ICRA

Indian Banking Sector

Final guidelines on liquidity coverage ratio to support credit growth

April 2025

Highlights

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ICRA estimates the final guidelines leading to improvement in LCR would result in a release of Rs. 2.3-2.5 trillion of HQLA. This is equivalent to 1.3-1.4% of non-food bank credit as of Mar'25 and would support the estimated credit expansion of 10.4-11.5% in FY2026. It will also aid the profitability of banks, though the impact is expected to be marginal.

- The final guidelines on liquidity coverage ratio (LCR) framework released by the Reserve Bank of India (RBI) **shall come into force with effect from April 01, 2026**. While ICRA estimated the draft guidelines to reduce the systemwide LCR by 14-17%, **the final guidelines are expected to increase the LCR of the bank by 6% (RBI's estimate)** at an aggregate level and improve their ability to pursue growth.

- The RBI, in its final guidelines, has retained haircuts on high-quality liquid assets (HQLA; Government securities, or G-secs) as proposed in draft circular in July 2024. **However, the additional run-off factor on internet and mobile banking (IMB) enabled retail and small business customer deposits has reduced to 2.5% instead of 5.0%, as proposed earlier. Moreover, the RBI has reduced the run-off factor on deposits** from wholesale funding from non-financial corporates to 40% from 100% currently.

- The increase in the run-off factor on IMB deposits by 2.5% will negatively impact the LCR by 7-12% (against ICRA's earlier estimate of 14-17%). Given that the net impact of the final LCR guidelines is expected to be a positive 6%, as assessed by the RBI, **ICRA estimates the positive impact on account of the reduction in the run-off factor on wholesale deposits from non-financial entities to be 13-18%.**

- ICRA estimates the 5.5-8.0% of total deposits (Rs. 12.0-16.5 trillion) as on December 31, 2024 to benefit from reduction in the run-off factor on non-financial entities like trusts (educational, charitable and religious), partnerships, LLPs, etc.

- The final LCR guidelines and other regulatory measures, like repo rate cut, deferment of increased provisioning on project finance, rollback of increased risk weights on loans given by banks to microfinance borrowers and non-banking financial companies (NBFCs) would support credit growth. **ICRA expects credit expansion of Rs. 19.0-20.5 trillion (growth rate of 10.4-11.3%) in FY2026.**

Comparison of LCR final guidelines with draft guidelines

Exhibit 1: Changes in run-off rates across deposits

Deposits	Old Run-off Rate (%)	Run-off factor in draft LCR guidelines (%)	Run off in LCR guidelines (%)
RD/SBD – Stable (IMB)	5	10	7.5
RD/SBD - Less Stable (IMB)	10	15	12.5
RD/SBD – Stable (Non-IMB)	5	5	5
RD/SBD - Less Stable (Non-IMB)	10	10	10
Operational Deposits	5-25	5-25	5-25
Non-Financial, Sovereign, Central Banks, etc.	40	40	40
Funding from non-financial entities	100	100	40
Others	100	100	100

Source: RBI, ICRA Research; RD – retail deposit; SBD – small business deposit; IMB – internet and mobile banking enabled

Exhibit 2: Haircuts on HQLA: No changes from the draft guidelines

Category of Collateral	Residual Maturity of Collateral				
	0-1 year	1-5 years	5-10 years	10-15 years	>15 years
Treasury Bills and Central Government Dated Securities (including Oil Bonds)	0.50%	1%	2%	3%	4%
SDLs (unrated)	2.50%	3%	4%	5%	6%
SDLs (rated)	1.50%	2%	3%	4%	5%

