Discussion paper on draft regulations issued by RBI related to

Housing Finance Companies (HFC) on June 17, 2020

Background:

In August 2019, Central Government has conferred certain powers for regulating HFCs with RBI. , HFCs were regulated by National Housing Bank (NHB) till then. HFCs will henceforth be treated as one of the categories of NBFCs for regulatory purposes by RBI.

RBI has carried out review of the extant guidelines applicable to HFCs and the draft norms released by RBI have sought defining the business more accurately. A progressive path for increasing capital adequacy has also been proposed. Also, to avoid double exposure to a project by way of lending to the developer as well as the buyer of the flat, RBI has proposed some tightening. This specifically pertains to real estate projects belonging to the same group of which the HFC is a part of. In such projects, HFC can either undertake an exposure on the group company in real estate business or lend to retail individual flat buyers in the projects of the group entities, but not do both.

Draft Regulations:

Details of the draft regulations proposed by RBI are as under:

1. Defining the term 'providing finance for housing' or 'housing finance':

Financing, for purchase/ construction/ reconstruction/ renovation/ repairs of residential dwelling units, which includes:

a. Loans to individuals or group of individuals including co-operative societies for construction/ purchase of new dwelling units.

b. Loans to individuals for purchase of old dwelling units.

c. Loans to individuals for purchasing old/ new dwelling units by mortgaging existing dwelling units.

d. Loans to individuals for purchase of plots for construction of residential dwelling units provided a declaration is obtained from the borrower that he intends to construct a house on the plot within a period of three years from the date of availing of the loan.

e. Loans to individuals for renovation/ reconstruction of existing dwelling units.

f. Lending to public agencies including state housing boards for construction of residential dwelling units.

g. Loans to corporates/ Government agencies (through loans for employee housing).

h. Loans for construction of educational, health, social, cultural or other institutions/centres, which are part of housing project in the same complex and which are necessary for the development of settlements or townships;

i. Loans for construction of houses and related infrastructure within the same area, meant for improving the conditions in slum areas for which credit may be extended directly to the slum-dwellers on the guarantee of the Government, or indirectly to them through the State Governments.

j. Loans given for slum improvement schemes to be implemented by Slum Clearance Boards and other public agencies;

k. Lending to builders for construction of residential dwelling units.

All other loans including those given for furnishing dwelling units, loans given against mortgage of property for any purpose other than buying/ construction of a new dwelling unit/s or renovation of the existing dwelling unit/s, will be treated as non-housing loans.

2. Defining 'principal business' and 'qualifying assets' for HFCs

A company will be treated as an NBFC if its financial assets are more than 50% of its total assets (netted off by intangible assets) and income from financial assets is more than 50% of the gross income and both these tests are required to be satisfied as the determinant factor for principal business of an NBFC.

Qualifying Assets refer to 'housing finance' or 'providing finance for housing' is subject to the following:

(a) Not less than 50% of net assets are in the nature of 'qualifying assets' for HFCs, out of which at least 75% should be towards individual housing loans as stated above.
(b) "Net assets" shall mean total assets other than cash and bank balances and money market instruments.

Such HFCs which do not fulfil the above criteria will be treated as NBFC – Investment and Credit Companies (NBFC-ICCs) and will be required to approach RBI for conversion of their Certificate of Registration from HFCs to NBFC-ICC.

However, a phased timeline will be given to HFCs which do not currently fulfil the qualifying assets criteria but wish to continue as HFCs in future. The timeline shall be phased as under:

Timeline	**At least 50% of net assets as qualifying assets i.e., towards housing finance**	**At least 75% of qualifying assets towards housing finance for individuals**
March 31, 2022	50%	60%
March 31, 2023	-	70%
March 31, 2024	-	75%

3. Classifying HFCs into systemically important and non-systemically important entities for regulatory purposes:

Presently HFC regulations are common for all HFCs irrespective of their asset size and ownership. RBI has proposed to issue HFC regulations by classifying them as systemically important and non-systemically important, so as to introduce a graded approach as applicable to NBFCs in general. In other words, non-deposit taking HFCs (HFC-ND) with asset size of ₹500 crore & above; and all deposit taking HFCs (HFC-D), irrespective of asset size, will be treated as systemically important HFCs. HFCs with asset size below ₹500 crore will be treated as non-systemically important HFCs (HFC-non-SI).

While the regulations for HFC-NDSI & HFC-Ds will be as existing under NHB regulations or harmonised with NBFC regulations, the regulations for HFC-non-SI (i.e., HFCs with asset size below ₹500 crore) will be brought on par with relevant regulations for NBFC-ND-non-SI.

4. Minimum Net Owned Fund (NOF) of ₹20 crore:

RBI proposes to increase the minimum NOF for HFCs from the current requirement of ₹10 crore to ₹20 crore. For existing HFCs the glide path would be to reach ₹15 crore within 1 year and ₹20 crore within 2 years. This step is aimed at strengthening the capital base, especially of smaller HFCs.

