Strong Signal by Regulator to Control Unsecured Personal Loans

CareEdge RATINGS

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Summary

RBI has issued a notification to all lenders for inter alia an increase in risk weights by 25% on unsecured consumer credit (excluding housing, education, vehicle and by gold loans), increase in risk weights by 25% of bank credit to NBFCs assigned for the AAA-A rated portfolio, excluding PSL-compliant loans and HFCs and review / include sectoral limits for such loans. The personal loans as well as advances to NBFCs have been growing strongly and have been the primary driver of incremental bank credit. We see this as a strong signalling impact to deter growth in the unsecured space while lenders are well-capitalised to manage decrease in CRAR which is anticipated to be around 25-45 bps. Meanwhile, the proportion of bank lending to larger NBFCs could be pared down as they approach the capital market, while aggregate dependence of mid-sized NBFCs on the banking sector for funding is likely to remain high despite an anticipated increase in lending cost by 25-30 bps. This could incentivize securitisation as a liability source for NBFCs.

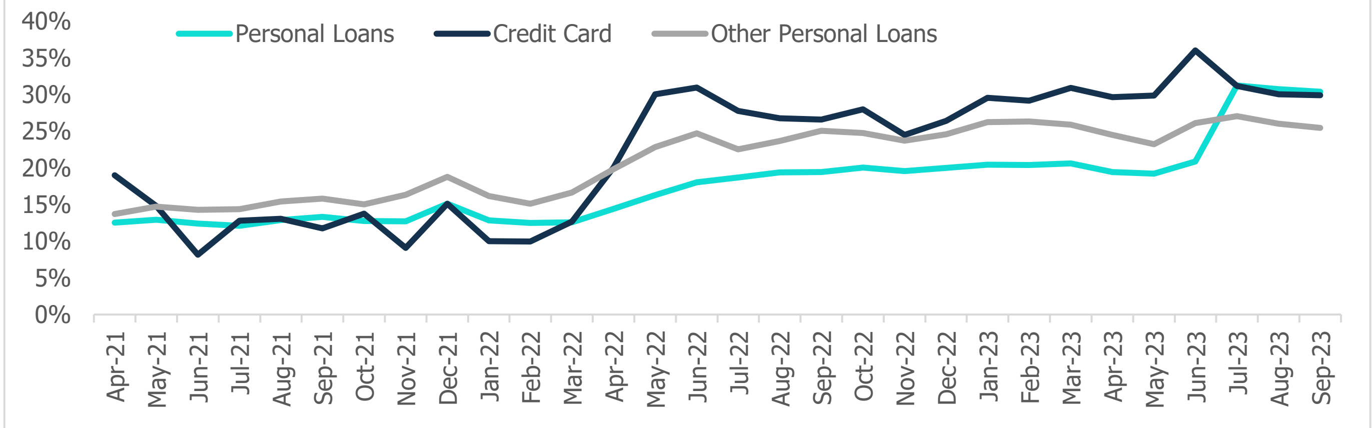
RBI's Regulatory Action

- RBI had been indicating its concerns over the growth in unsecured loans space in anticipation of a potential risk buildup. As a logical next step, RBI has now hiked the risk weights to the segment especially the unsecured loans segment.
    - Risk weight of consumer credit exposure (outstanding as well as new) hiked by 25% for banks, while housing, education, vehicle and by gold and gold jewellery loans have been excluded,
    - Risk weight of consumer credit exposure (outstanding as well as new) hiked by 25% for NBFCs, microfinance/SHG loans along with the above segments have been excluded.
    - Credit card receivables risk weights increased by 25% to 150%/125% for SCBs/NBFCs respectively.
    - Risk weight of bank credit to NBFCs also increased by 25% for NBFCs rated between AAA-A, while BBB and below which have risk weighting of 100% or more not to face increase in risk weights. Loans to HFCs, and PSL compliant loans will not attract higher risk weights.
- Additionally, all lending institutions would have to review and put in place sectoral /sub-segment exposure limits for consumer credit as part of prudent risk management. Unsecured consumer credit exposure limits would have to be strictly adhered to and monitored on an ongoing basis by the Risk Management Committee.

Strong signalling impact to deter growth in consumer credit while banks well-capitalised to manage impact on CRAR

Impact on Consumer Credit Lending: Banks and larger NBFCs could witness a partial slow down, while Fintechs which operate in the comparatively higher yield segment too would likely see an impact on growth, the impact on margin would not be similar. Meanwhile, co-lending partnerships between banks and NBFCs or fintech firms, might see some impact as banks may seek to compensate for the increased cost of capital by raising hurdle rates for co-lending arrangements. The lenders are anticipated to increase their pricing of these loans to partially cover the requirements to increase the capital buffers.

Figure 1: Growth in Personal Loans/ Credit Cards/ Other Personal Loans Stronger than Overall Credit



Source: RBI, CareEdge Calculations

Limited Impact on Capital: Currently, capital levels are quite comfortable for banks and NBFCs. An initial back of the envelop calculations with certain assumptions suggest that the impact on capital adequacy i.e. CET-1 would be ~25-45bps for banks and NBFCs. Banks have sufficient cushion to absorb this impact along with the impact of ECL computation and as a whole should not need to raise additional capital. However, this might vary for some smaller banks.

