Banks and non-banking financial companies

Change in risk weights to increase capital requirement and pull-down growth

November 2023

Agenda

1 Key Changes

2 Impact Analysis – Banks

3 Impact Analysis – NBFCs

Highlights

Click to Provide Feedback

- The Reserve Bank of India (RBI) came out with regulatory measures for consumer credit and bank credit to non-banking financial companies (NBFCs) on November 16, 2023. The key changes are around risk weight application for consumer credit loans for banks and non-banks and banks lending to NBFCs.
- High risk weights for consumer credit (largely credit card receivables and personal loans) would impact the capital position of banks by 80-85 basis points (bps)
- Higher risk weights for bank credit to NBFCs would lead to lower fund flow to NBFCs and impact bank credit growth
- Double whammy for NBFCs as growth would be impacted due to lower fund flow and margins and, hence, profitability would be impacted by higher borrowing costs
- NBFCs would need to recalibrate their growth plans.
- Some NBFCs might need to fast-track capital raising.

Key Changes

Key changes

RBI increases risk weights by 25 percentage points across loan categories for all regulated entities

Current Risk Weights	vs	Revised Risk Weights
100%	Consumer credit exposure of commercial banks*	125%
100%	Consumer credit exposure of NBFCs^	125%
125%	Credit card receivables of banks	150%
100%	Credit card receivables of NBFCs	125%
Risk weight as per credit rating	Bank credit to NBFCs#	Risk weight as per credit rating + 25 percentage points

Source: RBI, ICRA Research
**Excludes housing loans, vehicle loans, gold loans, and education loans; ^ Excludes housing loans, vehicle loans, gold loans, education loans and MFI loans*
 # For entities where the extant risk weight, as per external rating, is below 100%

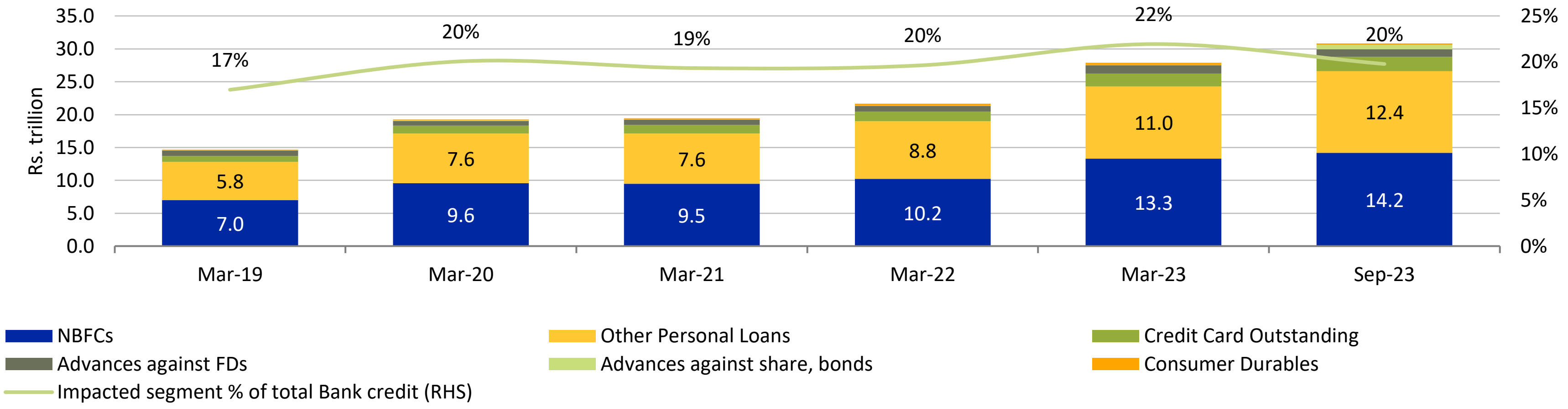
Bank credit to NBFCs to attract higher risk weights

- At present, banks' exposures to NBFCs, excluding core investment companies, are risk weighted as per the ratings assigned by accredited external credit assessment institutions.
- The RBI has increased the risk weights on such exposures of banks by 25 percentage points in all cases where the extant risk weight, as per the external rating of NBFCs, is below 100%.
- However, loans to housing finance companies (HFCs), and loans to NBFCs, which are eligible for classification as priority sector in terms of the extant instructions, shall be excluded.

