

ROLLBACK OF RISK WEIGHTS

SECTOR UPDATE

RBI on easing spree

The RBI has eased three norms: i) The regulator has reduced risk weights on MFI business loans of banks to 75% from 125% (as these are now part of regulatory retail) and to 100% on MFI consumption loans. ii) Risk weights on loans to NBFCs have been restored to pre-Nov'23 levels. These were increased by 25% in Nov-23. iii) Muthoot has got approval to open 115 branches.

The MFI relaxation shall benefit MFI-heavy banks other than SFBs but will benefit Bandhan and RBL the most. The NBFC relaxation shall benefit NBFCs by lowering their CoF. CIBC benefits the most. With norms being eased so much, probability of the RBI approving Sumant Kathpalia's (CEO of IIB) re-appointment for three years has improved.

RBI rolls back increase in risk weights on NBFCs and MFIs for banks

The roll back in risk weights for MFIs shall benefit all MFI-heavy banks, but not SFBs because other than AU no SFB had raised risk weights on MFI loans to 125%. AU had done it only on 20% of MFI loans that were consumption loans not on other loans. Other SFBs had not hiked risk weights. Banks that had hiked risk weights include Bandhan, RBL, IDFC First and IIB. These banks shall see improvement in CAR, but Bandhan and RBL shall likely benefit most. Banks that have a high exposure to NBFC include IDFC First, ICICI and BoB. Lower risk weight on NBFC loans shall result in a lower CoF for NBFCs especially those that have a high share of bank borrowings. Given increasing risks in the sector, we do not see banks going aggressive like before on NBFC lending even with this relaxation. Lending to PSL and to HFCs was already exempt from higher risk weights. Most NBFC MFIs had switched to the PTC/DA route to get funding. Given challenges in the sector, banks shall continue to give preference to this route over direct lending. Similarly, there is some rising stress in small-ticket MSME and banks would continue with their cautious approach here. Therefore, this change is more beneficial to the larger NBFCs. CIBC, SBI Cards, Five-Star, LTF and MMFS benefit in that order. In our view, CAR shall improve 280–300bp for Bandhan as the best case, ~40bp for RBL, 25bp for IDFC and 15bp for AU considering relaxation for both MFI and NBFC. The relaxation on MFI is positive for banks' CAR while relaxation in NBFC is positive only for NBFCs not banks. For banks, NBFC relaxation will be margin negative and RAROC neutral.

Ease in RBI stance—a positive

After very tight regulations in the last 1.5 years the RBI is easing norms, which is positive for the sector. Given deteriorating asset quality in a few segments, banks are unlikely to chase aggressive growth in mid-sized NBFC and MFIs but RBI's easing stance will be positive for loan growth when the environment stabilises and system liquidity improves.

Muthoot gets approval to open 115 branches

Muthoot has got the RBI's approval to open 115 branches. The last such approval for opening 150 branches was granted nearly three years ago in Jul-22.

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Some nuances on MFI exposures of banks

- For MFI loans covered by CGFMU, risk weights were maintained at 75% even after the hike to 125%. CGFMU loans are classified as regulatory retail where risk weights are 75%.
- IDFC First had increased risk weights on MFI loans to 125% only for those loans that were not covered by CGFMU.
- Similarly, AU SFB had increased risk weights to 125% only for 20% of MFI loans at the time of classification because these were consumption loans. The rest were classified as regulatory retail and had risk weights of 75% even after the hike.
- Bandhan hiked risk weights on all MFI loans from 75% to 125% and also on NBFC loans that led to a reduction of 360bp in CAR. Following this classification, the MFI/EEB book has reduced in proportion from 62% to 56% so the reversal will be lower than 360bp of CAR, in our view. Furthermore, while the entire portfolio was risk weighted at 75% before the hike, the Board may, in our view, decide to carry higher risk weights of 100% on individual loans and lower risk weight of 75% on group loans which would then result in a lower reversal.

Change of heart

At the recent media meet on February 7, 2025 to discuss the monetary policy the Governor and Deputy Governor had clarified in response to a media query that the RBI is unlikely to relax risk weights on NBFC loans because of interconnected risks. Even after this, the RBI relaxed risk weights on NBFC loans of banks. This possibly happened after the governor recently met CEOs of NBFCs and banks. The NBFCs would have asked for this relaxation. The RBI under the new Governor is adopting a more consultative approach than earlier.

Exhibit 1: Bank borrowings as a percentage of total borrowings

Bank borrowings, % to total borrowings	Q3FY25
MMFS	48%
Muthoot	56%
SBI Cards	65%
FIVESTAR	56%
L&T Finance	54%
Shriram Finance (Term Loans only)	22%
Shriram Finance (Total)	39%
CIFC	58%
BAF	37%

Source: Company, Nuvama Research

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