Source: RBI, ICRA Research; SDL – state development loans

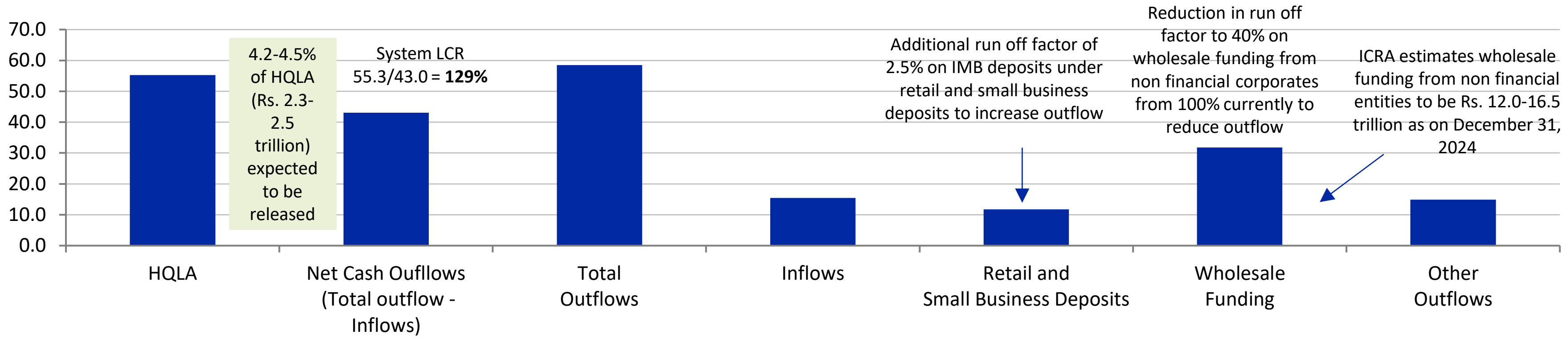
Impact of revised LCR framework on banks' LCR

↑	6%	**Net Impact** of revised LCR framework on banks' LCR as estimated by the RBI
↑	13-18%	ICRA estimates a positive impact of 13-18% on banks' LCR at an aggregate level as a result of **reduction in run off factor to 40% on deposits from non-financial entities from 100% currently**
↓	7-12%	ICRA estimates a negative impact of 7-12% on banks' LCR at an aggregate level **due to imposition of additional run off factor of 2.5% on IMB deposits and haircut on HQLA**

- Based on the draft LCR guidelines released in July 2024, ICRA had estimated a decline of 14-17% for the LCR due to the additional run-off factor of 5% on IMB enabled retail and small business customer deposits and haircuts on the HQLA. However, in the final LCR framework the RBI assigned additional run-off factor of only 2.5% on IMB deposits, instead of 5% proposed earlier, while retaining the proposed haircuts on HQLA. As a result, ICRA estimates the increase in the run-off factor to negatively impact the system level LCR by 7-12% against a previous estimate of 14-17%.
- Moreover, the RBI in its final guidelines has rationalised the composition of wholesale funding from 'other legal entities (OLE)'. Consequently, funding from non-financial entities like trusts (educational, charitable and religious), association of persons, partnerships, proprietorships, limited liability partnerships (LLPs) and other incorporated entities etc. shall be categorised as funding from 'non-financial corporates' and attract a lower run-off rate of 40% against 100% currently. This is expected to positively impact the LCR by 13-18%.
- **The decrease in the run-off factor on the wholesale deposits from non-financial corporates will offset the impact of increase in the run-off factor on IMB deposits, resulting in a net increase in LCR by 6%, as assessed by the RBI.**

LCR as on December 31, 2024 and category of deposit at banking sector level

Exhibit 3: System-wide drivers and constituents of LCR



Source: Banks (13 PSBs including IDBI and 19 large PVBs), ICRA Research; Figures in Rs. trillion

- ICRA estimates the increase in the run-off factor on IMB deposits and the haircut on HQLA to have a negative impact of 7-12% on banks' LCR (based on the proportion of these deposits to be 30-90% of total bank deposits).
- Further, ICRA estimates the deposits from non-financial entities like trusts (educational, charitable and religious), partnerships, LLPs, etc. to be Rs. 12.0-16.5 trillion as on December 31, 2024.
- The final guidelines will result in the release of HQLA to the tune of Rs. 2.3-2.5 trillion, which can then be deployed at a higher yield. While banks' profitability will improve because of the HQLA release, however, the same is estimated to be limited.

