Business Standard

RBI caps lending limits of NBFCs to bring them on a par with those of banks

Prescribes 9% CET1; Tightens norms for realty sector; loans to board members

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In yet another move to close the regulatory gap between banks and shadow banks, the Reserve Bank of India (RBI) has mandated exposure limits to the non-banking finance companies, in line with commercial banks.

In the large exposure framework released on Tuesday, the regulator capped aggregate exposure of NBFCs which are in the upper layer toward one entity at 20% of capital base. The limit can only be extended by another 5% with board's approval. For a particular borrower group, the cap is at 25%, with additional 10% if exposure is towards infrastructure.

The upper-layer NBFCs are typically the top 10 ones in terms of asset size.

However, NBFCs which are into infrastructure finance can have exposure of 25 per cent, with an option of additional 5 per cent of Tier I capital to a single counterparty. For a group of connected counterparties, infrastructure companies can have an exposure of 35 per cent of Tier-I capital.

In case of breach of the large exposure limits, the NBFCs have to report to the department of supervision of RBI. Consequently, it will be barred to undertake any further exposure (at the entity or group level) until it is down within the limit. The RBI has also warned that any failure to comply with the exposure limit may lead to imposition of penalties on the NBFCs.

These norms will come into effect from October 1, 2022.

BRIDGING THE GAP

- RBI narrows regulatory arbitrage of NBFCs by aligning large exposure, disclosure norms with banks
- Aggregate exposure to single entity capped at 20% of the capital base
- For group entities, exposure capped at 25% of capital base
- NBFCs have to report divergence in asset classification and provisioning
- Norms have also been tightened for lending to board members and their relatives

This is another step by the RBI to narrow the regulatory arbitrage that existed between banks and NBFCs. Over the years, RBI has been harmonising regulations between the NBFCs and the banks, in the wake of the many defaults seen in the shadow banking space, which started with Infrastructure Leasing and Financial Services (IL&FS) going bust.

RBI had come out with scale-based regulations for the NBFC sector, wherein large NBFCs will be subjected to greater scrutiny akin to that of the banks. Further, RBI harmonised the income recognition and non-performing asset (NPA) classification norms for NBFCs, which was seen as another step by the central bank to bring the regulations of NBFCs at par with the banks.

The RBI has also asked NBFCs to report details of their divergence in asset classification and provisioning requirements in their annual financial statements, if the divergence breaches the threshold set by the central bank.

The NBFCs have to disclose details of divergence if RBI finds that the additional provisioning requirements has exceed 5 per cent of the reported profits before tax and impairment loss on financial instruments for the reference period or if the additional gross non-performing assets (NPAs) identified by the central bank exceeds 5 per cent of the reported gross NPAs for the reference period. These guidelines will be applicable to the NBFCs in the upper and middle layer.

The RBI has also asked them to disclose all instances of breach of covenant of loan availed or debt securities issued by them. In addition to this, RBI has asked the NBFCs in the upper layer to list themselves on the bourses within three years of identification as an upper layer NBFC.

Further, the central bank has asked all NBFCs to make additional disclosures in their notes to accounts, including their exposure to real estate, capital market, intra-group exposure, and unhedged foreign currency exposure. They have also been asked to disclose their exposures to various sectors such as agriculture and allied activities, industries, services, personal loans, and others.

These guidelines will be effective for annual financial statements for the year ending March 31, 2023, and onwards, the RBI said.

The regulator has also tightened the norms for shadow banks for lending to the real estate sector, by mandating that the borrower should have prior approval from government or local authorities for the project for availing loans.

"To ensure that the loan approval process is not hampered on account of this, while the proposals may be sanctioned in normal course, the disbursements shall be made only after the borrower has obtained requisite clearances from the government / other statutory authorities," RBI said.

Norms have also been tightened for lending to board members and their relatives by NBFCs which are in the middle and upper layer.

These entities will now have to get board's approval to extend loans above Rs 5 crore and above to the directors, or relatives of directors. The same applies for any firm in which any of their directors or their relatives is interested as a partner, manager, employee or guarantor. In addition, the same approval is required for any company in which any of their directors, or their relatives is interested as a major shareholder, director, manager, employee or guarantor.

Middle layer NBFCs are - all deposit taking NBFCs (NBFC-Ds), non-deposit taking NBFCs with asset size of Rs 1000 crore and above and NBFCs which are Standalone Primary Dealers (SPDs), Infrastructure Debt Fund, Core Investment Companies (CICs), Housing Finance Companies (HFCs) and Infrastructure Finance Companies (NBFC-IFCs).

The regulator has also prescribed NBFCs which are in the upper layer to maintain a common equity tier-1 (CET1) capital of at least 9 per cent to the risk weighted assets, as compared to 5.5% for banks. The minimum capital adequacy requirement of NBFCs is 15%.

Common Equity Tier 1 capital will comprise of paid-up equity share capital issued by the NBFC, share premium resulting from the issue of equity shares, capital reserves representing surplus arising out of sale proceeds of assets and Statutory reserves.

RBI has said deferred tax assets shall be deducted in full, from CET1 capital if DTAs are associated with accumulated losses.