

**Results of the project** – After reviewing the project results and recommendations in the first half of 2008, Company B once again made the decision not to enter the Indian market.

“There were several reasons for the decision,” said the Company B executive. “First, as before, we simply did not see the projected financing volumes from our clients to warrant making the investment in India. There is significant risk in entering a market like India, and that, coupled with the expense and time to set up an NBFC, put us off for the time being.”

A second reason was timing, as the credit markets were showing signs of tightening at the time the project was reviewed. “Both we and our parent bank felt that things were likely to get worse before they got better – time certainly proved that fear to be correct – and we felt a wait-and-see approach was called for.”

Finally, Company B had investigated the use of a local partner to minimize its paid up capital requirement, and to provide local knowledge in the areas of credit and tax, but “quite simply, we came up empty,” the executive observed. “We couldn’t find anyone with whom we felt comfortable that had the experience we were looking for.”

**Next steps** – Company B will re-evaluate whether to enter the Indian market in the future, but probably not for at least several months, or perhaps even until 2010. The length and severity of the credit crisis will have much to do with when Company B revisits the opportunity.

“If our vendors came to us and insisted that equipment financing in India was critical to them, we certainly would work to accommodate them,” the executive said. “But right now most of our vendors are not planning expansion in India, and probably won’t until the credit markets improve. We’ll get into India at some point, but certainly not in the next several months.”
Appendix One

Accounting Standard 19

(In this Accounting Standard, the standard portions have been set in bold italic type. These should be read in the context of the background material which has been set in normal type, and in the context of the ‘Preface to the Statements of Accounting Standards’.)

The following is the text of Accounting Standard (AS) 19, ‘Leases’, issued by the Council of the Institute of Chartered Accountants of India. This Standard comes into effect in respect of all assets leased during accounting periods commencing on or after 1.4.2001 and is mandatory in nature from that date. Accordingly, the ‘Guidance Note on Accounting for Leases’ issued by the Institute in 1995, is not applicable in respect of such assets. Earlier application of this Standard is, however, encouraged.

Objective

The objective of this Statement is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosures in relation to finance leases and operating leases.

Scope

1. This Statement should be applied in accounting for all leases other than:
   a. lease agreements to explore for or use natural resources, such as oil, gas, timber, metals and other mineral rights; and
   b. licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights; and
   c. lease agreements to use lands.

2. This Statement applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. On the other hand, this Statement does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.

Definitions

3. The following terms are used in this Statement with the meanings specified:

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset.

An operating lease is a lease other than a finance lease.

A non-cancellable lease is a lease that is cancellable only:

1. upon the occurrence of some remote contingency; or
2. with the permission of the lessor; or
3. if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or
4. upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.

The inception of the lease is the earlier of the date of the lease agreement and the date of a commitment by the parties to the principal provisions of the lease.

The lease term is the non-cancellable period for which the lessee has agreed to take on lease the asset together with any further periods for which
the lessee has the option to continue the lease of the asset, with or without further payment, which option at the inception of the lease it is reasonably certain that the lessee will exercise.

Minimum lease payments are the payments over the lease term that the lessee is, or can be required, to make excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with:

a. in the case of the lessee, any residual value guaranteed by or on behalf of the lessee; or

b. in the case of the lessor, any residual value guaranteed to the lessor:
   i. by or on behalf of the lessee; or
   ii. by an independent third party financially capable of meeting this guarantee.

However, if the lessee has an option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable that, at the inception of the lease, is reasonably certain to be exercised, the minimum lease payments comprise minimum payments payable over the lease term and the payment required to exercise this purchase option.

Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.

Economic life is either:

a. the period over which an asset is expected to be economically usable by one or more users; or

b. the number of production or similar units expected to be obtained from the asset by one or more users.

Useful life of a leased asset is either:

a. the period over which the leased asset is expected to be used by the lessee; or

b. the number of production or similar units expected to be obtained from the use of the asset by the lessee.

Residual value of a leased asset is the estimated fair value of the asset at the end of the lease term.

Guaranteed residual value is:

a. in the case of the lessee, that part of the residual value which is guaranteed by the lessee or by a party on behalf of the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and

b. in the case of the lessor, that part of the residual value which is guaranteed by or on behalf of the lessee, or by an independent third party who is financially capable of discharging the obligations under the guarantee.

Unguaranteed residual value of a leased asset is the amount by which the residual value of the asset exceeds its guaranteed residual value.

Gross investment in the lease is the aggregate of the minimum lease payments under a finance lease from the standpoint of the lessor and any unguaranteed residual value accruing to the lessor.

Unearned finance income is the difference between:

a. the gross investment in the lease; and

b. the present value of
   i. the minimum lease payments under a finance lease from the standpoint of the lessor; and
   ii. any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.
Net investment in the lease is the gross investment in the lease less unearned finance income.

The interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of

a. the minimum lease payments under a finance lease from the standpoint of the lessor; and

b. any unguaranteed residual value accruing to the lessor, to be equal to the fair value of the leased asset.

The lessee's incremental borrowing rate of interest is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

Contingent rent is that portion of the lease payments that is not fixed in amount but is based on a factor other than just the passage of time (e.g., percentage of sales, amount of usage, price indices, market rates of interest).

4. The definition of a lease includes agreements for the hire of an asset which contain a provision giving the hirer an option to acquire title to the asset upon the fulfillment of agreed conditions. These agreements are commonly known as hire purchase agreements. Hire purchase agreements include agreements under which the property in the asset is to pass to the hirer on the payment of the last instalment and the hirer has a right to terminate the agreement at any time before the property so passes.

Classification of Leases

5. The classification of leases adopted in this Statement is based on the extent to which risks and rewards incident to ownership of a leased asset lie with the lessor or the lessee. Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return due to changing economic conditions. Rewards may be represented by the expectation of profitable operation over the economic life of the asset and of gain from appreciation in value or realisation of residual value.

6. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. Title may or may not eventually be transferred. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership.

7. Since the transaction between a lessor and a lessee is based on a lease agreement common to both parties, it is appropriate to use consistent definitions. The application of these definitions to the differing circumstances of the two parties may sometimes result in the same lease being classified differently by the lessor and the lessee.

8. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than its form. Examples of situations which would normally lead to a lease being classified as a finance lease are:

a. the lease transfers ownership of the asset to the lessee by the end of the lease term;

b. the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;

c. the lease term is for the major part of the economic life of the asset even if title is not transferred;

d. at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and

e. the leased asset is of a specialised nature such
that only the lessee can use it without major modifications being made.