RBI provides relief on LCR with final guidelines leading to estimated increase in aggregate LCR

Exhibit 4: Aggregate movement in LCR for public banks

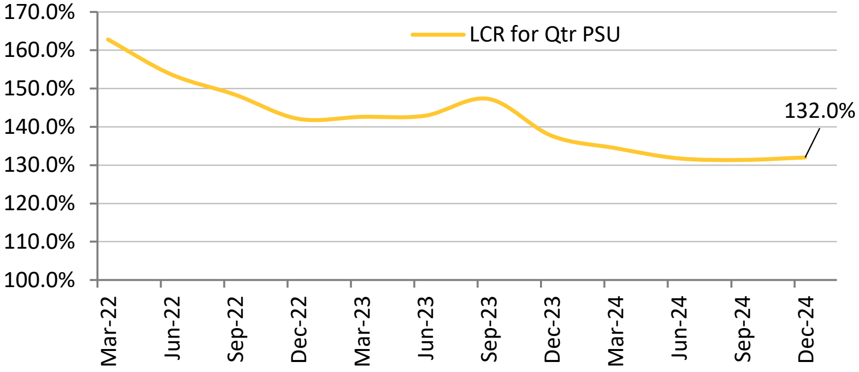
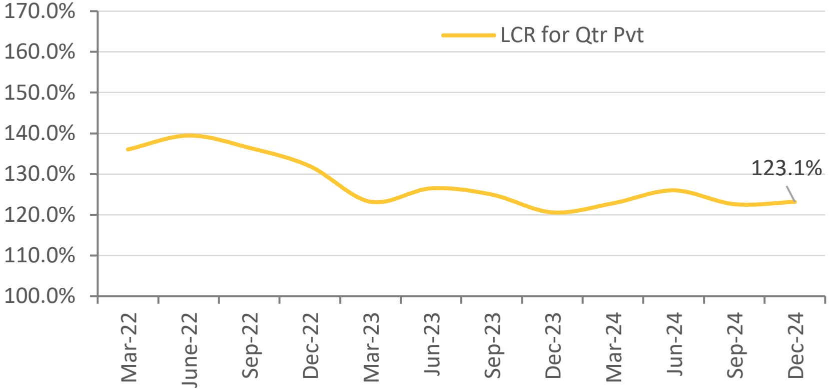


Exhibit 5: Aggregate movement in LCR for private banks

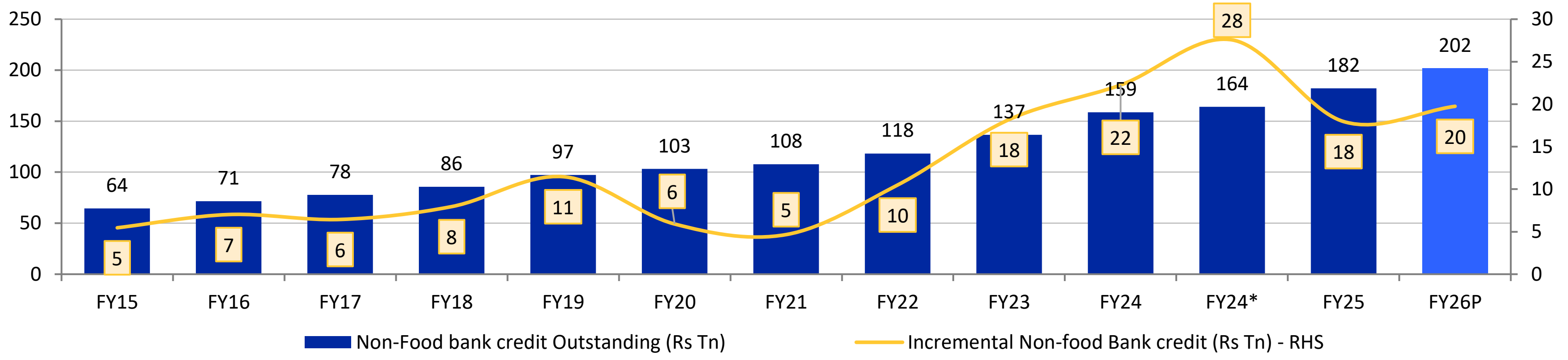


Source: ICRA Research; Banks (13 PSBs including IDBI and 19 large private banks (PVBs)); LCR – Liquidity Coverage Ratio

- With the elevated CD ratio, the banking sector's reliance on wholesale deposits has increased, leading to a steady decline in the average LCR of the sector. Though the same remains comfortably above the required level of 100%, it limits the banks' ability to pursue credit growth and necessitates the chasing of retail deposits.
- While the aggregate LCR for public sector banks has come down over the past few years due to strong growth in advances, it stands comfortably at 132% as on December 31, 2024. The private banks also witnessed a similar trajectory and their LCR stood lower at 123% as on December 31, 2024.
- The final LCR guidelines will provide relief to banks and will improve their ability to grow the loan book, while maintaining a comfortable LCR.