External credit rating (category) of NBFC	Current risk weight	Revised risk weight
AAA	20%	45%
AA	30%	55%
A	50%	75%
BBB and below	No change	

Bank credit to impacted segments outpaced overall credit expansion

Exhibit: Non-food bank credit outstanding to impacted segments

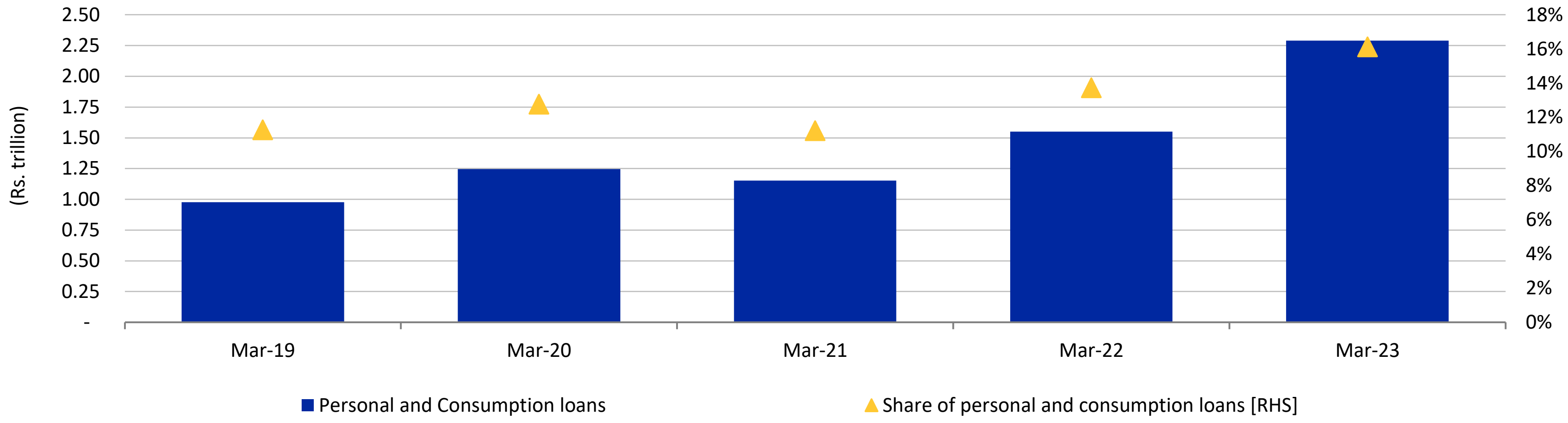


Source: ICRA Research, RBI

- Over the last three years (September 2020-September 2023), the credit to NBFCs rose at a compound annual growth rate (CAGR) of ~15% while other consumer loans increased at a CAGR of ~22%, which was much higher than the overall bank credit growth of ~14% during this period.

