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RBI Raises Risk Weights On Unsecured Retail Loans

1. **In line with expectation**, RBI has announced risk weight increase in consumer credit (excluding housing loans, education loans, vehicle loans and gold loans) to 125% from 100% and risk weights on credit card receivables to 150% for banks and 125% for NBFCs vis a vis 125% and 100% previously. In Sep-19, RBI had decided to reduce the risk weight for consumer credit excluding credit card receivables to 100% (link).
2. RBI also announced 25% increase in risk weights on bank loans to NBFCs (excluding core investment companies, housing finance companies and loans to NBFCs which are eligible for classification for priority sector) in all cases where the risk weight as per external rating of NBFCs is below 100%. **This came as a surprise and would lead to increased pricing by banks along with some potential slowdown in NBFC lending especially in lower rated segment.**
3. In Oct-23 MPC policy press conference, RBI had asked regulated entities to review and strengthen their internal surveillance mechanisms and build suitable safeguards. In addition to these measures, RBI has now asked regulated entities to review their extant sectoral exposure limits for consumer credit and put in place, if not already there, board approved limits which shall be strictly adhered to in respect of various sub-segments under consumer credit as may be considered necessary as part of prudent risk management.
4. The RBI's measures aim to curb the rapid expansion of specific consumer credit segments, emphasizing enhanced growth quality. **This will initially decrease capital adequacy due to higher risk weights, leading to elevated funding costs, particularly for NBFCs and potentially consumers, while also moderating growth.** Additionally, there may be a subsequent increase in delinquencies as the roll-over of debt slows down.
5. **Majority of listed banks and NBFCs are adequately capitalized to absorb the impact**, with an estimated effect of around 10-80 basis points for banks and approximately 20-450 basis points for NBFCs. Larger institutions are expected to experience minimal impact and may even benefit over time. However, mid and smaller-sized lenders may be affected to varying degrees on a case-by-case basis.

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