RBI Draft Rules for NBFCs - Liquidity Risk Management Framework

Why in news?

RBI has put up the draft circular, Liquidity Risk Management Framework for Non-Banking Financial Companies and Core Investment Companies.

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What are the new rules?

- **LCR** - Non-Banking Financial Companies (NBFCs) should maintain a liquidity coverage ratio (LCR) in line with banks.
- [The LCR requires banks to hold enough high-quality liquid assets (HQLA) that can be sold to fund banks during a stress scenario.]
- The LCR requirement shall be binding on NBFCs from April 01, 2020.
- The liquidity rules were proposed for all NBFCs.
- But for NBFCs with assets above Rs 5,000 crore and deposit-taking NBFCs, the LCR is mandatory.
- **HQLA** - RBI has asked the firms to have sufficient High Quality Liquid Asset (HQLA) that would keep them liquid for at least 30 days.
- HQLAs are generally cash or government securities that can be quickly sold in the market to raise cash.
- The minimum HQLAs to be held from April 1, 2020 will be 60% of the LCR.
- But by April 1, 2024, large and deposit-taking NBFCs should have HQLAs of a minimum of 100% of net cash outflows over the next 30 calendar days.
- **Collaterals** - An NBFC must actively manage its collateral positions, differentiating between encumbered and unencumbered (free of liabilities) assets.
- NBFCs should monitor such assets so that they can be mobilised in a timely manner.
- All NBFCs must have **contingency funding plans** for responding to severe disruptions.
- **Liquidity position** - Firms are to measure their liquidity in a granular manner, measuring as minutely as 1-7 days', 8-14 days', and 15-30 days' period.
- Asset-liability mismatches should not exceed 10-20% in the timeframes running up to a year.

- Liquidity position has to be reported to the RBI, along with the interest rate sensitivity statement.
- Liquidity positions should also be disclosed to the public for investors.
- [Earlier, the RBI also asked large NBFCs to introduce chief risk officers to manage asset-liability mismatches on the books.]
- In addition to the structural and dynamic liquidity needs, a stock approach will also have to be maintained to gauge liquidity needs.
- NBFCs were thus asked to maintain tools that would generate early warning on risk situations.

What is the rationale?

- Since the IL&FS crisis, there has been notable uncertainty in the NBFC market.
- Over the past few months, many NBFCs have not been able to borrow from markets, including banks.
- In this backdrop, the regulatory norms are good for the long-term sustainability of the NBFC sector.
- With the RBI bringing in the guidelines to manage asset-liability mismatches, lenders will get more confidence.
- It ensures that an NBFC has sufficient collateral to meet expected and unexpected borrowing needs.

Source: Business Standard