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Professional Risk Opinion

RBI Issues Master Directions for HFCs

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Overview

National Housing Bank (NHB) was set up as a principal agency for the promotion of housing finance institutions both at local and regional levels and to provide financial and other support to such institutions. To ensure a consistent regulatory regime, the Finance (No.2) Act, 2019 amended the National Housing Bank Act, 1987, conferring powers for regulation of Housing Finance Companies (HFCs) with Reserve Bank of India (RBI).

Earlier RBI had issued draft and then final regulatory framework for HFCs which treated HFCs as a specialised type of NBFC. These changes have been covered in our earlier notes. *(RBI proposes greater regulatory parity between HFCs and NBFCs and RBI releases regulatory framework for HFCs)*

RB has compiled and released these Master Directions for the better functioning of the financial system and HFCs. The current Master Directions also consolidates and repeals the directions issued by NHB (refer Annexure 1) and indicates the List of NBFC regulations applicable to HFCs (refer Annexure 2). These master directions have come into immediate effect.

Definition: As defined by the earlier regulation issued by RBI, an HFC continues to be defined as a company incorporated under the Companies Act, 2013 that fulfils the following conditions:

- It is an NBFC whose financial assets, in the business of providing finance for housing, constitute at least 60% of its total assets (netted off by intangible assets).
- Out of the total assets (netted off by intangible assets), not less than 50% should be by way of housing financing for individuals.

The glide path mentioned earlier for companies which do not satisfy the above criteria continues to be as follows.

Timeline	Minimum % of total assets towards housing finance	Minimum % of total assets towards housing finance for individuals
March 31, 2022	50%	40%
March 31, 2023	55%	45%
March 31, 2024	60%	50%

Minimum Net owned Funds (NOF): RBI has maintained the minimum NOF for HFCs at ₹20 crore. For existing HFCs, the timeline continues to be ₹15 crore by March 31, 2022 and ₹20 crore by March 31, 2023. Any existing HFC whose NOF is below ₹20 crore would have to provide a statutory auditor's certificate to RBI by April end of the relevant year with evidence of complying with the prescribed limits. HFCs which do not meet these limits would have to either surrender their Certificate of Registration (CoR) or approach RBI for conversion into NBFC – Investment and Credit Companies (NBFC-ICCs) along with necessary documentation.

Liquidity Risk framework and LCR: All non-deposit taking HFCs with asset size of ₹100 crore and above and all deposit taking HFCs (irrespective of asset size) pursue liquidity risk management, which would cover adherence to gap limits, use liquidity risk monitoring tools and adopt stock approach to liquidity risk. HFCs must maintain a liquidity buffer in terms of LCR by ensuring that they have sufficient High Quality Liquid Asset (HQLA) to survive any acute liquidity stress scenario which could last for 30 days. All non-deposit taking HFCs with asset size of ₹10,000 crore & above, and all deposit taking HFCs irrespective of their asset size.

Timeline	Minimum LCR
December 01, 2021	50%
December 01, 2022	60%
December 01, 2023	70%
December 01, 2024	85%
December 01, 2025	100%

All non-deposit taking HFCs with asset size of ₹5,000 crore & above, but less than ₹10,000 crore.

Timeline	Minimum LCR
December 01, 2021	30%
December 01, 2022	50%
December 01, 2023	60%
December 01, 2024	85%
December 01, 2025	100%

The following instructions issued in October 2020, continue to be applicable to all HFCs:

