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INDUSTRY OUTLOOK

NON-BANK FINANCE COMPANIES (NBFCs): EMERGING CONTOURS

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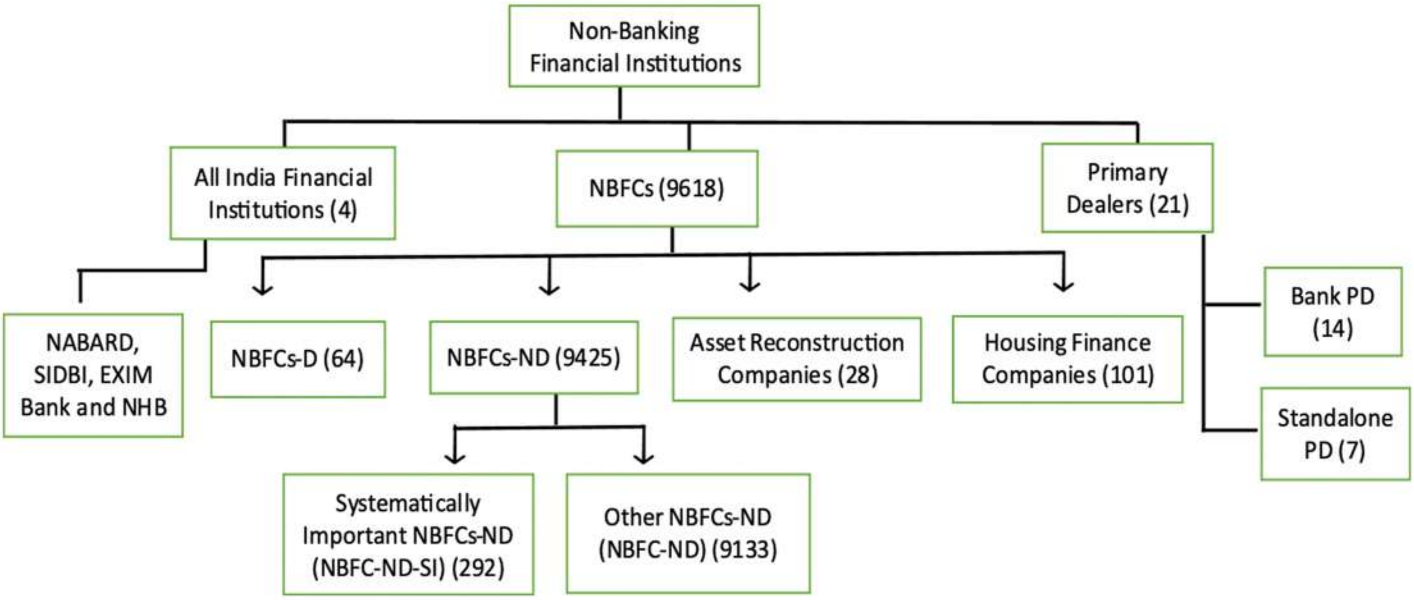
Introduction

Non-banking finance companies (NBFCs) form an integral segment of the Indian financial system. NBFCs, which have emerged as the driving force in India's rapid economic growth in areas ranging from customer satisfaction to social engagement, play a critical role in the core development of infrastructure, transport, employment generation, wealth creation opportunities, and financial support for economically weaker sections. With the expansion of NBFCs network, the nation not only achieves greater financial inclusion but also greater economic activity, which in turn works as a spiral in activities ranging from employment to welfare.

A snapshot of the structure of the NBFCs is given in the figure below (Figure 1).

Figure 1: Structure of NBFIs under the Reserve Bank's Regulation (2020)



Source: Report on Trend and Progress of Banking in India 2019-20.
Note – Other NBFCs-ND include 64 Core Investment Companies (CICs).

Table 1: Classification of NBFC Sector by Activity

Sl No.	Type of NBFC	Nature of Activity / Principal Business
1	Investment and Credit Company (ICC)	Lending and investments
2	Infrastructure Finance Company (IFC)	Providing loans for infrastructure development
3	Infrastructure Debt Fund (IDF)	Facilitate flow of long-term debt to infrastructure projects
4	Core Investment Company (CIC)	Acquisition of shares and securities
5	NBFC- Micro Finance Institution (NBFC-MFI)	Collateral free loans and advances to small borrowers
6	NBFC – Factor	Factoring business i.e. financing of receivables
7	Non-Operative Financial Holding Company (NOHFC)	For setting up new banks in private sector through its promoter/promoter groups
8	Mortgage Guarantee Company (MGC)	Providing mortgage guarantees for loans
9	Asset Reconstruction Company (ARC)	Acquiring and dealing in financial assets sold by banks and financial institutions
10	Peer-to-Peer Lending platform (P2P)	Providing an online platform to bring lenders and borrowers together to help mobilise funds
11	Account Aggregator (AA)	Collecting and providing information about a customer's financial assets in a consolidated, organised and retrievable manner to the customer or others as specified by the customer
12	Housing Finance Company (HFC)	Financing for housing

Source: "Performance of NBFCs during the Pandemic: A Snapshot"(17 May 2021) RBI Bulletin; https://www.rbi.org.in/Scripts/BS_ViewBulletin.aspx?Id=20262

NBFCs face issues of license cancellation [1] and thus their numbers keep changing frequently. As of 31st January 2021, there were 9507 NBFCs in India, the distribution of which is given in the table below.

