Workshop on

RBI Circular on Regulatory Measures on Consumer Credit by Banks & NBFCs

-Vinod Kothari

Vinod Kothari Consultants P. Ltd
finserv@vinodkothari.com

Kolkata:
1006-1009, Krishna
224 AJC Bose Road
Kolkata – 700 017
Phone: 033 2281 3742
Email: info@vinodkothari.com

Website: www.vinodkothari.com

New Delhi:
A-467, First Floor,
Defence Colony,
New Delhi-110024
Phone: 011 6551 5340
Email: delhi@vinodkothari.com

Mumbai:
403-406, Shreyas Chambers
175, D N Road, Fort
Mumbai
Phone: 022 2261 4021/ 3044 7498
Email: mumbai@vinodkothari.com

Bangalore:
4, Union Street,
Infantry Rd, Shivaji Nagar,
Bengaluru -560001
Phone: 033 2281 3742
Email: bengaluru@vinodkothari.com

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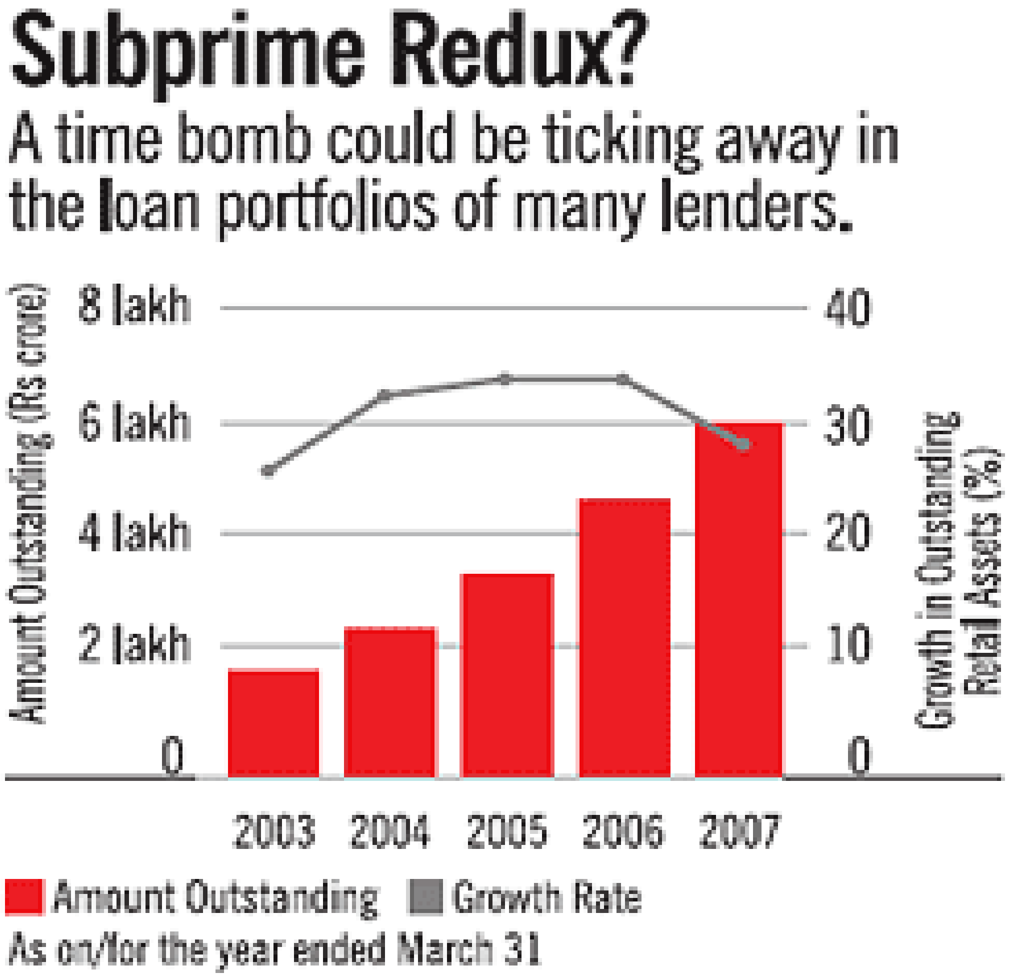
Background and highlights

