Press Release

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RBI norms to carve Rs.1.4 lakh crore headroom for bank credit

Rating based risk weightage to provide some funding respite to NBFCs

The Reserve Bank of India's (RBI's) move to align risk weights[1] of banks' exposure to non-banking finance companies (NBFCs)[2] with their respective credit ratings beneficial for both banks and NBFCs. Firstly, the release of capital for banks should increase deployment opportunities for banks. Secondly it enhances funding access for NBFCs.

So far banks have had to set aside capital assuming 100% risk weight uniformly for most NBFCs, barring specific categories such as asset finance companies (AFCs), infrastructure finance companies (IFCs) – including infrastructure debt funds structured as NBFCs (IDF-NBFCs) – and housing finance companies. This is set to be altered in the revised rating-based paradigm *(see Annexure 1 for illustrative calculations for difference in capital requirements under the earlier and changed dispensation)*.

Says Krishnan Sitaraman, Senior Director, CRISIL Ratings, "**The rating based approach for assigning risk weights will lead to capital savings for banks of ~Rs 13,000 crore, which will create additional lending headroom of ~Rs. 1.4 lakh crore[3] for the banking system. Of this, banks could deploy a portion towards higher rated NBFCs given the lower risk weight for these entities.**"

Bank debt to the NBFC sector has logged a compound annual growth rate of 20% in the past decade and reached a high of 55% as of December 2018. The first half of the current fiscal, saw a sharp increase in bank credit to NBFCs as bond yields spurted significantly, making market borrowings costlier thus spurring a rush for bank credit.

But then the IL&FS default resulted in an increase in negative sentiment towards NBFCs and reduction in funding access for them.

As a result, NBFCs resorted to higher securitisation, more of retail bond issuances and slowing down business growth to conserve liquidity as measures to meet the challenge. In this backdrop, the change in risk-weights should provide some respite for higher rated NBFCs.

Says Vydianathan Ramaswamy, Associate Director, CRISIL Ratings, "Our analysis of the top 30 NBFCs, covering more than two-third of the NBFC asset base, shows that 60% of them, stand to benefit from the RBI move. These are mainly diversified NBFCs and wholesale NBFCs, which are rated 'A' and above by domestic rating agencies. That's because their risk weights will drop to 20-50% range compared to 100% earlier."

The remaining 40% of the companies in the analysis set are in the asset finance and infra finance segments, for which risk weights were already lower (20-50% range) *(see Annexure 2 for distribution of top 30 NBFCs in different rating categories)*.

Overall, the capital release emanating from the revision in risk weights is bound to whet banks' appetite for loans to higher rated NBFCs which in turn could ease their funding challenges to some extent.

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[1] *As announced by the Reserve Bank of India (RBI) in its monetary policy announcement earlier this month.*

[2] *Excluding Core investment companies*

[3] *Assuming the risk weightage of ~100% for the incremental advances*

Annexure

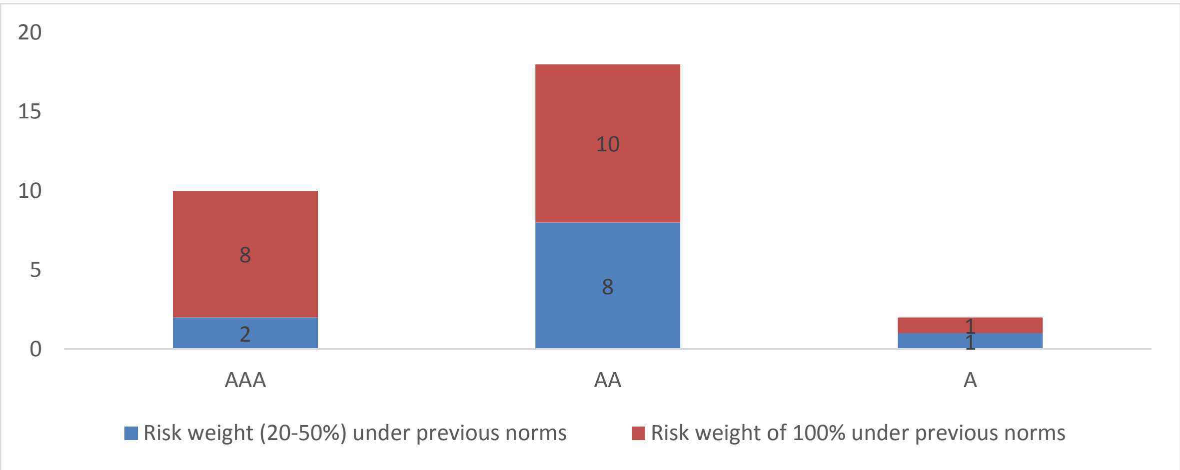
Annexure 1

Illustration of capital savings by banks under revised risk weight norms for NBFCs

	Under earlier norms			Under revised norms		
Credit rating	AAA	AA	A	AAA	AA	A
Risk weight (%)	100	100	100	20	30	50
Regulatory capital required on Rs 100 crore NBFC exposure (Rs crore)	9	9	9	9 *20% = 1.8	9 *30% = 2.7	9 *50% = 4.5
Savings on regulatory capital (Rs crore)	NA	NA	NA	7.2	6.3	4.5
% savings on regulatory capital	NA	NA	NA	80%	70%	50%

Annexure 2

Rating distribution of top NBFCs



Note: Based on published ratings from credit rating agencies

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