NBFCs Witness Improvement in Asset Quality in H1FY23

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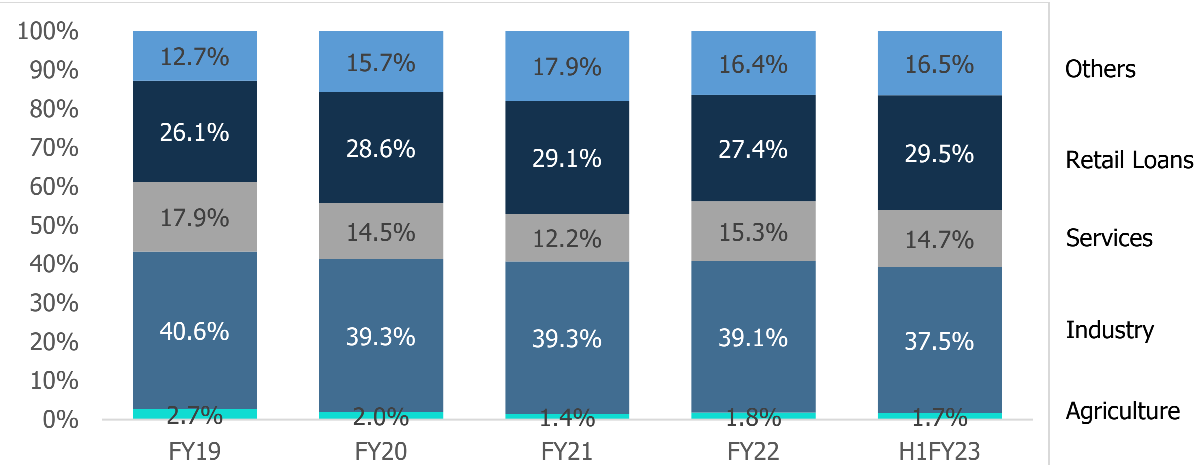
Synopsis

- A shift in the segmental distribution of credit with a tilt towards retail and a fall in the industry has been observed.
- Asset quality has improved, and SMA numbers have broadly reduced.
- Large NBFCs (NBFC-UL)[1] group recorded higher credit growth (y-o-y) of 17.2% and a better GNPA ratio of 4.2% as of September 2022 than the overall NBFC sector.
- In FY23 (April to November), NBFCs and HFCs remained the major issuers listed bonds during the year, while banks and body corporates were their major subscribers.

Segmental Movement in Credit – Share of Industry reduces, retail loans increase

Over 9,000 NBFCs are currently registered with the RBI. Even though the combined balance sheet size of NBFCs is approximately one-fifth when compared with the Scheduled Commercial Banks (SCBs), NBFCs play a significant role in the last-mile credit delivery. At the end of H1FY23, aggregate credit extended by NBFCs grew by 13.1% and stood at Rs 31.5 lakh crores.

Figure 1: Segmental Distribution of Credit



Source: RBI Financial Stability Report December 2022

Over the last four and half years, loans to industry lost market share from 40.6% in FY19 to 37.5% in H1FY23 and yet continued to constitute the largest segment, followed by personal loans at 29.5%, services at 14.7% and agriculture at 1.7%. Advances to service and retail segments grew the fastest in H1FY23. Government-owned NBFCs have been ceding ground in the industry segment. According to RBI's Financial Stability Report December 2022, NBFC-UL group recorded higher credit growth (y-o-y) of 17.2% and a better GNPA ratio of 4.2% as of September 2022 than the overall NBFC sector.

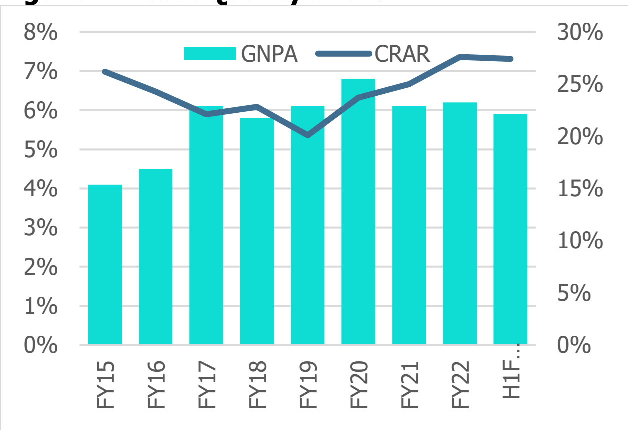
[1] The Scale Based Regulation (SBR) introduced for NBFCs classifies them into four layers namely Base Layer (NBFC-BL), Middle Layer (NBFC-ML), Upper Layer (NBFC-UL) and Top Layer (NBFC-TL) based on their size, activity, and perceived riskiness. Recently, sixteen entities have been identified for categorisation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