9. Indicators of situations which individually or in combination could also lead to a lease being classified as a finance lease are:
   a. if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
   b. gains or losses from the fluctuation in the fair value of the residual fall to the lessee (for example in the form of a rent rebate equaling most of the sales proceeds at the end of the lease); and
   c. the lessee can continue the lease for a secondary period at a rent which is substantially lower than market rent.

10. Lease classification is made at the inception of the lease. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease under the criteria in paragraphs 5 to 9 had the changed terms been in effect at the inception of the lease, the revised agreement is considered as a new agreement over its revised term. Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased asset) or changes in circumstances (for example, default by the lessee), however, do not give rise to a new classification of a lease for accounting purposes.

Leases in the Financial Statements of Lessees

Finance Leases

11. At the inception of a finance lease, the lessee should recognise the lease as an asset and a liability. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of the lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the lessee. In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate should be used.

Example

(a) An enterprise (the lessee) acquires a machinery on lease from a leasing company (the lessor) on January 1, 20X0. The lease term covers the entire economic life of the machinery, i.e. 3 years. The fair value of the machinery on January 1, 20X0 is Rs.2,35,500. The lease agreement requires the lessee to pay an amount of Rs.1,00,000 per year beginning December 31, 20X0. The lessor has guaranteed a residual value of Rs.17,000 on December 31, 20X2 to the lessor. The lessor, however, estimates that the machinery would have a salvage value of only Rs.3,500 on December 31, 20X2.

The interest rate implicit in the lease is 16 per cent (approx.). This is calculated using the following formula:

Fair value = \[ \text{ALR} + \frac{\text{ALR}}{(1+r)} + \frac{\text{ALR}}{(1+r)^2} + \ldots + \frac{\text{ALR} + \text{RV}}{(1+r)^n} \]

where ALR is annual lease rental, RV is residual value (both guaranteed and unguaranteed), n is the lease term, r is interest rate implicit in the lease.

The present value of minimum lease payments from the standpoint of the lessee is Rs.2,35,500.

The lessee would record the machinery as an asset at Rs.2,35,500 with a corresponding liability representing the present value of lease payments over the lease term (including the guaranteed residual value).
(b) In the above example, suppose the lessor estimates that the machinery would have a salvage value of Rs.17,000 on December 31, 20X2. The lessee, however, guarantees a residual value of Rs.5,000 only.

The interest rate implicit in the lease in this case would remain unchanged at 16% (approx.). The present value of the minimum lease payments from the standpoint of the lessee, using this interest rate implicit in the lease, would be Rs.2,27,805. As this amount is lower than the fair value of the leased asset (Rs. 2,35,500), the lessee would recognise the asset and the liability arising from the lease at Rs.2,27,805.

In case the interest rate implicit in the lease is not known to the lessee, the present value of the minimum lease payments from the standpoint of the lessee would be computed using the lessee's incremental borrowing rate.

12. Transactions and other events are accounted for and presented in accordance with their substance and financial reality and not merely with their legal form. While the legal form of a lease agreement is that the lessee may acquire no legal title to the leased asset, in the case of finance leases the substance and financial reality are that the lessee acquires the economic benefits of the use of the leased asset for the major part of its economic life in return for entering into an obligation to pay for that right an amount approximating to the fair value of the asset and the related finance charge.

13. If such lease transactions are not reflected in the lessee's balance sheet, the economic resources and the level of obligations of an enterprise are understated thereby distorting financial ratios. It is therefore appropriate that a finance lease be recognised in the lessee's balance sheet both as an asset and as an obligation to pay future lease payments. At the inception of the lease, the asset and the liability for the future lease payments are recognised in the balance sheet at the same amounts.

14. It is not appropriate to present the liability for a leased asset as a deduction from the leased asset in the financial statements. The liability for a leased asset should be presented separately in the balance sheet as a current liability or a long-term liability as the case may be.

15. Initial direct costs are often incurred in connection with specific leasing activities, as in negotiating and securing leasing arrangements. The costs identified as directly attributable to activities performed by the lessee for a finance lease are included as part of the amount recognised as an asset under the lease.

16. Lease payments should be apportioned between the finance charge and the reduction of the outstanding liability. The finance charge should be allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Example

In the example (a) illustrating paragraph 11, the lease payments would be apportioned by the lessee between the finance charge and the reduction of the outstanding liability as follows.

<table>
<thead>
<tr>
<th>Year</th>
<th>Finance charge (Rs)</th>
<th>Payment (Rs)</th>
<th>Reduction in outstanding liability (Rs)</th>
<th>Outstanding liability (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1 (January 1)</td>
<td>2,35,500</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(December 31)</td>
<td>37,680</td>
<td>1,00,000</td>
<td>62,320</td>
<td>1,73,180</td>
</tr>
<tr>
<td>Year 2 (December 31)</td>
<td>27,709</td>
<td>1,00,000</td>
<td>72,291</td>
<td>1,00,889</td>
</tr>
<tr>
<td>Year 3 (December 31)</td>
<td>16,142</td>
<td>1,00,000</td>
<td>83,858</td>
<td>17,031*</td>
</tr>
</tbody>
</table>

17. In practice, in allocating the finance charge to periods during the lease term, some form of approximation may be used to simplify the calculation.
18. A finance lease gives rise to a depreciation expense for the asset as well as a finance expense for each accounting period. The depreciation policy for a leased asset should be consistent with that for depreciable assets which are owned, and the depreciation recognised should be calculated on the basis set out in Accounting Standard (AS) 6, Depreciation Accounting. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the lease term or its useful life, whichever is shorter.

19. The depreciable amount of a leased asset is allocated to each accounting period during the period of expected use on a systematic basis consistent with the depreciation policy the lessee adopts for depreciable assets that are owned. If there is reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the asset is depreciated over the lease term or its useful life, whichever is shorter.

20. The sum of the depreciation expense for the asset and the finance expense for the period is rarely the same as the lease payments payable for the period, and it is, therefore, inappropriate simply to recognise the lease payments payable as an expense in the statement of profit and loss. Accordingly, the asset and the related liability are unlikely to be equal in amount after the inception of the lease.

21. To determine whether a leased asset has become impaired, an enterprise applies the Accounting Standard dealing with impairment of assets, that sets out the requirements as to how an enterprise should perform the review of the carrying amount of an asset, how it should determine the recoverable amount of an asset and when it should recognise, or reverse, an impairment loss.

