

## **RBI Proposes Liquidity Norms for NBFCs**

RBI in its draft circular on "Liquidity Risk Management Framework for NBFCs and Core Investment Companies (CICs)" (to be adopted by all deposit-taking and non-deposit taking NBFCs with an asset size of Rs 100 crore and above and all CICs registered with the RBI) has proposed certain guidelines for dealing with the Liquidity and IL&FS type of debt crisis in NBFCs.

## About IL&FS Debt Crisis

IL&FS Financial Services, a group company, defaulted in payment obligations of bank loans (including interest), term and short-term deposits and failed to meet the commercial paper redemption obligations.

- Consequent to defaults, rating agency ICRA downgraded the ratings of its short-term and longterm borrowing programmes.
- The defaults not only adversely affected hundreds of investors, banks and mutual funds associated with IL&FS but also resulted into <u>Liquidity Crisis in NBFCs</u>.

## **RBI** Guidelines

- Introduction of Liquidity Coverage Ratio: Liquidity Coverage Ratio (LCR) rule would be introduced in all deposit taking Non-Banking Financial Companies (NBFCs) and non-deposit taking shadow banks with an asset size of Rs 5,000 crore and above.
  - LCR is a requirement under Basel III whereby banks are required to hold an amount of high-quality liquid assets (HQLA) that's enough to fund cash outflows for 30 days.
  - HQLA are liquid assets that can be readily sold or immediately converted into cash
    at little or no loss of value or can be used as collateral for borrowing purposes.
- Mandatory holding of Government Securities by NBFCs in the form of high quality liquidity assets.
- Comprehensive Risk Mitigation Policies: Board of all NBFCs with assets of more than 5,000 crore are required to ensure an Asset liability management committee, asset risk management committee, and an asset-liability management support group in NBFCs for implementing Liquidity risk mitigation policies.
- Asset-Liability mismatch can not be more than 10% of the total outflows of NBFCs.
- NBFCs are required to formulate their Contingency Funding Plan as a liquidity crisis management tool that will help them with alternative sources of funding in liquidity crisis and will prevent over reliance on single source of funding like it is suspected that over reliance of NBFCs over commercial papers can bring them to default of over 1 lakh crore commercial papers issued by them in the past.

Commercial papers are short term debt instruments issued by companies to raise funds for a time period of up to one year

■ A granular maturity bucket system has been proposed to keep a check on mismatches across tenures. Unde new norms, the 1-30 days bucket would be bifurcated into 1-7 days, 8-14 days, and 15-30 days buckets. Also, NBFCs will need to monitor their cumulative mismatches (running total) across all other time buckets up to 1 year by establishing internal prudential limits with the approval of their boards.

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