NBFC Liquidity crisis

What is the issue?

- The Centre recently issued guidelines on push bank lending to NBFCs.
- This followed up the Budget and announcements of the Monetary Policy Committee.

What did the guidelines say?

- It has said that the **government credit guarantee** on NBFC assets or loans will be limited to **10% of the asset's value**, valid for 2 years from the purchase of the asset by the bank.
- The **Budget has set aside Rs.1 lakh crore** to refinance high-quality assets of "financially sound" NBFCs.
- It is unlikely that the fund transfer on this count will be substantial because assets are likely to take some time to turn substandard.

What is a tall order?

- The guidelines require the NBFCs to be AA-rated, with no asset-liability mismatch (ALM) in any of the lending categories.
- This is a tall order given that even high-rated NBFCs, such as those backed by public sector banks, have ALM in some buckets.
- The move does not address the existing skew of just a handful of NBFCs getting all the bank funds.
- According to the Financial Stability Report of June 2019, 30 out of 9,659 of them registered with the RBI account for 80% of the total exposure.
- This trend has worsened after the IL&FS — and now, DHFL — defaults, with banks turning more risk averse.
- With mutual funds, insurance and commercial papers too withdrawing from the scene, NBFCs have returned to the bank window which, however, is open to just a few.

What helps to solve the crisis?

- Raising the exposure limit to a single NBFC too perpetuates the status quo, while accommodating NBFC lending under priority sector targets may infuse some liquidity.
- However, the crisis calls for a determined response, with Rs.1 lakh crore of

NBFC dues coming up for redemption soon.

- This has impacted markets, despite the repo rate cut this month.
- NBFCs, strapped for funds, have in turn frozen lending to real estate and other sectors, leading to a tightening of interest rates while PE funds gain ground.
- The consumption and working capital crisis are explained by the domino effect of banks and other investors closing the NBFC tap.

What is the way forward?

- Expanding the scope of the one-time partial guarantee may be worth considering in this scenario.
- This will provide NBFCs out of the ambit of bank finance with access to cheap funds vis-a-vis commercial rates.
- RBI has been wary of extending bank finance to a larger number of NBFCs. Key sectors are weighed down by lack of access to cheap finance.
- This will continue loan defaults indefinitely, driving confidence down and rates up, even as the RBI strives for 'transmission' of rate cuts.

Source: Business Line