Figure 2: CET-1 Ratio Median (%) – Banks Stand Much Above than Regulatory Requirements

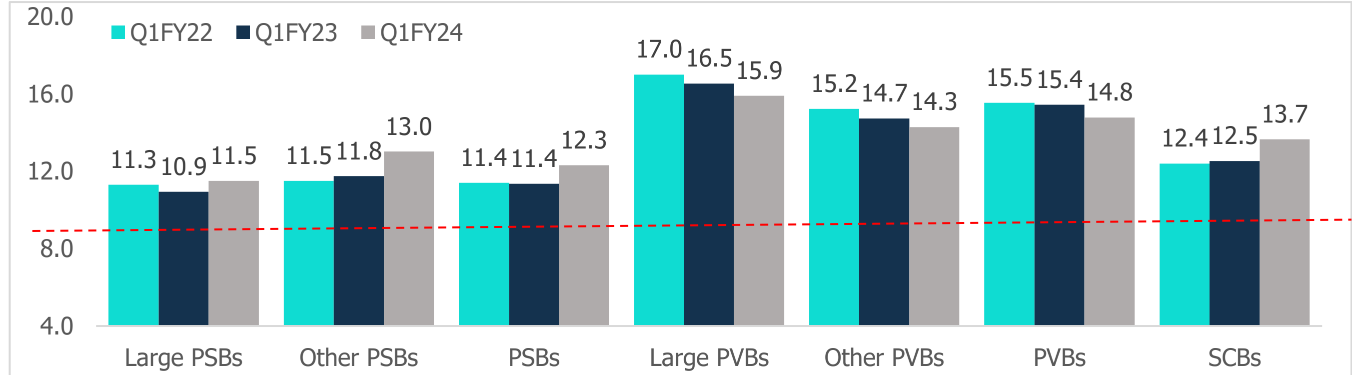
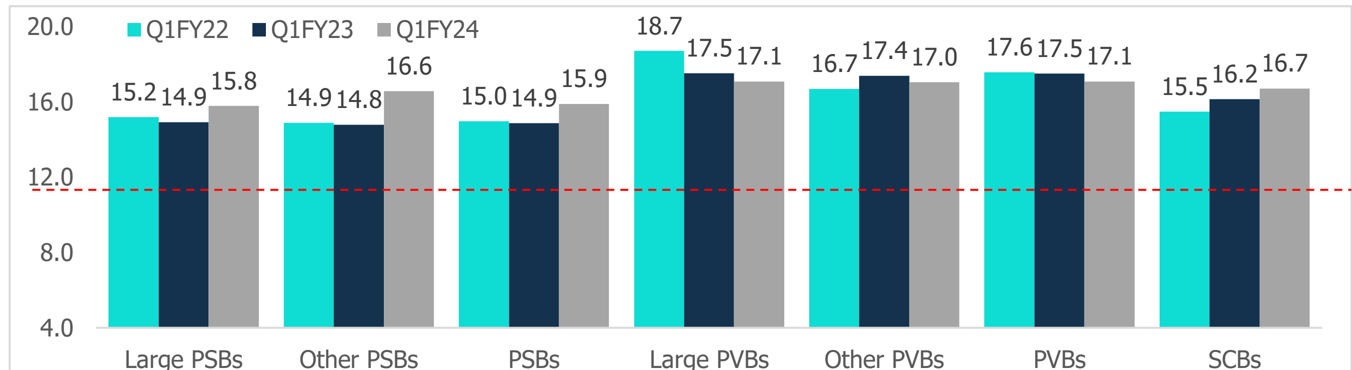


