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Assessment of Systemic Importance of Non-Banking Financial Companies (NBFCs) for the Indian Financial System

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Abstract

Non Banking Finance Companies (NBFCs) have changed the way banking is done in India. They have emerged as key players in the financial system. The amount of asset base they possess, credit they have borrowed and the amount of credit they have lent to various industries make them systemically very important for the Indian Financial System. This paper through secondary data analyzes the financial exposures and performance of both deposit taking and non deposit taking NBFCs. The issue of public deposits held by NBFCs accepting deposits and their exposures to various sectors have been studied in depth. Financial exposure and performance of NBFCs not accepting deposits and systemically important has been analysed and found to be commanding dominant share in the total market. The strong financial and profitability parameters have shown that NBFCs are performing better than Public Sector Banks in terms of Cost to Total Assets Ratio, Income to Total Assets Ratio, Net Profit to Total Assets Ratio, Gross Non Performing Assets to Total Assets Ratio and Net Non Performing Assets to Total Assets Ratio. However, the concern of shadow banking and fly by night NBFCs still loom large.

Keywords: NBFCs, Systemic Importance, Financial Exposure, Financial Performance, Shadow Banking, Non Performing Assets.

Introduction

The Non Banking Finance Companies have challenged the status quo of Indian Banking.

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares, stocks, bonds, debentures and securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale or purchase or construction of immovable property.[1]

NBFCs are similar to banks in all other activities except for the following differences[2]:

1. NBFC cannot accept demand deposits;
2. NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself;
3. Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

NBFCs are key players in the credit sector in India. Through their increased presence, flexibility, risk taking abilities and low operating costs they are enjoying a healthy market share in the total industrial and consumer credit sector. They directly compete with the banks.

However, Capital adequacy norms; CRR or SLR requirements; single and group borrower limits; prudential limits on capital market exposures; and the restrictions on investments in land and building and unquoted shares are not applicable to NBFCs – Non Deposit Taking.[3]

This paper through secondary data analysis provides deeper insights into the industry of NBFCs in India and attempts to assess the systemic importance they hold for the Indian Financial System.

Aim of the Study

This paper aims at studying the NBFC sector to;

1. Assess the systemic importance of NBFCs accepting and not accepting deposits.
2. Assess the financial Exposure of NBFCs vis a vis Banks, and other players in the financial system.
3. Assess the financial performance of the NBFCs
4. To identify the issues of Shadow Banking and to highlight the regulatory differences in regulating Banks and NBFCs
5. To assess the levels of NPA in NBFCs and to highlight the NPA management of NBFCs.

Broadly the NBFCs are divided into Deposit taking and Non Deposit Taking NBFCs.

Deposit Taking NBFCs

There is a deeper concern with regard to allowing NBFCs to accept deposits from people. Therefore the new licenses are not being issued to new NBFCs for accepting public deposits.

As a matter of public policy, Reserve Bank has decided that only banks should be allowed to accept public deposits and as such has since 1997 not issued any Certificate of Registration (CoR) to new NBFCs for acceptance of public deposits.[4]

In total there are 88 deposit taking NBFCs holding a valid CoR as on 30th April 2019.[5]

The financial performance of NBFCs accepting deposits is presented below.

Table: 01 Financial Performance of Non-Banking Finance Companies Accepting Public Deposits (NBFCs-D) in India

(2012-2013 to 2018-2019-upto September 2018)

(Amount : Rs. in Billion)

Items	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019*
A. Income	188	217	280	357	402	480	284
B. Expenditure	138	166	220	285	325	374	206
C. Tax Provisions	16	15	19	23	26	36	26
D. Operating Profit (PBT)	50	59	60	72	77	106	78
E. Net Profit (PAT)	34	43	41	49	50	70	51
F. Total Assets	1251	1885	1847	2399	2781	3460	3799
G. Cost to Income Ratio	73.4	76.4	78.5	79.8	80.9	77.8	83.3

Source: Reserve Bank of India

Analysis

The fund based incomes are much larger than the fee based incomes. A very interesting scenario is evident when we look at the Cost to Income ratio of the NBFCs. There is a consistent increase in the cost to income ratio which is a major concern faced by the companies.

There is also another very important statistics which is note worthy. Public Deposit protection caught the attention of the law makers with the following.

Table 2: State-wise Disappearance of Companies after Collecting Funds from the Market in India (As on 30.06.2001)

States	No. of Companies
Andhra Pradesh	22
Bihar	7
Delhi	33
Gujarat	65
Karnataka	11
Kerala	1
Madhya Pradesh	10
Maharashtra	19
Orissa	4
Punjab	7
Shillong	1
Tamil Nadu	21
Uttar Pradesh	10
West Bengal	18
India	**229**

Source: Rajya Sabha Unstarred Question No. 859, dated 30.7.2001.