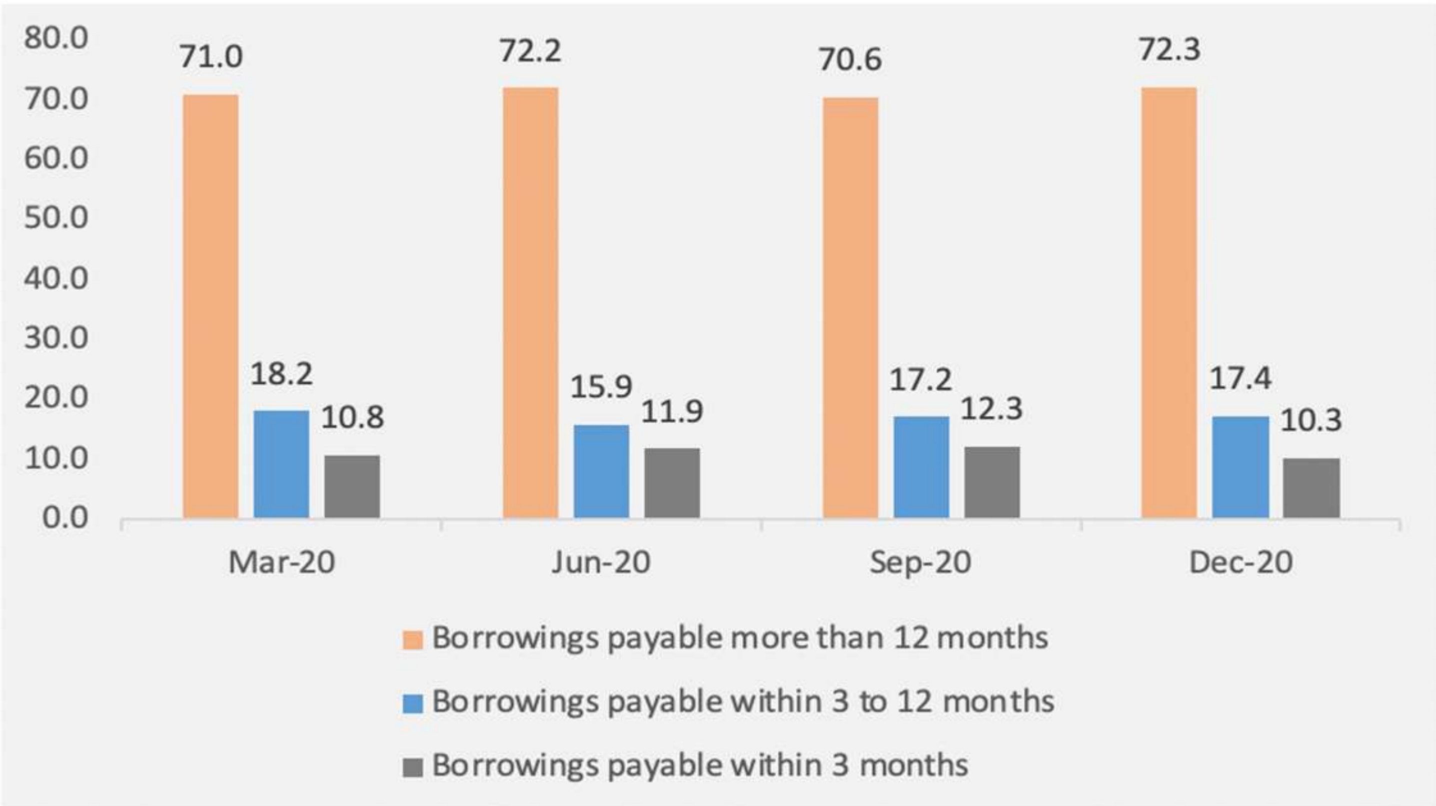
Table 2: Number of NBFCs (as on 31st January 2021)

NBFC-ND[2]	9123
NBFC-ND-SI[3]	292
ARC[4]	28
NBFC-D[5]	64

Source: Jayakumar, Nandini, et.al, (2021),"Performance of NBFCs during the Pandemic: A Snapshot", Department of Economic and Policy Research, Reserve Bank of India.
Note: Numbers include Core Investment Companies (CICs) and excludes Housing Finance Companies (HFCs).

