

# BANKING

## Key takeaways : Conference call with CMD of NHB

India Equity Research | Banking and Financial Services

We had organized a conference call with **Mr. R. V. Verma, Chairman & Managing Director, National Housing Bank (NHB)**, to gain more clarity and better perspective on recent circulars issued by the regulator for housing finance companies. National Housing Bank (the regulator) has issued a circular whereby housing finance companies (HFCs) will not be allowed to charge prepayment penalty on pre-closure of floating rate loans. Also, they will have to bring uniformity in lending rates for old and new customers with a similar risk profile. Key takeaways from the call are as follows:

- **Prepayment penalty will be waived for all floating loans**
  - It will be **applicable to existing loans as well**. Therefore, existing agreements will have to undergo a change to that effect.
  - As far as housing loans under **special schemes are concerned (which are fixed for 1,3 or 5 years and floating thereafter), prepayment penalty will be waived during the floating rate tenor**. However, nomenclature the product was offered (whether fixed, floating or fixed-cum-floating) and the marketing strategy while launching the product will have to be considered. Industry players will have to be consulted before making it applicable.
- **Special offers (during festive seasons) which are not based on benchmark PLR will be outside the purview of these circulars**. The regulator is not prohibiting offers at special rates via this circular.
- Uniformity in rates between old and new customers with a similar risk profile is needed as there is limited transparency on how floating rates move through the tenor of loans. **Spreads to the BPLR cannot be altered to the detriment of customers—only BPLR can change based on interest rate movements**. Pricing by HFCs has to be more transparent, objective and non-discriminatory.
- For HFCs, **loss of revenue from prepayment penalty fee will be minuscule** as prepayment penalty was not a significant chunk at all. Though prepayment penalty did not have significant financial impact on customers, the perception that no charges are levied whether prepayment is from own or borrowed sources will be a big relief.
- Most PSU banks (which account for 70% of retail housing loans in the banking sector) do not charge prepayment penalty and hence, **HFCs and PSU banks have a level playing field now**.
- The regulator sounded confident that **banking regulator RBI will also actively consider waving prepayment penalty** and bring about uniformity in lending rates for old and new customers. It has been reflected in Ombudsman Committee recommendation which in piecemeal has been accepted by the central bank.
- **Key rationale:** Maximum customer complaints (that NHB has received) over the past two-three years pertain to issues related to prepayment penalty charges and rate differential between existing and new loans.

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### Our view on impact for HFCs

- *Individual loan repayment in a year is of 15-17%, of which about two thirds is by way of prepayment* and one third being regular amortization. Even though the prepayment penalty is 2%, some financiers do not levy any penalty if it is from own sources (which forms almost two-thirds of the total prepayment). Hence, *in a year, HFCs (maximum) do not earn more than ~5-6bps of outstanding individual loan book as prepayment fee income.*
- Apart from the financial impact, we believe non-levy of prepayment charges will lead to a *significant increase in refinancing demand* as loan pricing will only be a key determinant for sticking with a financier. This will increase churn and *impact stability of loan book and ALM profile of HFCs.*

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**Recent Research**

Date	Company	Title	Price (INR)	Recos
24-Oct-11	<b>M&amp;M Financial Services</b>	Rural route to profit; Initiating Coverage	630	Hold
22-Oct-11	<b>Axis Bank</b>	Strong core, slippages at fore; Result Update	1,128	Buy
21-Oct-11	<b>Federal Bank</b>	Growth vaults, Slippages dive; Result Update	383	Buy

**Distribution of Ratings / Market Cap**

**Edelweiss Research Coverage Universe**

	Buy	Hold	Reduce	Total
Rating Distribution*	119	47	15	184
* 3 stocks under review				
	<b>&gt; 50bn</b>	<b>Between 10bn and 50 bn</b>	<b>&lt; 10bn</b>	
Market Cap (INR)	111	57	16	

**Rating Interpretation**

Rating	Expected to
<b>Buy</b>	appreciate more than 15% over a 12-month period
<b>Hold</b>	appreciate up to 15% over a 12-month period
<b>Reduce</b>	depreciate more than 5% over a 12-month period

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