NBFCs: Retail Lending Thrives, Asset Quality Continues to Improve

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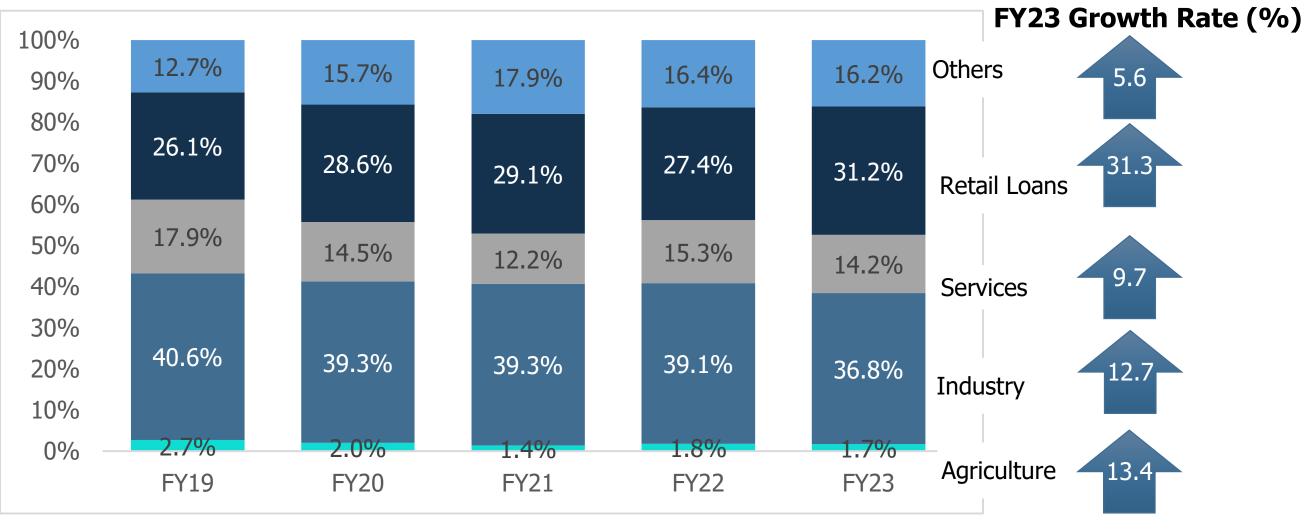
Synopsis

- A shift in the segmental distribution of credit with a tilt towards retail can be observed.
- Asset quality has improved, and SMA numbers have broadly reduced. Public sector NBFCs have reported a lower GNPA ratio compared to their private sector counterparts.
- Large NBFCs (NBFC-UL)[1] group recorded higher credit growth (y-o-y) of 18.8% and a better GNPA ratio of 3.7% as of March 2023 than the overall NBFC sector.
- In FY23, NBFCs and HFCs remained the major issuers of listed bonds during the year, while banks and body corporates were their major subscribers.

Segmental Movement in Credit – Share of Industry Reduces, Retail Loans Continue to Increase

Over 9,000 NBFCs are currently registered with the RBI. Even though the combined balance sheet size of NBFCs continues to be approximately one-fifth when compared with the Scheduled Commercial Banks (SCBs), NBFCs play a significant role in last-mile credit delivery. As of FY23, aggregate credit extended by NBFCs grew by 16.1%.

Figure 1: Segmental Distribution of Credit



Source: RBI Financial Stability Reports

Over the last five years, loans to industry lost market share from 40.6% in FY19 to 36.8% in FY23 and yet continued to constitute the largest segment, followed by personal loans at 31.2%, services at 14.2% and agriculture at 1.7%. Advances to the retail segment grew the fastest in H1FY23. Government-owned NBFCs have been ceding ground in the industry segment. According to RBI's Financial Stability Report June 2023, the NBFC-UL group recorded higher credit growth (y-o-y) of 18.8% and a better GNPA ratio of 3.7% as of March 2023 than the overall NBFC sector.