- Concern of the RBI over sharp rise in unsecured consumer lending
- What could be the concerns:
  - Inflationary potential
  - May result into increasing defaults over time
  - Given the interdependence of banks and NBFCs, may result into larger system risks
- In the past, this has been seen on multiple occasions:
  - 2003-2007
  - Microfinance crisis in 2010
- Concerns were expressed after the September 2023 growth rate date



- There has been a growth in terms of the consumer credit originated on Y-o-Y basis as shown in the table below:

YoY Growth in Originations (3M ended June 2023)		
Product	**Volume**	**Value**
Home Loan	-12%	-6%
LAP	7%	12%
Auto Loan	-3%	13%
Two- wheeler Loan	5%	18%
Personal Loan	22%	12%
Credit Card	1%	
Consumer Durable Loan	13%	20%

Source: TransUnion Report

Increase in Personal Loans

- The personal loans segment (the largest segment with a 34.1% share) witnessed a robust growth of 30.4% y-o-y for September 2023 boosted by the impact of the HDFC merger, growth in credit card outstandings, other personal loans, housing loans, and vehicle loans
  - Housing loans grew by 37.3% y-o-y in September 2023 compared to 15.9% a year ago mainly due to the merger (reclassification of HDFCs' advances).
  - Vehicle loans registered a robust growth of 21.2% y-o-y in September 2023 as compared to 19.8% in the yearago period
  - Credit Card outstanding continued to remain elevated in September 2023 reaching Rs 2.17 lakh crore, a yo-y growth of 29.9%

Particulars	% Increase in the Credit Growth	
	Sep 22 vs Sep 21	Sep 23 vs Sep 22
Personal Loans (Not Consumer Credit)	19.4	30.4
Vehicle Loan	19.8	21.2
Unsecured loan	25.1	25.5
Housing loan (Not Consumer Credit)	15.9	37.3

Source: RBI, CareEdge Calc.

Snapshot of the Circular

Regulatory Change	Increased Risk Weight in case of CC for Banks	Increased Risk Weight in case of CC for NBFCs	Increased Risk Weight on Banks lending to NBFCs	Sectoral Limits on Unsecured Credit
Timeline for Implementation	• Effective Immediately • Increased risk weight may be applied in the capital adequacy return filed with RBI			• February 29, 2024 • Effective steps may be taken soonest

What is Consumer Credit?

As per RBI XBRL Returns – Harmonization of Banking Statistics it means loan given to individuals and

INCLUDES

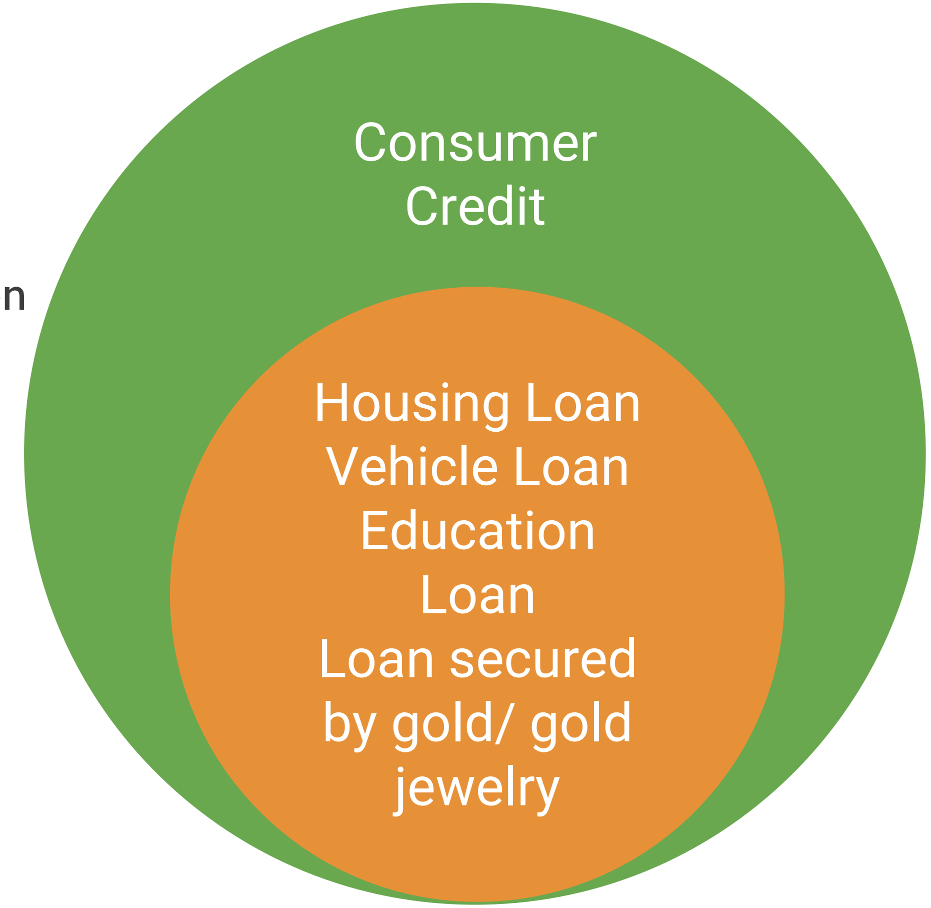
- Loans for consumer durables
- Credit Card Receivables
- Auto Loans (other than loans for commercial use)
- Loans given for other consumption purposes
- Personal loans to professionals (excluding loans for business purposes)
- Secured personal loans secured by gold, gold jewellery, immovable property, fixed deposits

