



RBI HAS ASSIGNED HIGHER RISK WEIGHTS TO UNSECURED LOANS

A prudent and preventive step against potential NPAs

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As a part of regulatory measures towards consumer loans and bank credit to NBFCs, the Reserve Bank of India (RBI) last week assigned higher risk weights to unsecured consumer loans of commercial banks and NBFCs by 25 percentage points. Consumer credit of banks and NBFCs which has a risk weight of 100% will now attract a risk weight of 125%. Risk weights on credit cards have been raised by 25 percentage points to 150% for banks and 125% for NBFCs. The move follows significant increase in the lending by the commercial banks on these categories of borrowers. The announcement comes in the background that earlier in May 2023, the RBI had written to all banks and NBFCs to be vigilant about retail, especially unsecured, loans.

Potential Impact



While this makes retail unsecured borrowing costlier for consumers and NBFCs, it may increase the cost of borrowing by these entities. Nevertheless, it is a prudent step by the RBI to maintain better asset quality in the system and to avoid lending to these entities turning into NPAs.

NBFCs may have to bear enhanced funding costs and capital requirements but would ring in more cautiousness in the system towards unsecured lending practices. Further, banks too may observe caution and due diligence in their lendings to NBFCs. Banks would be more careful in studying the risk profiles of the NBFCs and may slow down their lending to riskier borrowers.

Why the step?

Rise in unsecured retail loans

An in-depth scrutiny of banks' retail loan portfolios during the FY2023 revealed that retail loans witnessed a y-o-y growth of 19.4% by April 2023. Within the retail segment, credit card outstanding grew by 29.7% and had crossed Rs 2 lakh crore for the first time while other personal loan segments witnessed a growth of 24% and crossed Rs 11 lakh crore. Notably, these unsecured loans doubled in four years.



Retail loans grew at a compounded annual growth rate (CAGR) of 24.8 % during the period March 2021 to March 2023 which is nearly double the CAGR of 13.8 per cent for gross advances during the same period. Further retail loans made up around one-third of the total banking system's gross loans and advances. Unsecured retail loans rose from 22.9% to 25.2% while secured loans fell from 77.1% to 74.8%. The GNPA ratio of retail loans stood low at 1.4% in March 2023 but the share of special mention accounts (SMA) stood high at 7.4 % and it made up one-tenth of the retail assets portfolio of PSBs.¹

¹ Financial Stability Report, Issue No. 27, RBI, 28 Jun 2023

Strengthening credit standards



The RBI has mandated banks to review their extant sectoral exposure limits for consumer credit and put in place board approved limits sub-segments wise. The RBI has also mandated that limits would be fixed for all unsecured consumer credit exposures and *“shall be strictly adhered to and monitored on an ongoing basis”*.

Apt timing, festive times ring in unsecured loans

The banking system generally witnesses a rise in unsecured retail loans during the festive season. Hence, the announcement stands at a time when the time demands it.



Views are personal.

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