RBI IRACP Norms – Impact across Asset Classes for NBFCs

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Introduction

As on March 31, 2021, the NBFC sector (including HFCs), had an asset size of over Rs.54 lakh crore across 12 categories and the sector 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. 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. (RBI IRACP Norms – Gross NPAs of many NBFCs likely to inch up).

Further, to examine the impact across asset classes, we polled/discussed several NBFCs, which operate across asset classes for their inputs and initial expectations of impact of the circular on the relevant asset classes. While quite a few NBFCs are studying and quantifying the impact in greater detail, their initial responses have been summarised and presented below.

Indicator by Asset Class	Wholesale	Prime Housing	Afford. Housing	LAP	CV finance	MFI	SME Funding	Gold
Operation Intensity	●	●	●	●	●	●	●	◑
NPAs per due date	◑	◔	◑	◑	◑	◑	◕	◔
NPA Regularize	◑	◔	◕	◕	◑	◔	◕	○

Impact Intensity Scale: Low to High; grey indicates that some companies may not be impacted

○ ◔ ◑ ◕ ●

Notes:

- 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
- DPD and NPA classification could be delinked as a borrower would continue to be tagged as an NPA even if partial payment has been made. Hence, even with a less than 90 days DPD, the entity would be classified as NPA.
- Operational intensity is expected to rise across almost all asset classes given that NPA recognition and accounting for the same must be done every day and systems to monitor and recognise must be set up for the same.
- The DA book could witness some pressure based on how lenders/ servicers have accounted for these accounts.
- Some Housing, CV Financing, and wholesale lending firms which have followed these norms would not see significant impact on NPAs, while those firms which have followed the norms would witness a significant rise.
- Bounce rates (difference in due date and presentation date) would have significant impact especially in the small ticket loans in SME financing and Affordable housing asset classes.
- 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.
- With these changes, NBFCs will now be at a disadvantage since their ECL model computes credit loss as it occurs while banks have a longer period to account for the credit losses. However, these changes will reinforce their robust processes as is also required by the promoters.

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