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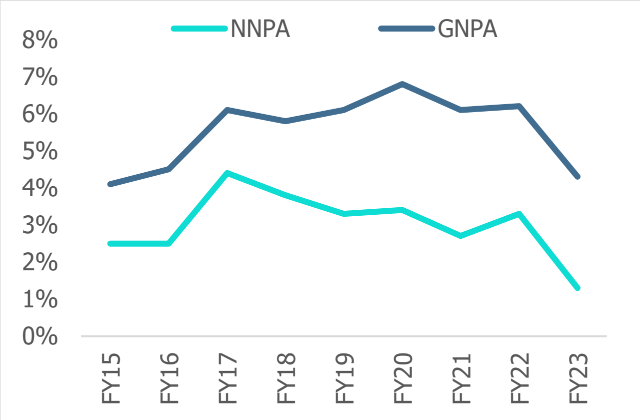
[1] The Scale Based Regulation (SBR) introduced for NBFCs classifies them into four layers namely Base Layer (NBFC-BL), Middle Layer (NBFC-ML), Upper Layer (NBFC-UL) and Top Layer (NBFC-TL) based on their size, activity, and perceived riskiness. Sixteen entities have been identified for categorisation as NBFC-UL under the framework.

Asset Quality Continues to Improve, while Capital Adequacy Remains Adequate

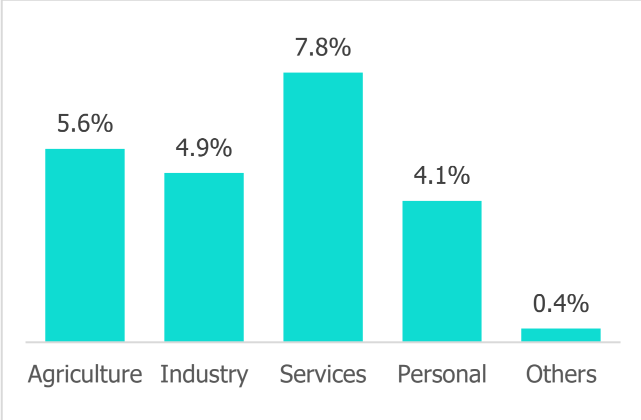
The GNPA ratio declined in March 2023, meanwhile, SMAs, too contracted from 10.5% of total advances in September 2022 to 5.8% in March 2023. On the other hand, restructuring of lending to large borrowers, however, saw an increase between September 2022 and March 2023. Public sector NBFCs (share of 44% in outstanding credit) have reported a lower GNPA ratio of 2.8% compared to their private sector counterparts (share of 56% in outstanding credit) GNPA ratio of 5.5%.

Figure 2: Asset Quality Improves



Source: RBI Financial Stability Reports

Figure 3: Segmental Asset Quality (March 2023)



Source: RBI Financial Stability Report June 2023

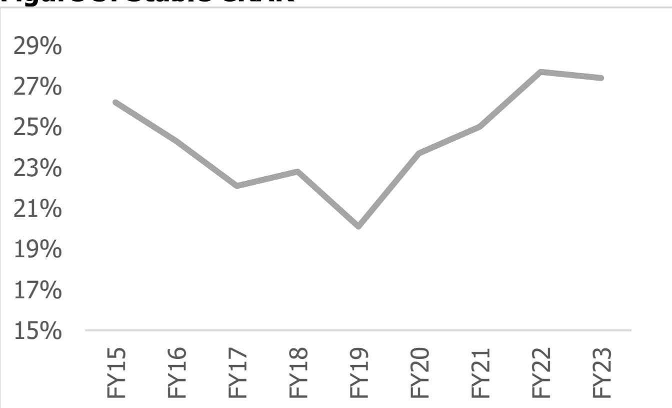
Figure 4: Potential weakness of Large Borrowers Reduces (%)

