NBFCs: Asset Focus on Retail, Need to Diversify Liabilities

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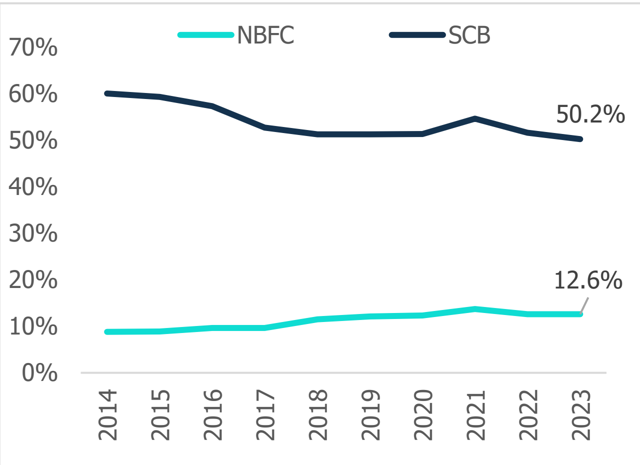
Synopsis

- A shift in the segmental distribution of credit with a tilt towards retail can be observed.
- Asset quality has improved. Public sector NBFCs have reported a lower GNPA ratio compared to their private sector counterparts.
- Large NBFCs (NBFC-UL)[1] registered higher credit growth (y-o-y) of 21.9% and a better GNPA ratio of 3.4% as of September 2023 compared to the overall NBFC sector.
- In H1FY24, NBFCs and HFCs remained the major issuers of listed bonds during the year, while banks and body corporates were their major subscribers.

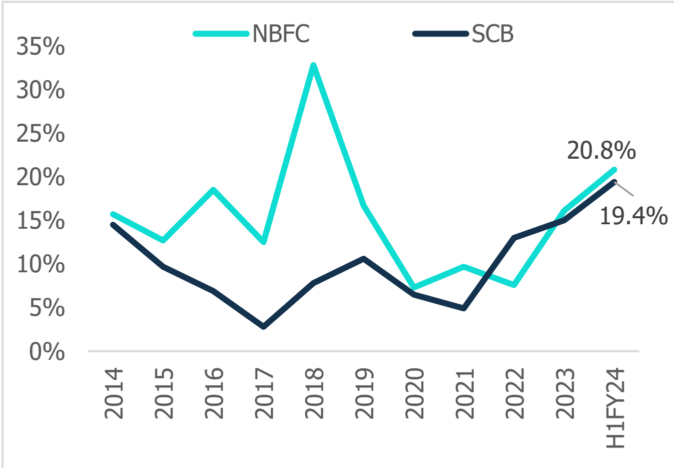
NBFCs have Continued to Grow Faster than SCBs'

Figure 1: Credit to GDP Ratio: NBFC vs SCBs



Source: RBI Financial Stability Reports

Fig 2: NBFCs Credit Growth vs SCBs Credit Growth



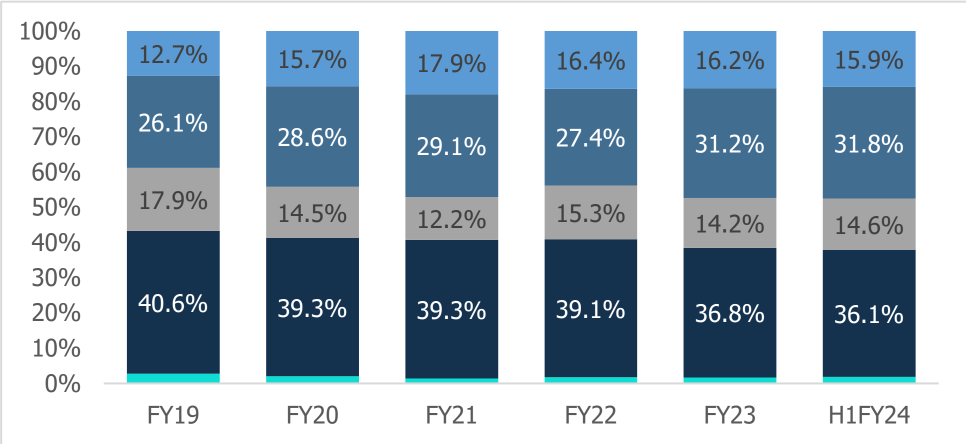
Source: RBI Financial Stability Report June 2023

- 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 Q2FY24, aggregate credit extended by NBFCs grew by 20.8%. compared to SCBs growth of 19.4%.
- NBFCs' credit intensity measured by the credit/GDP ratio has been rising consistently, reaching a high in 2021. Significantly, NBFCs' credit as proportion to SCBs' credit has also risen.