Large number of companies disappearing after collecting public funds from the markets in India has led to a situation of apprehension. Therefore RBI has stopped issuing new licences to NBFCs for accepting public deposits. RBI released a List of NBFCs categorized as 'High Risk Financial Institutions' (by FIU-IND) on account of non compliance with PMLA and PML Rules, i.e. non registration of Principal Officer (PO) as on 31.01.2018. In total there were 9491 NBFCs categorized as high risk.[6]

Ownership Pattern

Table 03 clearly indicates that Non Govt. companies own almost all of the Deposit taking NBFCs. Therefore, a greater risk is there with respect to the deposits mobilized by the NBFC-Ds.

Table 03: Ownership Pattern of Non-Banking Financial Company-Deposit-taking (NBFC-D) in India (As on 31st March, 2014 to 2017)

Amount: Rs. in Billion

Types	2014		2015		2016		2017 (P)	
	Number	Asset Size	Number	Asset Size	Number	Asset Size	Number	Asset Size
Government Companies	5	251	5	271	5	285	2	273
Non-Government Companies	210	1506	195	1781	169	2114	123	2482
Total	**215**	**1757**	**200**	**2052**	**174**	**2399**	**125**	**2755**

Source: Reserve Bank of India

Reserve Bank of India cancelled licenses of several NBFCs and barred those from accepting public deposits. This was aimed at ensuring that the NBFCs don't get to misuse the public deposits they had collected. As on 30th June 2018, licenses of 3,363 NBFCs were cancelled by RBI due to non compliance.[7] The primary reasons were that promoters did not comply with the regulations of RBI. RBI specifically prohibited the following companies from accepting public deposits.

Table 04: List of Deposit accepting NBFCs registered with RBI that have been prohibited from accepting deposits under Section 45 MB of RBI Act, 1934 (As on April 30, 2019)

Sr. No.	Company Name	CoR Number	Date of issue of Prohibitory Order
Chennai			
1	Integrated Finance Company Limited	A-07.00248	18-01-2005
2	Indo Asia Finance Ltd	A-07.00308	04-02-2016
3	Sri Vijayaram Hire Purchase & Leasing Finance Ltd	A-07.00251	11-05-2018
Kanpur			
1	Proficient Leasing & Finance Company Ltd	A-12.00.286	20-02-2014
2	Balaji Instalments Ltd	A-12.00269	18-09-2018
Bengaluru			
1	Trikaal Leasing and Finance Limited	A-02.00081	16.11.2016
Residuary Non-Banking company which has been prohibited from accepting deposits by RBI			
Kolkata			
1	Peerless General Finance and Investment Ltd	A-05.05605	

Source: Reserve Bank of India

Therefore we can sum up that when it comes to Public Deposits the Reserve Bank of India has been very strict on the NBFCs. Several steps have been taken by RBI to make the NBFCs accountable. The systemic importance of the NBFC-Ds can be estimated from the fact that the total assets as per Table 01 stands at RS. 3,799 Billion in the year 2018-19. Exposure of this extent makes the NBFC-Ds collectively systematically very important. Another important aspect is the deposits mobilized by the NBFCs in India. Table 05 highlights the importance of NBFCs in mobilizing Deposits.

Table 05: Deposits Mobilised by NBFC Sector in India (1997-1998 to 2016-2017)

(Rs. in Billion)

Year	NBFCs		RNBCs		Total Public Deposits
	No. of Reporting Companies	Public Deposits	No. of Reporting Companies	Public Deposits	
1997-1998	1420	135.72	9	102.49	238.20
1998-1999	1536	97.85	11	106.44	204.29
1999-2000	996	83.38	9	110.04	193.42
2000-2001	974	64.59	7	116.25	180.85
2001-2002	905	59.33	5	128.89	188.22

2002-2003	870	50.35	5	150.65	201.00
2003-2004	774	43.17	3	153.27	196.44
2004-2005	700	39.26	3	166.00	205.26
2005-2006	428	24.48	3	201.75	226.23
2006-2007	401	20.77	3	226.22	246.99
2007-2008	364	20.42	2	223.58	244.00
2008-2009	336	19.71	2	195.95	215.66
2009-2010	308	28.31	2	145.21	173.52
2010-2011	297	40.98	2	79.02	120.00
2011-2012	271	57.35	2	42.65	100.00
2012-2013	254	70.85	2	38.17	109.02
2013-2014	240	108.08	2	35.82	143.90
2014-2015	220	289.41	2	31.83	321.24
2015-2016	202	356.53	1	15.58	372.11
2016-2017 (P)	178	409.15	1	15.52	424.67

Source: Reserve Bank of India

NBFCs have around Rs.409.15 Billion in public deposits alone which has substantially grown in the last few years.

