ICRA
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INDIAN MORTGAGE FINANCE INDUSTRY

RBI's master circular consolidates regulatory framework; impact on HFCs likely to be limited

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RBI'S MASTER CIRCULAR ON HFCS

The RBI's master circular, dated February 17, 2021, consolidates the directions/regulations for HFCs.

Most HFCs are either already compliant or are expected to meet the defined criteria within the stipulated timeframe.

RBI's master circular consolidates regulations for HFCs; no major concern with respect to compliance

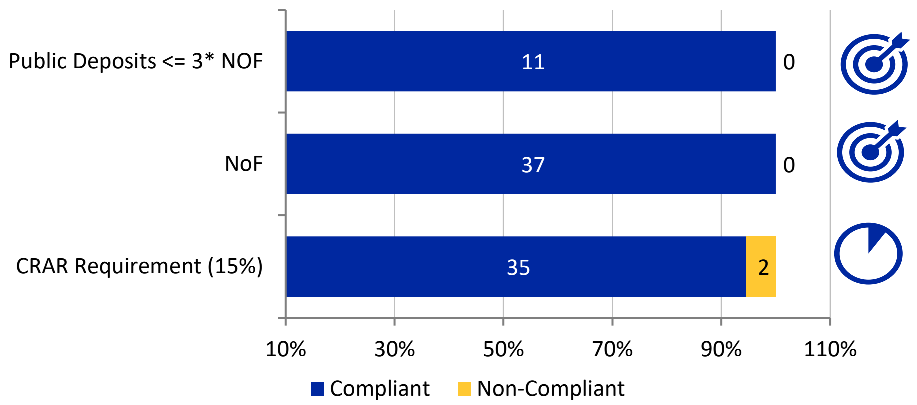
The Reserve Bank of India (RBI) issued a master circular titled 'Non-Banking Financial Company – Housing Finance Company (Reserve Bank) Directions, 2021' on February 17, 2021. This circular supersedes the previously issued directions by National Housing Bank (NHB) and the RBI and provides a consolidated regulatory framework applicable to housing finance companies (HFCs). ICRA has looked at some of the key aspects of the regulations and compared the same with corresponding regulations/directions for non-banking financial companies (NBFCs). In addition, ICRA tested a sample (37 HFCs which together contribute more than 95% to the portfolio of the HFCs) comprising ICRA-rated HFCs and some non-ICRA rated HFCs, where relevant data is available, and presented the impact on HFCs with respect to various aspects of the regulations.

Key findings of ICRA's analysis

- The regulations have stipulated a minimum net owned funds (NoF) requirement of Rs. 20 crore for HFCs; all 37 HFCs in the ICRA sample met this requirement as on March 31, 2020.
- Earlier, there were no defined criteria for qualifying assets for an entity to be classified as an HFC. However, the RBI introduced this concept last year (earlier in proposed guidelines and then in final guidelines, which are consolidated in the current circular). The criteria stipulate that housing finance should comprise at least 60% of the total assets (net of intangible assets). In addition, 50% of the total assets (netted off by intangible assets) should be towards individual housing loans. Both the conditions are to be met in a graded manner starting from 50% by March 2022 and reaching 60% by March 2024 for Housing Finance/Total Assets and starting from 40% by March 2022 and reaching 50% by March 2024 for Individual Housing Loans/Total Assets. ICRA has tested the sample for the ratio of Individual Housing Loans/Total assets as on March 31, 2020. Out of the ICRA sample of 37 HFCs, 34 are estimated to have already met the said condition (i.e. 50% of total assets as individual housing loans) as on March 31, 2020. Further, two HFCs are estimated to have individual housing loans comprising 40-50% of their total assets (net of intangible assets) and the remaining one is estimated to have individual housing loans less than 40% of the total assets (net of intangible assets). Thus, given the current portfolio composition and time available to meet the criteria, most of the HFCs are expected to meet the criteria comfortably.
- The RBI (and earlier NHB) has stipulated for HFCs to keep the capital to risk adjusted ratio (CRAR) at 15%. The guidelines permit a staggered movement to achieve a CRAR of 15% by March 2022. Out of the ICRA sample of 37 HFCs, 35 already had a CRAR of more than 15% as on March 31, 2020.
- For public deposit accepting HFCs, there is a condition that the public deposits cannot exceed three times of the NoF. Out of the ICRA sample of 37 HFCs, 11 are public deposit accepting HFCs and all are compliant on the said ceiling.