22. The lessee should, in addition to the requirements of AS 10, Accounting for Fixed Assets, AS 6, Depreciation Accounting, and the governing statute, make the following disclosures for finance leases:

a. assets acquired under finance lease as segregated from the assets owned;

b. for each class of assets, the net carrying amount at the balance sheet date;

c. a reconciliation between the total of minimum lease payments at the balance sheet date and their present value. In addition, an enterprise should disclose the total of minimum lease payments at the balance sheet date, and their present value, for each of the following periods:

i. not later than one year;

ii. later than one year and not later than five years;

iii. (iii) later than five years;

d. contingent rents recognised as income in the statement of profit and loss for the period;

e. the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date; and

f. a general description of the lessee's significant leasing arrangements including, but not limited to, the following:

i. the basis on which contingent rent payments are determined;

ii. the existence and terms of renewal or purchase options and escalation clauses; and

iii. restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.
Operating Leases

23. Lease payments under an operating lease should be recognised as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user’s benefit.

24. For operating leases, lease payments (excluding costs for services such as insurance and maintenance) are recognised as an expense in the statement of profit and loss on a straight line basis unless another systematic basis is more representative of the time pattern of the user’s benefit, even if the payments are not on that basis.

a. 25. The lessee should make the following disclosures for operating leases: the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:

i. not later than one year;

ii. later than one year and not later than five years;

iii. later than five years;

b. the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date;

c. lease payments recognised in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;

d. sub-lease payments received (or receivable) recognised in the statement of profit and loss for the period;

i. a general description of the lessee’s significant leasing arrangements including, but not limited to, the following: the basis on which contingent rent payments are determined;

ii. the existence and terms of renewal or purchase options and escalation clauses; and

iii. restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Leases in the Financial Statements of Lessors

Finance Leases

26. The lessor should recognise assets given under a finance lease in its balance sheet as a receivable at an amount equal to the net investment in the lease.

27. Under a finance lease substantially all the risks and rewards incident to legal ownership are transferred by the lessor, and thus the lease payment receivable is treated by the lessor as repayment of principal, i.e., net investment in the lease, and finance income to reimburse and reward the lessor for its investment and services.

28. The recognition of finance income should be based on a pattern reflecting a constant periodic rate of return on the net investment of the lessor outstanding in respect of the finance lease.

29. A lessor aims to allocate finance income over the lease term on a systematic and rational basis. This income allocation is based on a pattern reflecting a constant periodic return on the net investment of the lessor outstanding in respect of the finance lease. Lease payments relating to the accounting period, excluding costs for services, are reduced from both the principal and the unearned finance income.

30. Estimated unguaranteed residual values used in computing the lessor’s gross investment in a lease are reviewed regularly. If there has been a reduction in the estimated unguaranteed residual value,
the income allocation over the remaining lease term is revised and any reduction in respect of amounts already accrued is recognised immediately. An upward adjustment of the estimated residual value is not made.

31. Initial direct costs, such as commissions and legal fees, are often incurred by lessors in negotiating and arranging a lease. For finance leases, these initial direct costs are incurred to produce finance income and are either recognised immediately in the statement of profit and loss or allocated against the finance income over the lease term.

32. The manufacturer or dealer lessor should recognise the transaction of sale in the statement of profit and loss for the period, in accordance with the policy followed by the enterprise for outright sales. If artificially low rates of interest are quoted, profit on sale should be restricted to that which would apply if a commercial rate of interest were charged. Initial direct costs should be recognised as an expense in the statement of profit and loss at the inception of the lease.

33. Manufacturers or dealers may offer to customers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or dealer lessor gives rise to two types of income:

(a) the profit or loss equivalent to the profit or loss resulting from an outright sale of the asset being leased, at normal selling prices, reflecting any applicable volume or trade discounts; and

(b) the finance income over the lease term.

34. The sales revenue recorded at the commencement of a finance lease term by a manufacturer or dealer lessor is the fair value of the asset. However, if the present value of the minimum lease payments accruing to the lessor computed at a commercial rate of interest is lower than the fair value, the amount recorded as sales revenue is the present value so computed. The cost of sale recognised at the commencement of the lease term is the cost, or carrying amount if different, of the leased asset less the present value of the unguaranteed residual value. The difference between the sales revenue and the cost of sale is the selling profit, which is recognised in accordance with the policy followed by the enterprise for sales.

35. Manufacturer or dealer lessors sometimes quote artificially low rates of interest in order to attract customers. The use of such a rate would result in an excessive portion of the total income from the transaction being recognised at the time of sale. If artificially low rates of interest are quoted, selling profit would be restricted to that which would apply if a commercial rate of interest were charged.

36. Initial direct costs are recognised as an expense at the commencement of the lease term because they are mainly related to earning the manufacturer’s or dealer’s selling profit.

37. The lessor should make the following disclosures for finance leases:

a. a reconciliation between the total gross investment in the lease at the balance sheet date, and the present value of minimum lease payments receivable at the balance sheet date. In addition, an enterprise should disclose the total gross investment in the lease and the present value of minimum lease payments receivable at the balance sheet date, for each of the following periods:

i. not later than one year;

ii. later than one year and not later than five years;

iii. later than five years;

b. unearned finance income;

c. the unguaranteed residual values accruing to the benefit of the lessor;
d. the accumulated provision for uncollectible minimum lease payments receivable;

e. contingent rents recognised in the statement of profit and loss for the period;

f. a general description of the significant leasing arrangements of the lessor; and

g. accounting policy adopted in respect of initial direct costs.

38. As an indicator of growth it is often useful to also disclose the gross investment less unearned income in new business added during the accounting period, after deducting the relevant amounts for cancelled leases.

Operating Leases

39. The lessor should present an asset given under operating lease in its balance sheet under fixed assets.

40. Lease income from operating leases should be recognised in the statement of profit and loss on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern in which benefit derived from the use of the leased asset is diminished.

41. Costs, including depreciation, incurred in earning the lease income are recognised as an expense. Lease income (excluding receipts for services provided such as insurance and maintenance) is recognised in the statement of profit and loss on a straight line basis over the lease term even if the receipts are not on such a basis, unless another systematic basis is more representative of the time pattern in which benefit derived from the use of the leased asset is diminished.

