Press Release

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Revised NBFC guidelines to impact profitability by 25 bps

RBI norms to structurally strengthen NBFC sector and enhance lender confidence: CRISIL

CRISIL believes that the recent draft guidelines issued by the Reserve Bank of India (RBI) for non-banking finance companies (NBFCs) will adversely affect their profitability when implemented. CRISIL expects that the average return on assets (RoA) of NBFCs to drop by 25 basis points (bps) over the next two to three years. This will be primarily due to higher provisioning requirements on account of increase in standard asset provisioning and revision in recognition norms for non-performing assets (NPAs). However, proposals like increase in Tier-I capital adequacy ratio (CAR), stronger liquidity management, and enhanced disclosure requirements will structurally strengthen the NBFC sector over the medium term.

CRISIL believes that the tightening in NPA recognition norms to 90 days from 180 days and increase in standard provisioning requirement to 0.40 per cent from 0.25 per cent will adversely affect the profitability of the NBFC sector. As a result, the RoA is expected to drop by 25 bps over the medium term. Says **Mr. Pawan Agrawal, Senior Director – CRISIL Ratings,** ***"While the reported gross NPAs will increase in the near-term due to re-classification, the enhanced focus of NBFCs on collections in the initial buckets will lead to an improvement in asset quality gradually over the medium-term."***

The proposal to increase Tier-I capital adequacy ratio for NBFCs to 10 per cent (12 per cent for select NBFCs) from 7.5 per cent will improve the quality of capital and enhance the cushion against asset-side risks. Also, RBI has increased the risk weights for NBFCs engaged in capital market and commercial real estate financing and investments. While the existing Tier-I CAR of most NBFCs is comfortably above the revised regulatory requirement, the sector will have to raise around Rs.80 billion to maintain the current cushion over regulatory minimum, under the revised norms.

The guidelines have also stipulated a significant increase in disclosure requirements for NBFCs. These include disclosures on non-performing assets, provisioning, off-balance sheet transactions, and asset-liability profile. NBFCs would also have to seek RBI approval for major shareholding and key management changes. CRISIL believes that NBFCs would need to strengthen their internal processes and reporting systems to meet these stipulations, and that the revised guidelines will enhance transparency and improve corporate governance practices over the medium term.

The stipulation to maintain adequate liquidity to avoid negative mismatch in the upto 30-day bucket is largely similar to CRISIL's criteria on short-term liquidity management. Most CRISIL-rated NBFCs already maintain positive mismatches in the short-term buckets of upto 30 days.

Says **Mr. Suman Chowdhury, Director – CRISIL Ratings,** ***"The revised RBI guidelines will enhance the systemic stability of the NBFC sector and enhance lender confidence in this sector. CRISIL also believes that NBFCs will be able to smoothly transit to the tighter regulatory requirements, given the adequate time frame provided by RBI for transition."*** CRISIL believes that NBFCs will maintain their credit risk profiles under the revised regulatory regime, given their comfortable capitalisation, improving credit underwriting and collection mechanisms, and decreasing dependence on short-term funding.

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