[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.

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

Figure 3: Segmental Distribution of Credit



H1FY24 Growth Rate (%)

Source: RBI Financial Stability Reports

Over the last few years, loans to industry lost market share from 40.6% in FY19 to 36.1% in H1FY24 and yet continued to constitute the largest segment, followed by personal loans at 31.8%, services at 14.6% and agriculture at 1.9%. Growth in industrial advances was largely contributed by the Government NBFCs (18.3% y-o-y. According to RBI's Financial Stability Report December 2023, the Large NBFCs (NBFC-UL) logged higher credit growth (y-o-y) of 21.9% and a better GNPA ratio of 3.4% as of September 2023 than the overall NBFC sector.

During the last four years, the CAGR for personal loans of around 33% (Rs 11.9 lakh crore as of September 2023) has exceeded the overall credit offtake of approximately 15% for the NBFC sector. As per the FSR December 2023, the consumer loans, whose risk weights were increased recently by RBI, accounted for 44.7% of the incremental retail loan growth over the last one year. Moreover, share of unsecured loans in the NBFC sector rose from 24.6% in March 2020 to 31.9% in September 2023 and grew at a CAGR of 20.7%. However, this growth rate is likely to moderate given RBI's action of increasing the risk weights on consumer loans which would increase the capital required for such loans.

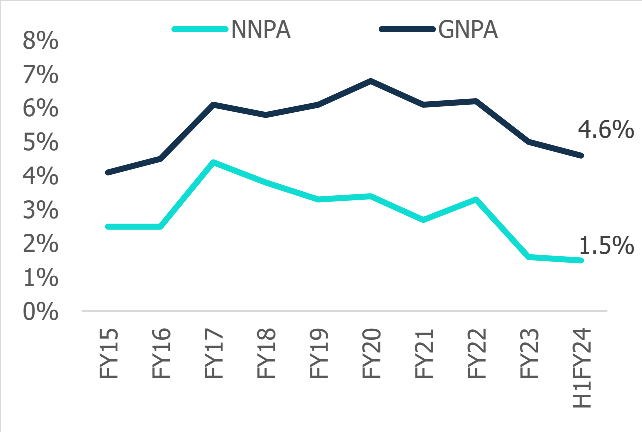
Figure 4: NBFC Retail Lending (%)

	Share of Retail Lending				Y-o-Y Growth	
	Mar-22	Sep-22	Mar-23	Sep-23	Mar-23	Sep-23
Retail Loans					25.8	32.5
Housing Loans	2.8	2.9	3.1	3.3	39.3	46.9
Consumer Durables	3.0	3.0	3.0	3.2	27.2	40.1
Credit Card o/s	3.9	4.4	4.2	4.1	34.5	22.6
Vehicle Loan	40.0	38.5	36.5	36.2	14.6	22.7
Education Loan	1.7	2.2	2.4	3.0	79.0	79.9
Adv. agt Shares	1.6	1.6	1.3	1.5	7.9	28.7
Other Retail Loans	47.1	47.4	49.5	48.6	32.2	33.6

Source: RBI Financial Stability Reports

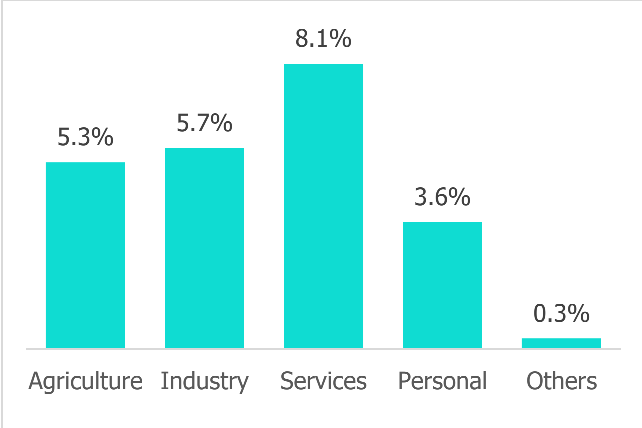
Asset Quality Continues to Improve, while Capital Adequacy Remains Adequate