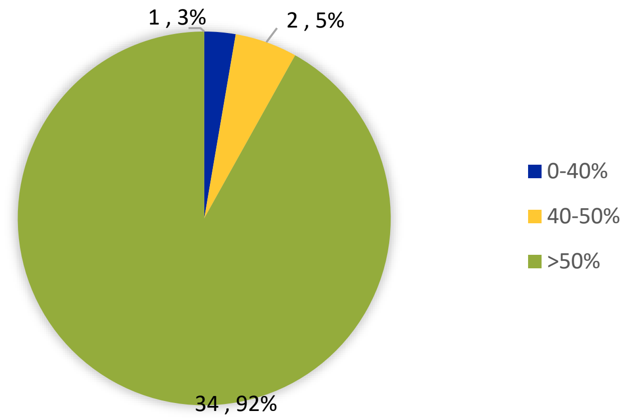
RBI'S MASTER CIRCULAR II COMPLIANCE STATUS OF HFCs

EXHIBIT 1: HFCs (nos.) on some of the Key Aspects (Mar'20 values)



Source: *HFCs' operational and financial data, ICRA research*

EXHIBIT 2: HFCs (nos.) on Individual Housing Loans/Total Assets - Mar'20 Values



Source: *HFCs' operational and financial data, ICRA research*

EXHIBIT 3: Comparison of HFC Guidelines with NBFC Guidelines and Impact on HFCs

	NBFC - HFC Guidelines	NBFC Guidelines	Impact on HFCs
Fresh registration and minimum net worth requirement	• Companies intending to function as HFCs shall seek registration with RBI under Section 29A of the National Housing Banking Act, 1987 (NHB Act) and existing HFCs holding a certificate of registration (CoR) issued by NHB need not approach RBI for a fresh CoR • Minimum NoF requirement of Rs. 20 crore • For existing HFCs, the glided path would be to reach Rs. 15 crore by March 2022 and Rs. 20 crore by March 2023	• Minimum NoF requirement - Rs. 2 crore for NBFC investment and Credit Company (NBFC-ICC) • NBFCs where higher NoF requirement exists include: NBFC – Micro Finance Institutions (NBFC-MFI), Infrastructure Debt Fund – NBFC (IDF-NBFC), NBFC -Infrastructure Finance Companies (NBFC-IFC), NBFC – Mortgage Guarantee Corporation (NBFC-MGC) and NBFC-Factor	• Fresh registration for HFCs would be shifted under RBI • Minimum NoF requirement for HFCs is higher compared to that for NBFC-ICC • NoF of all 37 HFCs in ICRA sample exceed Rs. 20 crore; therefore, unlikely to be impacted by this change
This is defining the term 'providing finance for housing' or 'housing finance' and qualifying assets criteria	**What's included in home loans** **Individual housing loans** • Home purchase loans • Home improvement • Home construction loans • Loan against property (LAP) residential with purpose of buying other residential property **Other housing loans** • Lending to public agencies including state housing boards for construction of residential dwelling units • Loans to corporates/Government agencies (through loans for employee housing) • Loans for slum development • Lending to builders for construction of residential dwelling units **What's not included** • Furniture and fixture loans • Loan against property (LAP) with purpose other than buying/improving property Not less than 60% of the total assets (netted off by intangible assets) should be in the nature of 'qualifying assets' i.e.	Not applicable	Based on the ICRA-rated portfolio, most HFCs would qualify for this criterion. HFCs, which fall short of the housing loans of 60% and minimum individual housing loans of 50%, would get a transition time of 1-3 years to achieve this number; therefore, this should be achievable. As mentioned previously, 34 of the 37 HFCs in the ICRA sample are estimated to have met the criteria of individual housing loans as 50% as on March 31, 2020 and two are estimated to be close to achieving the same. Only 1 HFC is estimated to have less than 40% of their total assets as individual housing loans.

