NBFCs may turn to bond market for funding needs

ANJALI KUMARI
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Non-banking financial companies (NBFCs) could turn to corporate bonds to fulfill their funding needs after the Reserve Bank of India (RBI) announced stricter norms for banks and NBFCs in relation to unsecured lending portfolios, market participants said.

As of March this year, NBFCs predominantly relied on bank borrowings, accounting for approximately 41.2 per cent of their total funding, according to a report by S&P Global Ratings.

The central bank has implemented a 25 per cent increase in the risk weight on banks' credit exposure to NBFCs, in addition to the risk weight already linked to the rating of these non-bank lenders.

This adjustment applies only when the current risk weight based on the NBFC's rating is below 100 per cent.

The risk weight increase for bank loans to NBFCs will be applicable to AAA, AAA, and A rates NBFCs. BBB+ and for all others; the risk weight is already 100 per cent.

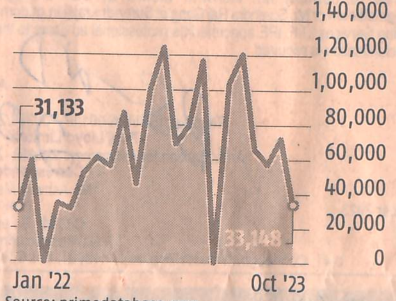
"Many NBFCs might rethink their business models. Currently, they will approach the bond market to meet their capital adequacy norms," Vinay Pai, Head of fixed income at Equirus Capital said.

NBFCs have the option to raise funds through commercial papers, but overreliance on short-term debt instruments could lead to an asset-liability mismatch.

"Obviously CP borrowing will be cheaper but if you borrow too much from the CP, NBFCs will be creating ALM risk and the market will not like it," said Ajay Manglunia, managing director and head — institutional fixed income at JM Financial.

TREND SO FAR

Corporate bond fundraise by NBFCs (in ₹ cr)



Source: primedatabase.com

Following RBI's recent action, the cost of borrowing for NBFCs from banks is projected to increase by 10-30 basis points.

Moreover, market participants expect a slight rise in yields on corporate bonds, ranging from 5-10 basis points due to the incremental surge in bond supply.

"With the move to raise risk weights on NBFC lending for banks, we expect cost of funds to inch up for most larger NBFCs (by 10-20bps) given that mostly large NBFCs have risk weights of less than 100 per cent given their rating profile stands between A to AAA and banks will pass on higher capital charge to NBFCs," a note by J M Financial said.

In the current financial year so far, companies and financial institutions have raised ₹ 5.31 trillion through bonds, against ₹8.7 trillion in the previous financial year, according to data by the National Securities Depository Limited (NSDL).

Market participants expect a total increase of a minimum of 15-20 per cent in corporate bond issuances for the entire current financial year compared to the last year.

Meanwhile, a section of the market believes banks will remain a steady source of funding for NBFCs.0

"The current guidelines seem to be more specific to unsecured retail credit. Many exemptions are also specified like housing loans, vehicle loans, and priority lending. Hence, we feel that banks will calibrate the exposure in terms of the underlying asset category of NBFCs before taking any rate calls. Banks are a large, steady source of funding for NBFCs and we do not expect this source to shrink," said Parag Sharma, joint managing director and chief financial officer at Shriram Finance.