ICRA expects credit expansion at 10.4-11.3% in FY2026

Exhibit 6: Non-food bank credit growth trends and estimates



Source: Banks (13 PSBs including IDBI and 19 large PVBs), ICRA Research; Figures in Rs. trillion

- ICRA expects the regulatory easing seen in the recent months to support a credit expansion of Rs. 19.0-20.5 trillion, clocking a growth rate of 10.4-11.3% in FY2026. Such measures include the repo rate cut, deferment of additional provisions on infra projects, along with the rollback of increased risk weights on loans given by banks to microfinance borrowers and NBFCs.
- In addition, the final guidelines on the LCR framework would increase the LCR by around 6% (as assessed by the RBI). ICRA expects the same to result in the release of Rs. 2.3-2.5 trillion of HQLA, equivalent to 1.3-1.4% of non-food bank credit as of Mar’25, to support banks’ credit expansion.

CD ratio seen inching up again, after marginal dip in past few fortnights

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Exhibit 7:Trends in credit-to-deposit ratio

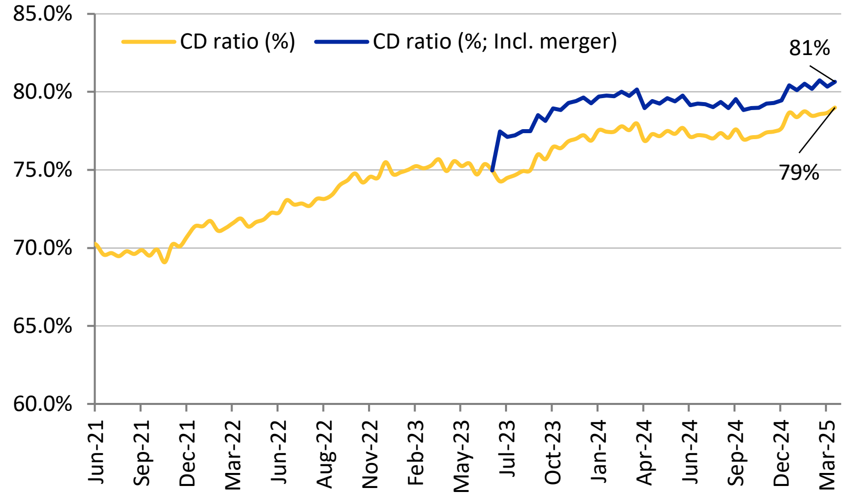
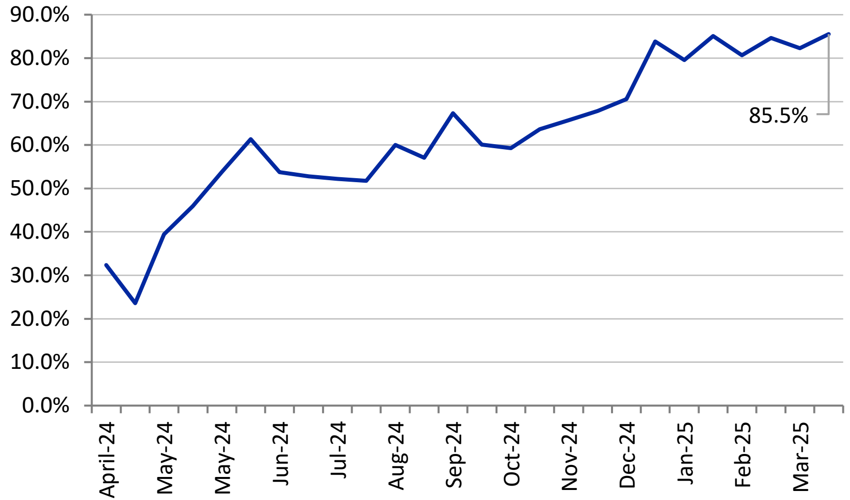


Exhibit 8: Trends in incremental CD ratio (YTD FY2025)



Source: ICRA Research, RBI; Incremental CD ratio (YTD FY2025) is calculated as incremental credit/incremental deposit from beginning of FY2025 to respective dates

- While the amended LCR framework is expected to improve the prospects of credit growth, the persisting challenges in deposit mobilisation, high credit-deposit (CD) ratio and rising stress in the unsecured retail and small business loans would continue to remain a drag on credit growth.

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Thank You!