Revised HFC Risk Weights to Facilitate Capital Release of 2-2.5%

CareEdge RATINGS

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Synopsis

- The Reserve Bank of India (RBI) has been harmonizing Housing Finance Companies (HFC) guidelines in line with guidelines for NBFCs and this latest circular is a part of the draft regulations released in January 2024. The circular aligns the deposit taking HFC norms with the norms of deposit taking NBFCs. These norms for deposit taking HFCs would increase the liquidity buffers and encourage further diversification of liabilities profile. CareEdge Ratings believes the liquidity and liability profile of large deposits taking HFCs is comfortable to adhere to changes suggested under the regulations.
- A recent review of risk weights for undisbursed amount of loans is expected to free up capital for HFCs in the range of 2% to 2.5%; expected capital benefit is higher for HFCs having greater share of individual housing loans.

Overview

RBI had taken over the regulation of HFCs from National Housing Bank (NHB) with effect from August 9, 2019, and hence various regulations were issued treating HFCs as a category of NBFCs. Some of these draft modifications issued in January 2024 have been covered earlier in our opinion piece 'Strong Balance Sheets Insulate Deposit taking HFCs from New Norms by RBI'. Hence, after further analysis additional regulations have been proposed to further harmonise the regulations. These regulations would be effective from January 01, 2025. These regulations can be divided primarily into two portions namely, Review of risk weights for HFCs and Realignment of guidelines regarding acceptance of public deposits and other norms applicable to all HFCs.

Review of Risk Weights for HFCs

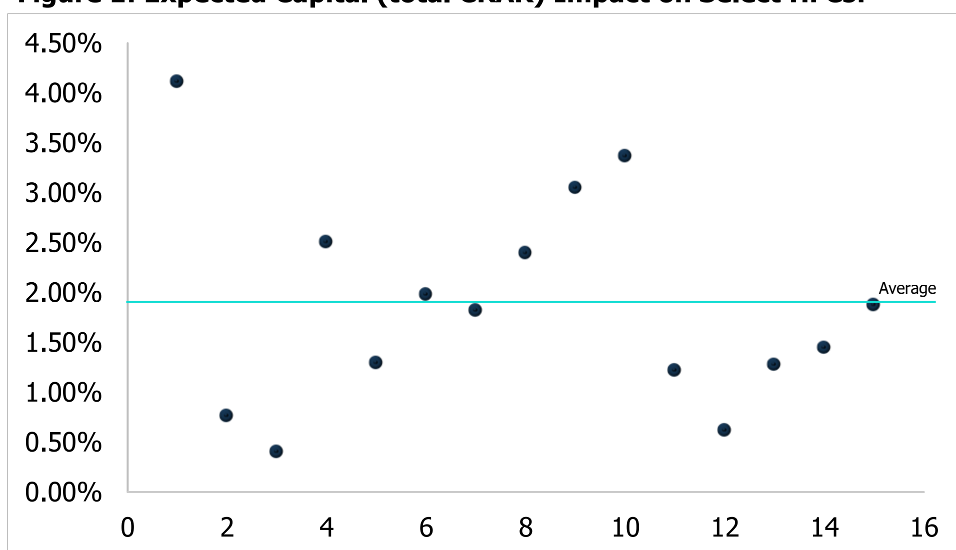
Risk weighted assets for undisbursed amount of housing loans have been reviewed as follows:

Segment wise Undisbursed credit	Applicable Credit conversion factor (CCF)	Earlier risk weights	Revised risk weights- as per loan category	
-Housing	50%	100%	**Weighted risk assets - On balance Sheet items**	**% Weight**
			1) Ticket size up to Rs.30 lakhs and LTV of ≤80%, classified as standard 2) Ticket size above Rs.30 lakhs up to Rs.75 lakhs and LTV of >80% to ≤90%, classified as standard 3) Ticket size above Rs.30 lakhs up to Rs.75 lakhs and LTV ≤80%, classified as standard	35%
			1) Ticket size up to Rs.30 lakhs and LTV of >80% to ≤90%, classified as standard 2) Ticket size above Rs.30 lakhs up to Rs.75 lakhs and LTV of >75% to ≤80%, classified as standard 3) Ticket size above Rs.75 lakhs and LTV of ≤ 75%, classified as standard (sanctioned on or after 1-08-2017)	50%