Figure 3: CAR Median (%) – Banks Stand Much Above than Required Level

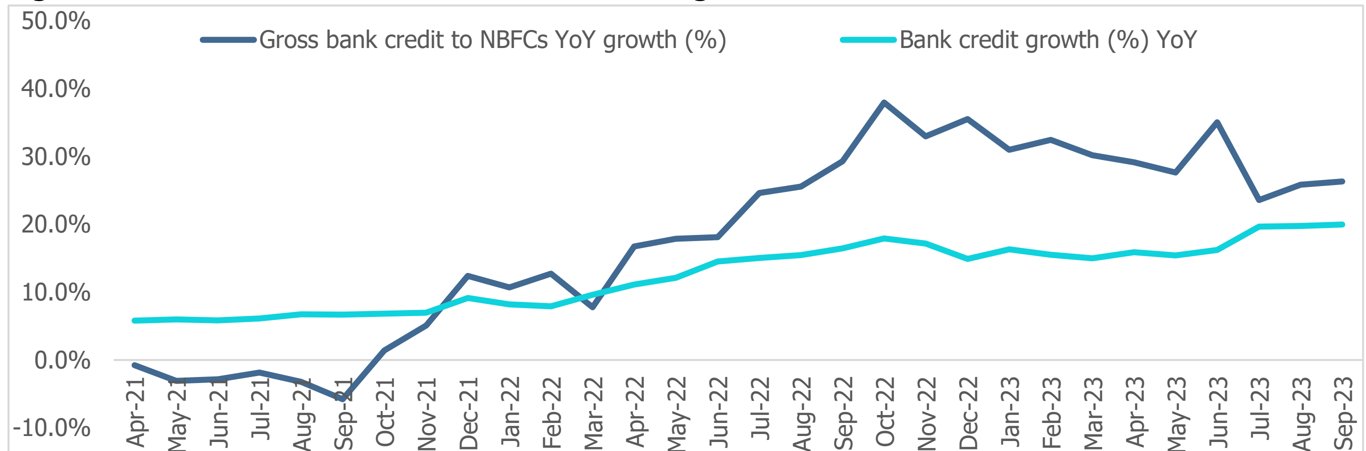


Source: Banks Presentations and Ace Equity Calculations; Note: 12 PSBs (5 Large + 7 others), and 17 PVBs (3 Large + 14 Others) used for Median calculation. Domestic Systemically Important Banks have to maintain a higher minimum ratio compared to other banks (SBI by 60 bps, HDFC and ICICI by 20 bps each).

The proportion of Bank Lending to Larger NBFCs could be pared down, while rates may witness an increase

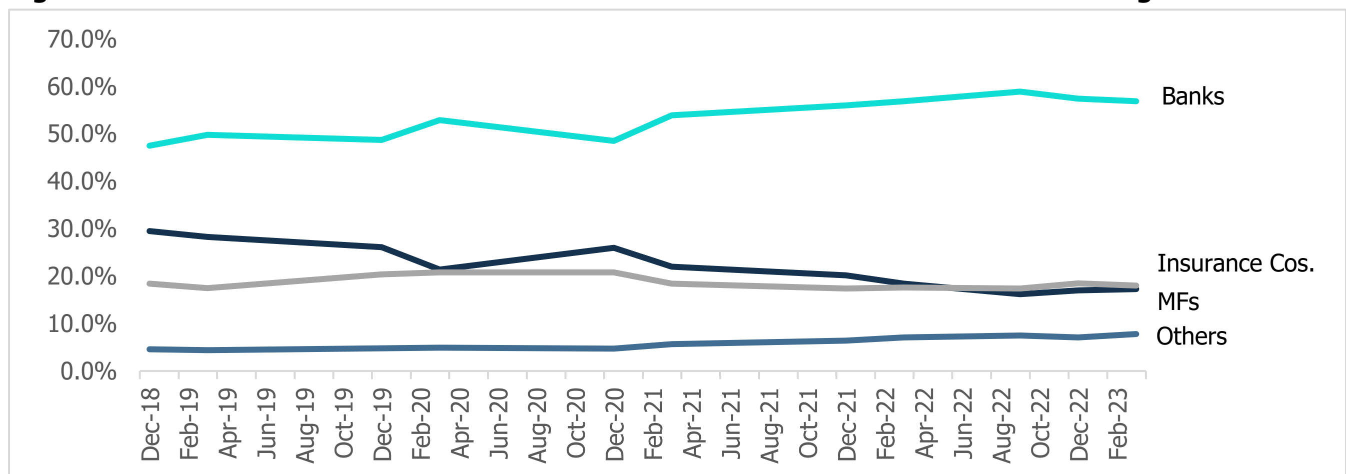
The credit exposure of banks to NBFCs stood at Rs 14.2 lakh crore in September 2023, indicating a 26.3% year-on-year (y-o-y) growth which has been higher than aggregate bank credit growth. This expansion is indicative of the robust progress observed in NBFCs during the post-pandemic period. Furthermore, the proportion of NBFC exposure in relation to aggregate credit has risen from 8.9% in September 2022 to 9.4% in September 2023.

Figure 4: Growth in Advances to NBFCs has been higher vis-à-vis overall Bank Credit Growth



Source: RBI, CareEdge Calculations

Figure 5: NBFCs owed close to 57% in FY23 to Banks and share has remained the Highest



Source: RBI Financial Stability Reports

RBI has prescribed an increase in risk weights for advances to AAA-A-rated NBFCs by 25%, while higher risk weights would not be applicable for entities in the BBB+ and below rating categories. This excludes the risk weights for bank loans to HFCs or bank loans backed by PSL loans. Further, around 40-50% of the current outstanding would fall in this category. Meanwhile as the notification is silent on covering the outstanding loans or whether only fresh loans would be subject to these norms.

Figure 6: Risk weights for NBFCs

Rating	AAA	AA	A
Current	20%	30%	50%
Revised	45%	55%	75%

Source: RBI, CareEdge

The momentum of bank lending to NBFCs which are not covered by the PSL guidelines could likely moderate as this will likely impute higher cost of funds (due to higher risk weights) for entities rated A- and above. The highly rated NBFCs would drive towards the capital markets. Hence, aggregate dependence of mid and smaller-sized NBFCs on the banking sector for funding is likely to remain high (despite an anticipated increase in lending cost by 25-30 bps) while larger NBFCs will continue to diversify their funding sources. This could lead to a greater than normal increase in securitisation and co-lending partnerships as a liability source for NBFCs.

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