Asset Quality Improves, while Capital Adequacy Remains Adequate

The GNPA ratio declined in September 2022 as it neared the sector's pre-pandemic levels. However, Special mention accounts (SMAs), however, increased from 8.5% per cent of total advances in December 2021 to 10.8% in September 2022.

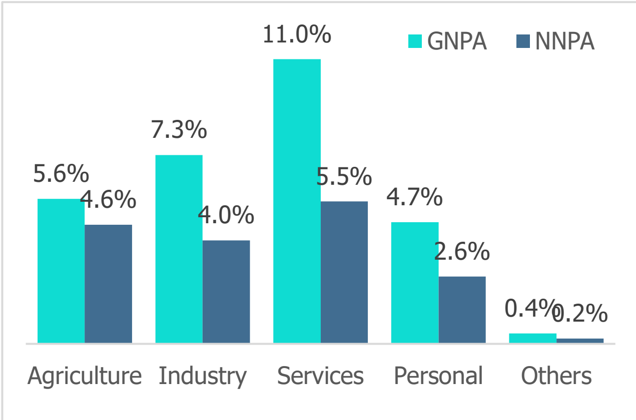
The capital adequacy (CRAR - Capital to Risk (Weighted) Assets Ratio) of NBFCs continued to be robust as of September 2022. The marginal decline was attributed to rising lending activities.

Figure 2: Asset Quality and CRAR



Source: RBI Financial Stability Report December 2022

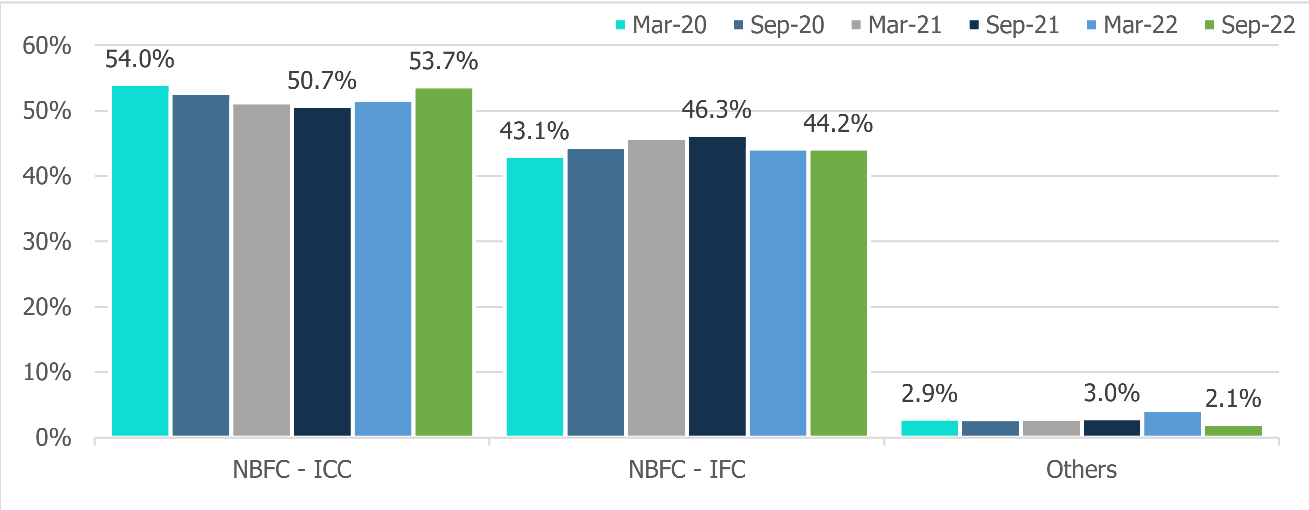
Figure 3: Segmental Asset Quality (Sep. 2022)



