Banks

India

Sector View: **Attractive** NIFTY-50: **22,548** **February 27, 2025**

A partial reversal of stance in a few areas

The RBI has notified banks about the following changes, effective from April 1, 2025: (1) The risk weight on microfinance loans within consumer credit will be reduced from 125% to 100% and (2) an additional risk weight of 25% introduced recently (November 2023 circular) on the exposure of banks to NBFCs will be removed. The reversal is not worrisome today, as these guidelines have played their role in correcting the flow and identifying spaces of excessive lending. With NPL formations peaking, the reversal is an expected outcome.

Reduction in risk weight on microfinance loans and bank lending to NBFCs

The RBI has announced the following for all banks: (1) the risk weight on microfinance loans in the nature of consumer credit to be reduced from 125% to 100% and (2) an additional risk weight of 25% introduced on the exposure of banks to NBFCs to be removed. These changes imply a partial reversal of tighter capital norms introduced by the RBI in its November 2023 circular (Exhibits 1, 2). The higher risk weights on the other segments of consumer credit (for instance, on unsecured personal loans and credit cards) will continue.

Tangible financial benefits difficult to assess and could come in different forms

The reduction in risk weights on NBFCs would benefit all banks, but we should expect this benefit to be higher for public banks, as they have a relatively lower capital compared to private banks and a higher exposure to NBFCs as well. The change in guidelines on MFI is likely to have a smaller impact and specific to a few lenders. While this is not a complete reversal, it nevertheless has a positive impact on banks such as Bandhan Bank (Exhibit 3), in our view. We understand that some lenders (such as SFBs) continue to classify a majority of the microfinance loans as regulatory retail (which attracts an RWA of 75%). Hence, the latest circular offers negligible benefit to them on the microfinance front.

Starting to see some degree of easing of the previous guidelines

We believe that these regulations have played their role in curbing growth to check for stress that usually is less recognizable during periods of strong growth. We have seen stress rising meaningfully in the MFI sector, but the impact on the rest of the portfolio is not as pronounced as we saw in MFI. For instance, we have not seen a material build-up in stress in personal loans at a sector level.

This circular could reflect in many ways, depending on the choices of management: (1) restart lending to NBFCs and MFIs, (2) upfront the credit losses, if any in MFI, and (3) carry the capital buffer on the balance sheet. Growth, in our view, is likely to take time as lenders are yet to fully recognize the stress, and the cycle would take time to reverse.

The recent relaxations (LCR, ECL, project financings) and several liquidity measures do give credence to the view that the measures are generally positive for lenders to restart growth. We are still some time away with deposits still being an issue, but we would want to be positive on lenders at this stage.

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Risk weight on the consumer credit category of microfinance loans will be lower

Exhibit 1: Risk weight guideline for banks across select exposure categories (%)

	Before November 2023 circular	November 2023 circular	February 2025 circular
Risk weight on exposures of banks to:			
Microfinance loans in the nature of consumer credit	100%	125%	100%
Microfinance loans not in the nature of consumer credit	75%	75%	75%
Credit card receivables	125%	150%	150%
Other forms of consumer credit (excl. housing loans, education loans, vehicle loans, loans against gold jewellery)	100%	125%	125%
NBFCs (except those eligible as PSL)	Risk weight associated with the given external rating	Risk weight associated with the given external rating + 25%	Risk weight associated with the given external rating

Source: RBI, Kotak Institutional Equities

Bandhan Bank saw a CET1 hit of ~360 bps when the risk weight on microfinance loans was increased from 75% to 125%

Exhibit 2: Impact on CET1 from hike in risk weight on microfinance loans post November 2023 circular

	Change in risk weight on microfinance	Capital impact
Bandhan Bank	Hiked from 75% to 125% in 1QFY25	~362 bps impact on CRAR from EEB portfolio
IDFC First Bank	Hiked from 75% to 125% in 2QFY25	~21 bps impact on CET1 from JLG portfolio
IndusInd Bank	Hiked from 75% to 125% in 2QFY25	~78 bps impact on CET1 from microfinance loans
RBL Bank	Hiked from 75% to 125% in 3QFY25	~40 bps impact on CET1 from JLG
Yes Bank	Hiked in 2QFY25	~12-13 bps impact on CET1 from two reasons: change in risk weight for microfinance and adjustment in LTV calculation in select products

