RBI Tightens Provisioning Norms on Standard Assets for NBFC-UL

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Synopsis

The Reserve Bank of India has issued a circular to tighten the provisioning norms of standard assets for large NBFCs in a bid to harmonise the same with banks. However, its impact would not be material as most large NBFCs already maintain Stage 1 and Stage 2 provisioning (under ECL norms) i.e. standard asset provisioning higher than the required levels.

Provisions in Sync with Banks

In the last decade, the scale of NBFCs has increased significantly, with few having loan books larger than mid-sized banks. The loan portfolio of NBFCs assets has been outpacing the banks' credit growth and now constitutes around 25% of banking advances and within the NBFC space, retail NBFCs have been growing the fastest. However, after the failure of a few large scale NBFCs in the recent past, RBI has accelerated the tightening of the prudential norms for the NBFCs, bringing them in line with those for banks. Over the last year, the regulator has issued a series of regulations, including the Scale based regulations, uniformity in the implementation of IRACP norms, and PCA framework for NBFCs.

RBI's recent circular dated June 6, 2022, looks at aligning the Provisioning for Standard Assets by NBFCs in the Upper Layer as per RBI's scale-based regulations with that prevalent for banks. These would be effective from October 01, 2022. The revised norms for the funded amount outstanding have been summarised in the table below:

Figure 1: Provisioning Norms for Standard Assets

Category of Assets	Rate of Provision
Individual housing loans and loans to Small and Micro Enterprises	0.25%
Housing loans extended at teaser rates	2.00%, which will decrease to 0.40% after 1 year from the date on which the rates are reset at higher rates (if the accounts remain 'standard')
Advances to Commercial Real Estate – Residential Housing (CRE – RH) Sector	0.75%
Advances to Commercial Real Estate (CRE) Sector (other than CRE-RH)	1.00%
Restructured advances	As stipulated in the applicable prudential norms for restructuring of advances
All other loans and advances not included above, including loans to Medium Enterprises	0.40%

Source: RBI

- Further, the current credit exposures arising on account of the permitted derivative transactions would also be subject to provisioning requirements as applicable to the loan assets in the 'standard' category of the concerned counterparties.

CareEdge View

The largest NBFCs have now adopted Ind AS and have classified their assets as per stages given below according to the expected credit loss scenario:

- Stage 1: Loans with low credit risk and where there is no significant increase in credit risk
- Stage 2: Loans with a significant increase in credit risk

- Stage 3: Credit impaired loans

Generally, Stage 1 and Stage 2 assets constitute standard assets, including standard restructured accounts. Most of the large-sized NBFCs generally have carried higher provisions than under Ind AS either by way of ECL requirement or through management overlay, especially during the Covid-19 pandemic, which has been in the range of approximately 2.5% -- higher than the minimum regulatory requirement. As a result, the larger NBFCs are unlikely to see a material impact on their profitability due to the increase in standard asset provisioning requirements. However, the credit growth in FY23 is expected to be higher than the previous year and NBFCs will continue to have an asset quality overhang in the near term largely in the unsecured asset classes. This is due to the impact of Covid and the new IRACP norms circular, which may keep the credit costs elevated in the near term.

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