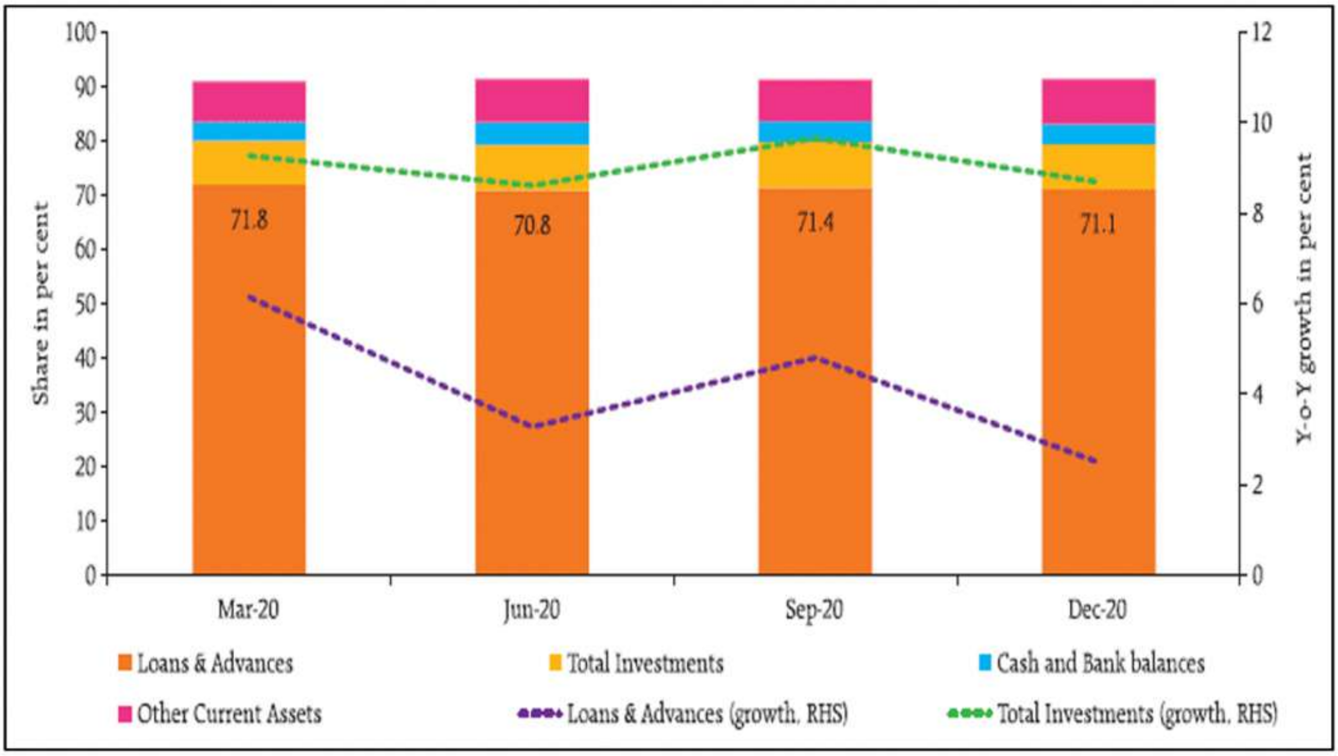
Some of the important NBFCs in India are The Indian Railway Finance Corporation, Reliance Capital Limited, Kotak Mahindra Finance Limited, Manappuram Finance and Leasing Limited (Manappuram Finance Ltd), the Industrial Finance Corporation of India (IFCI), Tata Motors Finance Limited, Hinduja Leyland Finance, Axis Finance Limited, Power Finance Corporation Limited, Shriram Transport Finance Company Limited, Bajaj Finance Limited, Mahindra & Mahindra Financial Services Limited (MMFSL), Muthoot Finance Ltd., HDB Finance Services, Cholamandalam Investment and Finance Company Limited, Tata Capital Financial Services Ltd., L&T Finance Limited and Aditya Birla Finance Limited.
Given the importance of NBFCs in our financial system, it would be good to look at their liability and asset profile. An analysis of NBFC liability structure (Figure 2) reveals that over 70 per cent of NBFC borrowings are long-term (that is, payable after more than one year) which means that they have a good credit worth.

Figure 2: Liability Structure (in %)



Source: Jayakumar, Nandini, et.al, (2021),"Performance of NBFCs during the Pandemic: A Snapshot", Department of Economic and Policy Research, Reserve Bank of India.

Figure 3: Asset Components (in %)



Source: Jayakumar, Nandini, et.al, (2021),"Performance of NBFCs during the Pandemic: A Snapshot", Department of Economic and Policy Research, Reserve Bank of India.

Moreover, their asset components (Figure 3) reveal their reliance on loans and advances, which is their main function. Lastly, as an addition, NBFCs were the largest net borrowers of funds from the financial system, with gross payables of ₹11.69 lakh crore and gross receivables of ₹1.86 lakh crore as at end-March 2021.[6] A further scrutiny of their loan portfolio (Figure 4) reveals that over 70 per cent of NBFC advances are long-term (that is, receivable after more than one year). Post the pandemic, an increase in the share of NBFCs' loans in the less than 3-month bucket indicates the NBFCs' role in facilitating short-term credit needs of the economy.

Figure 4: Loan Portfolio (in %)

Source: Jayakumar, Nandini, et.al, (2021),"Performance of NBFCs during the Pandemic: A Snapshot", Department of Economic and Policy Research, Reserve Bank of India.

Sectoral Credit of NBFCs

Industry remained the largest recipient of credit extended by the NBFC sector, followed by retail loans and services. The share of the retail loan portfolio increased in 2019-20 with a corresponding fall in the shares of all other sectors (Table 3). Barring retail, credit to agriculture, industry and services has declined in 2019-20.