Figure 5: Asset Quality Improves



Source: RBI Financial Stability Reports

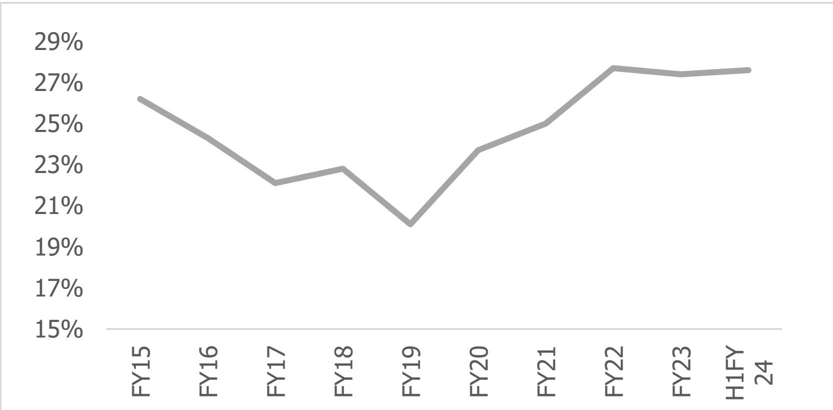
Figure 6: Segmental Asset Quality (Sep 2023)



Source: RBI Financial Stability Report December 2023

The GNPA and NNPA ratio of NBFCs continued its downward trajectory with improvement across sectors. Among major sectors, the personal loans. segment, which had grown rapidly in the last few years, continues to have the lowest GNPA ratio in September 2023 at 3.6%. The GNPA ratio of Government and private NBFCs moderated further to 2.5% and 6.1%, respectively, but that of private NBFCs' industrial advances remains high at 12.5% and constitutes 21.6% of overall GNPA of the NBFC sector.

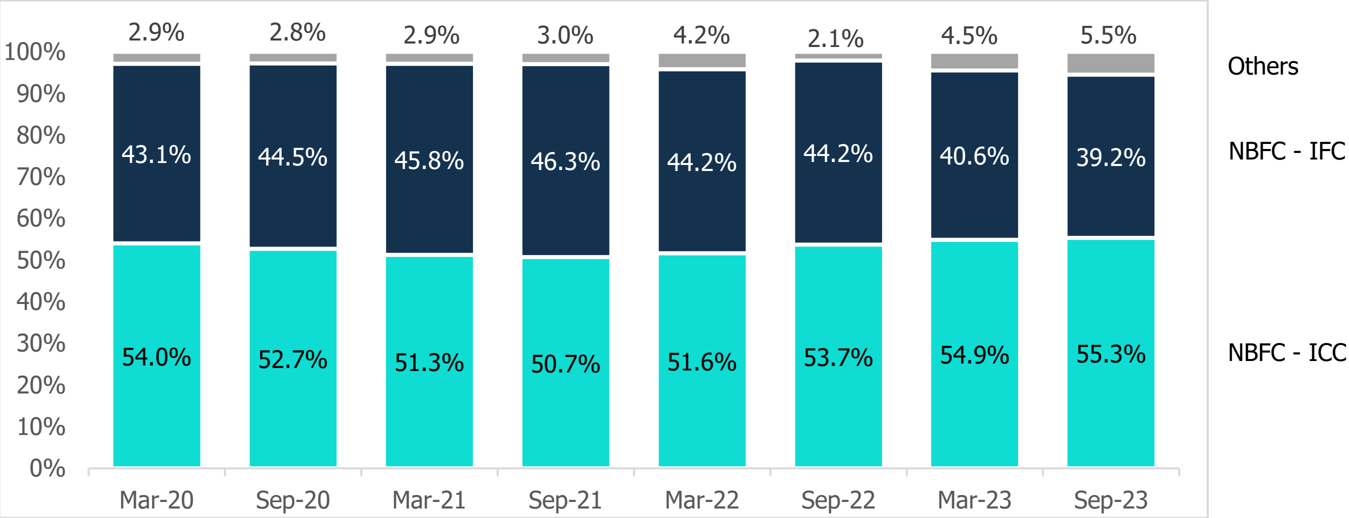
Figure 7: Stable CRAR



Source: RBI Financial Stability Reports

The capital position of NBFCs as measured by CRAR remained healthy, with CRAR at 27.6% in September 2023, significantly above the regulatory minimum requirement of 15%.

