Syllabus subtopic: Effects of liberalization on the economy, changes in industrial policy and their effects on industrial growth.

News:

• The Reserve Bank of India (RBI) has introduced ‘liquidity management framework’ for Non-Banking Financial Companies (NBFCs).
• The new guidelines are applicable to all non deposit-taking NBFCs with an asset size of ?100 crore and above, systemically important Core Investment Companies and all deposit-taking NBFCs irrespective of their asset size.

Prelims focus: about the new liquidity norms.

Mains focus: requirement and significance of these norms.

Why this was necessary?

This has come following liquidity crunch among some NBFCs in meeting their recent repayment obligations after the collapse of the Infrastructure Leasing and Financial Services (IL&FS) group.

This was necessary to strengthen their asset-liability management following the liquidity crisis faced by these firms in the past year.

What’s changed?

• Specific cap on negative asset liability mismatches for particular liquidity buckets.
• NBFCs are mandated to maintain liquidity coverage ratios (LCR). LCR will promote resilience of NBFCs to potential liquidity disruptions by ensuring that they have sufficient High Quality Liquid Assets (HQLA) to survive any acute liquidity stress scenario lasting for 30 days.
• Net cumulative mismatches for 1-7 days, 8-14 days, and 15-30 days shall not exceed 10%, 10% and 20% of the cumulative cash outflows in the respective time buckets.
• NBFCs should monitor their cumulative mismatches [running total] across all other time buckets up to one year by establishing internal prudential limits with the approval of the board.
• The LCR requirement will be binding on NBFCs from December 1, 2020, with the minimum HQLAs to be held being 50% of the LCR, progressively reaching up to the required level of 100% by December 1, 2024.

Exemption from LCR norms: Core Investment Companies, Type 1 NBFC-NDs, Non-Operating Financial Holding Companies and Standalone Primary Dealers.
What caused the non-bank lending sector crisis?

- NBFC crisis is being held up as one of the culprits of the current slowdown.
- There is a near consensus that this crisis was triggered by the collapse of Infrastructure Leasing and Financial Services Ltd (IL&FS) and the unfolding of the problems of Dewan Housing Finance Corporation Ltd (DHFL).
- Besides, Raising capital adequacy limits and liquidity margins for NBFCs might have tempered their profitability and hurt their valuations.