	NBFC - HFC Guidelines	NBFC Guidelines	Impact on HFCs
	housing finance for HFCs. Moreover, not less than 50% of the total assets (netted off by intangible assets) should be towards individual housing loans. A phased timeline is given to HFCs, which do not currently fulfil the qualifying assets criteria. The timeline shall be phased as under:		

Timeline	At least 60% of total assets (netted off by intangible assets) as qualifying assets, i.e. towards housing finance	At least 50% of total assets (netted off by intangible assets) towards housing finance for individuals
March 31, 2022	50%	40%
March 31, 2023	55%	45%
March 31, 2024	60%	50%

Harmonising definition of capital (Tier I & Tier II) with that of NBFCs	• "Tier I Capital" means owned fund as reduced by investment in the shares of other NBFCs including HFCs and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten per cent of the owned fund • "Tier II capital" includes the following: a. Preference shares other than those which are compulsorily convertible into equity; b. Revaluation reserves at discounted rate of fifty-five per cent; c. General provisions (including that for standard assets) and loss reserves to the extent these are not attributable to actual diminution in value or identifiable potential loss in any specific asset and are available to meet unexpected losses, to the extent of one and one fourth per cent of risk-weighted assets (RWAs);	• "Tier I Capital" means owned fund as reduced by investment in shares of other NBFCs and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten per cent of the owned fund; and perpetual debt instruments issued by a non-deposit taking NBFC in each year to the extent it does not exceed 15% of the aggregate Tier I Capital of such company as on March 31 of the previous accounting year • "Tier II capital" includes the following: ▪ (a) preference shares other than those which are compulsorily convertible into equity; ▪ (b) revaluation reserves at discounted rate of fifty five percent;	The definitions for Tier I and II have largely been harmonised between HFCs and NBFCs. There is no mention of perpetual instruments in the HFC guidelines unlike the NBFC guidelines. However, other disclosures do talk about perpetual debt. Thus, there is need for greater clarity on the same.

	NBFC - HFC Guidelines	NBFC Guidelines	Impact on HFCs
	d. Hybrid debt capital instruments, provided the instrument complies with the regulatory requirement; and e. Subordinated debt	▪ (c) General provisions (including that for standard assets) and loss reserves to the extent these are not attributable to actual diminution in value or identifiable potential loss in any specific asset and are available to meet unexpected losses, to the extent of one and one fourth percent of RWAs; ▪ (d) hybrid debt capital instruments; ▪ (e) subordinated debt; and ▪ (f) perpetual debt instruments issued by a non-deposit taking NBFC which is in excess of what qualifies for Tier I capital, to the extent the aggregate does not exceed Tier I capital	
CRAR requirement	• Every HFC shall maintain a minimum capital ratio on an ongoing basis consisting of Tier I and Tier II capital, which shall not be less than ▪ 13 per cent as on March 31, 2020; ▪ 14 per cent on or before March 31, 2021; and ▪ 15 per cent on or before March 31, 2022 and thereafter of its aggregate RWAs and of the risk-adjusted value of off-balance sheet items. The Tier I capital, at any point of time, shall not be less than 10 per cent. The total of the Tier II capital, at any point of time, shall not exceed 100 per cent of the Tier I capital.	• Every applicable NBFC shall maintain a minimum capital ratio consisting of Tier I and Tier II capital, which shall not be less than 15 percent of its aggregate RWA on-balance sheet and of the risk-adjusted value of off-balance sheet items. • The Tier I capital in respect of applicable NBFCs (excluding NBFC – MFI and IDF - NBFC), at any point of time, shall not be less than 10%. • Applicable NBFCs primarily engaged in lending against gold jewellery (such loans comprising 50 per cent or more of their financial assets) shall maintain a minimum Tier l capital of 12 per cent.	HFCs must comply with the regulations in a graded manner. This was already there as a part of earlier circulars issued by NHB. Therefore, HFCs were already in the process of complying with these guidelines. Moreover, as per ICRA's analysis of its sample of 37 HFCs, 35 HFCs already had a CRAR of more than 15% as on March 31, 2020.
Group entities engaged in real estate business	• The HFC can either take an exposure on the group company in the real estate business OR lend to retail individual homebuyers in the projects of group entities, but cannot do both	No such specification in NBFC guidelines; however, similar exposure limits also apply for NBFCs	Not expected to impact business of HFCs