Figure 8: 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 around 95% size of all NBFCs. As at end-September 2023, NBFC-ICCs' share was 90.1% of total retail credit, with NBFC-MFIs accounting for the balance 9.9%. Meanwhile, NBFC-IFCs had a share of 75.1% in gross industrial credit by the NBFC sector, with the top ten sectors accounting for 83% of their large loans.

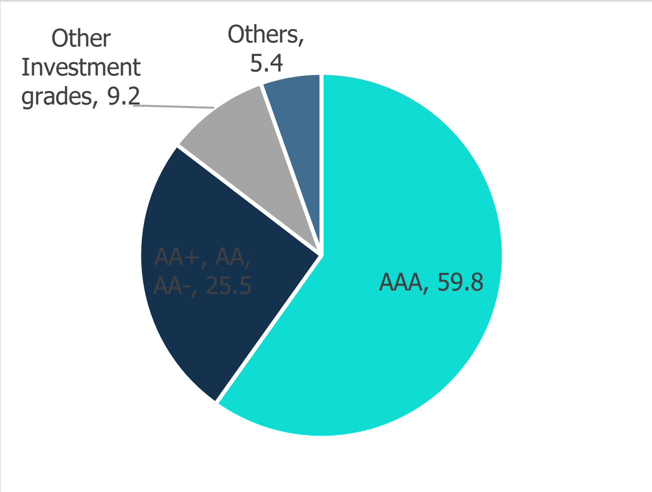
Figure 9: NBFCs' Share of Sources of Funds (%)

Description	Mar-21	Mar-22	Mar-23	Sep-23
Share Capital, Reserves and Surplus	26.7	29.4	29.1	27.9
Total Borrowings	63.0	60.6	61.5	62.1
Of which:				
Borrowing from banks	19.8	20.6	21.9	22.2
CPs and Debentures subscribed by banks	3.4	3.3	3.0	2.8
Total from banks	23.2	23.8	25.0	25.0
CPs and Debentures excluding banks	24.4	21.8	21.0	21.5
Others	10.2	10.0	9.5	10.0
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: RBI Financial Stability Reports

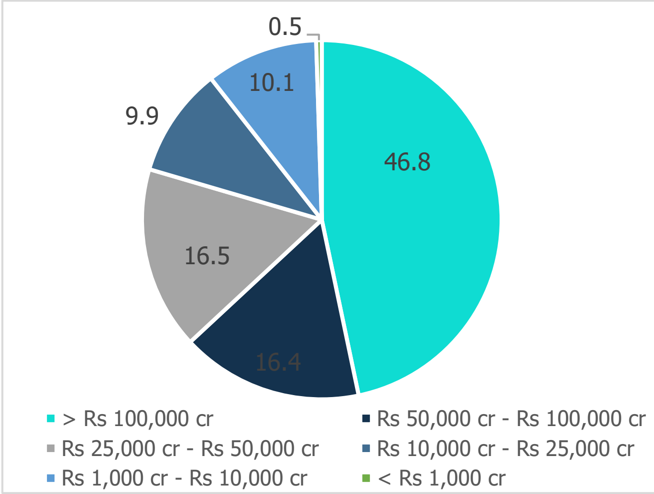
The reliance on funding from banks has gradually risen. Over 75% of resources mobilised from banks were secured in nature and more than 85% of such borrowings were by highly rated NBFCs (AA- and above). Large NBFCs with asset size above Rs. 25,000 crore accounted for nearly 80% of resources mobilised from banks.