Source: RBI Financial Stability Report December 2022

Movement in Asset Quality Ratios across Select NBFC Categories

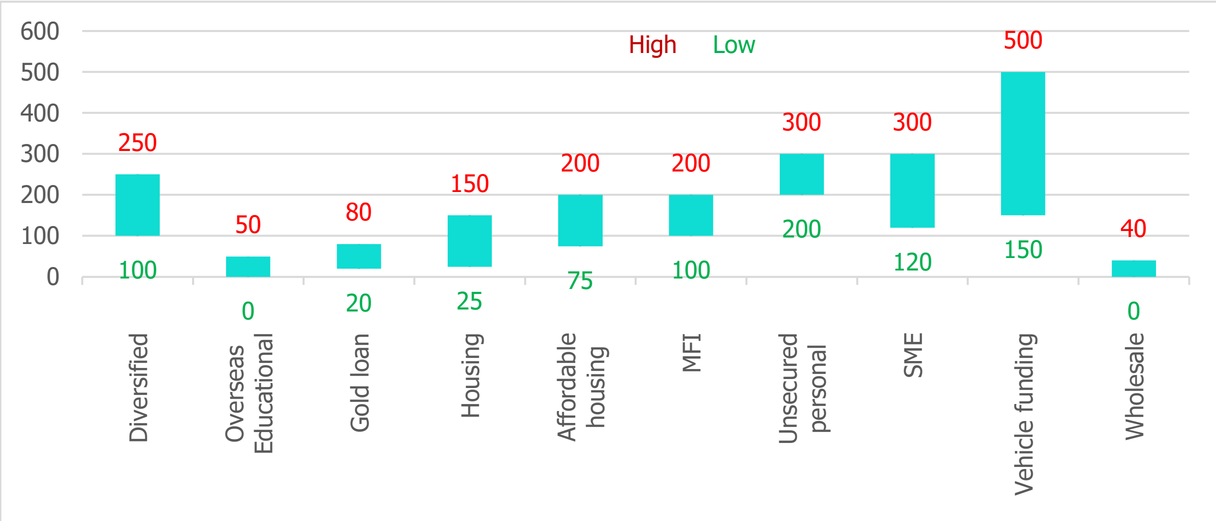
Figure 4: Share in Total Advances



Source: RBI Financial Stability Report December 2021 and 2022; 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. NBFC-IFC witnessed an increase in the SMA-2 numbers, while stress has reduced in NBFC- ICC. The revised asset classification norms, which came into effect from October 1, 2022, mandates that all NBFCs are required to collect the entire arrears to upgrade an NPA. Asset classification would start exactly from the overdue date, unlike the present practice of starting 90 days from the end of the month in which the account becomes overdue. These regulatory refinements may impact asset quality in the near term. The figure 5 captures CareEdge's expectations of the estimated impact of IRAC norm changes.

Figure 5: Estimated impact of IRAC norm changes (in bps)

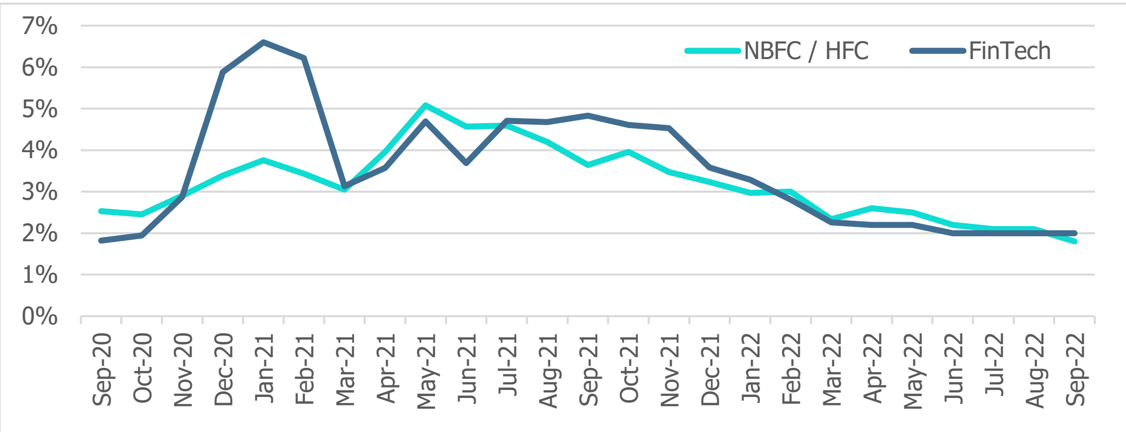


Source: CareEdge Calculations

The impact enumerated in figure 5 is the overall impact on particular asset classes. Various NBFCs have moved to this system over reporting periods of Q3FY22 to Q3FY23. Hence, the impact of revising asset classification norms has gradually been baked in.