	SMA-0	SMA-1	SMA-2	Restructured Assets (including NPAs restructured)	Total
Jun-22	9.0	1.7	5.9	0.3	16.9
Sep-22	3.9	0.8	8.2	2.1	15.0
Dec-22	5.0	0.6	5.1	4.7	15.4
Mar-23	3.4	0.6	1.4	3.9	9.3

Source: RBI Financial Stability Report June 2023

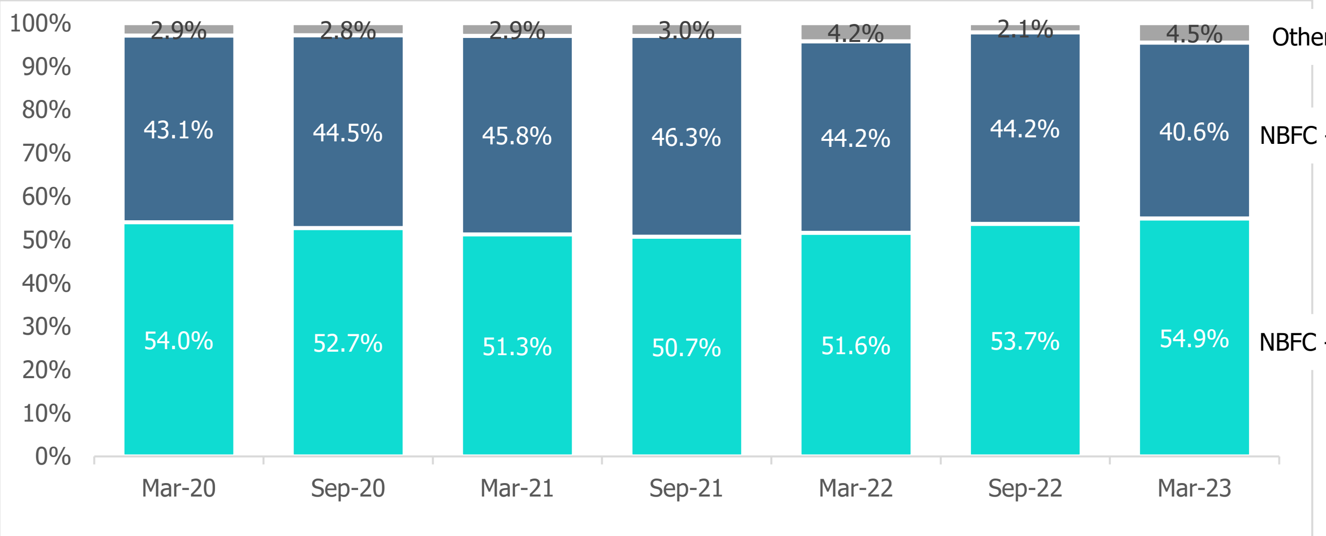
Over FY23, the potential weakness of large borrowers of NBFCs has reduced, indicative of the improving asset quality. The capital adequacy (CRAR - Capital to Risk (Weighted) Assets Ratio) of NBFCs continued to be robust as of March 2023. The marginal decline was attributed to rising lending activities.