Table 3: Sectoral Credit Deployment by NBFCs (₹ Crore)

Type	March 2019 (₹ Crore)	March 2020 (₹ Crore)	Percentage Variation	
			2018-19	2019-20
I. Gross Advances	**23,15,608**	**23,60,504**	**17.8**	**1.9**
II. Food Credit	**232**	**310**	**-3.6**	**33.5**
III. Non-food Credit (1 to 5)	**23,15,376**	**23,60,194**	**17.8**	**1.9**
1. Agriculture and Allied Activities	**70965**	**61,759**	**51.7**	**-13.0**
2. Industry (2.1 to 2.4)	**12,69,075**	**12,65,248**	**13.1**	**-0.3**
2.1 Micro and Small	41,985	75,849	-24.2	80.7
2.2 Medium	18,464	17,388	-24.2	-5.8
2.3 Large	7,08,181	5,86,983	13.7	-17.1
2.4 Others	5,00,445	5,85,028	19.4	16.9
3. Services	**3,85,177**	**3,72,596**	**19.8**	**-3.3**
Of which,				
3.1 Commercial Real Estate	1,51,617	1,29,232	21.2	-14.8
3.2 Retail Trade	29,296	37,179	8.3	26.9
4. Retail Loans	**4,52,442**	**5,50,302**	**25.9**	**21.6**
Of which,				
4.1 Housing Loans	15,663	21,468	18.2	37.1
4.2 Consumer Durables	5,151	5,128	-40.3	-0.4
4.3 Vehicle/Auto Loans	2,02,136	2,38,970	23.0	18.2
5. Other Non-food Credit	**1,37,716**	**1,10,289**	**18.4**	**-19.9**

Source: Report on Trend and Progress of Banking in India 2019-20;
https://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Trend%20and%20Progress%20of%20Banking%20in%20India

Borrowings by NBFCs

From the following Table (Table 4), it can be observed that NBFCs have raised more resources in terms of bank borrowings, borrowings from financial institutions (FIs), etc. While mobilization of resources through Commercial Papers (CPs) declined in March 2020, it increased moderately during September 2020. With the IL&FS default reducing market access, the NBFCs resorted to bank-based funding and borrowings from financial institutions in a greater measure.

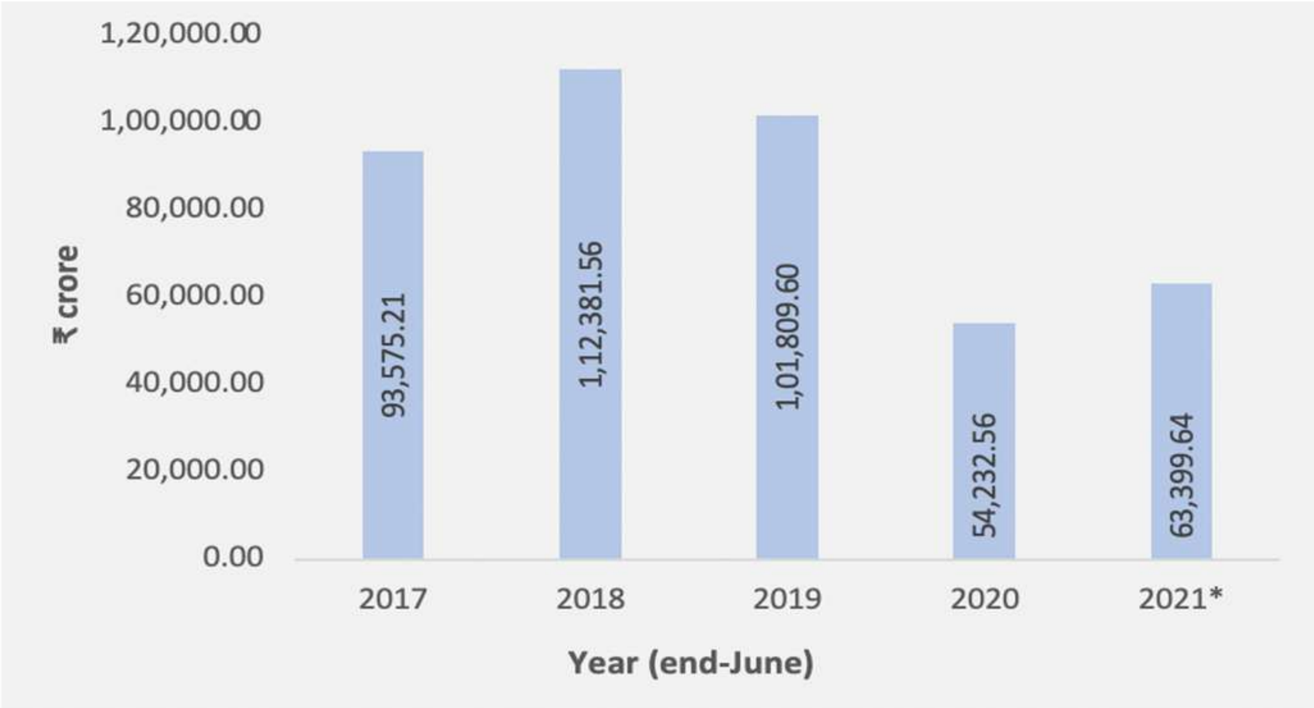
Table 4: Sources of Borrowing for NBFCs* (₹ crore)