10% of NBFC* portfolio to attract higher risk weight

Exhibit: Retail exposures of NBFCs, which would attract higher risk weight



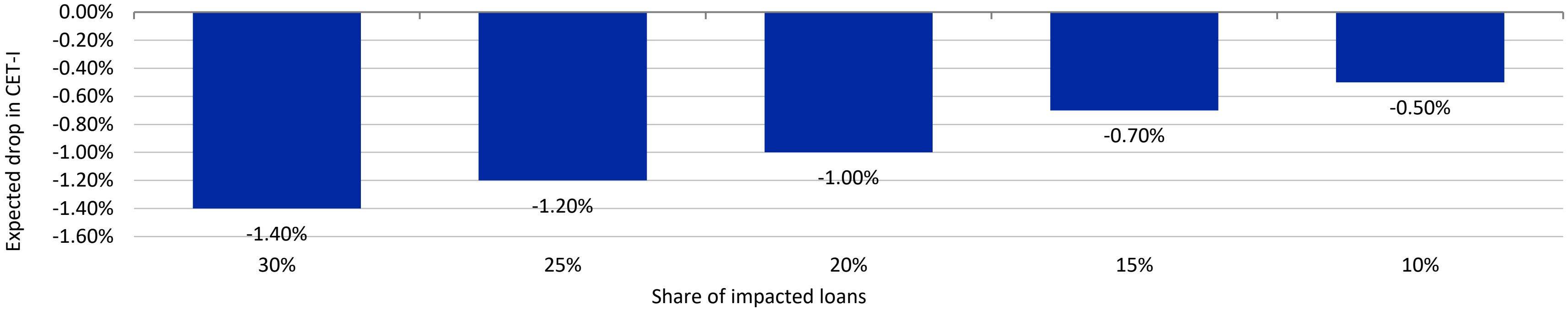
- Personal and consumption loans of NBFCs increased at a CAGR of 24% during March 2019 to March 2023 against the industry CAGR of 10%.

*Source: ICRA Research; *Excludes NBFC infrastructure loan book*

Impact Analysis – Banks

Impact on capitalisation manageable for banks

Exhibit: Impact on reported CET-I% based on share of impacted loans



Source: ICRA Research

- The overall risk-weighted assets (RWAs) of the impacted segments is estimated at Rs. 20.9 trillion, which is likely to increase to Rs. 28.6 trillion (+Rs. 7.7 trillion)
- At 8% core equity capital or CET-I for the incremental Rs. 7.7 trillion of RWAs, the incremental capital required will be Rs. 600 billion
- The overall CET-I for the banking system stood at Rs. 16.5 trillion or 13.6% of RWAs for the banking system
- The increase in RWAs will adversely impact the CET of banks by 80-85 bps
- The CET-I of private sector banks stood at 16.0% and is likely to be adversely impacted by 95-100 bps, given their higher exposure to unsecured consumer loans/credit cards
- The CET-I of public sector banks stood at 11.0% and is likely to undergo an adverse impact of 70-75 bps , although the impact for public banks is expected to be lower than private banks, given their lower exposure to unsecured consumer loans
- As per ICRA’s estimates (see exhibit), depending on the share of impacted assets, the adverse impact on the CET-I of an individual bank could range from 50-140 bps
- Given the strong outlook on profitability and the expected slowdown in the growth of the impacted segment of loans, the capital-raising requirement of banks, because of these regulatory changes, is likely to be limited

Analysis of impact on growth and profitability of banks

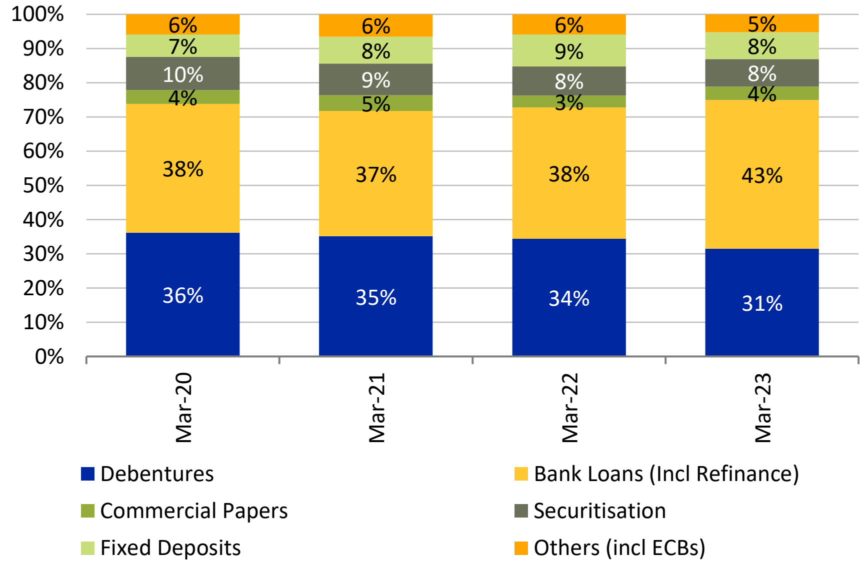
- With the decline in capital ratios and regulatory concerns regarding the impacted loans, banks would witness a moderation in credit growth by 0.5-1.0% on a YoY basis. The impact will be higher for the ones with lower capital cushions over regulatory levels.
- Increase in equity capital allocation towards the impacted loan segments will need banks to raise their lending rates while deposit costs are unlikely to be impacted, resulting in a marginal expansion of interest spreads
- Slower growth and lower leveraging of equity capital will moderate the return on equity of banks
- While the customer segments of banks and non-banks are different, banks could become more competitive in certain customer and product segments as the cost of borrowing for non-banks is likely to increase
- Banks with stronger capital positions and profitability to support internal capital generation could continue expanding their growth in the impacted segments, which could translate into better market share for such banks