- Loans against security of shares: HFCs lending against the collateral of listed shares shall maintain a Loan to Value (LTV) ratio of 50% for loans granted against the collateral of shares. Any shortfall in the maintenance of the 50% LTV occurring on account of movement in the share prices shall be made good within seven working days.
- Loans against security of single product – gold jewellery: HFCs shall maintain a Loan-to-Value (LTV) Ratio not exceeding 75% for loans granted against the collateral of gold jewellery and shall put in place a Board approved policy for lending against gold.
- Guidelines on Securitization Transactions and reset of Credit Enhancement: HFCs shall carry out securitization of standard assets and transfer of assets through direct assignment of cash flows and the underlying securities. In doing so, HFCs, among other things, shall conform to the minimum holding period (MHP) and minimum retention requirement (MRR) standards.
- Managing Risks and Code of Conduct in Outsourcing of Financial Services: It is imperative for HFCs outsourcing their activities that they ensure sound and responsive risk management practices for effective oversight, due diligence and management of risks arising from such outsourced activities.
- Implementation of Indian Accounting Standards: HFCs shall maintain a prudential floor in respect of impairment allowances and follow instructions on regulatory capital.
- Master Direction - Know Your Customer (KYC) Direction, 2016, as amended from time to time.
- Master Direction on Monitoring of Frauds in NBFCs (Reserve Bank) Directions, 2016, and Master Direction on Information Technology Framework for the NBFC Sector dated June 08, 2017.

Capital Requirement: The HFC must maintain a minimum capital ratio of 14% by March 31, 2021 and 15% post March 31, 2022. Of these numbers, Tier I capital would not be less than 10%, while Tier II capital would not exceed the Tier I capital levels.

Risk weights of select items.

Weighted risk assets - On balance Sheet items	Weight %
Investment in Bonds of public sector banks	20%
Fixed deposits/ certificate of deposits/ bonds of public financial institutions	100%
Mortgage-backed security, receipt or other security evidencing the purchase or acquisition by a housing finance company of an undivided right, title or interest in any debt or receivable originated by a housing finance company recognised by the Bank or NHB and supervised by NHB or a scheduled commercial bank and secured by mortgage of residential immovable property, provided the conditions specified below in Paragraph 6.2.4 are fulfilled.	50%
Shares of all companies and debentures/ bonds/ commercial papers of all companies/ units of all mutual funds.	100%
HFC's investments in innovative perpetual debt of other HFCs/ banks/ financial institutions.	100%
Outstanding Housing loans to individuals up to ₹30 lakh secured by mortgage of immovable property, which are classified as standard assets with LTV Ratio ≤ 80%	35%
Outstanding Housing loans to individuals up to ₹30 lakh secured by mortgage of immovable property, which are classified as standard assets with LTV Ratio > 80% and ≤ 90%	50%
Outstanding Housing loans to individuals above ₹30 lakh and up to ₹75 lakh secured by mortgage of immoveable property which are classified as standard assets with LTV ratio ≤ 75% (loan sanctioned before 01-08-2017)	35%
Outstanding Housing loans to individuals above ₹30 lakh and up to ₹75 lakh secured by mortgage of immoveable property which are classified as standard assets with LTV ratio > 75% and ≤ 80% (loan sanctioned before 01-08-2017)	50%

Outstanding Housing loans to individuals above ₹30 lakh and up to ₹75 lakh secured by mortgage of immoveable property which are classified as standard assets with LTV ratio ≤ 80% (loan sanctioned on or after 01-08-2017)	35%
Outstanding Housing loans to individuals above ₹75 lakh secured by mortgage of immoveable property, which are classified as standard assets with LTV ratio ≤ 75% (loan sanctioned before 01-08-2017)	75%
Outstanding Housing loans to individuals above ₹75 lakh secured by mortgage of immoveable property, which are classified as standard assets with LTV ratio ≤ 75% (loan sanctioned on or after 01-08-2017)	50%
Other housing loans	100%
Restructured housing loans	An additional risk weight of 25%

Regulatory Restrictions and Limits

An HFC shall not grant housing loans to individuals:

- up to ₹30 lakh with LTV ratio exceeding 90%,
- above ₹30 lakh and up to ₹75 lakh with LTV ratio exceeding 80%, and,
- above ₹75 lakh with LTV ratio exceeding 75%

An HFC also cannot lend **or** invest in any single borrower exceeding 15% of its owned fund, and any single group of borrowers exceeding 25% of its owned funds. On the other hand, an HFC cannot lend **and** invest more than 25% of its owned fund to a single party; and 40% of its owned fund to a single group of parties.