42. Initial direct costs incurred specifically to earn revenues from an operating lease are either deferred and allocated to income over the lease term in proportion to the recognition of rent income, or are recognised as an expense in the statement of profit and loss in the period in which they are incurred.

43. The depreciation of leased assets should be on a basis consistent with the normal depreciation policy of the lessor for similar assets, and the depreciation charge should be calculated on the basis set out in AS 6, Depreciation Accounting.

44. To determine whether a leased asset has become impaired, an enterprise applies the Accounting Standard dealing with impairment of assets that sets out the requirements for how an enterprise should perform the review of the carrying amount of an asset, how it should determine the recoverable amount of an asset and when it should recognise, or reverse, an impairment loss.

45. A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.

46. The lessor should, in addition to the requirements of AS 6, Depreciation Accounting and AS 10, Accounting for Fixed Assets, and the governing statute, make the following disclosures for operating leases:

a. for each class of assets, the gross carrying amount, the accumulated depreciation and accumulated impairment losses at the balance sheet date; and

i. the depreciation recognised in the statement of profit and loss for the period;

ii. impairment losses recognised in the statement of profit and loss for the period;

iii. impairment losses reversed in the statement of profit and loss for the period;

a. the future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods:
i. not later than one year;
ii. later than one year and not later than five years;
iii. later than five years;
b. total contingent rents recognised as income in the statement of profit and loss for the period;
c. a general description of the lessor’s significant leasing arrangements; and
d. accounting policy adopted in respect of initial direct costs.

Sale and Leaseback Transactions

47. A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor. The lease payments and the sale price are usually interdependent as they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends upon the type of lease involved.

48. If a sale and leaseback transaction results in a finance lease, any excess or deficiency of sales proceeds over the carrying amount should not be immediately recognised as income or loss in the financial statements of a seller-lessee. Instead, it should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

49. If the leaseback is a finance lease, it is not appropriate to regard an excess of sales proceeds over the carrying amount as income. Such excess is deferred and amortised over the lease term in proportion to the depreciation of the leased asset. Similarly, it is not appropriate to regard a deficiency as loss. Such deficiency is deferred and amortised over the lease term.

50. If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

51. If the leaseback is an operating lease, and the lease payments and the sale price are established at fair value, there has in effect been a normal sale transaction and any profit or loss is recognised immediately.

52. For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognised immediately.

53. For finance leases, no such adjustment is necessary unless there has been an impairment in value, in which case the carrying amount is reduced to recoverable amount in accordance with the Accounting Standard dealing with impairment of assets.

54. Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of the significant leasing arrangements leads to disclosure of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.

55. Sale and leaseback transactions may meet the separate disclosure criteria set out in paragraph 12 of Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.
Appendix

Sale and Leaseback Transactions that Result in Operating Leases

The appendix is illustrative only and does not form part of the accounting standard. The purpose of this appendix is to illustrate the application of the accounting standard.

A sale and leaseback transaction that results in an operating lease may give rise to profit or a loss, the determination and treatment of which depends on the leased asset's carrying amount, fair value and selling price. The following table shows the requirements of the accounting standard in various circumstances.

<table>
<thead>
<tr>
<th>Sale price established at fair value (paragraph 50)</th>
<th>Carrying amount equal to fair value</th>
<th>Carrying amount less than fair value</th>
<th>Carrying amount above fair value</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profit</strong></td>
<td><strong>No profit</strong></td>
<td><strong>Recognise profit immediately</strong></td>
<td><strong>Not applicable</strong></td>
</tr>
<tr>
<td><strong>Loss</strong></td>
<td><strong>No loss</strong></td>
<td><strong>Not applicable</strong></td>
<td><strong>Recognise loss immediately</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sale price below fair value (paragraph 50)</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profit</strong></td>
<td><strong>No profit</strong></td>
<td><strong>Recognise profit immediately</strong></td>
<td><strong>No profit (note 1)</strong></td>
</tr>
<tr>
<td><strong>Loss not compensated by future lease payments at below market price</strong></td>
<td><strong>Recognise loss immediately</strong></td>
<td><strong>Recognise loss immediately</strong></td>
<td>(note 1)</td>
</tr>
<tr>
<td><strong>Loss compensated by future lease payments at below market price</strong></td>
<td><strong>Defer and amortise loss</strong></td>
<td><strong>Defer and amortise loss</strong></td>
<td>(note 1)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sale price above fair value (paragraph 50)</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profit</strong></td>
<td><strong>Defer and amortise profit</strong></td>
<td><strong>Defer and amortise profit</strong></td>
<td><strong>Defer and amortise profit (note 2)</strong></td>
</tr>
<tr>
<td><strong>Loss</strong></td>
<td><strong>No loss</strong></td>
<td><strong>No loss</strong></td>
<td><strong>(note 1)</strong></td>
</tr>
</tbody>
</table>

Note 1. These parts of the table represent circumstances that would have been dealt with under paragraph 52 of the Standard. Paragraph 52 requires the carrying amount of an asset to be written down to fair value where it is subject to a sale and leaseback.

Note 2. The profit would be the difference between fair value and sale price as the carrying amount would have been written down to fair value in accordance with paragraph 52.
Appendix Two

Reserve Bank of India NBFC Application

FORM OF APPLICATION FOR CERTIFICATE OF REGISTRATION TO COMMENCE/CARRY ON THE BUSINESS OF A NON-BANKING FINANCIAL INSTITUTION BY A COMPANY

Name and address of registered office of the company (in block letters)

By Registered Post A.D./Hand Delivery

To

The General/Dy. General Manager*, Department of Supervision (Financial Companies Wing), Reserve Bank of India, Regional Office,

(Place)

Dear Sir,

Application for a Certificate of Registration to commence/carry on the business of a non-banking financial institution

We make this application in terms of sub-section (2) of section 45-IA of the Reserve Bank of India Act, 1934 for issue of a Certificate of Registration. The required documents/information as per the instructions are furnished.

We are desirous of commencing/carrying on* the business of a non-banking financial institution. Hence, we hereby request you to kindly issue the necessary Certificate of Registration under sub-section (1) of section 45-IA of the Reserve Bank of India Act, 1934 to enable our company to commence/carry on* the business of a non-banking financial institution.

We declare that to the best of our knowledge and belief the information furnished in the statements/annexes enclosed hereto is true/correct and complete.