Impact Analysis – NBFCs

NBFCs | Bank funding for NBFCs to get dearer; growth to be recalibrated

- Direct bank credit constitutes close to 45% of the total funding mix of NBFCs.
- Only 20-30% of the overall bank credit to NBFCs/HFCs (Rs. 14.2 trillion in September 2023) is estimated to qualify as priority sector and hence attract lower risk weights.
- Double whammy for NBFCs due to higher risk weights –
  - Incremental funding could be affected; growth shall moderate
  - Cost of funds would go up by an estimated 30-50 bps, as banks would price in the higher capital allocation for these loans.
- NBFCs could look at raising funds from debt capital markets, which would push up the yields and spreads over G-sec.
- Growth plans would moderate in the absence of requisite fund availability or NBFCs may prefer securitisation {pass-through certificates (PTCs)/direct assignment (DA)} or co-lending for expansion of assets under management (AUM).
- Competitive pressure for NBFCs shall intensify in segments (such as home loans, new vehicle loans, etc), where they compete with banks as banks shall have better pricing power.

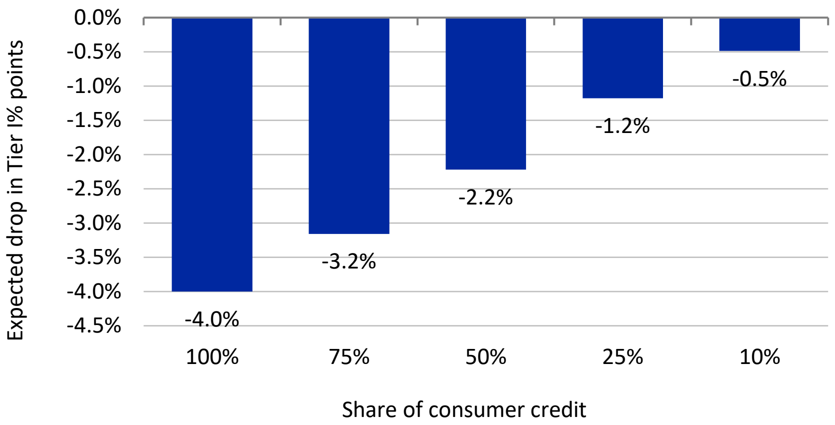
Exhibit: Funding profile of NBFCs/HFCs



Source: ICRA Research, data of 19 NBFCs and 10 HFCs
NCD – Non-convertible debentures, TL/WC – Term loans/Working capital loans, CP – Commercial paper, PTC/DA – Pass-through certificates/Direct assignment, FD – Fixed deposits

NBFCs |Entities focused on consumer credit would need to frontload capital raising

