

RBI proposes greater regulatory parity between HFCs and NBFCs

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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).

In August 2019 a review of the extant regulatory framework applicable to the HFCs was proposed to be carried out along with the issuance of revised regulations.

Subsequently, on June 17, 2020, RBI has released proposed changes to the regulatory framework for HFCs. As per the framework, it was decided that HFCs would be regulated as a category of Non-Banking Financial Company (NBFC). Accordingly, the extant regulations of HFCs are being brought into tandem with the NBFC regulations taking care to minimise disruptions.

NHB has not formally defined providing 'finance for housing' or 'housing finance'. RBI has proposed 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
- Classifying into systemically important and non-SI entities
- Increase in the Minimum Net Owned Fund (NOF)
- Harmonizing definitions of Capital (Tier I & Tier II)
- Applicability of the Liquidity Risk framework and LCR
- Group entities engaged in real estate business
- Fraud monitoring, IT framework, Securitization, etc.

Differences to be harmonised over next few years include

- Capital Risk Adjusted Ratio
- Risk weights of various exposures
- Different provisioning norms
- Exceptions available to NBFCs in norms on concentration of credit / investment compared to HFCs.
- Issue of public deposits

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

Key sections	Comments												
<p>Defining principal business and qualifying assets for HFCs</p> <p>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.</p> <p>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 similar to MFIs have been proposed</p> <ul style="list-style-type: none"> • 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 <p>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</p> <table border="1" data-bbox="71 1086 794 1310"> <thead> <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> </thead> <tbody> <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> </tbody> </table>	Timeline	At least 50% of net assets as qualifying	At least 75% of qualifying assets for individuals	March 31, 2022	50%	60%	March 31, 2023	-	70%	March 31, 2024	-	75%	<ul style="list-style-type: none"> • <i>In the extant NHB regulations, along with the object clause, an HFC had to have at least 51% of its portfolio as individual loans.</i> • <i>However, as per these norms, an HFC would only need to have a minimum of 37.5% (75% of 50%) of its portfolio as individual loans.</i> • <i>This would result in the dilution of norms and permit HFCs to be able to lend to higher risk products.</i> • <i>This could also increase the ALM mismatch as the builder loan products have inbuilt moratoriums and structured payments</i>
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<p>Classifying HFCs into systemically important and non-systemically important entities</p> <p>Introduce a graded approach as applicable to NBFCs. Non-deposit taking HFCs with asset size of ₹500 crore & above; and all deposit taking HFCs, to be treated as systemically important HFCs. HFCs with asset size below ₹500 crore to be treated as non-systemically important HFCs.</p>	<ul style="list-style-type: none"> • <i>This would bring the HFCs in line with the NBFC segment and increase the regulatory oversight.</i> 												
<p>Minimum Net Owned Fund (NOF) of ₹20 crore</p> <p>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</p>	<ul style="list-style-type: none"> • <i>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.</i> • <i>Smaller HFCs may face issues while raising the capital may choose to be reclassified in other categories of NBFCs or exit the segment.</i> 												

<p>Harmonizing definitions of Capital (Tier I & Tier II) with that of NBFCs</p> <ul style="list-style-type: none"> • Include Perpetual Debt Instruments (PDIs) as a component of Tier I / II capital in lines with NBFCs only by non-deposit taking systemically important HFCs. • PDIs or any other debt capital instrument in the nature of PDIs, already issued by either deposit taking HFCs or non-systemically important HFCs will be reckoned as Tier I / II capital for a period not exceeding three years. • Since HFCs are treated as a category of NBFCs for regulatory purposes, investments in shares of other HFCs and also in other NBFCs (whether forming part of group or not), shall be reduced from the Tier I capital to the extent it exceeds, along with other exposures to group companies, 10% of HFC owned funds. 	<ul style="list-style-type: none"> • <i>The inclusion of perpetual debt instruments would slightly ease the capital adequacy computation; however, this is not a significant move as smaller HFCs have been automatically excluded due to the inclusion of ‘systemically important’ criteria.</i> • <i>Further, HFCs who have accepted public deposits have also been excluded which includes several large HFCs who have accessed public deposits to diversify their borrowing profile.</i> • <i>RBI is looking at deposit taking HFCs in line with banks where a higher proportion of core capital is required to protect the deposit holders.</i>
<p>Liquidity Risk framework and LCR</p> <p>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.</p>	<ul style="list-style-type: none"> • <i>This would bring the HFCs in line with the NBFC segment and increase the regulatory oversight.</i> • <i>It would also improve HFC’s ALM and liquidity framework</i>
<p>Group entities engaged in real estate business</p> <p>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.</p> <p>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.</p>	<ul style="list-style-type: none"> • <i>Under extant NHB regulations, HFC could take a double exposure to a single asset by financing both the buyers as well as the developer. This lacuna was also exploited by HFCs to lend to the group construction arm. The RBI has done well to plug this loophole.</i> • <i>Further, by capping the exposure to group companies, RBI has brought in appropriate risk management norms</i>
<p>Other areas where RBI has proposed greater parity between housing financiers and NBFCs include:</p> <ul style="list-style-type: none"> • Monitoring of frauds • Information technology framework. • Securitization • Lending against shares. • Foreclosure charges • Managing risks and code of conduct in outsourcing of financial services • Implementation of Indian Accounting Standards. 	<ul style="list-style-type: none"> • <i>According to RBI, as there are minimal or no specific guidelines for HFCs in these areas, NBFC specific guidelines are being made applicable to HFCs.</i>

