NORTHERN ARC

Note on the RBI's measures announced on April 17, 2020 and their impact on NBFC(s)

Context

The Government of India, in response to the continuous increase in the number of Covid-19 cases across the country, had extended the nationwide lockdown to May 3, 2020 on April 14, 2020. Further to this, the Reserve Bank of India, vide its notification on April 17, 2020, released a set of measures to support the economy, financial services sector and the end customers who are bearing the brunt of the economic fallout of the lockdown. These measures were over and above the first set of announcements that were made by the RBI on March 27, 2020.

Key aspects of the announcement

Three key aspects of announcements are detailed in different sections of this note:
1.1. Dedicated line of funding to NBFC(s) and NBFC-MFI(s) through TLRTO
1.2. Refinancing Facilities for NABARD, SIDBI and NHB
1.3. Provisioning and Asset Classification

Dedicated line of funding to NBFC(s) and NBFC-MFI(s)

Central Banks across the world have used long term financing operations to infuse liquidity in the economy through banks, when such an intervention is considered critical. Targeted Long-Term Repo Operations (TLRTO) is one such scheme which allows banks to borrow up to three-year funds form the RBI, at a floating rate linked to the Repo rate, by providing government securities/ SLR securities that the bank holds as collateral.

The RBI had earlier commenced Targeted Long-Term Repo Operations (TLTRO) on March 27, 2020, which were expected to be a key source of liquidity for NBFCs and corporates.

TLRTO operations in a bank are managed by its respective treasury departments. The funds raised by any bank through TLRTO are targeted to be deployed in corporate debt. The treasury teams of the banks deploy the liquidity in NCDs/CPs investments unlike in case of lending which are managed by respective corporate lending teams.

Most banks had made initial investments (made from the funds raised through TLRTO 1.0) in papers issued by higher rated (AAA or AA category) entities. This had led to concerns that well governed but smaller and lower rated NBFCs and MFIs may not be able to avail the much-needed liquidity through this route. To address this concern, the RBI has initiated TLTRO 2.0 amounting to INR 50,000 crore to begin with. These funds will require to be deployed by banks in investment grade bonds, CPs and NCDs of NBFCs, based on the following criteria:

- 10 per cent in securities/instruments issued by Micro Finance Institutions (MFIs)
- 15 per cent in securities/instruments issued by NBFCs with asset size of INR 500 crore and below
- 25 per cent in securities/instruments issued by NBFCs with asset size between INR 500 crore and INR 5,000 crore

The asset size of the institution will be determined as per the latest audited balance sheet. The auction for the first tranche of the TLTRO 2.0 amounting to INR 25,000 will be conducted on April 23,2020. Banks will have to deploy the funds raised through this mechanism within a period of 45 days.

TLTRO 1.0

Banks which were holding a large surplus of SLR securities were the key participants in the auction. As a result, mainly large banks participated with higher bids and were allotted higher amounts. Largest beneficiaries were AAA PSU and Private Corporates and AAA NBFCs. Very few entities with AA rating benefitted in the first phase.

Number of Bids submitted towards the 4th auction however diminished. One of the reasons attributed to this is the availability of surplus liquidity with Banks. Limiting the maximum amount invested in securities issued by a particular entity or group to 10 percent could also have caused this. Summary of bids and allotment is below:

Tenor	3-year			
Date of Reversal	March 24, 2023	April 3, 2023	April 7, 2023	April 13, 2023
Notified Amount (in ₹ crore)	25,000	25,000	25,000	25,000
No of bids received	11	13	18	11
Total amount of bids received (in ₹ crore)	60,500	99,760	1,13,470	61,415
Amount allotted (in ₹ crore)	25,009	25,016	25,016	25,009
Pro-rata Allotment Percentage (%)	41.33	25.07	22.04	40.71

TLTRO 2.0 – Way forward

The RBI has directed banks to invest the funds raised through TLRTO 2.0 in instruments with a minimum investment grade rating. Given that banks usually make investments in AA and above instruments, Banks are working towards revising their underwriting policies and processes to take exposure in Capital market instruments (NCDs/ CPs) issued by entities rated below AA. However, banks are concerned about the credit risk, rating downgrades, weak collections, and tight liquidity positions of the underlying issuers.

With the limitation of maximum amount invested in securities issued by a particular entity or group to 10 percent not applicable under TLTRO 2.0, it is expected that banks would focus on their existing clients to begin with. Although RBI has clarified that the investments made in small and medium NBFCs and MFIs will be kept out of calculation of adjusted non-food bank credit (ANBC) for the purpose of determining PSL targets, banks may restrict their exposures to these institutions within the tenures of 18-24 months. ALM of the issuers will also be a key consideration for taking new exposures. Unrated entities and entities with non-Investment grade rating may not be considered by most banks as it is envisaged that they will access liquidity from NABARD and SIDBI. Also, many banks do not have the required internal policy approvals to invest in structured issuances as of now.

Northern Arc is working with private and public sector banks encouraging them to participate in the bidding process. This will ensure that a larger pool of capital is available, and the coverage of this program can be maximised for issuers cutting across small, medium, and large entities. It is also working with senior management team of banks, their credit teams, and the treasury teams on fast tracking their credit underwriting processes. Banks are exploring investments via structured transactions like the pooled bond issuance along with risk participation from Northern Arc and other large financial institutions.

Northern Arc till date has executed 32 transactions in the pooled bond and pooled loan format raising over INR 3000 crores for its clients. On the NBFC side, Northern Arc continues to work closely with its clients to structure transactions that are best suited for their balance sheets.

Refinancing facilities for NABARD, SIDBI AND NHB

The RBI has opened special refinance facilities for a total amount of INR 50,000 crore to NABARD, SIDBI and NHB to enable them to meet sectoral credit needs. This will comprise of

- INR 25,000 crore to NABARD for refinancing regional rural bank, cooperative banks, and MFIs
- INR 15,000 crore to SIDBI for on-lending/refinancing to SMEs
- INR 10,000 crore to NHB for supporting housing finance companies (HFCs)

All the three development finance institutions (NABARD, SIDBI & NHB) are in the process of formulating their policies on how these funds will be deployed will be finalised and released in next couple of days. It is expected that it will include SFBs, NBFCs, NBFC-MFIs and rating requirement will be brought down below investment grade as well. Northern Arc is working with the respective teams on the credit appraisal process in order to reduce the lead time of the application process and on-board entities on whom they do not have any exposure. The expectations are that this policy change will enable the benefit of the scheme to be accessible to all.

Northern Arc is also exploring structured products like Pooled Loan Issuance (PLI) Pooled Bond Issuances (PBI) and SPiCETM Loans/ Bonds to tap into this capital and enable financing for NBFCs and MFIs.

Provisioning and asset classification

The moratorium period for all standard loans as on February 29, 2020 will be excluded from number of days past due for the purpose of asset classification. This includes all standard loans, even the ones which were overdue as on February 29, 2020. This declaration by the RBI is in line with the stance adopted by Basel Committee.

In respect of accounts in overdue but standard as on February 29, 2020, where moratorium benefit has been extended and the asset classification benefit utilized, lending institutions shall provide at least 10 per cent of the total outstanding of such accounts, to be phased over two quarters Q4 FY20 and Q1 FY21.

NBFCs which are required to comply with Indian Accounting Standards (IndAS) shall continue to be guided by the guidelines duly approved by their Boards and as per ICAI advisories for recognition of the impairments.