TIGHTER REGULATIONS

NBFCs well placed to comply with RBI's latest norms

Analysts say new rules will not impact most NBFCs, but Crisil expects their average return on assets to drop

BY JOEL REBELLO, DINESH UNNIKRISHNAN & ANUP ROY

MUMBAI

Most non-banking finance companies (NBFCs) are well placed to adjust to an increase in provisioning requirements, higher capital adequacy ratio and tighter norms on bad loan classification, analysts said, even as rating agency **Crisil Ltd** said the new norms, when implemented, will impact NBFCs' profitability.

The Reserve Bank of India (RBI) draft guidelines, released on Wednesday, propose to raise tier I capital or the core capital for all NBFCs. The guidelines propose to give NBFCs two years to arrange for the required capital.

For non-deposit taking captive NBFCs, or those engaged in financing the parent company's products, core capital is to be raised to 12% of assets from 7.5%.

NBFCs engaged in lending to infrastructure should have a core capital ratio of 10%, unchanged from the current level. If the draft guidelines are finalized without any change, NBFCs dealing with gold loans will have to carry a minimum core capital adequacy ratio of 12% from April 2014 against 10% now.

NBFCs will also have to classify loans as bad in 90 days, the same as commercial banks. This can be done in a phased manner in the next three years, the draft norms said. Under current norms, they wait for at least 180 days to classify an asset as bad when a borrower defaults.

The draft rules also propose an increase in the provisioning for standard assets for NBFCs from 0.25% to 0.40% of the outstanding amount, effective 31 March 2014.

Adarsh Parasrampuria, research analyst at **Prabhudas Lilladher Pvt. Ltd**, said the guidelines are positive from the governance point of view and won't impact NBFCs because there is enough time for them to comply with them.

"The initial draft, which was released last year, proposed a blanket 12% tier I capital. At 10%, the current norms are easier to comply with. Even the reduction in the time to classify bad loans is not a big deal because they have at least two years to conform," Parasrampuria said.

In August 2011, an RBI working group, headed by former deputy governor Usha Thorat had recommended increasing core capital of all NBFCs to 12% from 7.5%.

HEMANT MISHRA/MINT

Policy framework: *The RBI draft guidelines propose to raise tier I capital for all NBFCs and will give NBFCs two years to arrange for the required capital.*

The draft guidelines are based on recommendations made by the working group.

S. Ranganathan, head of research at **LKP Securities Ltd**, said NBFCs have been expecting tighter regulations ever since the working group report was released in August 2011.

"It's a tough call to say which NBFCs will be impacted more but one thing is sure that large NBFCs which are backed by companies like **Mahindra and Mahindra Financial Services Ltd** and **Tata Capital Financial Services Ltd** will not find it difficult," he said.

Pradeep Bandivadekar, chief operating officer, corporate finance division, Tata Capital, called the revision "prudent".

"But in terms of level-playing field, while the governance and capital has been aligned, it will also be good if NBFCs are allowed to operate in foreign exchange and security management businesses," Bandivadekar said.

Nirmal Jain, chairman of **India Infoline Ltd**, said NBFCs should be covered by the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act like banks to recover bad loans.

"NBFCs should also be given a level-playing field in matters such as gold loans where we are restricted with a loan-to-value ratio of 60%, while banks are lending as much as 95% against the value of gold. This is not a fair proposition," Jain said.

Crisil expects the average return on assets of NBFCs to drop by 25 basis points (bps) over the next two to three years. One bps is one-hundredth of a percentage point.

"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," a Crisil release said.

Vimal Bhandari, managing director at **IndoStar Capital Finance Pvt. Ltd**, said the new norms will impact small NBFCs, especially those focused on lending to first-time borrowers.

"They could face difficulty in raising fresh capital; if they are unable to provide for the higher level of capital required, they may need to shrink their operation. There could be some degree of industry consolidation," he said.

The draft hasn't given any timeframe for government-owned NBFCs such as **Power Finance Corp. Ltd** and **Rural Electrification Corp. Ltd** to comply with norms, said Nilanjan Karfa, analyst at **Brics Securities Ltd**.

"These financial institutions should not be existing in the first place or existing in a small way only because large part of their book is state government utility financing at 12-13% whereas the state government raises capital at sub-9%," Karfa said in a note on Thursday.

There is also no clarity on the timeframe for microfinance companies. In December last year, RBI had created a separate category of NBFC-MFIs with a view to streamline regulations for such companies.

"It's not very clear whether the new rules will apply to NBFC-MFIs. If they are coming under the new regulations, it will create some stress on their operations in the form of higher provisioning and asset classification requirements, given that the customer segment of such NBFCs are totally different," said Kishore Kumar Puli, managing director and chief executive officer of **Trident Microfin Pvt. Ltd** and chief of the Andhra Pradesh chapter of Microfinance Institutions Network, an industry body.

Gold loan companies have been preparing for tighter regulations over a period of time. "We have been gearing up to comply with new NPA (non-performing assets) and capital norms. It is not a cause of major concern," said John Muthoot, chairman and managing director of **Muthoot Fincorp. Ltd**, one of the top three gold loan lenders in India.

joel.r@livemint.com