<table>
<thead>
<tr>
<th>Yours faithfully,</th>
</tr>
</thead>
<tbody>
<tr>
<td>Signature:</td>
</tr>
<tr>
<td>Date:</td>
</tr>
<tr>
<td>Name:</td>
</tr>
<tr>
<td>Place:</td>
</tr>
<tr>
<td>Designation:</td>
</tr>
<tr>
<td>Company Seal:</td>
</tr>
</tbody>
</table>

Encl. : ..............Sheets

*Strike out whichever is not applicable.
DOCUMENTS REQUIRED TO BE ENCLOSED TO THE APPLICATION FORM

1. Identification particulars (Annex I).
3. Information about the management (Annex III).
4. Certified copies of up-to-date Memorandum and Articles of Association of the company.
5. Certified copies of Certificate of Incorporation and Certificate of Commencement of Business.
6. A Board resolution specifically approving the submission of the application and its contents.
7. A copy each of the Profit and Loss account and audited Balance Sheet for the last 3 years or for such shorter period as are available (for companies already in existence).
8. Business plan of the company for the next three years giving details of its (a) thrust of business; (b) market segment; and (c) projection of investments and income.
9. A company which is incorporated before January 9, 1997 and has net owned fund of less than Rs. 25 lakhs as on the date of application, may also furnish a time-bound programme as to how it proposes to attain the minimum net owned fund of Rs. 25 lakhs.

INSTRUCTIONS

(Fill up the application form strictly in accordance with these instructions)

GENERAL

(1) Application should be made in the prescribed form only. Wherever space is insufficient, information may be furnished in separate sheet/s.

(2) Application along with enclosures duly completed should be submitted in duplicate, before July 8, 1997 to the Department of Supervision (Financial Companies Wing), Reserve Bank of India, Regional Office under whose jurisdiction the registered office of the company is situated.

(3) A photocopy of the application as submitted may be kept with the company for its record.

(4) Application should be signed by any of the following officials authorised by the Board of Directors, in this behalf (viz., Chairman, Managing Director, Chief Executive Officer, Company Secretary, a whole-time Director or any other official).

(5) Application should bear common seal of the company.

(6) An acknowledgement for having submitted the application may be obtained from the Regional Office concerned.
(7) The particulars/information to be furnished in Annex II of the application should be based on figures as disclosed in the latest annual audited balance-sheet. However, in the case of a company incorporated after 9-1-1997, such particulars/information should be based on the balance-sheet as on a date falling within thirty days preceding the date of application.

ANNEX I

(8) In case the company has changed its name earlier, a list of all the earlier names of the company and date/s of change together with the names of Chief Executive Officer and Chairman at the time of change of name should be furnished.

(9) If the company was registered with Reserve Bank of India in terms of Circular DFC (COC) No. 828/174-92/93, dated April 12, 1993, the letter in original advising registration should be enclosed.

(10) If the company has ever defaulted in timely repayment of deposit and payment of interest, a list of all such pending cases and the action taken in respect of each case should be furnished. The company should also submit a list containing the details of all the court cases pending against it, including those pending in consumer fora, pertaining to its deposits acceptance activities.

ANNEX II

(11) This statement is to be filled only by a non-banking financial company which was in existence as on January 9, 1997 and carrying on business of a non-banking financial institution.

(12) For filling up Annexure II, please refer to the guidelines to non-banking financial companies on prudential norms for income recognition, accounting standards, asset classification, provisioning for bad and doubtful debts, capital adequacy, concentration of credit/investment, etc.

(13) The contents of Annexure II should be certified by a Chartered Accountant.

ANNEX III

(14) ‘Substantial interest’ means holding of beneficial interest by an individual or his/her spouse or minor child, whether singly or taken together, in shares of a company/capital of a firm, the amount paid-up on which exceeds 10 per cent of the paid-up capital of the company or total capital subscribed by all the partners of a partnership firm.
ANNEX I

IDENTIFICATION PARTICULARS

COMPANY CODE
(to be filled by RBI)
..............................................
..............................................

1.1 Name of the Company ...........................................................................................................

1.2 Whether the company had changed its name earlier?

<table>
<thead>
<tr>
<th>[Please see item (8) of instructions]</th>
<th>Yes/No</th>
</tr>
</thead>
</table>

2. Date of incorporation
3. Date of commencement of business
4. State in which the company is registered ...........................................................................

5. Full Address of the Company
   (i) Registered Office ..............................................................................................................
    .................................................................................................................................
    ..............................................
    Phone No. ................................................................. Fax............................... Email:
   (ii) Corporate/Administrative Office .....................................................................................
    .................................................................................................................................
    ..............................................
    Phone No. ................................................................. Fax...............................
   (iii) No. of branches :

<table>
<thead>
<tr>
<th>Status :</th>
<th>(a) Public</th>
<th>(b) Private</th>
<th>(c) Deemed public</th>
</tr>
</thead>
<tbody>
<tr>
<td>(d) Government company (e) Other (to be specified)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

7. Whether the company was transacting the business of

| Yes/No |
Non-banking financial institution as on January 9, 1997?

If yes—

(i) the date of commencement of such business:

(ii) Classification as made by RBI

(EL/HP/LC/IC/Nidhi/RNBC/MNBC)

(iii) Reference No. and date of RBI Classification advice

<table>
<thead>
<tr>
<th>(iv) Whether the company was already registered with RBI?</th>
<th>Yes/No</th>
</tr>
</thead>
<tbody>
<tr>
<td>[Please see item (9) of instructions]</td>
<td></td>
</tr>
<tr>
<td>If yes,—</td>
<td></td>
</tr>
<tr>
<td>(a) Registration No.</td>
<td></td>
</tr>
<tr>
<td>.........................................................................</td>
<td></td>
</tr>
<tr>
<td>(b) Reference No. and date of RBI advice</td>
<td></td>
</tr>
<tr>
<td>.........................................................................</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(v) Whether the company has been issued a Certificate in terms of Circular DFC (COC) No. 2/02/04/96-97, dated July 24, 1996?</th>
<th>Yes/No</th>
</tr>
</thead>
<tbody>
<tr>
<td>If yes,—</td>
<td></td>
</tr>
<tr>
<td>(a) Certificate No.</td>
<td></td>
</tr>
<tr>
<td>.................................................................................................................</td>
<td></td>
</tr>
<tr>
<td>(b) Reference No. and date of RBI advice</td>
<td></td>
</tr>
<tr>
<td>.................................................................................................................</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(vi) Whether the company has ever defaulted in the repayment of principal and/or payment of interest on deposits?</th>
<th>Yes/No</th>
</tr>
</thead>
<tbody>
<tr>
<td>[Please see item (10) of instructions]</td>
<td></td>
</tr>
</tbody>
</table>
(vii)(a) Whether any of the group companies regulated by other regulators such as SEBI, IRDA, etc.
(b) If yes, give details of the company:
   i) Name
   ii) Address
   iii) Nature of business
   iv) Regulator
   v) Approval/Certificate/Registration No.
(c) Action if any initiated/pending against the company by the regulator with details (strictures, penalties, adjudications, investigations etc)