Figure 5: Stable CRAR



Source: RBI Financial Stability Reports

Figure 6: Share in Total Advances

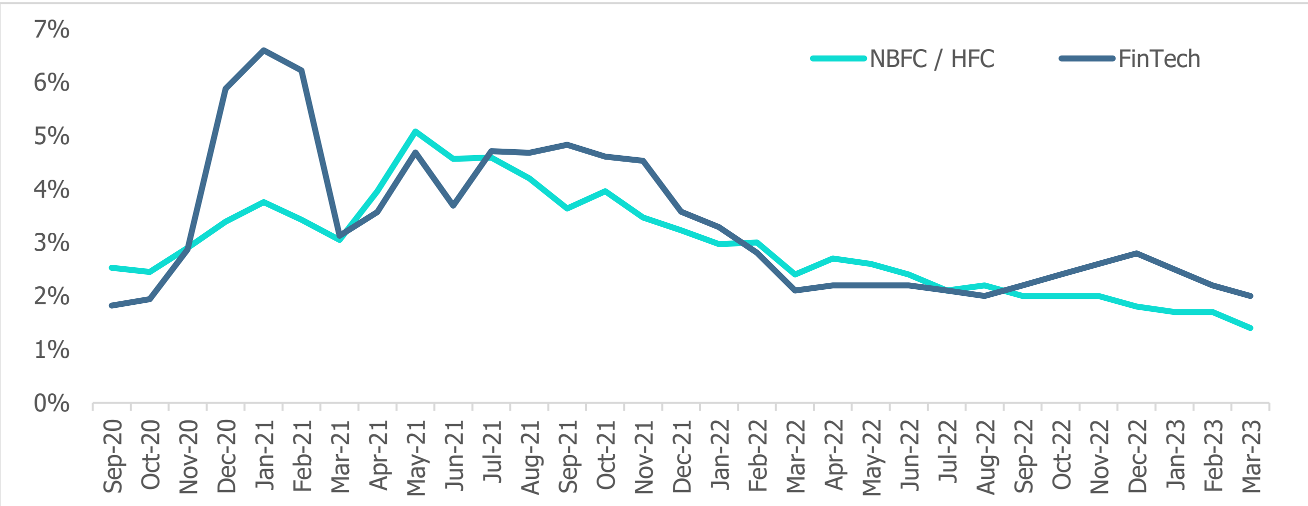


Source: RBI Financial Stability Reports; Note: NBFC – Investment and Credit Company (NBFC-ICC); NBFC – Infrastructure Finance Company (NBFC-IFC)

NBFC-ICC and NBFC-IFC continue to be the largest segments and account for over 90% size of all NBFCs. Further, if we examine the asset quality numbers across select NBFC categories, all the categories of NBFCs witnessed an improvement in their GNPA and stress too has broadly reduced with SMA numbers on the decline.

Consumer Credit Quality Continues on an Uptrend

Figure 7: Delinquency Levels in Aggregate Consumer Credit



Source: RBI Financial Stability Report June 2023

Impairment in consumer credit, measured in terms of the proportion of the portfolio at 90 days past due or beyond, which had increased in the pandemic, especially in the second wave shows a reduction in FY23. However, on account of the increase in policy rates and the subsequent impact on overall asset quality, would require closer monitoring.

Figure 8: Consumer Distribution by Risk Tier for NBFCs

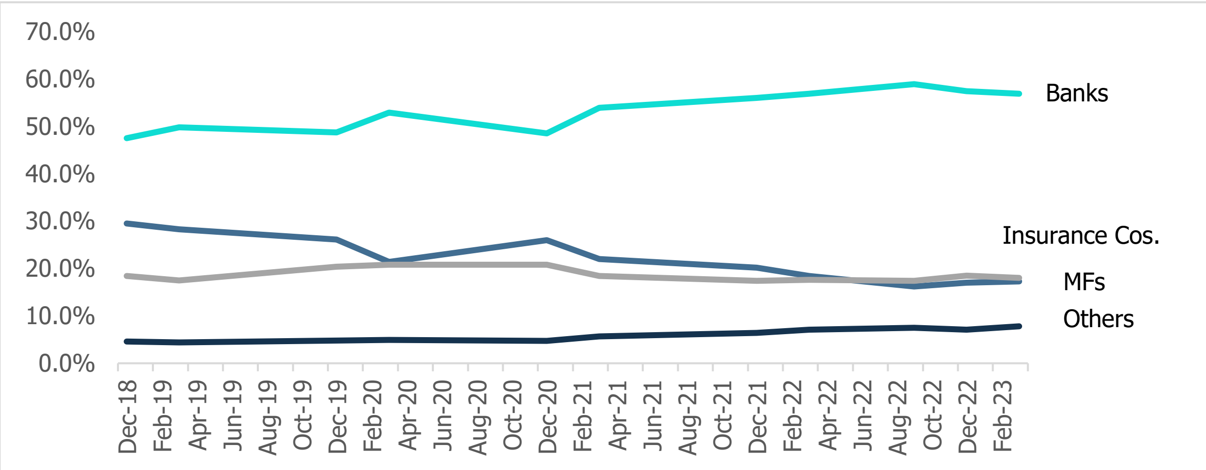
	Mar-21	Mar-22	Mar-23
Subprime	33.5%	31.6%	27.2%
Near prime	25.1%	23.3%	24.9%
Prime	28.5%	32.8%	35.6%
Prime plus	11.6%	11.3%	11.0%
Super prime	1.2%	1.0%	1.3%
Total	**100%**	**100%**	**100%**
Below Prime	58.6%	54.9%	52.1%