Sl No.	Items	March-end 2019	March-end 2020	September-end 2020	2018-19 (per cent variation)	2019-20 (per cent variation)
1	Debentures	9,19,314	9,40,499	9,15,293	3.4	2.3
2	Bank Borrowings	6,26,495	7 ,08,035	7,34,322	50.3	13.0
3	Borrowings from Financial Institutions (FIs)	40,759	73,811	1,16,443	27.2	81.1
4	Inter-corporate borrowings	75,805	78,288	81,044	33.1	3.3
5	Commercial Paper (CP)	1,59,158	70,066	89,065	9.5	-56.0
6	Other borrowings	2,89,254	4,09,642	4,16,276	25.9	41.6
7	Total Borrowings	21,10,785	22,80,341	23,52,444	19.3	8.0

Source: Report on Trend and Progress of Banking in India 2019-20. Available athttps://www.rbi.org.in/Scripts/Annual Publications.aspx?head=Trend+and+Progress+of+Banking+in+India *Note – as per the latest report available with RBI.

While resource mobilization through Commercial Papers (CPs) marginally improved up to May 2021 compared to June 2020 (see following Figure 5), on average, the decline is substantial compared to previous years from 2017.

Figure 5: Deployment of Funds (via CP) by Mutual Funds towards NBFCs



Source: https://www.sebi.gov.in/statistics/mutual-fund/deployment-of-funds-by-all-mutual-funds.html#
*Note - Figures are till May

Institutional Initiatives

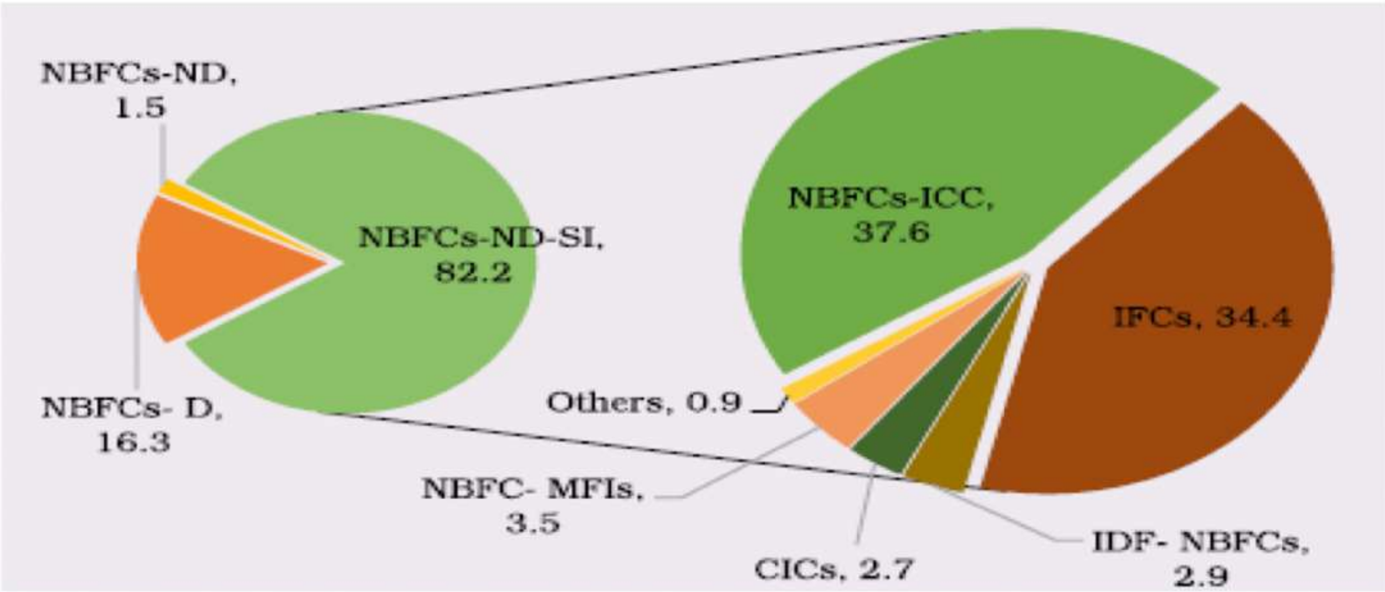
Priority Sector Lending

Recognizing the role played by NBFCs in providing credit to diverse segments, viz., persons at the bottom of the pyramid, sectors contributing significantly to the economic growth in terms of export and employment, and to augment the liquidity position of the NBFCs, it was decided in August 2019 [7] to allow banks to classify lending to registered NBFCs (other than MFIs) as Priority Sector Lending (PSL) up to 5 per cent of a bank's total PSL, for on-lending to Agriculture/MSME/Housing till March 31, 2020. With a view to ensuring continued availability of credit to these sectors to aid faster economic recovery, the scheme has been extended till 30th September 2021.[8]

Targeted Long-Term Repo Operations

Another such measure is the extension of Targeted Long-Term Repo Operations (TLTRO) to NBFCs. Under the scheme [9] on tap TLTRO with tenors of up to three years for a total amount of up to ₹1,00,000 crore at a floating rate linked to the policy repo rate is provided. This enables small borrowers who are connected with NBFCs to avail loans. The scheme is expanded till 30th September 2021.[10] According to the RBI, NBFCs garnered 60 per cent of the total disbursement; whereas the Non-deposit taking NBFCs, particularly NBFCs-ND-SI, have been major beneficiaries. As on 4 September 2020, ₹ 76,843 crores have been requested by NBFCs and HFCs, four-fifth of which has been disbursed.

