RBI releases regulatory framework for HFCs

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Overview

RBI had earlier released a draft framework for public comments (RBI proposes greater regulatory parity between HFCs and NBFCs) in June 2020 and has now issued revised regulatory framework for HFC.

These regulations supersede the relevant regulations issued by National Housing Bank (NHB), and are applicable to all HFCs. However, HFCs would continue to comply with all extant instructions issued by NHB, not covered in these regulations.

The exemption granted to HFCs from the provisions of Chapter III B of Reserve Bank of India Act, 1934 except for section 45-IA (Requirement of registration & net owned funds) was withdrawn on November 11, 2019.

Additionally, HFCs would be exempt from section 45-IB (Maintenance of percentage of assets) and section 45-IC (Reserve fund) of the Reserve Bank of India Act. However, corresponding provisions of section 29B and 29C of the National Housing Bank Act, 1987 would continue to be applicable to HFCs.

RBI has finalised the following definition: Financing, for purchase/ construction/ reconstruction/ renovation/ repairs of residential dwelling units. (*Detailed definition is given in the Annexure).*

Key changes proposed for HFCs are as follows

- Defining principal business and qualifying assets for HFCs
- Minimum Net Owned Fund (NOF)
- Applicability of the Liquidity Risk framework and LCR
- Group entities engaged in real estate business
- Fraud monitoring, IT framework, Securitization, etc.

Further harmonisation between the HFCs and NBFCs regulations will be taken up in a phased manner in the next two years so as to ensure disruption free transition.

Key changes and CARE's comments on the same have been presented below:

<table>
<tr><th>Draft section</th><th>Final Section</th><th>Comments</th></tr>
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<td>
Defining principal business and qualifying assets for HFCs According to the NHB, an HFC was an entity which had the transacting of the business of providing finance for housing, whether directly or indirectly as one of its principal objects.
According to the RBI, NBFCs are entities whose financial assets are more than 50% of its total assets (netted off by intangible assets) and income from financial assets is more than 50% of the gross income. Further as HFCs cater to the housing sector, the qualifying criteria proposed was

50% of outstanding loans are towards assets which qualify for housing as per the revised definition
Further at least 75% of such loans will have to be toward individual housing loans

Any of the current HFCs which do not fulfill the above criteria would have to be reclassified and reregistered as Investment and Credit Companies. However, if the entity wants to continue as an HFC, the following time line has been proposed
<table>
<tr><th>Timeline</th><th>At least 50% of net assets as qualifying</th><th>At least 75% of qualifying assets for individuals</th></tr>
<tr><td>March 31, 2022</td><td>50%</td><td>60%</td></tr>
<tr><td>March 31, 2023</td><td>-</td><td>70%</td></tr>
<tr><td>March 31, 2024</td><td>-</td><td>75%</td></tr>
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<td>
Defining principal business and qualifying assets for HFCs: Housing finance company shall mean 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

Any of the current HFCs which do not fulfill the above criteria would have to be reclassified and reregistered as Investment and Credit Companies. However, if the entity wants to continue as an HFC, the following time line has been proposed
<table>
<tr><th>Timeline</th><th>Minimum % of total assets towards housing finance</th><th>Minimum % of total assets towards housing finance for individuals</th></tr>
<tr><td>March 31, 2022</td><td>50%</td><td>40%</td></tr>
<tr><td>March 31, 2023</td><td>55%</td><td>45%</td></tr>
<tr><td>March 31, 2024</td><td>60%</td><td>50%</td></tr>
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As per the earlier draft regulations, an HFC would only need to have a minimum of 37.5% (75% of 50%) of its portfolio as individual loans which could have resulted in the dilution of norms and permit HFCs to be able to lend to higher risk products.
However, the final regulations have focused on housing finance for individuals which is seen as a favored asset class

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Minimum Net Owned Fund (NOF) of ₹20 crore

To strengthen the capital base, RBI is planning to increase the minimum NOF for HFCs from ₹10 crore to ₹20 crore. For existing HFCs, the time line would be ₹15 crore within 1 year and ₹20 crore within 2 years

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Minimum Net Owned Fund (NOF) of ₹20 crore

RBI has increased the minimum NOF for HFCs from ₹10 crore to ₹20 crore. For existing HFCs, the time line would be ₹15 crore by March 31, 2022 and ₹20 crore by March 31, 2023.

Any 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

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- *Around 100 HFCs are registered with the NHB. The largest HFCs (top 20 or so) which hold over 70% of the market share already comply with this requirement.*
- *Smaller HFCs may face issues while raising the capital may choose to be reclassified in other categories of NBFCs or exit the segment.*

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Liquidity Risk framework and LCR

Non-deposit taking NBFCs with asset size of ₹100 crore & above, systemically important Core Investment Companies and all deposit taking NBFCs (except Type 1 NBFC-NDs, Non-Operating Financial Holding Companies and Standalone Primary Dealers) have to follow the framework and ratio. This is being extended to all non-deposit taking HFCs with asset size of ₹100 crore & above and all deposit taking HFCs.

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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.