Source: RBI Financial Stability Report June 2023

The quality of incremental credit has improved, with the share of lower-rated borrowers declining over the last couple of years. Further, the distribution by risk tier also shows an improvement in the customer mix.

Movement in Share of Lender Groups

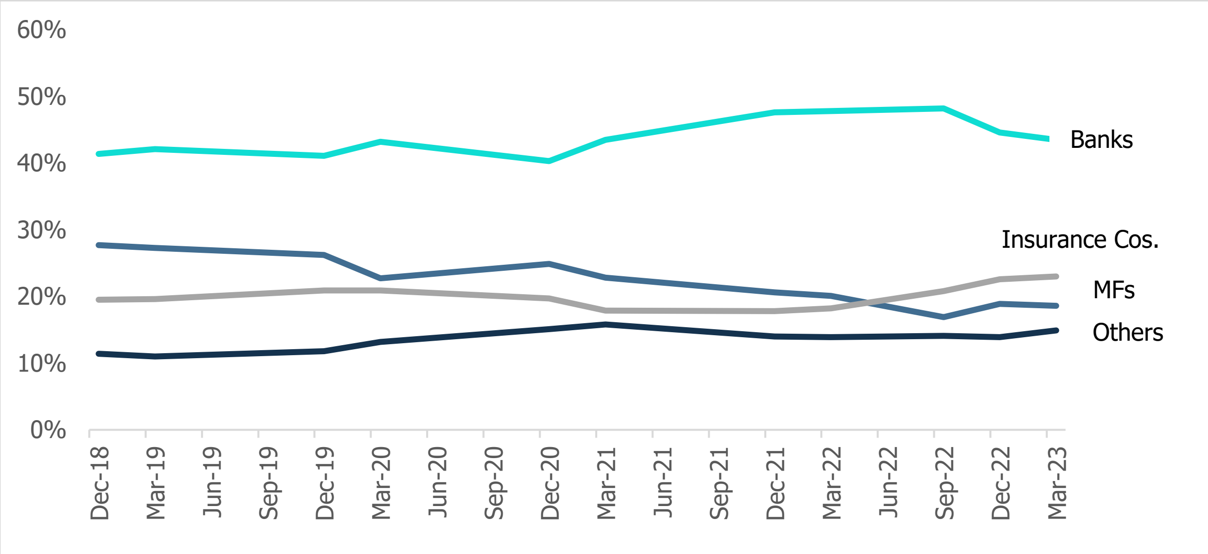
Figure 9: NBFCs – Share of Banks Remains High but Declines in Q4FY23



Source: RBI Financial Stability Reports

NBFCs are the largest net borrowers of funds from the financial system. NBFCs owed close to 57% in FY23 (similar levels in FY22) to Banks followed by 17.3% (18.4% in FY22) to MFs and 18% (17.6% in FY22) to insurance companies. The share of MFs and Insurance companies has been broadly declining for several quarters but has held steady for the last couple of quarters. The share of Banks has remained the highest although it declined in Q4FY23 and the share of MFs increased marginally in the same period. If the funding mix is considered, the share of SCBs would be even higher due to the significant loan asset sell-down (direct assignment) as a funding source which is not included in the above computation.

