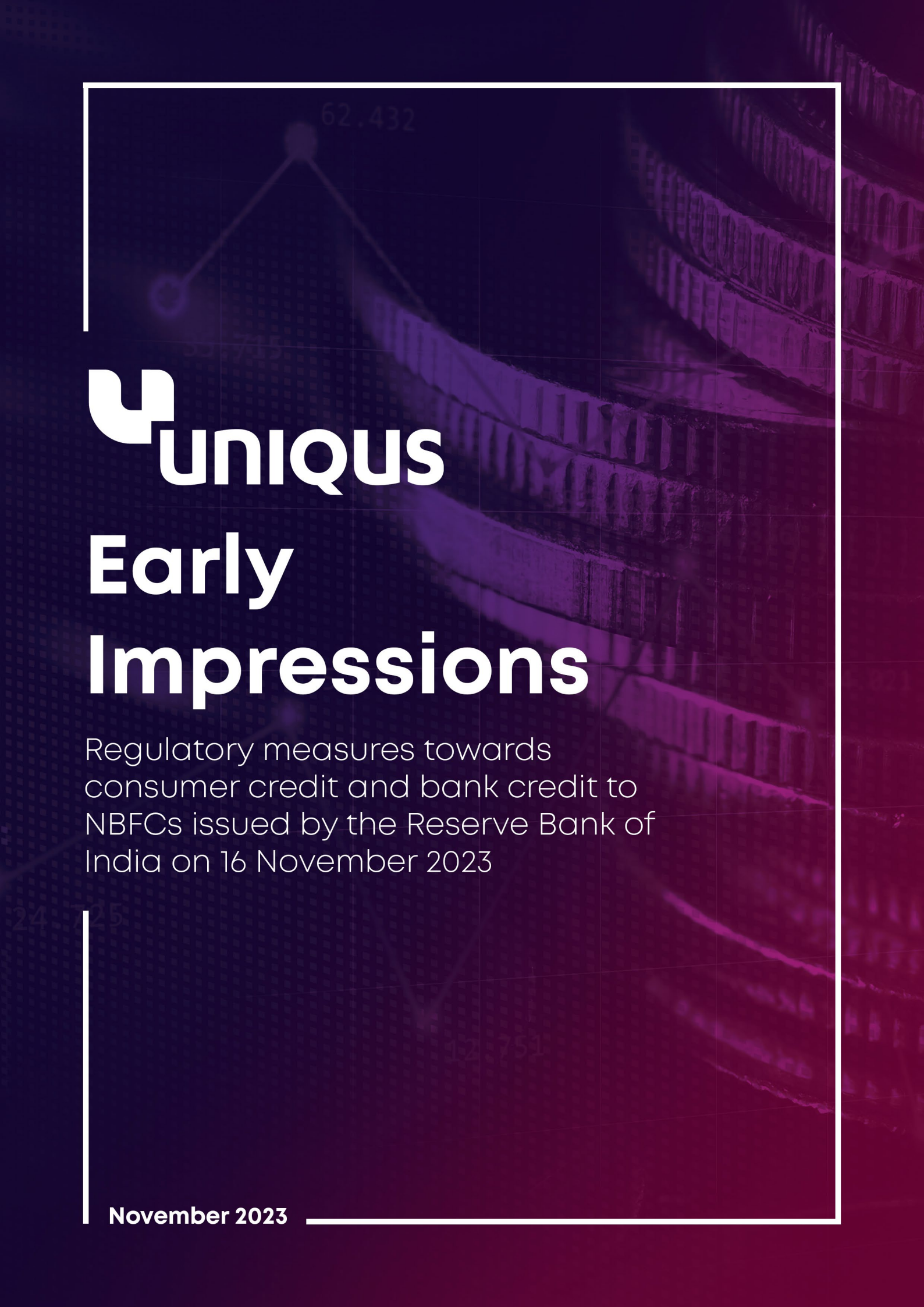




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Early Impressions

Regulatory measures towards consumer credit and bank credit to NBFCs issued by the Reserve Bank of India on 16 November 2023

November 2023

Background

1. Background

2. Uniquus Point of View

The RBI Governor's Statement dated October 6, 2023 stated that certain components of personal loans were recording very high growth. He further stated that such loans were being closely monitored by the RBI for signs of incipient stress. Banks and NBFCs were advised to strengthen their internal surveillance mechanisms, address the build-up of risks, if any, and institute suitable safeguards in their own interest. The Governor emphasised the need for robust risk management and stronger underwriting standards. With this as the background, the RBI on November 16, 2023 instituted the following measures which are expected to address the concerns raised in the Governor's Statement dated October 6, 2023:

Consumer credit exposure of commercial banks

Extant norms

Consumer credit attracts a risk weight of 100%

Changes introduced

It has been decided to increase the risk weights in respect of consumer credit exposure of commercial banks (outstanding as well as new), including personal loans, but excluding housing loans, education loans, vehicle loans and loans secured by gold and gold jewellery, by 25 percentage points to 125%