All non-deposit taking HFCs with asset size of ₹10,000 crore & above, and all deposit taking HFCs irrespective of their asset size

<table>
<tr><th>Timeline</th><th>Minimum LCR</th></tr>
<tr><td>December 01, 2021</td><td>50%</td></tr>
<tr><td>December 01, 2022</td><td>60%</td></tr>
<tr><td>December 01, 2023</td><td>70%</td></tr>
<tr><td>December 01, 2024</td><td>85%</td></tr>
<tr><td>December 01, 2025</td><td>100%</td></tr>
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- *The LCR standard aims to ensure that an entity maintains an adequate level of unencumbered HQLAs that can be converted into cash to meet its liquidity needs for a 30 calendar day time horizon under significantly severe liquidity stress scenario. At a minimum, the stock of liquid assets should enable the entity to survive until day 30 of the stress scenario, by which time it is assumed that appropriate corrective actions can be taken.*
- *Stock of high quality liquid assets (HQLAs)/ Total net cash outflows over the next 30 calendar days*
- *This would bring the HFCs in line with the*

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<td>All non-deposit taking HFCs with asset size of ₹5,000 crore & above, but less than ₹10,000 crore:
<table>
<tr><th>Timeline</th><th>Minimum LCR</th></tr>
<tr><td>December 01, 2021</td><td>30%</td></tr>
<tr><td>December 01, 2022</td><td>50%</td></tr>
<tr><td>December 01, 2023</td><td>60%</td></tr>
<tr><td>December 01, 2024</td><td>85%</td></tr>
<tr><td>December 01, 2025</td><td>100%</td></tr>
</table>
</td>
<td>NBFC segment and increase the regulatory oversight.
Given the attention on HFCs/ NBFCs and their liquidity position, today most NBFCs/ HFCs strive to meet 100% LCR norms and have comfortable ALMs. For few HFCs which may not meet the norms, or have technical challenges, these regulations will provide a guide path.
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<td>Group entities engaged in real estate business

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.</td>
<td>Group entities engaged in real estate business

No change from the draft guidelines</td>
<td>
Under extant regulations, HFC could take an exposure to a single asset by financing both the buyers as well as the developer. The RBI has done well to plug this loophole.
Further, by capping the exposure to group companies, RBI has brought in appropriate risk management norms
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The following instructions, shall apply to all HFCs:

a) 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.
b) Definition of public deposits as contained in Master Direction – NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 2016. However, any amount received from NHB or any public housing agency shall also be exempted from the definition of public deposit.
c) Implementation of Indian Accounting Standards: HFCs shall maintain a prudential floor in respect of impairment allowances and follow instructions on regulatory capital.
d) 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.

e) 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.

f) Levy of foreclosure charges: HFCs shall not impose foreclosure charges/ pre-payment penalties on any floating rate term loan sanctioned for purposes other than business to individual borrowers, with or without co-obligant(s).

g) 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.

h) 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.

Concluding Remarks

Overall the regulations pertaining to HFCs have been harmonised with the extant NBFC regulations. The inclusive definition of housing loan and restrictions on financing of group companies are significant positives. With the earlier reduction in risk weights, the capital requirements would be muted from capital adequacy perspective. However, there is a cap in the gearing ratios. Further, the market currently has limited appetite for expanded leverages and would do well to check that. 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 - Detailed definition of housing finance

"Housing Finance" shall mean financing, for purchase/ construction/ reconstruction/ renovation/ repairs of residential dwelling units, which includes:

- Loans to individuals or group of individuals including co-operative societies for construction/ purchase of new dwelling units.
- Loans to individuals or group of individuals for purchase of old dwelling units.
- Loans to individuals or group of individuals for purchasing old/ new dwelling units by mortgaging existing dwelling units.
- Loans to individuals for purchase of plots for construction of residential dwelling units provided a declaration is obtained from the borrower that he intends to construct a house on the plot within a period of three years from the date of availing of the loan.
- Loans to individuals or group of individuals for renovation/ reconstruction of existing dwelling units.
- Lending to public agencies including state housing boards for construction of residential dwelling units.
- Loans to corporates/ Government agencies for employee housing.
- Loans for construction of educational, health, social, cultural or other institutions/ centres, which are part of housing projects and which are necessary for the development of settlements or townships (see note below).
- Loans for construction meant for improving the conditions in slum areas, for which credit may be extended directly to the slum-dwellers on the guarantee of the Central Government, or indirectly to them through the State Governments.
- Loans given for slum improvement schemes to be implemented by Slum Clearance Boards and other public agencies.
- Lending to builders for construction of residential dwelling units.

All other loans including those given for furnishing dwelling units, loans given against mortgage of property for any purpose other than buying/ construction of a new dwelling unit/s or renovation of the existing dwelling unit/s as mentioned above, will be treated as non-housing loans and will not be falling under the definition of "Housing Finance".

Integrated housing project comprising some commercial spaces (e.g. shopping complex, school, etc.) can be treated as residential housing, provided that the commercial area in the residential housing project does not exceed 10% of the total Floor Space Index (FSI) of the project.

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