Consumer Credit Quality on an Uptrend

Figure 6: Delinquency Levels in Aggregate Consumer Credit

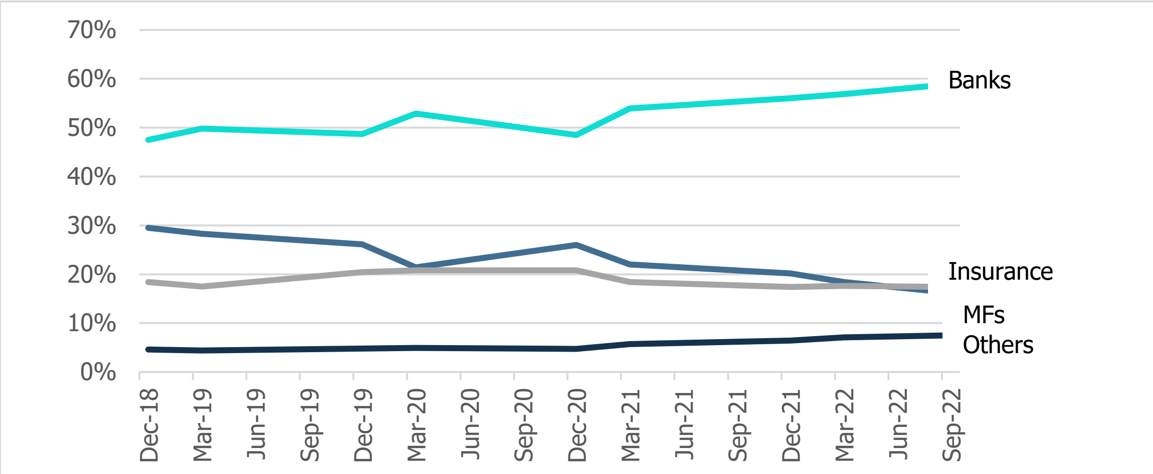


Source: RBI Financial Stability Report December 2022

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 H1FY23 after the pandemic. However, on account of the increase in policy rates and the subsequent impact on overall asset quality, would require closer monitoring. Generally, short-term personal loans are written off within 180 to 360 days. Hence, the stock of GNPA is usually low.

Movement in Share of Lender Groups

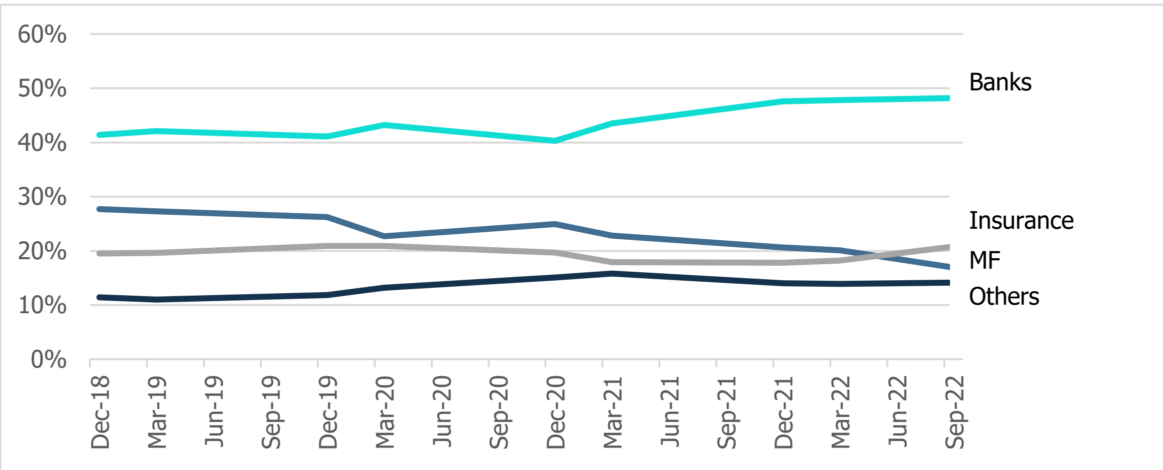
Figure 7: NBFCs – Share of Banks on a Rise