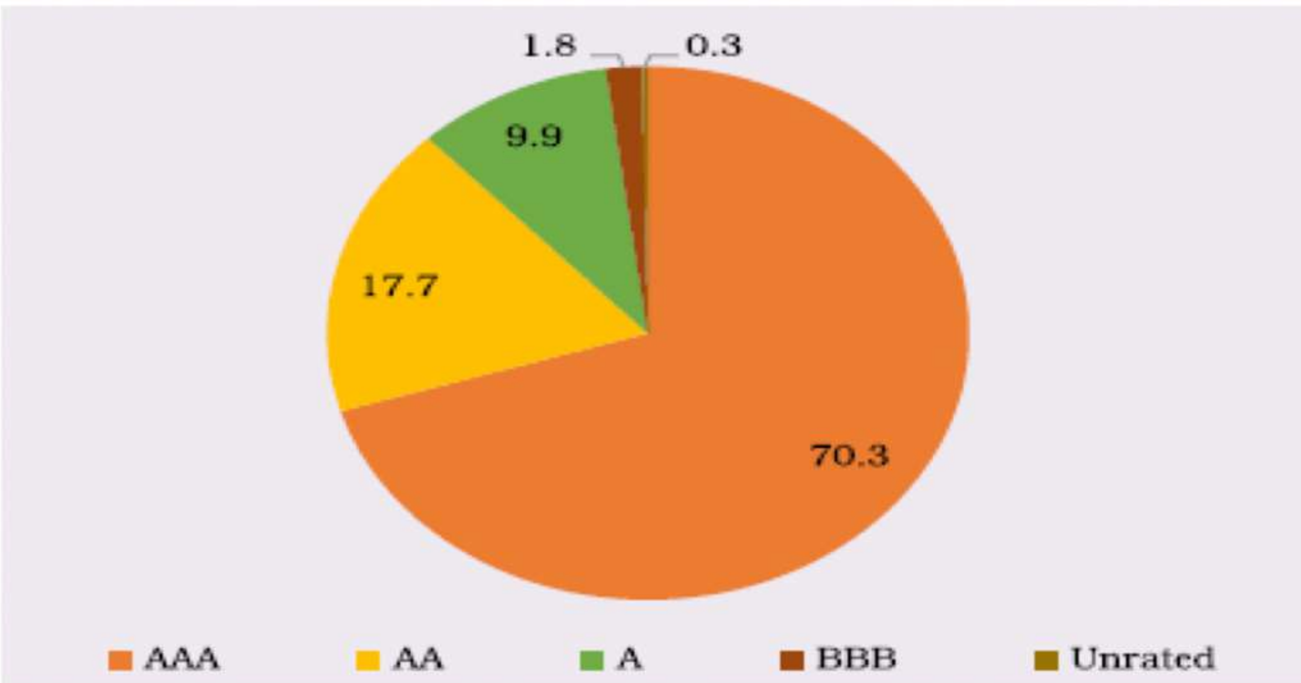
Figure 6: Distribution of TLTRO Funds amongst Categories of NBFCs as on 4 September 2020 (per cent)



Source: Report on Trend and Progress of Banking in India2019-20;https://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Trend%20and%20Progress%20of%20Banking%20in%20India

A rating-wise analysis shows that AAA and AA rated firms accessed aggregate 88 per cent of disbursements. [AAA:70.3%+AA:17.7%; total=70.3%+17.7%=88%].

Figure 7: Rating-wise Share of NBFCs in Total Disbursement as on 4 September 2020 (per cent)



Source: Report on Trend and Progress of Banking in India 2019-20; https://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Trend%20and%20Progress%20of%20Banking%20in%20India

Special Liquidity Facility

To nurture the embryonic growth impulses of the economy, the RBI extended fresh support of ₹50,000 crore on April 7, 2021, to All India Financial Institutions (AIFIs) for new lending in 2021-22, out of which a special liquidity facility (SLF) of ₹25,000 crore was extended to National Bank for Agriculture and Rural Development (NABARD) to support agriculture and allied activities, the rural non-farm sector and Non-Banking Financial Companies - Micro Finance Institutions (NBFC-MFIs). [11]

Debt Recovery

The above was complemented with the Finance Ministry's move of operationalizing a budget announcement that lowered the minimum loan size eligible for debt recovery by NBFCs under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 to ₹20 lakhs from the existing level of ₹50 lakhs.[12] This would enable to enhance the capital composition of NBFCs.

Exploration of New Regulatory Framework

To prevent systemic failure and shocks and to keep pace with the changing needs of the market, the RBI has proposed a framework [13] with NBFCs grouped in four layers: Base Layer (BL), Middle Layer (ML), Upper Layer (UL) and possible Top Layer (TL).

• Base Layer: There will be moderate regulatory intervention for NBFCs at BL. Over 9,200 NBFC will be in the BL, which can comprise entities currently classified as non-systemically important NBFCs (NBFC non-deposit taking), peer-to-peer lending platforms, account aggregators, non-operative financial holding companies, and NBFCs with asset size up to ₹1000 crore. The RBI proposes to harmonise the extant NPA classification norm of 180 days to 90 days for NBFC-BL.