Figure 10: Rating-wise Distribution of NBFCs Resources Mobilised from Banks (%)



Source: RBI Financial Stability Reports

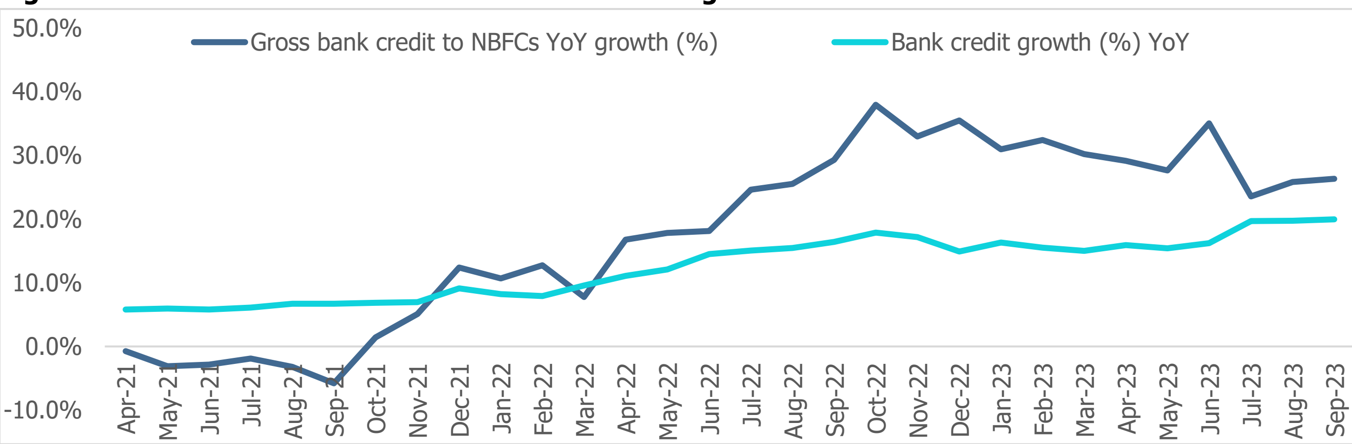
Figure 11: Asset Size-wise Distribution of NBFCs Resources Mobilised from Banks (%)



Source: RBI Financial Stability Report June 2023

The advances of banks to NBFCs stood at Rs 14.2 lakh crore in September 2023, indicating a 26.3% year-on-year (y-o-y) growth which has been higher than aggregate bank credit growth. This expansion is indicative of the robust progress observed in NBFCs during the post-pandemic period. Furthermore, the proportion of NBFC exposure in relation to aggregate credit has risen from 8.9% in September 2022 to 9.4% in September 2023.

Figure 12: Growth in Advances to NBFCs has been higher vis-à-vis overall Bank Credit Growth



Source: RBI, CareEdge Calculations

Hence, along with an increase in the risk weights of consumer loans, RBI has also prescribed an increase in risk weights for advances to AAA-A-rated NBFCs by 25%, while higher risk weights would not be applicable for entities in the BBB+ and below rating categories. This excludes the risk weights for bank loans to HFCs or bank loans backed by PSL loans.

Figure 13: Risk weights for NBFCs

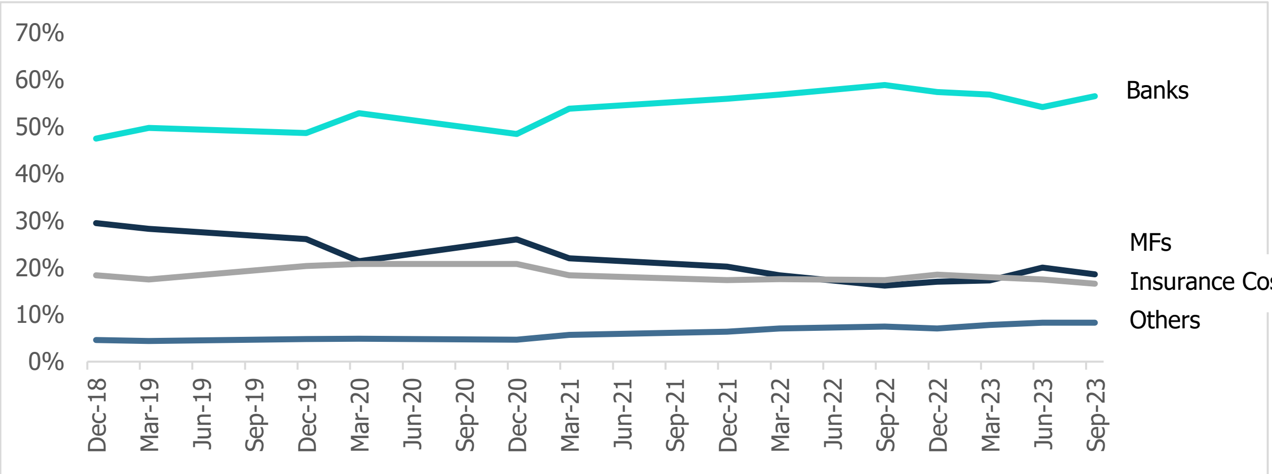
Rating	AAA	AA	A
Current	20%	30%	50%
Revised	45%	55%	75%