Source: Companies, Kotak Institutional Equities

Bandhan Bank likely to see the highest benefit on capital ratios from the latest circular

Exhibit 3: Estimated impact on capital from relaxation in risk weight in February 2025 circular, (financials as on December 2024)

	RWA (Rs bn)	Exposures under consideration (Rs bn)		RWA impact (Rs bn)		CET-1 capital			
		Microfinance	NBFCs	Microfinance	NBFCs	Current CET1 (%)	Current CET1 capital (Rs bn)	Revised CET1 (%)	CET1 benefit (%)
PSU banks									
SBI	35,659	-	5,523	-	1,381	11.0	3,919	11.4	0.4
BOB	8,841	-	872	-	218	13.8	1,217	14.1	0.3
PNB	8,314	-	1,050	-	262	12.1	1,006	12.5	0.4
Canara	7,289	-	999	-	250	13.6	993	14.1	0.5
Union	6,782	-	670	-	168	15.5	1,052	15.9	0.4
Private banks									
HDFC Bank	25,305	126	1,159	31	290	19.5	4,926	19.7	0.3
ICICI Bank	15,467	66	626	16	156	15.9	2,464	16.1	0.2
Axis Bank	11,138	51	379	13	95	14.6	1,627	14.8	0.1
IndusInd	4,292	326	219	81	55	16.3	700	16.9	0.5
Yes	2,990	18	70	5	18	13.3	398	13.4	0.1
IDFC First	2,655	110	129	27	32	13.7	363	14.0	0.3
Federal	2,027	41	167	10	42	15.3	309	15.7	0.4
Bandhan	1,568	360	159	90	40	13.7	215	14.9	1.2
RBL	1,082	65	37	16	9	13.7	148	14.0	0.3
KVB	648	-	17	-	4	17.2	112	17.4	0.1
City Union	381	-	11	-	3	23.5	89	23.6	0.2
DCB Bank	354	8	31	2	8	14.8	52	15.2	0.4
SFBs									
AU SFB	838	7	23	2	6	18.8	158	19.0	0.2
Equitas SFB	295	5	3	1	1	17.9	53	18.0	0.1
Ujjivan SFB	251	14	14	3	3	24.7	62	25.3	0.7
Utkarsh SFB	152	9	8	2	2	18.0	27	18.6	0.5

Notes:

(1) We have included 9MFY25 profits in the calculation of CET1 capital.

(2) We have assumed 30% and 40% of NBFC exposures for universal banks and SFBs resp. to be eligible for PSL, wherever disclosures are inadequate.

(3) For Bandhan, Ujjivan and Utkarsh, the 25% microfinance risk weight relaxation is assumed to be applicable only for JLG loans.

(4) For HDFCB, ICICIBC and Axis Bank, we assume microfinance loans (in the nature of consumer credit) at ~0.5% of all loans.

(5) For Federal Bank, we assume 10% of loan book to be towards NBFCs.

(6) For SFBs, we assume only ~10% of the JLG loan book is in the nature of consumer credit (risk weight cut from 125% to 100%), while the rest of the book is assumed to be in regulatory (risk weight unchanged at 75%).

Source: Companies, Kotak Institutional Equities estimates

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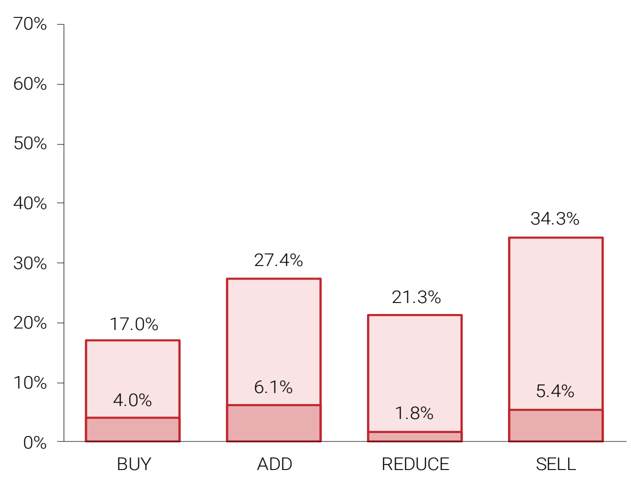

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Source: Kotak Institutional Equities

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