• Middle Layer: The Middle Layer (ML) would cover NBFC non-deposit taking systemically important (NBFC-ND-SI), deposit taking NBFCs, Housing Finance Companies (HFCs), infrastructure finance companies, infrastructure debt funds, standalone primary dealers and core investment companies. While no changes are proposed in the capital requirement for these, the linkage of their exposure limits are proposed to be changed from owned funds to Tier I capital, as also currently applicable for banks. Further, some other restrictions would be applied on NBFCs in ML including prohibition of extension of loans to companies for buyback of shares/securities.

• Upper Layer: This layer would incorporate systemically significant NBFCs. The regulatory framework for such NBFCs would be bank-like with appropriate modifications. Further, Common Equity Tier 1 (CET-1) capital could be introduced for NBFC-UL at 9 per cent. Such NBFCs would be prescribed differential standard asset provisioning on the lines of banks. This layer (UL) is likely to consist of 25-30 large players.

• Top Layer: At the very top, there will be few NBFCs, which will be subjected to the regulations proposed specifically for them. The top layer (TL) will be those NBFCs that can pose extreme risks.

New Relief Package

The recent relief package announced by the finance minister in June 2021 gives a guarantee that will be provided to Scheduled Commercial Banks (SCBs) for loans to new or existing NBFC-MFIs or Micro Finance Institutions (MFIs) for on lending up to ₹1.25 lakh to approximately 25 lakh small borrowers. All borrowers (including defaulters up to 89 days) will be eligible and guarantee cover for funding will be provided by Member Lending Institutions (MLIs) to MFIs/NBFC-MFIs till 31st March 2022 or till guarantees for an amount of ₹7,500 crore are issued, whichever is earlier. [14]

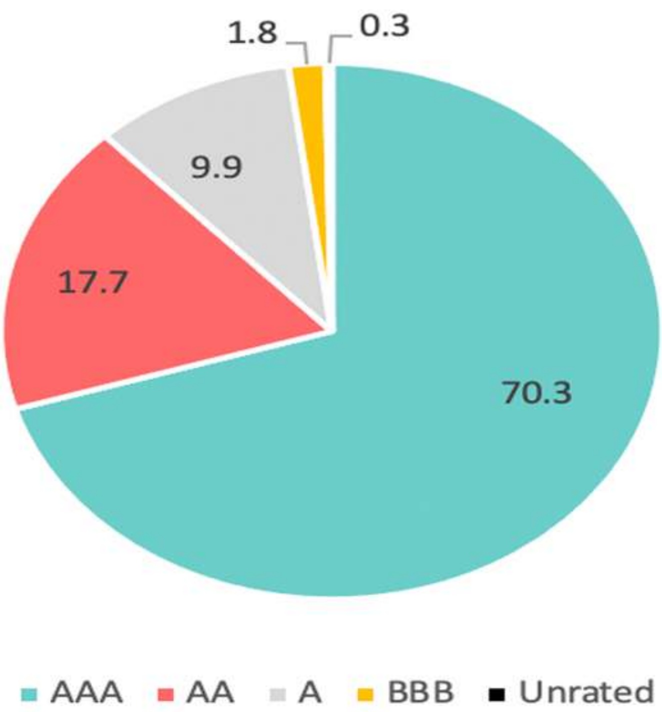
Industry Risk

The COVID pandemic has exacerbated the stress of the NBFC sector. For example, low credit growth, which was likely in the wake of second wave of the COVID pandemic. This has been expected by experts[15] across the board and the market has been also giving clear signals in the form of dampened demand. This is likely to continue given that certain industries (like the automotive) have been further facing supply shocks after the demand resurgence during the unlock process.

Fund Disbursement of TLTRO

There exist structural issues when it comes to fund disbursal. As per our previous data (Figure 7) which is reproduced below (Figure 8), roughly 70 per cent of the funds disbursed to NBFCs went to AAA rated firms, about 18 per cent went to AA and about 10 per cent went to NBFCs rated 'A'. NBFCs with ratings of BBB and below received just 2.1 per cent, to be precise, of the TLTRO funds. This, one can argue, defeats the whole purpose of the fund allocation which aims at bolstering the stressed portion and not the already well-off in relative terms.[16]

Figure 8: Rating-wise share of NBFCs in Total Disbursements



Source: Business Standard (31st December 2020). Available at https://www.business-standard.com/article/finance/just-2-1-of-tltro-funds-went-to-nbfcs-that-needed-them-most-rbi-report-120123001044_1.html; and Report on Trend and Progress of Banking in India2019-20;https://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Trend%20and%20Progress%20of%20Banking%20in%20India

Delinquency and Non-Performing Assets

Time management due to liquidity crunch is another issue which the sector has been witnessing. The market has been wanting that extra bit of time for funds management as can be argued from the table below (Table 5) where we see that the delinquency rates has been increasing over the pandemic period. However, from Table 6 it can be seen that in terms of actual NPAs, both the GNPA and NNPA has declined moderately from Mar'20 to Mar'21, possibly due to higher provisioning. However, NBFC-MFIs, which are primarily dependent on bank borrowings for funding, have been undergoing asset quality stress during the pandemic. Their GNPA ratio ballooned from 2.0 per cent of total advances in March 2020 to 4.9 per cent in March 2021 [17] as business dislocation dampened recoveries.