Source: RBI, CareEdge

The momentum of bank lending to NBFCs which are not covered by the PSL guidelines could likely moderate as this will likely impute higher cost of funds (due to higher risk weights) for entities rated A- and above. The highly rated NBFCs would drive towards the capital markets. Hence, aggregate dependence of mid and smaller-sized NBFCs on the banking sector for funding is likely to remain high (despite an anticipated increase in lending cost by 25-30 bps) while larger NBFCs will continue to diversify their funding sources. This could lead to a greater than normal increase in securitisation and co-lending partnerships as a liability source for NBFCs.

Movement in Share of Lender Groups

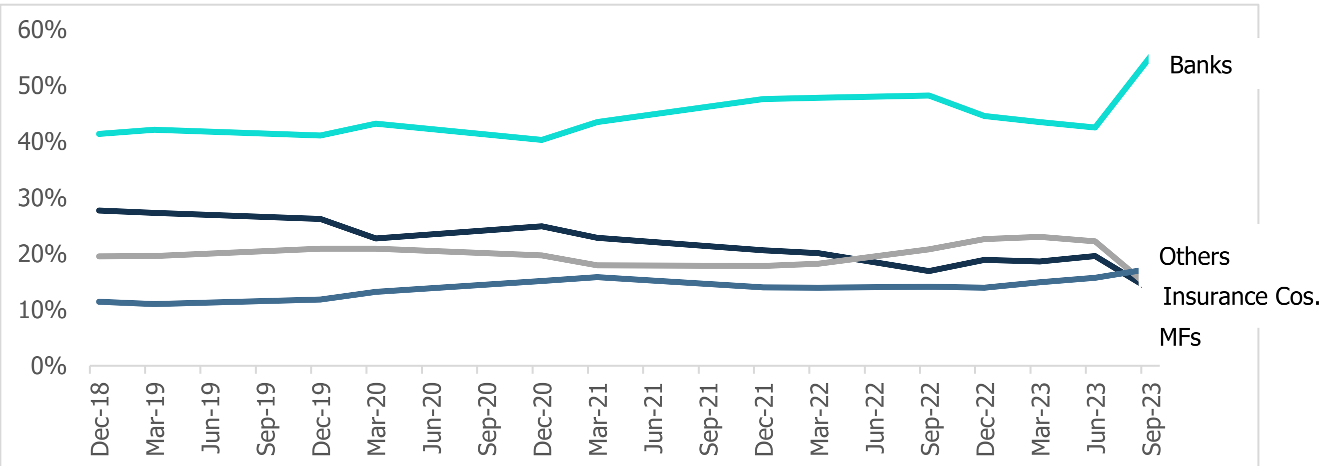
Figure 14: NBFCs – Share of Banks Remains Above 50% in Q2FY24



Source: RBI Financial Stability Reports

NBFCs are the largest net borrowers of funds from the financial system. NBFCs owed close to 56.5% in Q2FY24 to Banks followed by 18.6% (16.2% in Q2FY23) to MFs and 16.6% (17.4% in Q2FY23) to insurance companies. The share of MFs and Insurance companies has been on a declining trend for several quarters but has held broadly steady for the last few quarters. The share of Banks has remained the highest and the share of MFs and Insurance Companies decreased on a quarterly basis. 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.