Difference in the treatment of the following items would currently continue and remain distinct for HFCs, however, these differences would be harmonised over the next few years.

- CRAR: The minimum CRAR currently prescribed for HFCs is 12% and would be progressively increased to 15% by March 31, 2022 (in line with NBFCs).
- Risk weights: HFCs depending on asset classification, LTV, type of borrower, etc. assign risk weights in the range of 30% to 125%. NBFCs have lesser flexibility for risk weights, which are broadly classified into 0%, 20% and 100%.
- Different provisioning norms applicable to standard, substandard and doubtful assets in HFCs' books.
- NBFCs have certain exceptions in the norms on concentration of credit / investment compared to HFCs.
- While no such limits have been prescribed for NBFCs, limits prescribed for HFCs for exposure to CRE by way of investment in land & building shall not be more than 20% of capital fund and for CME shall not be more than 40% of net worth total exposure of which direct exposure should be 20% of net worth.
- HFCs can issue public deposits for varying lengths compared to NBFCs and have greater flexibility in terms of overall limits, interest on premature repayment of deposits and maintenance of liquid assets.

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 double financing of an asset are significant positives. One major factor which will have significant impact on capital adequacy is the change in risk weights. At present risk weight for HFCs vary from 30% to 125% and majority of the portfolio will have risk weights in the range of 30 to 70% against 100% risk weight used in NBFCs. While harmonising the risk weights, RBI may look at risk weights followed in the banking system for various asset classes, however, in this process, the notional capital requirement of the HFCs is likely to increase. The unintended dilution of individual loan exposure actually increases the risk of exposure to high yield developer loans compared to the highly competitive but usually much safer individual mortgage loans. However, this could be mitigated by increasing the risk weights of such loans and reverting back to the extant floor of 51% for individual loans.

Currently, the larger HFCs meet the above guidelines. Post September 2018, the NBFCs & HFCs went through a period of tight liquidity which restricted their funding avenues and increased their cost of borrowing. The sector had to respond through slowing down disbursements, reducing capital market borrowing, correcting ALM profiles and building up liquidity buffers. Hence, the capital composition in terms of gearing is comfortable for the HFCs and is unlikely to face significant challenges when harmonised with NBFCs going forward.

Annexure - Detailed definition of housing finance

NHB has not formally defined providing 'finance for housing' or 'housing finance'. RBI has proposed the definition as "Financing, for purchase/ construction/ reconstruction/ renovation/ repairs of residential dwelling units", which includes:

- a. Loans to individuals or group of individuals including co-operative societies for construction/ purchase of new dwelling units.
- b. Loans to individuals for purchase of old dwelling units.
- c. Loans to individuals for purchasing old/ new dwelling units by mortgaging existing dwelling units.
- d. 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.
- e. Loans to individuals for renovation/ reconstruction of existing dwelling units.
- f. Lending to public agencies including state housing boards for construction of residential dwelling units.
- g. Loans to corporates/ Government agencies (through loans for employee housing).
- h. Loans for construction of educational, health, social, cultural or other institutions/centres, which are part of housing project in the same complex and which are necessary for the development of settlements or townships;
- i. Loans for construction of houses and related infrastructure within the same area, meant for improving the conditions in slum areas for which credit may be extended directly to the slum-dwellers on the guarantee of the Government, or indirectly to them through the State Governments;
- j. Loans given for slum improvement schemes to be implemented by Slum Clearance Boards and other public agencies;
- k. 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, will be treated as non-housing loans.