| 8. Name/s of Statutory Auditor/s with address/es | ......................................................... |
| | .................................................................. |
| | .................................................................. |
| 9.1 Name/s & Address/es of bankers | ......................................................... |
| | .................................................................. |
| | .................................................................. |
| 9.2 Whether the company has committed any default in repayment of any loan, advance or any other credit facility availed from any bank? | Yes/No |
| | .................................................................. |
| | .................................................................. |

9.3 If yes, furnish full details, such as name of Bank/Branch, type of facility, period and quantum of default, etc.

10. Name and Designation of CEO/Authorised official .........................................................
    ........................................................................

| Date: | Name: |
| Place: | Designation: |
| Signature: | Company Seal: |
**PART A**

**CAPITAL FUNDS - TIER-I**

<table>
<thead>
<tr>
<th>Item Name</th>
<th>Item Code</th>
<th>Amount Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Paid-up Equity Capital</td>
<td>111</td>
<td></td>
</tr>
<tr>
<td>(ii) Free reserves (Please see note below):</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) General Reserves</td>
<td>112</td>
<td></td>
</tr>
<tr>
<td>(b) Share Premium</td>
<td>113</td>
<td></td>
</tr>
<tr>
<td>(c) Capital Reserves (representing surplus on sale of assets held in separate account)</td>
<td>114</td>
<td></td>
</tr>
<tr>
<td>(d) Debentures Redemption Reserve</td>
<td>115</td>
<td></td>
</tr>
<tr>
<td>(e) Capital Redemption Reserve</td>
<td>116</td>
<td></td>
</tr>
<tr>
<td>(f) Credit Balance in P &amp; L Account</td>
<td>117</td>
<td></td>
</tr>
<tr>
<td>(g) Other free reserves (to be specified)</td>
<td>118</td>
<td></td>
</tr>
<tr>
<td>(iii) Total (111 to 118)</td>
<td>110</td>
<td></td>
</tr>
<tr>
<td>(iv) Accumulated balance of loss</td>
<td>121</td>
<td></td>
</tr>
<tr>
<td>(v) Deferred Revenue Expenditure</td>
<td>122</td>
<td></td>
</tr>
<tr>
<td>(vi) Other Intangible Assets</td>
<td>123</td>
<td></td>
</tr>
<tr>
<td>(vii) Total (121 to 123)</td>
<td>120</td>
<td></td>
</tr>
<tr>
<td>(viii) Owned funds (110 - 120)</td>
<td>130</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** ‘Free reserves’ shall include balance in share premium account, capital and debenture redemption reserves and any other reserves shown in the balance-sheet and created through an allocation out of profits but not being (a) a reserve created for repayment of any future liability or for depreciation on assets or for bad debts, or (b) a reserve created by revaluation of assets of the company.

<table>
<thead>
<tr>
<th>Item Name</th>
<th>Item Code</th>
<th>Amount Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(ix) Investment in shares of: [please see Note (1) below]:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Subsidiaries</td>
<td>141</td>
<td></td>
</tr>
<tr>
<td>(b) Companies in the same Group</td>
<td>142</td>
<td></td>
</tr>
<tr>
<td>(c) Other non-banking financial companies</td>
<td>143</td>
<td></td>
</tr>
<tr>
<td>(x) The book value of debentures bonds, outstanding loans and advances (including hire-purchase and lease finance) made to and deposits with [please see note (2) below]:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Subsidiaries</td>
<td>144</td>
<td></td>
</tr>
<tr>
<td>(b) Companies in the same Group</td>
<td>145</td>
<td></td>
</tr>
<tr>
<td>(xi) Total (141 to 145)</td>
<td>140</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td>(xii) Amount of item 140 in excess of 10 per cent of item 130 above</td>
<td>150</td>
<td></td>
</tr>
<tr>
<td>(xiii) Tier-I Capital: Net owned funds (130 - 150)</td>
<td>151</td>
<td></td>
</tr>
</tbody>
</table>

**Notes:**

1. Investments in shares includes investment in fully convertible debentures and/or convertible portion of partially convertible debentures. Investments held either in investment account or stock-in-trade should be included under this item.

2. Debentures whether held in investment account or by way of stock-in-trade should be included under this item. Non-convertible debentures, non-convertible portion of partially convertible debentures and optionally convertible debentures should also be included under this item.
### PART B

**CAPITAL FUNDS - TIER-II**

<table>
<thead>
<tr>
<th>Item Name</th>
<th>Item Code</th>
<th>Amount Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Preference Share Capital</td>
<td>161</td>
<td></td>
</tr>
<tr>
<td>(ii) Revaluation reserves (see para 5.2-2 of guidelines)</td>
<td>162</td>
<td></td>
</tr>
<tr>
<td>(iii) General provisions and loss reserves (see para 5.2-3 of guidelines)</td>
<td>163</td>
<td></td>
</tr>
<tr>
<td>(iv) Hybrid debt capital instruments (see para 5.2-4 of guidelines)</td>
<td>164</td>
<td></td>
</tr>
<tr>
<td>(v) Subordinated debt (see para 5.2-5 of guidelines)</td>
<td>165</td>
<td></td>
</tr>
<tr>
<td>(vi) Aggregate Tier-II Capital (161 to 165) (see para 6 of the guidelines)</td>
<td>160</td>
<td></td>
</tr>
<tr>
<td><strong>Total Capital Funds (151 + 160)</strong></td>
<td>170</td>
<td></td>
</tr>
</tbody>
</table>
## PART C
RISK ASSETS AND OFF-BALANCE SHEET ITEMS