<table>
<tr><th></th><th>NBFC - HFC Guidelines</th><th>NBFC Guidelines</th><th>Impact on HFCs</th></tr>
<tr><td></td><td>If the HFC decides to take any exposure in its group entities (lending and investment) directly or indirectly, such exposure cannot be more than 15% of the owned fund for a single entity in the group and 25% of the owned fund for all such group entities
For extending loans to individuals who choose to buy housing units from entities in the group, the HFC would follow arm’s length principles in letter and spirit</td><td></td><td></td></tr>
<tr><td>Guidelines on liquidity management framework</td><td>All non-deposit taking HFCs with an asset size of Rs. 100 crore and above and all deposit-taking HFCs (irrespective of asset size) shall pursue liquidity risk management, which inter alia should cover adherence to gap limits, making use of liquidity risk monitoring tools and adoption of stock approach to liquidity risk
HFCs shall maintain a liquidity buffer in terms of the liquidity coverage ratio (LCR), which will promote the resilience of HFCs to potential liquidity disruptions by ensuring that they have sufficient high quality liquid assets (HQLA) to survive any acute liquidity stress scenario lasting for 30 days. Guidelines on the LCR will be applicable to HFCs as per the following timeline:
Guidelines on LCR
i) All non-deposit taking HFCs with asset size of Rs. 10,000 crore & above, and all deposit-taking HFCs irrespective of their asset size:
<table>
<tr><th></th><th>Dec 1, 2021</th><th>Dec 1, 2022</th><th>Dec 1, 2023</th><th>Dec 1, 2024</th><th>Dec 1, 2025</th></tr>
<tr><td>Minimum LCR</td><td>50%</td><td>60%</td><td>70%</td><td>85%</td><td>100%</td></tr>
</table>
ii) All non-deposit taking HFCs with asset size of Rs. 5,000 crore & above but less than Rs. 10,000 crore with the timeline as:
<table>
<tr><th></th><th>Dec 1, 2021</th><th>Dec 1, 2022`</th><th>Dec 1, 2023</th><th>Dec 1, 2024</th><th>Dec 1, 2025</th></tr>
</table></td>
<td>Similar guidelines applicable for NBFCs; however, NBFCs need to comply with these regulations from December 2020.
Applicable non-deposit taking and all deposit taking NBFCs (irrespective of their asset size) shall adhere to the set of liquidity risk management guidelines.
NBFCs shall maintain a liquidity buffer in terms of LCR which will promote resilience of NBFCs to potential liquidity disruptions by ensuring that they have sufficient HQLA to survive any acute liquidity stress scenario lasting for 30 days. The stock of HQLA to be maintained by the NBFCs shall be minimum of 100% of total net cash outflows over the next 30 calendar days. Guidelines on the LCR will be applicable to HFCs as per the following timeline:
Guidelines on LCR
i) All non-deposit taking NBFCs with asset size of Rs.10,000 crore and above, and all deposit taking NBFCs irrespective of their asset size:</td>
<td>Harmonises the guidelines for NBFCs and HFCs; however, HFCs get one more year to comply with the LCR</td></tr>
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<tr><th></th><th>NBFC - HFC Guidelines</th><th>NBFC Guidelines</th><th>Impact on HFCs</th></tr>
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<td><table><tr><th></th><th>Dec 1, 2020</th><th>Dec 1, 2021</th><th>Dec 1, 2022</th><th>Dec 1, 2023</th><th>Dec 1, 2024</th></tr><tr><td>Minimum LCR</td><td>50%</td><td>60%</td><td>70%</td><td>85%</td><td>100%</td></tr></table>
ii) All non-deposit taking NBFCs with asset size of Rs. 5,000 crore and above but less than Rs. 10,000 crore, as per the time-line given below:
<table><tr><th></th><th>Dec 1, 2020</th><th>Dec 1, 2021</th><th>Dec 1, 2022</th><th>Dec 1, 2023</th><th>Dec 1, 2024</th></tr><tr><td>Minimum LCR</td><td>30%</td><td>50%</td><td>60%</td><td>85%</td><td>100%</td></tr></table></td>
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<tr>
<td>Securitisation</td>
<td>All HFCs (systemically important and non-systemically important) under the ambit of the guidelines on securitisation transactions as applicable to NBFCs</td>
<td>Guidelines already applicable to NBFCs</td>
<td>Harmonises the guidelines for NBFCs and HFCs</td>
</tr>
<tr>
<td>Acceptance of public deposits</td>
<td>No HFC shall accept or renew public deposits unless it has obtained a minimum investment grade rating for fixed deposits from any of the approved credit rating agencies at least once a year and a copy of the rating is sent to NHB and it is complying with all prudential norms
An HFC, which has obtained a credit rating for its public deposits not below the minimum investment grade rating and is complying with all prudential norms, may accept public deposits not exceeding three times of its NoF</td>
<td>No NBFC with NoF of Rs. 25 lakh and above shall accept public deposits unless it has obtained a minimum investment grade or other specified credit rating for fixed deposits from any of the approved credit rating agencies at least once a year and a copy of the rating is sent to the bank along with a return on prudential norms
An investment and credit company or a factor (a) having minimum NoF as stipulated by the bank, and (b) complying with all prudential norms, shall accept or renew public deposits, together with the amounts remaining outstanding on the books of the company as on the date of acceptance or renewal of such deposit, not exceeding one and one-half times of its NoF</td>
<td>HFCs enjoy a higher limit of public deposits compared to NBFCs
As per ICRA's analysis, all 11 public deposit-accepting HFCs in the ICRA sample have raised public deposits within the said ceiling</td>
</tr>
</table>