5. Harmonising definitions of Capital (Tier I & Tier II) with that of NBFCs:

The components of Tier I and Tier II capital are similar for NBFCs and HFCs except for the treatment of perpetual debt instruments (PDI). Presently PDIs are not considered as part of capital of HFCs unlike that of NBFCs. RBI has proposed to align the definitions of capital (both Tier I and Tier II) of HFCs with that of NBFCs, the changes being:

i. Inclusion of PDIs as a component of Tier I and Tier II capital on the lines of NBFCs.
ii. PDIs can be treated as part of Tier I / Tier II capital only by non-deposit taking systemically important HFCs.
iii. PDIs or any other debt capital instrument in the nature of PDIs, already issued by either deposit taking HFCs or non-systemically important HFCs will be reckoned as Tier I or Tier II capital as the case may be for a period not exceeding three years.
iv. Since HFCs are treated as a category of NBFCs for regulatory purposes, investments in shares of other HFCs and also in other NBFCs (whether forming part of group or not), shall be reduced from the Tier I capital to the extent it exceeds, in aggregate along with other exposures to group companies, ten per cent of the owned fund of HFC.

6. Public deposits

Public deposit is as defined under RBI master direction with an addition that any amount received by HFCs from NHB or any public housing agency is also exempt from the definition of public deposit.

7. Liquidity Risk framework and LCR

Non-deposit taking NBFCs with asset size of ₹100 crore & above, systemically important Core Investment Companies and all deposit taking NBFCs (except Type 1 NBFC-NDs, Non-Operating Financial Holding Companies and Standalone Primary Dealers) were advised to adhere to the guidelines as mentioned in DOR.NBFC (PD) CC. No.102/03.10.001/2019-20 dated November 04, 2019**.** RBI has proposed to extend these guidelines to all non-deposit taking HFCs with asset size of ₹100 crore & above and all deposit taking HFCs. It will be the responsibility of the Board to ensure that the guidelines are adhered to. The internal controls required to be put in place by HFCs as per these guidelines shall be subject to supervisory review. Further, as a matter of prudence, all other HFCs are encouraged to adopt these guidelines on liquidity risk management on voluntary basis.

8. Group entities engaged in real estate business

In order to address concerns on double financing due to lending to construction companies in the group and also to individuals purchasing flats from the latter, the HFC concerned may choose to lend only at one level. That is, the HFC can either undertake an exposure on the group company in real estate business OR lend to retail individual home buyers in the projects of group entities, but not do both. If the HFC decides to take any exposure in its group entities (lending and investment) directly or indirectly, such exposure cannot be more than 15% of owned fund for a single entity in the group and 25% of owned fund for all such group entities. As regards extending loans to individuals, who choose to buy housing units from entities in the group, the HFC would follow arm's length principles in letter and spirit.

9. Securitization

NHB has not prescribed specific guidelines on securitisation. RBI has proposed to bring all HFCs (systemically important and non-systemically important) under the ambit of guidelines on securitisation transaction as applicable to NBFCs

10. Lending against shares

Currently, there are no guidelines in place for lending against the security of shares by HFCs. RBI has proposed to extend instructions applicable to NBFCs to lend against the collateral of listed shares.

As per RBI guidelines for lending against shares by NBFCs with assets size of Rs.100 crores and above, LTV ratio of 50% is required to be maintained at all times; shortfall if any due to movement of share prices shall be made good in 7 working days. Only Group 1 securities should be accepted as collateral for loans above Rs.5 lakhs where the lending is done for investment in capital market.

11. Foreclosure charges

As a measure of customer protection and also in order to bring in uniformity with regard to repayment of various loans by borrowers of banks and NBFCs, no foreclosure charges/pre-payment penalties shall be levied on any floating rate term loan sanctioned for purposes other than business to individual borrowers with or without co-obligants. Since similar regulations are currently not prescribed for HFCs, RBI has proposed to extend these instructions to HFCs.

12. Other norms:

In addition to the above, there exist certain major differences between extant regulations of the HFCs vis-à-vis that for NBFCs which are as follows:

a. Capital requirements (CRAR and risk weights) – The minimum CRAR prescribed for HFCs currently is 12% and which will be progressively increased to 14% by March 31, 2021 and to 15% by March 31, 2022. Further, the risk weights for assets of HFCs are in the range of 30% to 125% based on asset classification, LTV, type of borrower, etc. However, for NBFCs, the minimum CRAR is 15% and risk weights are broadly under 0%, 20% and 100% categories.

b. Income Recognition, Asset Classification and Provisioning (IRACP) norms – There are major differences in provisioning norms applicable to standard, substandard and doubtful assets in HFCs' books.

c. Norms on concentration of credit / investment – The credit concentration norms for NBFCs and HFCs are similar. However, NBFCs enjoy certain exceptions in this regard.

d. Limits on exposure to Commercial Real Estate (CRE) & Capital Market (CME) – The limits prescribed for HFCs for exposure to CRE by way of investment in land & building shall not be more than 20% of capital fund and for CME shall not be more than 40% of net worth total exposure of which direct exposure should be 20% of net worth. No limits prescribed for NBFCs.

e. Regulations on acceptance of Public Deposits:

Regulations on	HFCs	NBFCs
Period of public deposit	12 months to 120 months	12 months to 60 months
Ceiling on quantum of deposit	3 times of Net Owned Funds (NFO)	1.5 times of NOF
Interest on premature repayment of deposits	1% to 4% below prescribed rate	2% to 3% below prescribed rate
Maintenance of liquid assets	13%	15%

Harmonising the regulations mentioned at above para will be carried out in a phased manner over a period of two to three years, until such time, HFCs will continue to follow the extant norms.