Segment wise Undisbursed credit	Applicable Credit conversion factor (CCF)	Earlier risk weights	Revised risk weights- as per loan category	
			1) Ticket size above Rs.75 lakhs and LTV of ≤ 75%, classified as standard (sanctioned before 1-08-2017)	75%
			2) Other housing loans	100%
-Other loans			**100%**	
-Fund/non-fund-based exposure to CRE-Residential			For exposures categorised as standard: 75% For exposures not categorised as standard: 100%	

- The move to align the risk weights on undisbursed portion of loan with the original loan categorisation is positive and expected to reduce capital charge.
- The benefit in terms of capital release shall be more for HFCs having higher share of individual housing loans since risk weights in this category (post CCF) shall reduce from 100% to 50% while the same remains unchanged for loans against property (LAP- categorised as other loans) at 100%.

Figure 1: Expected Capital (total CRAR) Impact on Select HFCs:



Source: Company disclosures, CARE Estimates

- Overall, CARE Rating expects the new norms to free up risk capital in the range of 2% to 2.5% for housing finance companies.

Guidelines Regarding Acceptance of Public Deposits

Currently HFCs which accept public deposits are subject to relaxed prudential norms on deposit acceptance when compared to NBFCs. The RBI has determined to align HFCs towards the regulatory regime on deposit acceptance which is applicable to deposit-taking NBFCs and specify uniform prudential parameters. The revised guidelines cover 1) maintenance of a minimum percentage of liquid assets, 2) safe custody of liquid assets, 3) full cover for

public deposits, 4) rating of deposits, ceiling on quantum of deposits, and period of deposits, 5) branches and appointment of agents to collect deposits, and 6) restrictions on investments in unquoted shares.

Maintenance of a minimum percentage of liquid assets: Currently, deposit taking HFCs are required to maintain 13% liquid assets against public deposits held by them which would be increased to 15% in a phased manner as per the table below

Timeline	Unencumbered approved securities, to be held as a % of public deposits	Total liquid assets along with unencumbered approved securities to be held as a % of public deposits
Currently	6.50%	13%
January 01, 2025	8.00%	14%
July 01, 2025	10%	15%

Rating of deposits: The deposit taking HFCs need to maintain an investment-grade credit rating which would be reviewed annually to remain eligible for garnering public deposits. If the credit rating goes into the sub-investment grade, such HFCs would not be able to renew existing deposits or accept fresh deposits until the rating is revised to investment grade.

Ceiling on quantum of deposits: The ceiling on the quantum of public deposits held by deposit-taking HFCs has been lowered to 1.5x from 3x of NOF. HFCs holding deposits more than the revised limit would not be able to accept fresh public deposits or renew existing deposits till they conform to the revised limit. However, the existing excess deposits will be allowed to run off until maturity.

Period of deposits: Currently HFCs can accept or renew deposits between tenors of 1 year to 10 years. Under the revised guidelines, tenor of deposits has been restricted to between one year and five years. However, existing deposits with maturities above five years would be run down as per the existing repayment profile.

Branches and appointment of agents to collect deposits: A deposit taking NBFC can open its branch or appoint agents as per the following criteria

- NOF is up to Rs. 50 crore: Within the State where its registered office is situated; and
- NOF is more than Rs. 50 crore and its credit rating is AA or above: Anywhere in India. However, an NBFC which has an asset size greater than Rs 50 crore but has a credit rating below AA, can open branches only within the state where its registered office is situated.

CareEdge Views

- The recent circular is in continuation to RBI's review of regulatory framework for HFCs seeking to bring about regulatory parity between HFCs and NBFCs. These norms for deposit taking HFCs would increase the liquidity buffers and encourage further diversification of liabilities profile. CareEdge Ratings believes that liquidity and liability profile of large deposits taking HFCs is comfortable to adhere to changes suggested under the regulations.
- Additionally, a review of risk weights for undisbursed amount of loans is expected to free up capital for HFCs in the range of 2% to 2.5% with the expected capital benefit being higher for HFCs having greater share of individual housing loans.

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