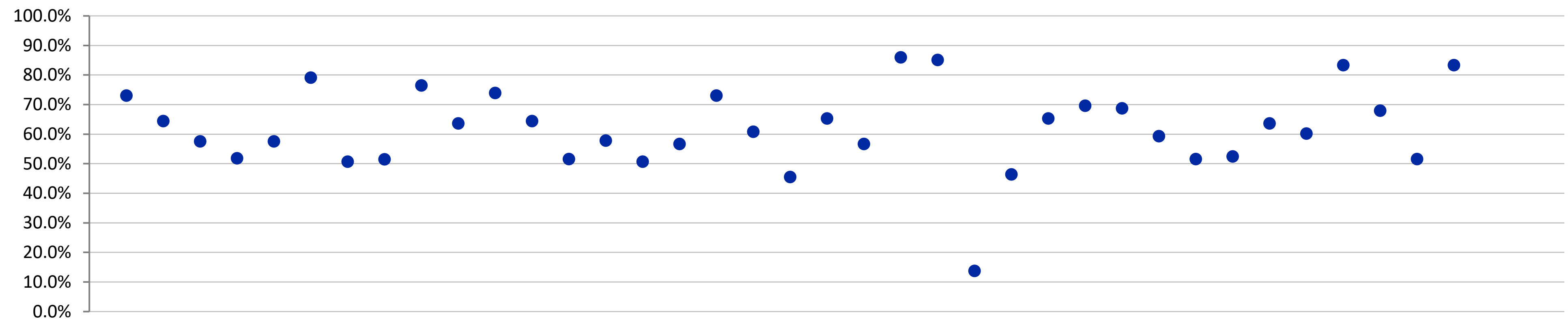
	NBFC - HFC Guidelines	NBFC Guidelines	Impact on HFCs
Maintenance of minimum percentage of liquid assets	• Every HFC accepting public deposits shall: ▪ invest and continue to invest in India in unencumbered approved securities, valued at a price not exceeding the current market price of such securities, an amount which, at the close of business on any day, shall not be less **than six and a half per cent of the public deposits outstanding** at the close of business on the last working day of the second preceding quarter ▪ Maintain in India an account with a scheduled bank in term deposits or certificates of deposit (free of charge or lien) or deposits with/subscription to bonds issued by NHB, or partly in such an account or in such deposit or partly by way of such subscription, a sum which, at the close of business on any day, together with the investment made under the above paragraph shall not be less than thirteen per cent of the public deposits outstanding at the close of business on the last working day of the second preceding quarter ▪ All other provisions of Section 29B of the NHB Act shall mutatis mutandis be applicable to the above requirement as if the expression 'public deposit' is the same as the expression 'deposit' as contemplated under the said provision	• Every NBFC-Deposit Taking (NBFC-D), shall invest and continue to invest in India in unencumbered approved securities valued at the price not exceeding the current market price of such securities an amount which shall, at the close of business or any day, not be less **than 15% of the 'public deposit',** as defined under sub-paragraph (xv) of paragraph 3 of these directions, outstanding at the close of business on the last working day of the second preceding quarter	Maintenance of liquid assets much higher for NBFCs compared with HFCs
Full cover for public deposits - Creation of floating charge in favour of depositors	• HFCs should ensure that a full cover is always available for the public deposits accepted by them. While calculating this cover, the value of all debentures (secured and unsecured) and outside liabilities other than the aggregate liabilities to depositors may be deducted from the total assets. Further, the assets should be evaluated at their book value or realisable/market value, whichever is lower, for this purpose.	• To ensure the protection of depositors' interest, NBFCs shall ensure that a full cover is always available for the public deposits accepted by it. • NBFCs shall create a floating charge on the statutory liquid assets maintained in terms of section 45-IB of the RBI Act and in terms of notifications issued by the bank from time to	HFCs have already been adhering to these requirements; hence, no incremental impact on their operations