The HFC can either undertake an exposure on the group company in real estate business OR lend to retail individual home buyers in the projects of group entities, but not do both. 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 owned fund for a single entity in the group and 25% of owned fund for all such group entities. Further, an HFC shall not invest in land or buildings, except for its own use, more than 25% of its capital. Additionally, capital market exposure has been capped at 40% of the net worth for HFCs.

Public Deposits. Only an HFC with a minimum of an investment grade rating can issue public deposit. The public deposits that can be raised by an HFC has been capped at 3 times of its NOF. Further, no HFC would have deposits inclusive of public deposits more than 13 times of its NOF on or after March 31, 2021; and 12 times of its NOF after March 31, 2022. In case an HFC fails to repay any public deposit or part thereof as per the terms, it shall not grant any loan or other credit facility or make any investment or create any other asset as long as the default exists. No HFC shall invite or accept or renew public deposit at a rate of interest exceeding twelve and half per cent per annum or as revised by RBI. HFCs would have to always ensure that there is full cover available for public deposits.

Concluding Remarks

Overall, the regulations pertaining to HFCs have been harmonised with the extant NBFC regulations. Specific norms for LCR have been issued for HFCs with asset size greater than Rs 5,000 crore. RBI has maintained the flexibility of the HFCs with respect to risk weights, as NBFCs generally have lesser flexibility for risk weights, which are broadly classified into 0%, 20% and 100%. As the flexibility has been continued, the HFCs would not require additional capital to service the same loan book and can maintain the current levels, subject of course to minimum capital requirements. Currently the larger HFCs meet the above guidelines and are unlikely to face significant challenges when HFC regulations are further harmonised with NBFCs going forward.

Annexure 1 – List of Repealed NHB Circulars

Circular No.	Date	Subject
NHB(ND)/DRS/REG/MC-01/2019	July 1,2019	MC01-Master Circular-The Housing Finance Companies-NHB Directions-2010
NHB(ND)/DRS/REG/MC-02/2019	July 1,2019	MC02-Master Circular-Housing Finance Companies-issuance of Non-Convertible Debentures on private placement basis-NHB Directions-2014
NHB(ND)/DRS/REG/MC-03/2019	July 1,2019	MC03-Master Circular-Fair Practices Code
NHB(ND)/DRS/REG/MC-04/2019	July 1,2019	MC04-Master Circular-Miscellaneous Instructions to all Housing Finance Companies
NHB(ND)/DRS/REG/MC-05/2019	July 1,2019	MC05-Master Circular-Housing Finance Companies-Auditor's Report-NHBDirections-2016
NHB(ND)/DRS/REG/MC-06/2019	July 1,2019	MC06-Master Circular-Housing Finance Companies–Approval of Acquisition or Transfer of Control–NHB Directions-2016
NHB(ND)/DRS/REG/MC-07/2019	July 1,2019	MC07-Master Circular-Housing Finance Companies–Corporate Governance-NHB Directions-2016
NHB(ND)/DRS/Policy Circular No.96/2019-20	July 19,2019	Disbursement of housing loan to individuals linked to the stages of construction
DOR.NBFC(HFC). CC.No.111/03.10.136/2019-20	May 19,2020	Extending MD–know Your Customer (KYC) Direction, 2016to HFCs
DOR.NBFC(HFC). CC.No.118/03.10.136/2020-21	October22, 2020	Review of regulatory framework for Housing Finance Companies

Annexure 2 – List of NBFC regulations applicable to HFCs

Para No. of this Direction	Particulars	Reference to regulations issued by the Reserve Bank
3.1.1	Guidelines on Liquidity Risk Management Framework	Para 15 A of Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016
3.1.2	Guidelines on Liquidity Coverage Ratio	Para 15 B of Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016
3.1.3	Loans against security of shares	Para 22 of Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016
3.1.4	Loans against security of single product – gold jewellery	Para 27 and Para 39 of Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016
3.1.5	Guidelines on Securitisation Transactions	Para 105 and 106 of Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016
3.1.6	Managing Risks and Code of Conduct in Outsourcing of Financial Services	Para 120 of Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016
3.1.7	Implementation of Indian Accounting Standards	DOR (NBFC). CC.PD.No.116 /22.10.106/2020-21 July 24, 2020

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	+91-22-6754 3573

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: