

RBI to provide liquidity to non-bank financial firms

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Original post [here](#).

On July 1, the Reserve Bank of India (RBI) [announced](#) guidelines for a \$4 billion (₹300 billion) special liquidity scheme (SLS) to purchase short-term debt from eligible non-banking financial firms (NBFCs) and housing finance companies (HFCs). The RBI said its purpose is to “avoid any potential systemic risk to the financial sector.”

This liquidity scheme is consistent with what the Finance Minister announced as part of a COVID-19 relief package on [May 13](#). The Indian government’s broader “[Self-Reliant India Movement](#)” (Aatmanirbhar Bharat Abhiyaan), a special economic and comprehensive package, is equivalent to [10% of India’s GDP](#).

SBI Capital Markets (SBICAP), a subsidiary of a state-owned commercial lender, set up [the SLS Trust](#), a special purpose vehicle (SPV). RBI will provide funds by subscribing to special securities issued by the Trust. These securities will be granted unconditional and irrevocable guarantees by the Indian government. RBI will provide liquidity to the SLS Trust based on its realized purchases of short-term paper from eligible companies. The total outstanding short-term paper purchased by the Trust may not exceed \$4 billion (₹300 billion).

In order to participate in the SLS, NBFCs and HFCs must fulfill the following eligibility criteria:

- NBFCs, including Microfinance Institutions, that are registered with the RBI under the RBI Act, 1934, excluding those registered as Core Investment Companies;
- HFCs that are registered under the National Housing Bank Act of 1987;
- The eligible institution’s capital adequacy ratio should not be below the regulatory minimum (i.e., 15% for NBFCs and 12% for HFCs);
- The institution’s net non-performing assets should not be more than 6% (as of March 31, 2019);
- The institution should have made a net profit in at least one of the last two preceding financial years;
- The institution’s borrowing should not have been reported as “special mention account” (whose repayments are overdue for between 31 to 90 days) by any bank during the one year prior to August 1, 2018; and
- The institution should be rated investment grade by an Securities and Exchange Board of India (SEBI) [\[FG1\]](#) registered rating agency.

The SLS Trust will purchase commercial paper (CP) and negotiable certificate of deposits (NCDs) of eligible NBFCs and HFCs on an application basis. The Trust can invest in securities either on the primary or secondary market.

The CP and NCDs of eligible institutions must meet [the following requirements](#):

- The CP and NCDs must be rated investment-grade by credit rating agencies registered with SEBI.
- The CP and NCDs must be issued before September 30, when the SPV will cease purchases.
- The CP and NCDs must have residual maturity of up to 90 days.
- The CP and NCDs should be in the NBFCs and HFCs' standard books as on date of sale and should not have defaulted on that date.

The SLS Trust has launched an investment committee, consisting of representatives from the SBICAP and its parent company, the State Bank of India. The unanimous decision by the committee will ultimately determine further details of the purchase, including the followings:

- Any additional evaluation criteria
- Optional collateral requirement
- The maximum amount of liquidity that the Trust will provide to a single NBFC/HFC
- Interest rate (yield)
- Purchasing market (primary/secondary)

The NBFCs and HFCs must use the acquired liquidity solely to repay pre-existing liabilities and shall not be used to expand assets.

The SLS is similar to a liquidity scheme that RBI set up during the Global Financial Crisis. [In February 2009](#), RBI announced a liquidity scheme of ₹200 billion (\$2.6 billion) for NBFCs in order to “meet the temporary liquidity mismatches.” An SPV was set up to purchase short-term paper, and RBI extended the scheme [twice](#). [Anand Sinha](#), former Deputy Governor of the RBI, recalls that “the actual condition of NBFCs was not so alarming” and only one NBCF used the scheme.

Some commenters argue that the SLS will successfully support small and medium-sized non-banks that are unable to raise funds from CP and bond markets. [One commentary suggests](#) that NBFCs could be facing CP repayments of close to \$8.7 billion (₹650 billion) in the coming three months.

At the same time, some are doubtful that the SLS will be sufficient to buttress financial stability. For instance, Abizer Diwanji, leader for financial services at EY, [notes](#) that the SLS could be too small given that NBFCs account for \$3.6 trillion (₹27 trillion) in term of lending, of which \$2.5 trillion (₹19 trillion) is financed via the capital markets.

Non-banks in India had been [facing difficulties before the COVID-19 crisis](#), particularly since the default of [Infrastructure Leasing & Financial Services \(IL&FS\) in September 2018](#). On July 1, Fitch Ratings [reported](#) that India's non-bank financial institutions will “continue to face elevated near-term risks, even as economic activity picks up with the easing of the country's nationwide lockdown.” The same commentary also noted that the moratorium will “erode payment

discipline and its extension will result in lagged asset-quality problems” for non-banks, “particularly when combined with the economic damage from the pandemic and lockdown.”

As of July 7, India has reported more than [719,600 total cases](#). The country has [overtaken](#) Russia as the third country in terms of positive cases, behind the US and Brazil.