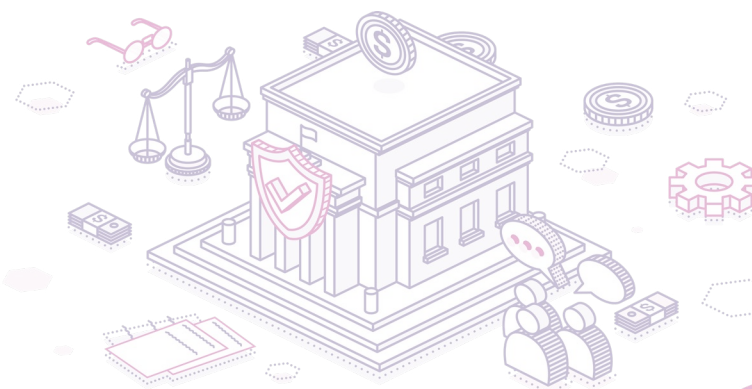
Consumer credit exposure of NBFCs

Extant norms

NBFCs' loan exposures generally attract a risk weight of 100%

Changes introduced

It has been decided that the consumer credit exposure of NBFCs (outstanding as well as new) categorised as retail loans, excluding housing loans, educational loans, vehicle loans, loans against gold jewellery and microfinance/SHG loans, shall attract a risk weight of 125%



1. Background

2. Uniquus Point of View

Credit card receivables

Extant norms

Credit card receivables of scheduled commercial banks (SCBs) attract a risk weight of 125% while that of NBFCs attract a risk weight of 100%

Changes introduced

It has been decided to increase the risk weights on such exposures by 25 percentage points to 150% and 125% for SCBs and NBFCs respectively

Bank credit to NBFC's

Extant norms

Exposures of Banks to NBFCs, excluding core investment companies, are risk weighted as per the ratings assigned by accredited external credit assessment institutions (ECAI)

Changes introduced

It has been decided to increase the risk weights on such exposures of Banks by 25 percentage points (over and above the risk weight associated with the given external rating) in all cases where the extant risk weight as per external rating of NBFCs is below 100%. For this purpose, loans to HFCs, and loans to NBFCs which are eligible for classification as priority sector in terms of the extant instructions shall be excluded

Strengthening credit standards

Extant norms

NA

Changes introduced

The regulated entities shall review their extant sectoral exposure limits for consumer credit and put in place, if not already there, Board approved limits in respect of various sub-segments under consumer credit as may be considered necessary by the Boards as part of prudent risk management. In particular, limits shall be prescribed for all unsecured consumer credit exposures. The limits so fixed shall be strictly adhered to and monitored on an ongoing basis by the Risk Management Committee. Further, all top-up loans extended by REs against movable assets which are inherently depreciating in nature, such as vehicles, shall be treated as unsecured loans for credit appraisal, prudential limits and exposure purposes

Uniquus Point of View

Our assessment of the above directive of the RBI is as follows:

1. Background

2. Uniquus Point of View

01 The RBI does believe that lending to certain asset classes could potentially result in elevated credit losses in the future, to cushion the impact of which, capital levels are being raised with immediate effect. Each lending institution will immediately need to assess the incremental capital which they may need basis the product profile of their lending book

02 In addition to maintaining higher capital, regulated entities have also been required to review their extant sectoral exposure limits for consumer credit and put in place limits under various sub segments

03 It will be interesting to note how the RBI view on potential stress in the consumer credit exposure plays out vis a vis the Ind AS numbers which will be reported by NBFC's in the coming periods. Assuming the RBI belief of potential stress in the consumer credit exposure is accurate, considering that NBFC's follow the Expected Credit Loss (ECL) approach for provisioning, one should expect to see an uptick in provisioning amounts as the same should also factor in forward looking data / outcomes for provision determination. This will potentially offset the incremental capital which the lending institution may require by applying higher risk weights for prescribed asset classes

04 Generally, one would expect to see enhanced / greater focus on underwriting for incremental lending to asset classes prescribed by the RBI. This area may expect to see greater involvement from the Board / Risk Management Committee. This could potentially also be an area of regulatory supervision by the RBI on a go forward basis

05 Whilst the outcome of the above activities will play out in the future, it would not be unrealistic to assume that one may see some slow down in consumer credit lending due to the requirement to now maintain higher capital (potential impact on cost of lending increasing and hence the borrowing being non affordable for the consumer) and introduction of Board approved limits / sub limits. This will also have a broader economic impact such as the consumer durables business, which are dependent on consumer borrowings to fund purchases

A TEAM THAT YOU CAN TRUST TO DELIVER



Sandip Khetan

Co-Founder, Global Head of ARC
sandip.khetan@uniquis.com



Sagar Lakhani

Partner, ARC - India
sagarlakhani@uniquis.com



Venkateswaran Narayanan

Partner, ARC - India
vn@uniquis.com



Akash Loonia

Director, ARC - India
akashloonia@uniquis.com



Ayushi Khakkar

Associate Director, ARC - India
ayushikhakkar@uniquis.com



Anish Gandhi

Manager, ARC
anishgandhi@uniquis.com



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To know more about us, please visit www.uniquis.com