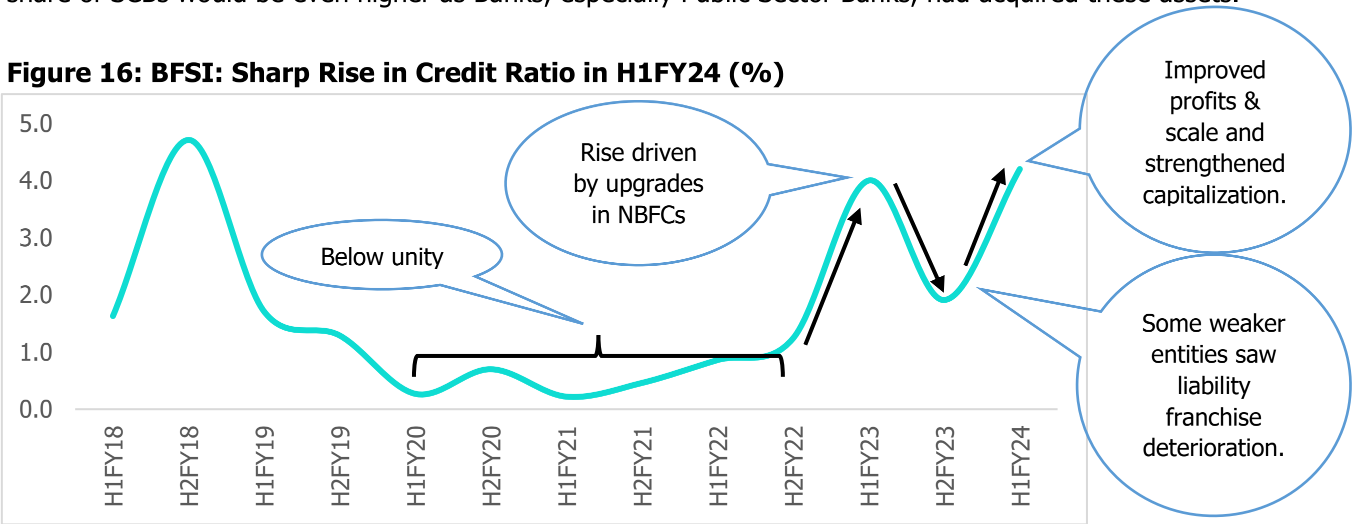
Figure 15: Housing Finance Companies (HFCs) – Share of Banks Shoots Up in Q2FY24



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 sharp upward trend in Q2FY24 which can be attributed to the merger of HDFC Ltd with HDFC Bank, while Insurance companies and MFs showed a downward trend for the same period. This movement can be attributed to HDFC having a diverse liability franchise compared to others, and with HDFC merging into HDFC Bank, share of banks has increased. 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 16: BFSI: Sharp Rise in Credit Ratio in H1FY24 (%)



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.

Banks & Financial Services reported healthy credit ratio over the past two years with the trend continuing in H1FY24.

- Post COVID and related asset quality concerns, credit ratio for the BFSI sector crossed unity for the first time in H2FY22 after a period of three years. Subsequently, with the sector demonstrating improvement in asset quality and strong equity capital raising abilities, Credit Ratio rose to 4.00 in H1FY23.
- The Credit Ratio though witnessed a dip in H2FY23, stood strong at 1.91 in H2FY23 and peaked at 4.20 in H1FY24. Credit Ratio during H1FY24 is driven by improved profitability with most of the players in financial services scaling up the businesses and strengthening the capitalization through fresh equity mobilization.
- Credit Ratio improvement of banking players during this period was driven by sharp improvement in Net Interest Margins (NIMs) supported by hardening interest rate environment, improved asset quality and capitalization metrics.

Despite rising interest rates, profitability in midsized NBFCs/financial services will be protected, due to optimization of operating expenditure (opex), moderated increase in interest rates and lower credit costs. Against this backdrop, the credit outlook is expected to be stable 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 tilt towards retail continues along with improved asset quality levels. The unsecured personal loans might see some slowdown due to RBI actions. The share of banks as a lender to NBFCs has remained above 50% as Large NBFCs with asset size above Rs. 25,000 crore accounted for nearly 80% of resources mobilised from banks. Hence RBI has increased requirement for capital for banks.

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