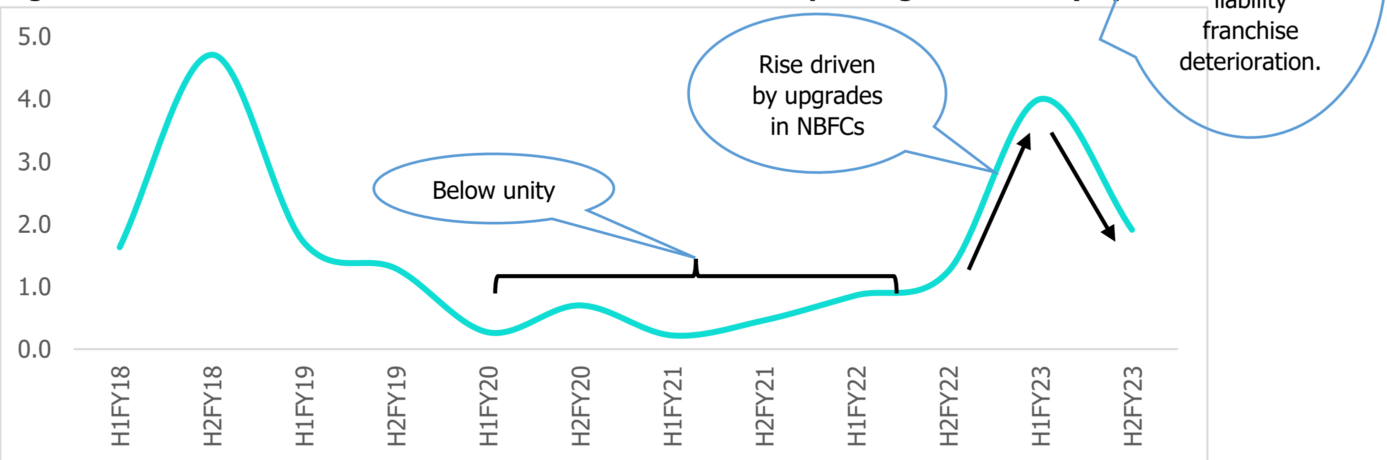
Figure 10: Housing Finance Companies (HFCs) – Share of Banks Remains High, Declines in Q4FY23



Source: RBI Financial Stability Reports

HFCs were the second-largest borrowers of funds from the financial system. Banks continue to remain the largest funding segment, but the share of Banks has shown a downward trend in Q4FY23, while Insurance companies and MFs showed an upward trend for the same period. Furthermore, most HFCs sell-downs their retail assets to banks to generate liquidity. Hence, the funding mix if these direct assignments are considered, the share of SCBs would be even higher as Banks, especially Public Sector Banks, had acquired these assets.

Figure 11: BFSI: Moderation in Credit Ratio in H2FY23 after peaking in H1FY23 (%)



Source: CareEdge Ratings; Note: Credit Ratio Upgrades/Downgrades: A ratio higher than unity denotes more upgrades than downgrades. An increase in ratio as compared to previous periods denotes an improvement in the credit quality of rated entities and vice versa.

BFSI sector reported moderation in credit ratio in H2FY23. Upgrades continue to outnumber downgrades. The proportion of upgrades continues to be high in H2FY23 and is attributed to:

- Significant improvement in scale of operations asset quality.
- Strengthening of capitalization through equity issuances, both public and private.
- Group entities benefiting from an improvement in the credit profile of parents.

- However, the downgrades increased substantially, mainly due to continuing deterioration in some of the weaker entities.

Despite rising interest rates, profitability in mid-sized NBFCs/ financial services will be protected, due to optimization of opex, moderate increase in interest rates and lower credit costs. Against this backdrop, the credit outlook is expected to be positive for Banks and NBFCs/ financial services.

Conclusion

Financial entities have generally emerged resiliently from the pandemic and are expanding their business as the economic recovery takes hold. The share of banks as a lender to NBFCs has declined as large NBFCs raised Long Term instruments from the capital market, meanwhile, mid-sized as well as smaller NBFCs continue to rely on the banking system as the primary source of funding.

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