Tough Reserve Rules to Hit NBFCs

Non-Banking Finance companies (NBFCs) have been stumped by a provision in the new Companies Act. It mandates all such players that raise funds by issuing debentures to create a debenture-redemption reserve (DRR) and maintain 15% of the monies in low-interest securities or SLR-backed instruments.

SLR or the statutory liquidity ratio is the percentage of deposits banks need to maintain in liquid form — cash, gold or government bonds.

The Companies Act appears stricter for NBFCs, particularly on two counts: creation of a DRR equivalent to 50% of debentures or bonds over the repayment term, and building liquidity support at the start of fiscal for debentures maturing during the year (at least 15% of the value maturing). "This is a retrograde step. Cost of funds could increase 80 to 90 basis points (100 bps 1%). The move is sure to impact profitability of those companies which raise debt through bond issues," said G S Sundararajan, group director, Shriram Group, and MD, Shriram City Union Finance, an NBFC that is active in the bond market.

While one RBI's Nachiket Mor Committee wants SLR requirements for NBFCs to be abolished, another arm of the government - the ministry of corporate affairs (MCA) - wants increased investments in SLR-backed securities, he said. Though market players are not clear whether the norms are prospective or retrospective, Sundararajan said, "Our legal interpretation suggests it is prospective."

The Act has not only increased reserve requirement for debentures raised through public source (from 25% to 50%), it has also introduced requirements for privately placed debentures (to 50%).

"If implemented with retrospective effect, creation of DRR will adversely impact dividend paying capacity of NBFCs given their higher dependence on borrowing through this route (around 60% of overall borrowings). Moreover, negative carry of 200-300 bps on liquidity support for maturing debentures will impact earnings, though the impact will be marginal (around 0.5% over FY15-16 on profitability)," analysts from Edelweiss wrote in a report.

The Act requires companies issuing debentures to earmark an amount not less than 15% of the amount maturing in a particular year by way of investment and deposits in specified securities, which are liked to SLR — simply put, in low interest-bearing instruments.

"The Act seems to be tougher on NBFCs given their higher dependence on borrowing through the bond market. However, NBFCs have made a representation to the MCA and asked for exemption (similar to that was available previously) and clarification on ambiguity of implementation (retrospective/prospective effect). But, if implemented in the current form, it is likely to impact NBFCs' dividend payout and margins (negative carry on 15% of funds), albeit marginally," the Edelweiss report said.

Gilt lender Manappuram's managing director I Unnikrishnan concurred, "The Act will impact distributable surplus. The mandatory requirements of additional SLR-linked investments will affect profitability and I sincerely hope the requirements are prospective and not retrospective."

(Times of India)