Source: RBI Financial Stability Report December 2022

NBFCs are the largest net borrowers of funds from the financial system. NBFCs owed close to 59% (57% in FY22) to Banks followed by 16.2% (18.4% in FY22) to MFs and 17.4% (17.6% in FY22) to insurance companies. The share of Banks has continued to rise as yields hardened in the bond market. The share of MFs and Insurance companies have been on a consistent declining trend for the last several quarters. This is due to a mix of higher interest rates in the bonds markets led by higher long-term G-Sec rates and risk aversion in the debt capital markets restricting funding availability for NBFCs rated lower than the highest categories. 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 (PSBs were significant acquirers of these assets).

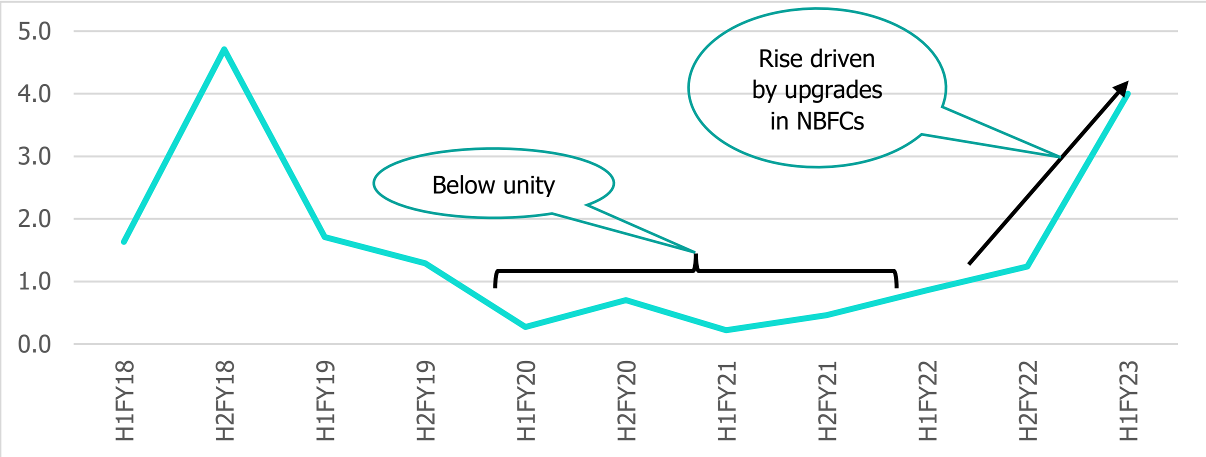
Figure 8: Housing Finance Companies (HFCs) – Share of Banks Remains High



Source: RBI Financial Stability Report December 2022

HFCs were the second-largest borrowers of funds from the financial system. The share of Banks and Insurance companies showed an upward trend for the same period (%), while MFs as a funding source has reduced significantly 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 9: BFSI: Sharpest rise in Credit Ratio (%)



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.

NBFCs and HFCs saw major upgrades in the BFSI sector. Higher proportion of upgrades in H1FY23 attributed to:

- Proven resilience in business and asset quality, despite liquidity crisis and Covid impact, especially for NBFCs funding mortgages and other secured assets.
- Significant fund infusion by promoters and marquee private equity players.
- Scaling up of operations and asset base supported by liquidity and restricted leverage.
- The credit outlook is expected to be stable for Banks and NBFCs with scaling up of operations.
- Overall, NBFCs/HFCs have shown significant growth in Q1FY23 which is likely to sustain for the rest of the year with improved access to equity and bank funding.
- Ability to access debt funding and rising interest rates are key monitorables. Rising interest rate is a risk to both profitability as well as to the ability of borrowers to repay.

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 continued to increase as yields hardened in the bond market. Macro stress tests indicate that under the baseline scenario, the GNPA of NBFCs reduces to 5.8%, while under the medium risk and high risk, the GNPA ratio rises to 6.9% and 8%, respectively.

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