Table 5: Delinquency Rates for NBFCs

	NBFC/HFC[18]
Jan-20	5.3
Feb-20	5.2
Mar-20	4.8
Apr-20	5.2
May-20	5.2
Jun-20	5.0
Jul-20	5.1
Aug-20	5.2
Sep-20	5.4
Oct-20	5.3
Nov-20	5.8
Dec-20	6.3
Jan-21	6.7

Source: Financial Stability Report (July 2021), RBI.
Note – Based on 90 days past due balances.

Table 6: Non-Performing Assets of NBFCs

	GNPA Ratio	NNPA Ratio
Mar-15	4.1	2.5
Mar-16	4.5	2.5
Mar-17	6.1	4.4
Mar-18	5.8	3.8
Mar-19	6.1	3.3
Mar-20	6.8	3.4
Mar-21	6.4	2.7

Source: Financial Stability Report (July 2021), RBI.

The RBI's Report on Trend and Progress of Banking in India 2019-20 brought out that the year 2019-20 marked a significant moderation in NBFCs' financial performance, after double digit balance sheet growth in the previous three years. A challenging macroeconomic environment, weak demand compounded by risk aversion, liquidity stress and rising borrowing costs in the wake of the IL&FS default resulted in a substantial deceleration in asset growth in 2019-20. The impact was particularly pronounced for NBFCs-ND-SI." In 2020, NBFCs' industrial credit growth was impacted by the stress in thermal power projects, lower demand for finance owing to slowdown in construction activities, fall in manufacturing sector output as well as disruptions due to COVID-19. Besides around thirty-forty per cent of the NBFC exposure appears to be in risky segments like real estate, personal credit, microfinance, unsecured SME and segments of commercial vehicle and passenger vehicle financing, which were more severely affected by the pandemic. The Covid-19 pandemic, with its probability of third wave, and further delta virus and its other variants in certain other countries has increased uncertainty and the emergence of any further waves of infections and its consequent impact on the business of NBFCs needs to be carefully monitored in the medium term.

ENDNOTES

1. Reasons vary from non-maintenance of funds, failure to repay deposits, actions not in public interest or any other reasons not fulfilled as those mentioned by the RBI. See RBI Act, 1934 for more details. Recently, RBI has imposed penalty on 14 banks on non-compliance to lending rules to NBFCs. See, "Reserve Bank of India imposes monetary .
2. Non-systemically important non-deposit taking NBFCs (NBFCs-ND) with an asset size of less than ₹500 crore.
3. Non-deposit taking NBFC with asset size greater than ₹500 crore is considered systemically important (NBFCs-ND-SI).
4. Asset Reconstruction Companies.
5. Deposit-taking NBFCs (NBFCs-D).
6. Financial Stability Report (July 2021), Reserve Bank of India.
7. "Priority Sector Lending – Lending by banks to NBFCs for On-Lending", RBI Notification (13th August 2019). Available at https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11659&Mode=0
8. "Statement on Developmental and Regulatory Policies", RBI Press Release (4rth December 2020). Available at https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=50748
9. "Statement on Developmental and Regulatory Policies", RBI Press Release (4rth December 2020). Available at https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=50748
10. "Statement on Developmental and Regulatory Policies", RBI Press Release (4rth April 2021). Available at https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=51382
11. "Statement on Developmental and Regulatory Policies", RBI Bulletin (16th June 2021). Available at https://rbi.org.in/scripts/BS_ViewBulletin.aspx?Id=20319
12. "Loan recovery: Ministry gives more power in the hands of NBFCs", The Hindu Business Line (13th February 2021). Available at https://www.thehindubusinessline.com/money-and-banking/loan-recovery-ministry-gives-more-power-in-the-hands-of-nbfcs/article33831409.ece
13. "Revised Regulatory Framework For NBFCs: A Scale-Based Approach", Discussion Paper, Reserve Bank of India (22nd January 2021). Available at https://rbi.org.in/scripts/PublicationsView.aspx?Id=20316
14. "Nirmala Sitharaman announces economic package for MSMEs, raises credit line limit to ₹4.5 lakh crore", FirstPost (28th June 2021). Available at https://www.firstpost.com/business/nirmala-sitharaman-announces-economic-package-for-msmes-raises-credit-line-limit-to-rs-4-5-lakh-cr-9761211.html
15. See https://www.theweek.in/news/biz-tech/2021/05/17/second-wave-to-slow-down-credit-growth-of-nbfcs-emkay-global.html for more details.
16. "Just 2.1% of TLTRO funds went to NBFCs that needed them most: RBI report", Business Standard (31st December 2020). Available at https://www.business-standard.com/article/finance/just-2-1-of-tltro-funds-went-to-nbfcs-that-needed-them-most-rbi-report-120123001044_1.html
17. RBI Financial Stability Report (July 2021).
18. Pursuant to the amendment of National Housing Bank Act, 1987, HFCs are also treated as a category of NBFCs for regulatory purposes. See https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=47871 for details.

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