EXCLUDES

- Education loans
- Consumption loans given to farmers under KCC
- Loans given for investment in financial assets
- Loans given for creation/ enhancement of immovable assets

Consumer Credits excluded from the purview of the Circular

- The increased risk weight of 125% will apply to:
  - All "consumer credit" as per the definition/items given in the table below.
  - Unsecured personal loans, loans to individuals for no specific purpose
  - Revolving lines of credit or any other line of credit given to individuals, not specifically for business purposes
- But will not apply to
  - Housing loans
  - Educational loans
  - Vehicle loans
  - Loans secured by gold and gold jewelry (in case of NBFCs, it will only be loan against gold jewelry)
- In our view, the increased risk weight will also not apply to:
  - Business loans
  - MFI loans, as the same may be contended to not be for personal consumption (in case of NBFCs MFI loans have been specifically exempted)



Significance of assigning Risk Weight for Capital Adequacy

- Risk weights are assigned based on the perceived riskiness of the different asset classes, including consumer credit.
- The significance of risk weights in case of consumer credit exposure is that it determines the regulatory capital that banks are required to hold against such exposures.
- Higher risk exposures are assigned higher weights which means that lenders must allocate more regulatory capital to cover potential losses associated with such exposures.
- On the other hand, lower risk exposures are assigned lower weights, requiring less capital.

Applicability of increased risk weight (1/2)

TYPE OF LOAN	APPLICABILITY OF RISK WEIGHT
Loan given to a proprietary firm	The definition refers to credit extended to "individual". Technically, there is no difference between an individual and a proprietary concern, but if the loan is given to a concern, it partakes the character of a business loan. Hence, it is not covered
Priority sector loans given by banks	Priority sector loans will most likely be in the excluded category. In any case, the intent of the regulator cannot be to treat a lending as priority, and risk at the same time.
MSME loans	As the loans are for business purpose, hence not covered as "consumer credit"
LAP loans given without any end-use restrictions	If the LAP loan is given for personal or consumption purpose, or is not otherwise linked with business purpose, it may be taken as personal loan, and hence, subject to 125% risk weight
LAP loan given for business purposes	Not considered as consumer credit
Loan against shares, but for personal use	Would have been considered as capital market exposure, and hence, alraedy risk weighted at 125%
Loan for purchase of a commercial vehicle	Not consumer credit
Loan for personal use vehicle	Excluded from scope, hence, 100% risk weight will apply

Applicability of increased risk weight (2/2)

TYPE OF LOAN	APPLICABILITY OF RISK WEIGHT
Top up loan in case of a housing loan	A home equity line of credit or home equity loan, does not usually qualify as housing loan. Since the end use of this is not controlled, it maybe taken as consumer credit. If yes, 125% risk weight will apply
Loan for insurance premium in case of a house	The requirement to have the house insured is stipulation of the HFC for the purpose of home loan. Hence, the loan may be incidental or ancillary to home loan. HFC regulations apply the same risk weight to insurance loan too.
Invoice finance transaction	Not a case of consumer credit
Gold loan	Specifically excluded
Micro finance loan	Specifically excluded in case of NBFCs. In case of banks, it may be argued that the purpose is not consumption
Fintech loans, BNPL loans, etc.	125% risk weight will apply
Payday loans or other similar short term financing done by new age NBFCs	125% risk weight will apply

Impact of increase in Risk Weights

Co-Lending

Yes, since the asset stays on the books of both the co-lenders, higher risk weight will have to be assigned to the respective portions

Transfer of Loan Exposures

The underlying loans are put on the balance sheet of the buyer. Hence, the risk weights for consumer credit will have to be increased

Securitisation

In case of pass-through certificates, the buyer acquires a security, which is risk weighted based on the ratings-based risk weights as per SSA Directions. There is no change in those risk weights, even if the underlying loans are consumer credits. Whether there will be a downgrade of the ratings is the call of the rating agency, in which the risk weights may be impacted.

