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Non-Banking Financial Companies (NBFCs)

Series of regulatory actions; necessary prudence for an orderly sector expansion

March 2024

Highlights

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Downside risks to FY2025 growth higher post the series of regulatory actions; NBFC-Others would be most impacted

Weakening in funding environment heightens earnings slippage risk from projected levels for FY2025; ICRA expect a 20-30 bps impact for NBFC-Others.

Overall risk profile of the sector, however, is expected to remain under control on the back of adequate capital

Downside risks for assets under management (AUM) growth for non-banking financial companies (NBFCs) in FY2025 have increased over the recent past, with a series of regulatory actions across the financial sector space. Slower AUM growth could pose near-term challenges; however, risk profiles are largely under control, characterised by limited (vis a vis recent historical trend) loan quality concerns and an adequate capital profile.

Actions on the sector and some NBFCs indicate concerns around high credit growth in the space and other operational & regulatory lapses observed in the recent past in those entities. Thus, notwithstanding the near-term performance impact, especially earnings, it is critical for entities to slow down growth, to stem the increase of regulatory tightening and for an orderly sector expansion.

In view of the above, growth could take a back seat in the near term. ICRA believes that the NBFC sector could witness a 1-3% moderation vis-a-vis base expectation (13-15% YoY growth in FY2025) as entities look to improve their controls and compliances. The funding environment is expected to remain tight.

ICRA has classified NBFCs into three categories*- **NBFC-Infra, HFC and NBFC-Others**. **NBFC-Others** will be most impacted; 2-4% growth moderation is possible from the 17-19% base case projected levels for FY2025. While the **HFCs** would also witness some downside, **NBFC-Infra**, which largely constitutes Government-owned entities with measured growth expectations, would be the least impacted.

Bankers are the largest lenders to the NBFCs and banking credit growth is likely to slow down in FY2025. Apart from direct lending, they also invest in the debt papers and securitisation transactions by the NBFCs. Within the banking space, private banks, in the recent past, have steadily increased their share in extending credit.

Private banks operate at a higher credit-deposit (CD) ratio at present and are thus likely to face elevated headwinds in maintaining credit flow like in the recent past. The NBFCs, thus, face the risk of increase in the cost of funds (CoF) in FY2025 vis-a-vis previous expectations.

ICRA expects **NBFC-Others'** asset quality to weaken marginally in FY2025, this, along with slower growth and higher cost of funds, may affect their earnings. A 20-30 bps hit on expected return on managed assets (RoMA) of 2.5-2.7% for **NBFC-others** is likely, and minimal impact on the HFCs, if the above pans out.

*Source: ICRA Research; *NBFC-Others (Excluding Housing Finance Companies[HFCs] and NBFC-Infrastructure finance companies [NBFC-Infra])*

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Thank You!