<table>
<thead>
<tr>
<th>Item Name</th>
<th>Item Code</th>
<th>Amount Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Adjusted value of funded risk assets, i.e., on-balance sheet items (Totally with Part D)</td>
<td>181</td>
<td></td>
</tr>
<tr>
<td>(ii) Adjusted value of non-funded and off-balance sheet items (Totally with Part E)</td>
<td>182</td>
<td></td>
</tr>
<tr>
<td>(iii) Total risk-weighted assets/exposures (181 + 182)</td>
<td>180</td>
<td></td>
</tr>
<tr>
<td>(iv) Percentage of capital funds to risk-weighted assets/exposures:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Tier-I capital (Percentage of Item 151 to Item 180)</td>
<td>191</td>
<td></td>
</tr>
<tr>
<td>(b) Tier-II capital (Percentage of Item 160 to Item 180)</td>
<td>192</td>
<td></td>
</tr>
<tr>
<td>(c) Total (Percentage of Item 170 to Item 180)</td>
<td>193</td>
<td></td>
</tr>
</tbody>
</table>
### WEIGHTED ASSETS, I.E., ON-BALANCE SHEET ITEMS

<table>
<thead>
<tr>
<th>Item Name</th>
<th>Item code</th>
<th>Book value</th>
<th>Risk weight</th>
<th>Adjusted value</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Cash and bank balances including fixed deposits &amp; Certificates of Deposits</td>
<td>210</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>II. Investments (see paras 2.6-1 to 2.6-7 of the guidelines)—</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Government and approved securities as defined under section 45-IB of RBI Act, 1934</td>
<td>221</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>(b) Shares/debentures/bonds/ units of mutual funds—</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Amounts deducted in Part ‘A’ [Item (ix)]</td>
<td>222</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>(ii) Amounts not deducted in Part A</td>
<td>223</td>
<td>100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>III. Current Assets—</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Stock on hire (Please see Note 3 below):</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Amounts deducted in Part A [Item (x)]</td>
<td>231</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>(ii) Amounts not deducted in Part A</td>
<td>232</td>
<td>100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) Inter-corporate loans/deposits:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Amounts deducted in Part ‘A’ [Item (x)]</td>
<td>233</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>(ii) Amounts not deducted in Part A</td>
<td>234</td>
<td>100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(c) Loans and advances fully secured by company’s own deposits</td>
<td>235</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>(d) Loans to staff</td>
<td>236</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>(e) Other secured loans and advances considered goods:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Amounts deducted in Part A [Item (x)]</td>
<td>241</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>(ii) Amounts not deducted in Part A</td>
<td>242</td>
<td>100</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
(f) Bills purchased/discounted:

| (i) Amounts deducted in Part A [Item (x)] | 243 | 0 | 0 |
| (ii) Amounts not deducted in Part A | 244 | 100 |

(g) Others (to be specified) | 245 | 100 |

IV. Fixed Assets: (net of depreciation)

(a) Assets leased out—

| (i) Amounts deducted in Part A [Item (x)] | 251 | 0 | 0 |
| (ii) Amounts not deducted in Part A | 252 | 100 |

(b) Premises | 253 | 100 |

(c) Furniture & Fixtures | 254 | 100 |

V. Other assets:

(a) Income-tax deducted at source (net of provisions) | 255 | 0 | 0 |

(b) Advance tax paid (net of provision) | 256 | 0 | 0 |

(c) Interest due on Government Securities | 257 | 0 | 0 |

(d) Others (to be specified) | 258 | 100 | 0 |

Total weighted assets (Items 210 to 258) | 200 | — |

Notes:

1. Netting may be done in respect of assets where provisions for depreciation or for bad and doubtful debts have been made.

2. Unquoted shares are to be valued at cost or break-up value of the shares (as per last audited balance-sheet of the company concerned), whichever is less.

3. Stock on hire should be shown net of finance charges; i.e., interest and other charges, recoverable.

4. Assets which have been deducted from owned fund to arrive at net owned fund pursuant to Paragraph 5.1 of the guidelines will have a weightage of 'O'.
### PART E

**WEIGHTED NON-FUNDED EXPOSURES/OFF-BALANCE SHEET ITEMS**

<table>
<thead>
<tr>
<th>Items</th>
<th>Item code</th>
<th>Book value</th>
<th>Conversion factor</th>
<th>Equivalent value</th>
<th>Risk weight</th>
<th>Adjusted value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Financial &amp; Other guarantees</td>
<td>310</td>
<td></td>
<td>100</td>
<td></td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>2. Share/debenture underwriting obligation</td>
<td>320</td>
<td></td>
<td>50</td>
<td></td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>3. Partly paid shares/debentures</td>
<td>330</td>
<td></td>
<td>100</td>
<td></td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>4. Bills discounted/rediscoun ted</td>
<td>340</td>
<td></td>
<td>100</td>
<td></td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>5. Lease contracts entered into but yet to be executed</td>
<td>350</td>
<td></td>
<td>100</td>
<td></td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>6. Other contingent liabilities (To be specified)</td>
<td>360</td>
<td></td>
<td>50</td>
<td></td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>7. Total non-funded exposures (Items 310 to 360)</td>
<td>300</td>
<td></td>
<td>-</td>
<td></td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

*Note*: Cash margin/deposits shall be deducted before applying the conversion factors.
PART F
OTHER DATA

I. Aggregate of credit exposures categories into:

<table>
<thead>
<tr>
<th>Item Name</th>
<th>Item Code</th>
<th>Amount Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Standard assets</td>
<td>411</td>
<td></td>
</tr>
<tr>
<td>(ii) Sub-standard assets</td>
<td>412</td>
<td></td>
</tr>
<tr>
<td>(iii) Doubtful assets</td>
<td>413</td>
<td></td>
</tr>
<tr>
<td>(iv) Loss assets</td>
<td>414</td>
<td></td>
</tr>
</tbody>
</table>

II. Aggregate provisioning in respect of I above as per the guidelines prescribed:

<table>
<thead>
<tr>
<th>Item name</th>
<th>Item code</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Sub-standard assets (10 per cent of total outstanding)</td>
<td>421</td>
</tr>
<tr>
<td>(ii) Doubtful assets (100 per cent to the extent not covered by realisable value of security + 20 to 50 per cent of the secured portion for the period the asset has remained doubtful)</td>
<td>422</td>
</tr>
<tr>
<td>(iii) Loss assets (100 per cent of the outstanding balance)</td>
<td>423</td>
</tr>
</tbody>
</table>

(see Para 4 of the guidelines)