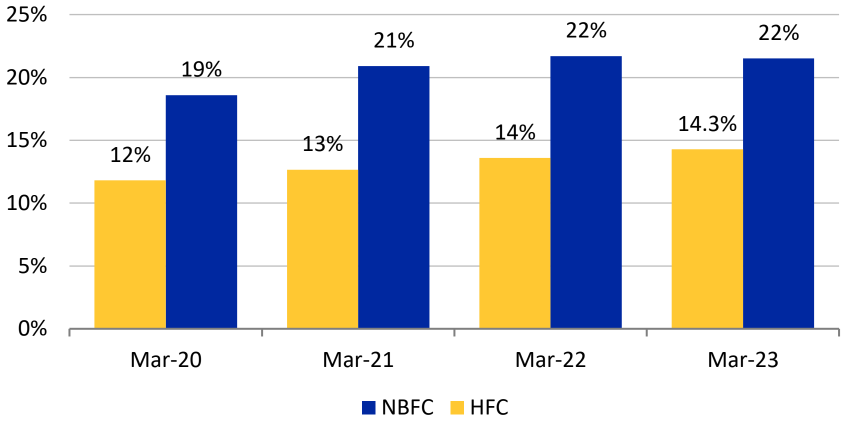
Exhibit: Impact on reported Tier I% based on share of unsecured loans



Source: ICRA Research

- Entities with a higher share of consumer credit would need to fast-track their planned capital raise to maintain prudent leverage.

Exhibit: Net worth/AUM of NBFCs and HFCs



Source: ICRA Research, based on ICRA's sample set of 19 NBFCs (non-Infra) and 10 HFCs

- While the capital position is adequate at the industry level for the medium-term growth of NBFCs and HFCs, specific entities with a higher share of unsecured loans/consumer credit and/or high growth would need fresh capital raise.

Other changes on strengthening of credit standards

Boards of regulated entities to set exposure limits for various sub-segments of consumer credit, especially for all unsecured consumer credit exposures

Top-up loans against movable and depreciating assets, such as vehicles, to be classified as unsecured exposures

- While some shift is likely between secured and unsecured loans in the portfolio mix, the impact is not expected to be significant. Slight recalibration of business models may be required.
- Higher provisioning will be required for unsecured loans. However, most entities are already under IndAS, whereby provisioning is higher than RBI requirements under prudential norms.
- Some of these top-up loans could qualify for business purposes, they would not attract higher risk weights. However, further clarity will be required on this.

Click to Provide Feedback

Analytical Contact Details

Name	Designation	Email	Contact Number
Karthik Srinivasan	Senior Vice President, Group Head	karthiks@icraindia.com	+91-22-61143444
A M Karthik	Senior Vice President, Co-Group Head	a.karthik@icraindia.com	+91-44-4596308
Anil Gupta	Senior Vice President, Co-Group Head	anilg@icraindia.com	+91-124-4545314
Manushree Saggar	Senior Vice President, Sector Head	manushrees@icraindia.com	+91-124-4545316
Sachin Sachdeva	Vice President, Sector Head	sachin.sachdeva@icraindia.com	+91-124-4545307
R Srinivasan	Vice President, Sector Head	r.srinivasan@icraindia.com	+91-44-4596315
Aashay Choksey	Vice President, Sector Head	aashay.choksey@icraindia.com	+91-22-61143430

ICRA

Business Development/Media Contact Details

Name	Designation	Email	Contact Number
L Shivakumar	Chief Business Officer	shivakumar@icraindia.com	022-61693304
Neha Agarwal	Head – Research Sales	neha.agarwal@icraindia.com	022-61693338
Rohit Gupta	Head Business Development - Infrastructure Sector	rohitg@icraindia.com	0124-4545340
Vivek Bhalla	Head Business Development - Financial Sector	vivek.bhalla@icraindia.com	022-61693372
Vipin Saboo	Head Business Development – Corporate Sector - West & East	vipin.saboo@icraindia.com	022-61693348
Shivam Bhatia	Head Business Development – Corporate Sector - North & South	shivam.bhatia@icraindia.com	0124-4545803
Naznin Prodhani	Head – Media & Communications	communications@icraindia.com	0124-4545860

ICRA

Thank You!