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Non-banking Financial Companies

Paradigm shift towards unsecured loan segment, a key driver of overall NBFC growth

JULY 2023

Highlights

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Unsecured loan AUM stood about Rs. 5.1 trillion as of March 2023; expected to expand by 26-28% in FY2024

Co-lending and partnership-based AUM grew by more than 3x during FY2023

Loan losses in unsecured loans (excluding microfinance) can go up to ~2-4x of the overall NBFC retail loan losses

- Unsecured loans of non-banking financial companies (NBFCs) grew at a robust pace in most of the previous years (FY2019-FY2023), barring the Covid-19 pandemic-affected period. While the base was low in the past, it currently accounts for a sizeable share (24%) of the NBFC retail loan book (Rs. 21.2 trillion as of March 2023).
- The assets under management (AUM) in the unsecured loan segment stood about Rs. 5.1 trillion as of March 2023, consisting of personal loans, consumption loans (CL), microfinance and unsecured small and medium-sized enterprise (SME) loans. Loans other than microfinance accounted for 70% of the overall unsecured loans. Overall unsecured loans are expected to expand by 26-28% in FY2024.
- New lenders in the space include entities, which have diversified to this segment either directly via cross-sell or indirectly via partnerships with fintechs and other smaller lenders. Digitisation and access to commensurate borrower-level data have played a key role in the recent growth spurt.
- Co-lending and partnership-based AUM grew by more than 3x in FY2023 as larger NBFCs and banks looked to grow their retail books and diversify by adding new borrowers and venturing into newer asset segments.
- Disbursement growth in unsecured loans (excluding microfinance) exceeded AUM growth, barring the pandemic period, because of their shorter tenure, higher prepayments and top-ups/loan renewals, basis borrower requirement and higher loan eligibility. This has led to a steadily increasing disbursement to AUM ratio. In March 2023, the ratio was >100%, indicating a high churn in these loans.
- Coming out of the pandemic, the underwriting policies were tightened; it is crucial for the lenders to keep the thresholds higher for good quality growth going forward. Considering the high churn in the portfolio, the borrower's credit track record would have to be assessed more rigorously.
- Loan losses in unsecured loans (excl microfinance) can go up to ~2-4x of the NBFC retail loan losses. Entities have a stringent write-off policy. While loan losses in this segment are expected at 4-6% on a steady-state basis, this segment can generate adequate risk-adjusted returns at a commensurate scale.

NBFCs including housing finance companies (HFCs); Consumption loans (CL) include consumer durable loans, education loans, credit card outstanding (o/s) and other lifestyle finance

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Thank You!