RBI IRACP Norms – Gross NPAs of many NBFCs likely to inch up. Limited impact on credit costs.

November 16, 2021

Overview

In absolute terms, the asset size of NBFC sector (including HFCs), as on March 31, 2021, was over Rs.54 lakh crore with over 9,600 NBFCs registered across 12 categories and the sector has grown at a CAGR of close to 18% over the last five years and currently stands at 25% of the size of the banks.

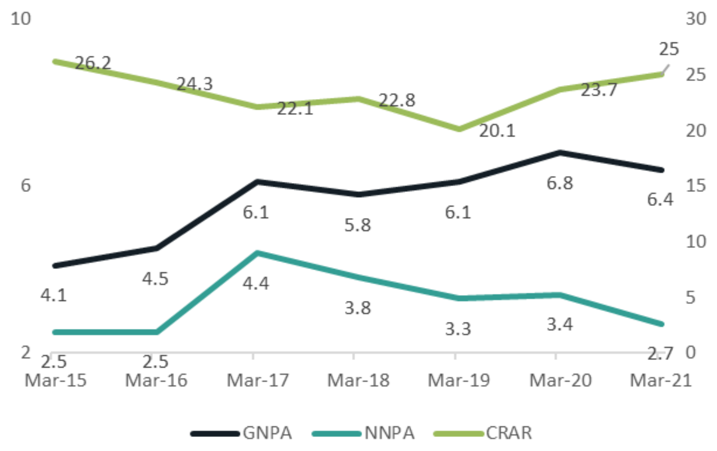
RBI has been issuing a series of regulations including the Scale Based Regulations (RBI introduces Scale-based Regulations for NBFCs) which are impacting the NBFC sector. In the current circular, RBI to ensure uniformity in the implementation of Income Recognition, Asset Classification and Provisioning (IRACP) norms across all lending institutions has clarified a portion of the existing guidelines which would be applicable across all lending institutions including NBFCs.

The circular includes the following clarifications, while other clarifications have been mentioned ahead:

Revised Norms	Comments
Accounts classified as NPAs to be upgraded as 'standard' asset only if entire arrears of interest and principal are paid	Earlier in many NBFCs, NPAs were upgraded as standard assets if partial payment of the overdue was done. This change tightens the norms and makes upgradations of accounts more stringent and difficult.
Classify borrowers as SMA/ NPA as part of day-end process for the relevant date and the SMA or NPA classification date shall be the calendar date for which the day end process is run	This would mean that slippages would be recognised on the date of slippage and would be applicable on all loans including retail loans. With reporting for accounts overdue by even one day.

CARE Ratings View:

Figure 1: Asset quality and CRAR of NBFCs (%)



The banking sector has largely been following an automated system for tagging accounts as NPAs, under which the accounts were tagged as NPAs on the day the account becomes overdue for more than 90 days. However, in many NBFCs, this classification was being made at the end of the reporting period. Further, many NBFCs were upgrading NPAs as overdues in the accounts reduced to less than 90 days, while banks do not upgrade a NPA till all the overdues are collected. With these changes, the norms have been made largely congruent between banks and NBFCs.

The tightening norms made applicable to NBFCs could result in more loans being classified as NPAs as both partially paid loans could be classified as a slippage and would increase the Gross NPAs in the middle of the year. The increase in Gross NPAs would vary according to the different asset classes, borrower characteristics, loan tenure, etc. Consequently, across various asset classes, CARE expects an increase of up to 300 bps with limited impact for shorter tenure loans. The average increase is expected to be around 150 bps in Gross NPAs, being a proportion of assets moving from SMA2 buckets.

At the same time, credit cost may not go up significantly since large NBFCs follow Ind AS recognising entire credit losses in the year in which such losses occur. While NPAs would inch up, the required provisions as percentage of such NPAs is likely to reduce to some extent. In some stray cases, however, the higher requirements under IRAC norms would lead to higher provision requirement than being provided under Ind AS.

Other clarifications mentioned in the circular include:

Revised Norms	Comments
Cash credit/Overdraft (CC/OD) account is classified as NPA if the outstanding remains continuously more than the sanctioned limit/drawing power for 90 days, or credits are either nil or lower than interest debited during the previous period	Clarifies recognition norms and ensures uniformity across all institutions. The harmonization of norms between NBFCs and banks has continued on the asset side, with specific guidance on indicating repayment/servicing terms
Interest payments in respect of term loans, an account will be classified as NPA if the interest applied at specified rests remains overdue for more than 90 days. This would be done by March 31, 2022.	
Exact due dates for repayment of a loan, frequency of repayment, breakup between principal and interest, examples of SMA/NPA classification dates, etc. to be clearly specified in the loan agreement. This would be done by December 31, 2021.	This would reduce scope for ambiguity and timely recognition of asset impairment, if any.

Classification of SMAs

Loans other than revolving facilities		Loans as revolving facilities like cash credit/overdraft	
Categories	Principal or interest payment or any other amount wholly or partly overdue	Categories	Outstanding balance remains continuously more than sanctioned limit or drawing power, whichever is lower, for a period of:
SMA-0	Up to 30 days		
SMA-1	More than 30 days and up to 60 days	SMA-1	More than 30 days and up to 60 days
SMA-2	More than 60 days and up to 90 days	SMA-2	More than 60 days and up to 90 days

SMA classification is applicable to all loans, including retail loans, irrespective of size of exposure of the lending institution. However, agricultural advances governed by crop season-based asset classification norms to be exempt.

Contact:

Sanjay Agarwal	Senior Director	sanjay.agarwal@careratings.com	+91-22-6754 3582/+91-810-800-7676
Saurabh Bhalerao	Associate Director – BFSI Research	saurabh.bhalerao@careratings.com	+91-22-6754 3519/+91-900-495-2514
Mradul Mishra	(Media Contact)	mradul.mishra@careratings.com	+91-22-6837 4424

CARE Ratings Limited
Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022
Tel.: +91-22-6754 3456 I CIN: L67190MH1993PLC071691

Connect: