EARLY IMPRESSIONS

Reserve Bank of India's draft circular on Review of regulatory framework for Housing Finance Companies (HFCs) and harmonization of regulations applicable to HFCs and Non-Banking Finance Companies (NBFCs)

January 2024

Foreword

Subsequent to transfer of regulation of HFCs from National Housing Bank (NHB), the RBI had issued revised regulatory framework for HFCs vide circular dated 22 October 2020 wherein it was stated that further harmonisation between regulations of HFCs and NBFCs will be taken up in a phased manner.

In pursuit of this goal, the RBI has recently unveiled a draft circular on 15 January 2024, titled *"Draft circular on Review of regulatory framework for HFCs and harmonisation of regulations applicable to HFCs and NBFCs"* for public feedback. The primary objective of this circular is to rationalise the regulations governing HFCs and bring them into closer conformity with the regulatory framework applicable to NBFCs. The proposed modifications encompass aspects related to the acceptance of deposits and other regulatory aspects, with some changes being universally applicable to all HFCs.

This Uniqus Early Impressions provides an overview of the key aspects of the proposed changes in regulation for HFCs and offers insights on potential impact of the proposed change in regulations on HFCs.

We sincerely hope you find the enclosed publication informative. We will be happy to participate in any discussions required to provide clarifications on our views enclosed in the attached publication. We look forward to hearing from you.

Thank you.

For Uniqus India Private Ltd.

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Salient features of the RBI circular

Currently, HFCs accepting public deposits are subject to more relaxed prudential parameters on deposit acceptance as compared to NBFCs. Since the regulatory concerns associated with deposit acceptance is same across all categories of NBFCs, it has been decided to move HFCs towards the regulatory regime on deposit acceptance as applicable to deposit-taking NBFCs and specify uniform prudential parameters as prescribed under Master Direction – Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

Proposed Critical Changes

Some of the critical changes proposed in the revised regulations as stated below would apply to HFCs accepting or holding public deposits.

Topic	Guidelines	Potential impact
Maintenance of minimum percentage of liquid assets	**Current guidelines** According to Section 29B of the NHB Act, 1987, HFCs that accept deposits are currently obligated to maintain 13% of liquid assets in relation to their public deposits **Proposed guidelines** All deposit taking HFCs should consistently maintain liquid assets amounting to 15% of their public deposits in a gradual manner as specified in the circular Also, the minimum investment requirements in approved securities (primarily G-secs), will need to be scaled up from 6.5% of public deposits to 10% by FY 25	Requirement to maintain liquid assets at 15% of public deposits, would require the HFCs to recalibrate their liquidity and risk management strategy Further the requirement to have a higher investment in approved securities as a percentage of public deposits will potentially have an adverse impact on yields as such investments are not expected to earn a yield which a loan asset would generate

Topic	Guidelines	Potential impact
Full cover for public deposits	**Current guidelines** HFCs are required to maintain full asset cover for public deposits accepted by them at all times **Proposed guidelines** In addition to ensuring full asset cover for public deposits accepted by them at all times, it would now be incumbent upon HFCs to inform NHB in case the asset cover falls short	The proposed change to report shortfall to the NHB will mean the need to institutionalise oversight on achievement of full asset cover. In practice this could mean that HFCs may end up maintaining greater than 100% cover to avoid any slippages
Ceiling on quantum of deposits	**Current guidelines** The ceiling on quantum of public deposits held by deposit taking HFCs, which comply with all prudential norms and minimum investment grade credit rating as specified is 3 times of Net Owned Funds (NOF) **Proposed guidelines** The proposed amendment limits the quantum of public deposits to 1.5 times the NOF	The amendment to lower the quantum of public deposits which can be raised by HFCs would require HFCs to reassess their funding strategies, which could have a consequential negative impact on their overall cost of borrowings
Period for repayment of public deposits	**Current guidelines** Currently, HFCs were allowed to accept or renew public deposits repayable after a period of 12 months or more but not later than 120 months (10 years) from the date of acceptance or renewal of such deposits **Proposed guidelines** The proposed changes limit the maximum maturity of public deposits to 60 months i.e. 5 years	The changes will impact the asset liability management practices considering long term nature of housing finance
Regulations on opening of branches and appointment of agents to collect deposits	**Current guidelines** No such regulations currently exist for HFCs **Proposed guidelines** HFCs shall now need to: • Maintain NOF of greater than Rs 500 million; • Credit rating should be greater than AA	The proposed changes align guidelines for opening of branches and appointment of agents with that applicable for NBFCs

Topic	Guidelines	Potential impact
Setting limits for investment in unquoted shares	**Current guidelines** There are currently no guidelines which limit HFCs for making investment in unquoted shares **Proposed guidelines** As per the proposed changes, HFCs accepting deposits will now need to establish board-approved internal limits for investment in unquoted shares. This requirement applies specifically to investments in unquoted shares of a company that is neither a subsidiary nor part of the same group as the HFC	This amendment aims to establish governance over HFCs investments in unquoted shares by imposing additional responsibilities on the BOD
Participation in Currency Futures	**Current guidelines** There are currently no guidelines pertaining to the participation of HFCs in Currency Futures **Proposed guidelines** HFCs can now participate in currency futures exchanges, subject to the guidelines issued in the matter by Foreign Exchange Department of the RBI and provide necessary disclosures in the balance sheet following guidelines issued by SEBI	This change expands the range of financial instruments accessible to HFCs for mitigating the impact of currency fluctuations and possibly could result in hedge accounting becoming prevalent as part of risk management framework in a HFC
Participation in Interest Rate Futures (IRF)	**Current guidelines** There are currently no guidelines regarding the participation of HFCs in IRF **Proposed guidelines** HFCs can now participate in the designated IRF exchanges recognized by SEBI, as clients, subject to adherence to instructions contained in Rupee Interest Rate Derivatives (Reserve Bank) Directions, 2019, for the purpose of hedging their underlying exposures	This change expands the range of financial instruments accessible to HFCs for mitigating the impact of interest rate risk and will better aid in risk management. It could possibly also result in hedge accounting becoming prevalent as part of risk management framework in a HFC
Credit Default Swaps (CDS)	**Current guidelines** There are currently no guidelines regarding the participation of HFCs in CDS **Proposed guidelines** HFCs are allowed to engage in the CDS market solely as users, purchasing credit protection exclusively to mitigate the credit risk associated with the corporate bonds in their possession. In their capacity as users, HFCs must adhere to the guidelines outlined by the RBI	This change aids HFCs by offering a fresh method to mitigate credit risk, subject to adherence to regulatory guidelines Depending on the usage, this change could also potentially further the development of the CDS market in India

Topic	Guidelines	Potential impact
Issuance of Co-branded credit cards	**Current guidelines** There are no guidelines regarding the issuance of co-branded credit cards by Housing Finance Companies (HFCs) **Proposed guidelines** As per the proposed changes, HFCs will now be allowed selectively to issue co-branded credit cards with scheduled commercial banks, without risk sharing, with prior approval of the RBI, for an initial period of two years and a review thereafter. HFC will be required to fulfil minimum eligibility and RBI directions	This change provides HFCs opportunities for collaboration with banks and leverage their existing customer base to generate additional revenue
Finalization of balance sheet	**Current guidelines** Current guidelines did not specify any time limit for HFCs to finalize the balance sheet **Proposed guidelines** HFCs shall be required to finalize their balance sheet within 3 months from the date to which it pertains	This proposed change is likely to accelerate the financial reporting process and require HFCs to reorganise operating model for financial reporting to meet the new timeline requirements This will also necessitate an enhancement of the Internal Financial Controls to reflect the revised financial close process
Periodicity of Information System (IS) Audit	**Current guidelines** Periodicity of Information System (IS) Audit **Proposed guidelines** The periodicity of IS Audit shall be as per IS Audit policy of HFCs	This change will provide flexibility to HFCs in deciding the periodicity of IS audits based on their internal risk management policies

Topic	Guidelines	Potential impact
Investment through AIF	**Current guidelines** The investments/ loans/ exposures to subsidiaries, companies in the same group and other HFCs, in excess of 10 percent of owned fund, is reduced from the owned fund, in order to arrive at NOF of an HFC **Proposed guidelines** For the purpose of determining NOF, Investment made by HFC in entities of the same group, either directly or indirectly, for example through an Alternative Investment Fund (AIF), shall be treated alike. This is applicable when at least 50% of the funds in the AIF company originated from the HFC, or when the HFC is the beneficial owner in the case of an AIF trust and at least 50% of the trust funds have been contributed by the HFC	This change would aid transparency in understanding the investments into entities through AIFs
Technical Specifications for all participants of Account Aggregator ecosystem	**Current guidelines** Currently there are no technical specifications prescribed **Proposed guidelines** HFCs acting either as 'Financial Information Provider' or 'Financial Information User' are expected to adopt the technical specifications published by Reserve Bank Information Technology Private Limited (ReBIT)	The changes now require HFCs to align to standardized guidelines, potentially impacting their technological infrastructure, systems, and processes in order to comply with the prescribed specifications

How Uniqus sees the proposed changes

The RBI has progressed in its earlier stated objective to ensure parity in regulation for HFCs and NBFCs. The proposed regulations aim to achieve this objective. This is consistent with the RBI's objective to eliminate regulatory arbitrage between HFCs and NBFCs. The proposed regulations also provide greater flexibility to HFCs to access the derivatives market, which will enable better risk management.

In the short term, the proposed regulations may require certain business, operational and risk management (including ALM) changes by HFCs, however, in the medium to long term it is expected that the proposed changes will provide a level playing field between HFCs and NBFCs and will aid the RBI in enhanced regulation, especially considering that the nature of business of the HFCs and NBFCs is inherently similar i.e. that of lending.

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