RBI plans PCA framework, different supervisory system for NBFCs by 2022

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The RBI contemplates a return to an earlier supervisory rating framework for NBFCs, too, while ensuring financial statement disclosures here are on a par with banks

The Reserve Bank of India (RBI) is planning a prompt corrective action (PCA) framework and a different supervisory system for non-banking financial companies (NBFCs) by 2022.

Its medium-term strategy, termed Utkarsh 2022, talks of a "revised and effective PCA framework for NBFCs" as part of a policy for achieving "excellence" in performance of its statutory role, among other steps. This means NBFCs will have to strictly meet benchmarks on capital requirement, non-performing assets (NPAs), and asset quality.

The RBI contemplates a return to an earlier supervisory rating framework for NBFCs, too, while ensuring financial statement disclosures here are on a par with banks. This framework is what is termed CAMELS, an abbreviation used globally in this regard regarding bank supervision — for capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk.

The ongoing stress at NBFCs was triggered by a series of payment defaults and delays by Infrastructure Leasing & Financial Services, beginning August. It was followed by defaults in interest payments by Dewan Housing Finance Corporation and a recent default in payment to another lender by Altico Capital.

Utkarsh 2022 was announced by the RBI on July 23 as a medium-term strategy for the period between 2019 and 2022 but without making public the details on specific goals. A copy of these has now been reviewed by Business Standard. It shows how the regulator is planning to regulate and supervise NBFCs in such a way that there is no "regulatory arbitrage" between these and banks.

At present, the RBI uses PCA as an early-warning tool, to maintain the financial health of commercial banks — whether state-owned or private. It is initiated once set thresholds on capital, asset quality, and NPAs are breached. The framework has been in place since 2002 and was tightened by the RBI in 2017. In the latter, restrictions on expansion, dividend distribution, and management compensation, among others, were to be imposed on banks in fragile health. The RBI is supposed to review the PCA framework in 2020 and it is then expected to include NBFCs in the revised norms.

"Differentiated supervisory frameworks for large 'deposit-taking and systemically important' NBFCs and smaller NBFCs, with a refined CAMELS rating framework," states one of the RBI's strategic goals. As of end-October, 81 NBFCs were deposit-taking and 9,409 were non-deposit taking (of which 278 were deemed systematically important). The RBI is already closely monitoring top NBFCs to ensure against systemic risk.

The RBI adopted CAMELS from 1998 to 2013, as a supervisory rating model for on-site inspection of banks. It was then replaced with a risk-based supervision system, known as the Supervisory Program for Assessment of Risk and Capital (SPARC). Unlike CAMELS, this is a transaction-based and compliance-based system. The RBI, under SPARC, comprehensively evaluates both present and future risks, tries to identify incipient issues, and to determine a supervisory stance based on the evaluation. The aim is to facilitate timely intervention and corrective action.

The RBI says it has been following what it calls a 'light touch' regulatory and supervisory approach for NBFCs. However, RBI Governor Shaktikanta Das had said in June that the intention was to change the approach. "It is our endeavour to have an optimal level of regulation and supervision, so that the NBFC sector is financially resilient and robust," Das had said.

The RBI is not in favour of an asset quality review for the segment but has been monitoring the top 50 NBFCs. Including housing finance companies, these account for 75 per cent of the segment's asset size. The RBI is keeping a watch on various aspects of their functioning, including capital adequacy, stability, and cash inflow.

RBI's medium-term strategy for NBFCs

- To make financial statement disclosures of NBFCs on a par with banks
- Integrated off-site monitoring system for ongoing oversight
- Robust compliance culture through enforcement of regulations and cancellation of licences
- Differentiated supervisory framework for large 'deposit-taking and systemically important' NBFCs and smaller NBFCs
- Uniform accounting standards through implementation of Ind-AS