III. Other provisions in respect of:

<table>
<thead>
<tr>
<th>Item name</th>
<th>Item code</th>
<th>Provision required</th>
<th>Actual provision made</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Depreciation in fixed assets</td>
<td>431</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) Depreciation in investments</td>
<td>432</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Loss/intangible assets</td>
<td>433</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iv) Taxation</td>
<td>434</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(v) Gratuity/provident fund</td>
<td>435</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(vi) Others (to be specified)</td>
<td>436</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### PART G

**PARTICULARS REGARDING INVESTMENTS IN AND ADVANCES TO COMPANIES/FIRMS IN THE SAME GROUP AND OTHER NBFCs**

<table>
<thead>
<tr>
<th>Item Name</th>
<th>Item Code</th>
<th>Amount Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Outstanding loans and advances to and deposits with subsidiaries and companies in the same Group (Details enclosed in Appendix No.)</td>
<td>510</td>
<td></td>
</tr>
<tr>
<td>(ii) Investments in shares of subsidiaries, companies in the same Group and non-banking financial companies (Details enclosed in Appendix No.)</td>
<td>520</td>
<td></td>
</tr>
<tr>
<td>(iii) Investments by way of shares, debentures, loans and advances, leasing, hire-purchase finance, deposits, etc., in other companies, firms and proprietary concerns where directors of the company hold substantial interest (Details enclosed in Appendix No.)</td>
<td>530</td>
<td></td>
</tr>
</tbody>
</table>
**PART H**

PARTICULARS REGARDING CONCENTRATION OF ADVANCES (INCLUDING OFF-BALANCE SHEET EXPOSURE AND INVESTMENTS) TO PARTIES OTHER THAN THOSE IN PART G ABOVE

<table>
<thead>
<tr>
<th>Item Name</th>
<th>Item Code</th>
<th>Amount Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Loans and advances, including off-balance sheet exposures, to any single party in excess of 15 per cent of owned fund of the NBFC (Details enclosed in Appendix No.)</td>
<td>610</td>
<td></td>
</tr>
<tr>
<td>(ii) Loans and advances, including off-balance sheet exposures, to a single group of parties in excess of 25 per cent of owned fund of the NBFC (Details enclosed in Appendix No.)</td>
<td>620</td>
<td></td>
</tr>
<tr>
<td>(iii) Investments in other companies in excess of 25 per cent of the owned fund of the NBFC (Details enclosed in Appendix No.)</td>
<td>630</td>
<td></td>
</tr>
</tbody>
</table>

Certified that the data/information furnished in this statement are in accordance with the guidelines issued by the Reserve Bank of India relating to income recognition, accounting standards, asset classification, provisioning for bad and doubtful debts, capital adequacy and concentration of credit and investments. They have been compiled from the books of account and other records of the company and to the best of my knowledge and belief they are correct.

For and on behalf of

<table>
<thead>
<tr>
<th>Name of the Company :</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Signature :</td>
<td></td>
</tr>
<tr>
<td>Date :</td>
<td>Name :</td>
</tr>
<tr>
<td>Designation :</td>
<td>Company Seal :</td>
</tr>
</tbody>
</table>
AUDITOR’S REPORT

We have examined the books of account and other records maintained by..................Limited in respect of the capital funds, risk assets/exposures and risk asset ratio, etc., as on..........and report that to the best of our knowledge and according to the information and explanations given to us and as shown by the record examined by us, the figures shown in Parts A, B, C, D, E, F, G and H of the statement are correct.

Place:
Date:

Chartered Accountants
**ANNEX III**

**INFORMATION ABOUT THE PROMOTERS, CHAIRMAN, MANAGING DIRECTOR, DIRECTORS AND THE CHIEF EXECUTIVE OFFICER OF THE COMPANY**

*(PLEASE SEE NOTE ON PAGE 2)*

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Name</td>
<td></td>
</tr>
<tr>
<td>2. Designation</td>
<td>Chairman/Managing Director/ Director/Chief Executive Officer*</td>
</tr>
<tr>
<td>3. Nationality</td>
<td></td>
</tr>
<tr>
<td>4. Age</td>
<td></td>
</tr>
<tr>
<td>5. Business Address</td>
<td></td>
</tr>
<tr>
<td>6. Residential Address</td>
<td></td>
</tr>
<tr>
<td>7. Educational/professional qualifications</td>
<td></td>
</tr>
<tr>
<td>8. Line of business or vocation</td>
<td></td>
</tr>
<tr>
<td>9. Name/s of other companies in which the person has held the post of Chairman/ Managing Director/Director/Chief Executive Officer</td>
<td></td>
</tr>
<tr>
<td>10. (i) Whether associated as Promoter, Managing Director, Chairman or Director with any NBFC including a Residuary Non-Banking Financial Company which has been prohibited from accepting deposits/prosecuted by RBI?</td>
<td>Yes/No</td>
</tr>
<tr>
<td></td>
<td>(ii) If yes, the name/s of the company/ies</td>
</tr>
<tr>
<td>11 (i) Whether prosecuted/convicted for any economic offence either in the individual capacity or as a partner/director of any firm/company?</td>
<td>Yes/No</td>
</tr>
<tr>
<td></td>
<td>(ii) If yes, particulars thereof</td>
</tr>
<tr>
<td>12. Experience in the business of NBFC (number of years)</td>
<td></td>
</tr>
<tr>
<td>13. Equity shareholding in the company</td>
<td></td>
</tr>
<tr>
<td>No. of shares</td>
<td></td>
</tr>
<tr>
<td>Face value</td>
<td>Rs.</td>
</tr>
<tr>
<td>Percentage to total equity share capital of the company</td>
<td></td>
</tr>
<tr>
<td>14. Name/s of the companies, firms and proprietary concerns in which the person holds substantial interest</td>
<td></td>
</tr>
<tr>
<td><em>(Please see item 14 of instructions)</em></td>
<td></td>
</tr>
</tbody>
</table>
15. Names of the principal bankers to the concerns at 14 above

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Signature :</td>
</tr>
<tr>
<td></td>
<td>Date : Name :</td>
</tr>
<tr>
<td></td>
<td>Place: Designation :</td>
</tr>
<tr>
<td></td>
<td>(Chief Executive Officer) Company Seal :</td>
</tr>
</tbody>
</table>

**Note**: Separate form should be submitted in respect of each of such functionaries, by using photocopy of this format.
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• Evolution of the Paperless Transaction and its Impact on the Equipment Finance Industry
• Indicators for Success Study
• Credit Risk: Contract Characteristics for Success Study
• Study on Leasing Decisions of Small Firms

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