Few Implications of the Circular

Increased cost of lending

- From banks to NBFCs and retail individuals
- NBFCs to retail individuals

Bank and NBFC partnerships

- Higher yield expectations

Review of internal risk exposure limits by the Board

Impact on the internal assessment of capital adequacy (ICAAP)

Change in Risk Weight for loans to NBFCs

- The risk weights on exposures of SCBs to NBFCs, excluding core investment companies, shall be increased by 25 percentage points (over and above the risk weight associated with the given external rating) in all cases where the extant risk weight as per external rating of NBFCs is below 100%
- **Exclusion:** Loan to HFCs, Loan to NBFC that is treated as PSL.

Rating (Long Term/ Short Term)	Existing Risk Weight	Revised Risk Weight
AAA/ A1+	20%	45%
AA/ A1	30%	55%
A/ A2	50%	75%
BBB/ A3	100%	No change
BB & below/ A4 & D	150%	
Unrated	100%	

Housing Loans

- For being eligible for being treated "claims against residential property" under para 5.10 of Basel III circular (applicable in case of banks), the Basel definition should be relevant
- RBI/NHB definition of what qualifies as housing finance for individuals for the purpose of "housing finance company" test seems broadly aligned with the above.
  - The RBI HFC Master Directions states that "Housing Finance" shall mean financing, for purchase/ construction/ reconstruction/ renovation/ repairs of residential dwelling units, which includes a specified list of exposures.
- However, in case of a gap, for capital adequacy, the definition provided under the Basel Norms above should prevail.

"Lending to individuals meant for acquiring residential property which are fully secured by mortgages on the residential property that is or will be occupied by the borrower, or that is rented, shall be risk weighted as indicated as per Table 7 below (in the Basel circular), based on Board approved valuation policy. LTV ratio should be computed as a percentage with total outstanding in the account (viz. "principal + accrued interest + other charges pertaining to the loan" without any netting) in the numerator and the realisable value of the residential property mortgaged to the bank in the denominator."

Lending to NBFCs vs Acquiring exposure through DA ,etc.

Ways of acquiring Exposure	Risk Weights
Lending directly to NBFC	25% higher than the rating-based risk weight. A-rated corporate borrower attracts 50% risk weight - hence, the NBFC risk weight is 75%
Purchase of portfolio by way of direct assignment	Depending on the nature of portfolio. If consumer credit, then 125%
Co-lending	Depending on the nature of portfolio. If consumer credit, then 125%
Investment in securitisation	Depends on the rating of the tranche, maturity, thickness, etc., and whether the transaction is STC. For an investment in AAA tranche, the risk weight may be as low as 15% for non STC, and 10% for STC.

Top Up Loans

- Meaning of top-up:
  - Existing facility (usually secured)
  - Run down for sometime (satisfactory performance)
  - Another facility tagged with the first facility
- Modes of Tagging
  - Sharing of security interest
  - Common EMIs
  - Common maturity
- Top up loans secured by immovable property (security on first facility)- will also be considered as secured
- Increase in risk weights for consumer credit, and the sectoral cap for unsecured consumer credit, are two separate things
  - Top up loans will be taken as unsecured consumer credit for the purpose of "credit appraisal, prudential limits and exposure purposes"
  - For increase risk weights, the purpose of the loans shall be considered, irrespective of being secured or unsecured

Sectoral Exposure on Consumer Credit

- Self imposed caps depending on the business, diversification, asset focus, etc
- No absolutism in the regulatory prescription
- Risk Management Committee to set these sectoral caps
- In absence of Risk Management Committee the Board of Directors may monitor the sectoral caps
- Sectoral Limits are based on Asset Under Management (AUM)
- For monitoring risk exposure in FLDG the entire portfolio value has to be considered.
- Portfolio concentration may be corrected by securitisation, direct assignment or Co-lending transactions.