FIDC

Finance Industry Development Council

(A Representative Body of Assets and Loan Financing NBFCs)

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Shri Shaktikanta Das
Governor
Reserve Bank of India
Central Office Building
Shahid Bhagat Singh Marg
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May 14, 2020

Respected Sir,

NOTE ON PROVISIONING REQUIREMENTS UNDER RBI CIRCULAR DT 27TH MARCH & 17TH APRIL, 2020 AND THE ICAI ADVISORY

In view of Covid-19 induced lock down and its consequential impact on the livelihood of millions of people particularly MSMEs and truck/taxi drivers and unorganized labour who are most vulnerable and earn and pay their instalments, RBI has permitted NBFCs to allow moratorium to their customers for instalments falling due between March and May, 2020 and also allowed standstill on asset classification during this period. In other words, all standard accounts (0-90 dpd contracts) as on 1st March 2020 can be frozen during this period of 3 months till 31st May20.

RBI has also specified provisioning guidelines applicable in respect of these accounts and advised NBFCs to comply with Ind AS in line with duly approved Board policies and the advisories issued by ICAI for recognition of impairment.

We list out the key issues of concerns for NBFCs:

1. **Request to allow utilising Reserves to make additional provision for COVID19:**

   RBI has vide its circular dt 17th April, 2020 advised NBFCs which follow Ind AS accounting to be guided by the board approved guidelines in terms of asset classification and provisioning and as per ICAI advisories for recognition of the impairments. The ICAI has vide its advisory dt. 31st March, 2020 advised measuring the impact of Covid-19 on the portfolio quality in the form of risk of default (PD), estimated amount of default (LGD) with adverse impact on the business of the borrowers or debtors due to Covid-19 on one hand and prudential regulatory actions to sustain the economy such as loan repayment holidays, reduction in interest rates etc. on the other hand. As per Ind AS 109 and Ind AS 107 both of which are applicable in respect of ECL measurement and disclosure in the financial statements, the NBFCs will be required to make additional provisioning in terms of ICAI advisory and it will surely make a severe dent on the profitability and net worth of the respective NBFCs particularly considering the impact of Covid-19 on the vulnerable sections of society viz. daily wage earners and informal segment self-employed customers and marginal farmers.

NBFC/HFCs appropriate profits to Statutory (earmarked) and Other Reserves. Utilization of these Reserves is governed by the statute requiring its creation. The pre-existing economic slow-down with its significant impact on NBFC/HFCs loan book further exacerbated by the Covid-19 is an unprecedented adverse event for the financial sector. There is an imminent need for extra ordinary measures to deal with the emergent situation.

While NBFCs / HFCs would create normal ECL provisions out of their current year profits, we urge upon RBI to consider, as a one-time measure, to allow NBFC/HFCs to draw-down from their Reserves including those also created under section 45-IC of the RBI Act and adjust towards additional ECL provision requirement, in excess of provision calculated as per normal Probability of Default (PD) and Loss given Default (LGD). This will enable the NBFC/HFCs to shore-up their balance sheet strength by reporting a more fortified ECL provision cover against their likely increase in delinquent loans and remain eligible to access equity/debt capital when situation normalizes.

Request:

RBI may favourably consider allowing one-time draw-down from Statutory Reserves and Other Reserves with the approval of the Board of Directors of the NBFC/HFCs to be

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adjusted to enhance ECL provision, in excess of provision calculated as per normal Probability of Default (PD) and Loss given Default (LGD).

2. To allow Stage 2 provision to be included for calculation of Tier II Capital

The RBI Circular on Implementation of Indian Accounting Standards dated March 13, 2020, requires that lifetime ECL shall not be reckoned for regulatory capital (numerator) while it shall be reduced from the risk weighted assets. Under Ind-AS, lifetime ECL is computed where the NBFC determines that there is a significant increase in credit risk and is relevant for both stage 2 (31 to 90 days overdue) and stage 3 (over 90 days overdue) assets. In respect of stage 2 assets that are delinquent but not classified as NPA, ECL provisions are invariably much higher (on an average 2%) than the comparable 0.40% standard asset provisions as applicable under the RBI IRAC norms. Hence, NBFCs are not only required to make higher provisions under ECL but are also denied the benefit of treating this provision as Tier II, which is available under the IRAC norms.

Request:

RBI may, therefore, consider permitting any provisions made as per ECL, in respect of the standard assets to be reckoned with for the purpose of Tier II capital.

3. Request to increase Ceiling on including Standard Assets Provision for Tier II capital:

For Capital Adequacy calculation, the extant RBI guidelines cap utilization of standard assets provision at 1.25%. The ceiling of 1.25% was set up in the context of the Standard Assets provisioning @ 0.40% under IRAC norms.

The standard asset provisioning has substantially increased under Ind AS and shall further increase as NBFC/HFCs make additional provisions under RBI circulars dated March 27 and April 17, 2020. The NBFC/HFC would need support to maintain / augment capital while they fortify their Balance Sheet by making additional provisioning.

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Request:

Increase the ceiling of 1.25% for considering standard asset provision for calculation of Capital Adequacy to 2.50% for NBFC/HFCs following provisioning norms under IndAS. This shall be in tune with the stricter provisioning norms under IndAS.

We sincerely appeal to the Reserve Bank of India to consider these measures to help NBFCs manage the current situation and to enable them to play a due role in the rebuilding efforts.

Thanking you,

Yours faithfully,

For FINANCE INDUSTRY DEVELOPMENT COUNCIL

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Cc to:

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