	NBFC - HFC Guidelines	NBFC Guidelines	Impact on HFCs
	• All HFCs accepting/holding public deposits shall create a floating charge on the assets invested by them in terms of sub-sections (1) and (2) of Section 29B of the NHB Act, 1987 in favour of their depositors through the mechanism of a 'trust deed'. The charge so created shall also be registered with the Registrar of Companies and the information in this regard shall be furnished to the trustees and NHB.	time, in favour of the depositors through the mechanism of a 'trust deed'. The charge is required to be registered with the Registrar of Companies and the information in this regard is required to be furnished to the trustees and the bank.	
NPA definition	• 90+ dpd	• 90+ dpd or 180+ dpd depending on the type of NBFC	No impact
Risk weights on individual housing loans	• 35-75% depending on the loan-to-value (LTV) and ticket size	• 100% risk weight for all types of loans	No impact
Restructuring of loans	• Nothing specific mentioned except 25% higher risk weights on restructured loans	• Different criteria available for restructuring by NBFCs. For e.g., DCCO extension in case of real estate and infrastructure loans etc.	Historically, restructuring was not allowed for HFCs. The new circular is silent on this aspect. As HFCs also have commercial real estate (CRE) exposures, there needs to be clarity on the applicability of restructuring guidelines as in the case of NBFCs

Source: *RBI and NHB circulars, ICRA research*

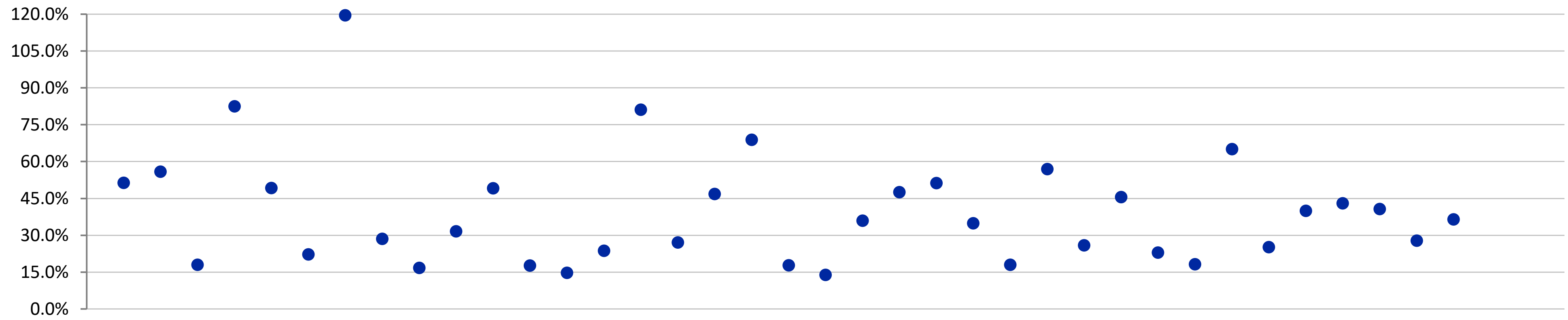
ANNEXURE 1 – HFCS' POSITION ON QUALIFYING ASSETS AND CRAR

EXHIBIT 4: Individual HL/Total Assets (net of intangible assets) as on March 31, 2020 of 37 HFCs in ICRA Sample



Source: *HFCs' financial & operational data, ICRA research*

EXHIBIT 5: CRAR as on March 31, 2020 of 37 HFCs in ICRA Sample



Source: *HFCs' financial & operational data, ICRA research*

ICRA
A MOODY'S INVESTORS SERVICE COMPANY

ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

Alliance with Moody's Investors Service

The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

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- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

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