Criteria for Computing Short-Term Debt Limits for NBFCs

The attractiveness of raising relatively low-cost funds at the shorter end of the maturity spectrum has, over time, spurred a number of non-banking finance companies (NBFCs) to use this as a means of reducing their overall cost of funds. Accessing short-term funds without appropriate safeguards can, however, precipitate an asset-liability mismatch. This would have a critical bearing on an NBFC's liquidity position in terms of the timely repayment of its contracted short-term debt obligations.

CRISIL attaches considerable importance to an NBFC's liquidity position while analysing its financial risk profile. This article elucidates CRISIL's criteria for determining the maximum permissible short-term debt that an NBFC can raise while maintaining a given rating level. This short-term debt limit covers all short-term borrowings including those raised through commercial paper, short-term debentures, bank borrowings, inter-corporate deposits and other borrowings with a contracted maturity profile of less than a year.

FUNDAMENTAL PRINCIPLE

The fundamental principle underpinning CRISIL's approach to the permissible short-term debt limit is a comparison between an NBFC's assets and liabilities having a maturity of less than a year. Apart from considering the scheduled maturity profiles of an NBFC's assets and liabilities, CRISIL gives due credence to, inter alia, its refinancing capabilities, its asset quality as reflected in its collection efficiency and delinquency levels, estimated level of prepayment on the loans based on past trends and its unutilised bank limits.

In the case of NBFCs that have strong credit profiles as evident in their high credit ratings, CRISIL's criteria for computing the short-term debt limit factors in this strength even if there is a mismatch between the maturity profiles of the assets and liabilities in the one-year bucket. This is because of the highly-rated NBFCs' ability to refinance their liabilities. The comfort derived from an NBFC's refinancing capabilities to ensure adequate matching of assets and liabilities reduces in correspondence with its rating.

CRISIL has parameterised this approach by applying a multiple to the level of assets that are expected to mature within one year.

Based on this, CRISIL's model for determining an NBFC's maximum permissible short-term debt (STD) limit uses the following algorithm:

Total permissible STD = Additional permissible STD + Existing STD

where,

Additional permissible STD = (Multiplier*short-term assets[1]) - short-term liabilities[2]

and,

[1] Assets with a maturity of less than one year as per CRISIL's sensitized analysis

[2] Liabilities with a maturity profile of less than one year as per CRISIL's sensitized analysis

Existing STD = Aggregate of all borrowings with a contracted maturity of less than a year

(see Exhibit 1 below for an illustration)

While arriving at the quantum of maturing assets and liabilities, CRISIL sensitises the NBFC's asset and liability maturity profile for factors such as its collection efficiency, delinquency levels, prepayment levels and the expected trends in these factors, going forward. This is done on the merits of each individual case, based on CRISIL's understanding of the entity's past operations and expected performance.

Specific conditions under which a higher limit is permissible

While an NBFC's permissible short-term debt limit is normally determined through the fundamental principle described above, CRISIL's criteria also allows for higher limits to be assigned under the following circumstances:

Availability of unutilised bank lines

In a scenario where an NBFC has unutilised bank lines that are available to meet repayment obligations in the less-than-one-year maturity bucket, the amount of unutilised bank lines is considered as an added comfort while computing the total permissible short-term debt limit. An NBFC can also use the unutilised bank lines to create short-term assets, which can provide an additional cushion to its asset-liability profile.

Growth in short-term assets

The above criteria do not take into account any growth in an NBFC's short-term assets. But if an NBFC plans to aggressively increase the level of its short-term assets, CRISIL may appropriately enhance its short-term debt limit based on its estimation of the entity's ability to ramp up its asset base, going forward.

LIQUIDITY BACK-UP FACILITY

CRISIL requires rated short-term debt, especially commercial paper and debentures with a daily put-call option, to have a liquidity back-up facility. An NBFC usually provides this through bank lines that are unutilised to the extent of the rated short-term debt outstanding. Deviations are, however, permitted based on CRISIL's overall understanding of the company's credit risk profile and specifically, its asset-liability management policy.

CRISIL does, however, allow NBFCs to raise rated short-term debt without a liquidity back-up facility if the company provides an effective liquidity plan detailing the alternative options available to redeem its short-term debt on maturity. This could include, inter alia, liquidity lines such as an unconditional inter-corporate deposit line from a strong parent. In cases where the liquidity plan relies significantly on refinancing, CRISIL stresses its assumptions for factors like systemic developments in the debt markets resulting in possible stresses like high call rates or a spike in money market rates.

Exhibit 1: Calculation of an NBFC's Maximum Permissible Short-Term Debt Limit

	Rs.mn.
Assets maturing in one year (A')	1000
Assets maturing in one year-sensitized (A=M*A')#	1000
Liabilities maturing in one year (B)	750
Gap between assets and liabilities (A-B)	250
Existing STD* (C)	600
Bank lines available (D)	900
Bank lines utilized (E)	450
Unutilised bank lines (D-E)	450
Maximum permissible STD (A-B+C+D-E)	1300

** includes bank borrowings and other debt with a contracted maturity of less than one year*

 # The multiplier "M" used here reflects CRISIL's estimate of the NBFC's refinancing ability, which is linked to its credit risk profile and indicated by its credit rating. Here "M" is assumed to be = 1.

CONCLUSION

Thus, CRISIL's criteria for computing the short-term debt limit for NBFCs gives them the flexibility to raise debt to conduct business without significantly stressing their credit risk profile. CRISIL's criteria allows NBFCs to run calibrated mismatches in their asset-liability profile, if required, to enhance business growth, provided adequate comfort is available for managing such mismatches by leveraging their refinancing abilities, unutilised bank lines and other liquidity back-up plans.