Non Deposit Taking NBFCs (NBFCs-ND)

Non Deposit taking NBFCs dominate the sphere of NBFCs. They are deeply entrenched in the Indian Financial system. There are very large numbers of NBFCs operating as non deposit taking. These NBFCs for convenience can be functionally divided into the following categories.

1. Core Investing Companies
2. Asset Finance Companies
3. NBFC-Factor
4. NBFC-Micro Finance Institutions
5. NBFC-Infrastructure Debt Funds
6. NBFC-Infrastructure Finance Companies
7. NBFC-Peer to Peer

There are 9,307 NBFCs categorized as NBFC-ND as on April 30, 2019.[8] On the basis of their asset size large NBFCs are categorized as systemically important as NBFC- ND-SI. In total a total of 264 NBFCs are categorized as NBFC-ND-SI[9]. All NBFCs – ND with an asset size of Rs. 500 crore and more as per the last audited balance sheet will be considered as a systemically important NBFC – ND (NBFC-ND-SI).[10]

Now looking at the performance of the Non Deposit accepting NBFCs Systematically Important, we can clearly see those having a large asset base and it is constantly growing.

Table 06: Selected Financial Parameters of Non-Deposit taking Systemically Important Non-Banking Financial Companies (NBFCs-ND-SI) in India (As on March, 2013 to 2017)

(Amount: Rs. in Billion)

Items	**2013**	**2014**	**2015**	**2016**	**2017 (P)**
Total Income	1272	1386	1470	1785	1909
Total Expenditure	1039	1028	1084	1343	1498
Net Profit	233	256	280	318	263
Total Assets	**11601**	**12226**	**12920**	**14832**	**16917**
Financial Ratios (In %age)					
Income to Total Assets	11.0	11.3	11.4	12.0	11.3
Expenditure to Total Assets	9.0	8.4	8.4	9.1	8.9
Net Profit to Total Income	18.3	18.5	19.0	17.8	13.8
Net Profit to Total Assets	2.0	2.1	2.2	2.1	1.6

Source: India stat.com

On the basis of Table 06, we can sum up the following;

1. Total income in absolute terms has constantly risen from Rs. 1,272 in 2013 to 1,909 Billion in 2017.
2. The income to asset ratio has remained on an average at 11.70. That shows a healthy profitability ratio earned by NBFCs. The ROI at 11.7 year on year is an indicator of good performance of NBFCs-ND-SI
3. On an average the NBFCs have contained their expenditures. It has remained at around 8.7 year on year. This has led to good profitability.
4. Net profit to Total Assets Ratio has also been healthy at around 2.1%.

Table 07: Bank Group-wise Amount Borrowed by Non-Deposit taking Systemically Important Non-Banking Financial Companies (NBFCs-ND-SI) in India (As on 31.03.2017)

(Rs. in Billion)

Bank Groups	Term Loans	Working Capital Loans	Debentures	Commercial Paper	Others	Total
Nationalised Banks	936	10	415	157	147	1665
The State Bank Group	330	521	3	179	1	1034
Old Private Banks	281	31	2	0	0	313
New Private Banks	447	103	954	204	106	1814
Foreign Banks	67	3	6	92	3	170
Total Banks	**2060**	**668**	**1381**	**631**	**257**	**4996**

Source: Reserve Bank of India

Table 08: Major Components of Liabilities and Assets of Non-Deposit taking Systemically Important Non-Banking Financial Companies (NBFCs-ND-SI) by Classification of NBFCs in India (As on 31st March, 2016 and 2017)

Amount: Rs. in Billion

Category/Liability/Asset	Year	Asset Finance Company	IDF-NBFC	NBFC-IFC	Investment Company	NBFC-MFI	Loan Company	Total
Liability								
Borrowings	2016	1189	49	4593	1025	413	3402	10671
Other Liabilities		380	17	973	1029	156	1605	4160
Total Liabilities		**1569**	**67**	**5566**	**2054**	**569**	**5007**	**14832**
Borrowings	2017	1167	98	4668	1039	400	4545	11917
Other Liabilities		410	22	1157	1154	204	2053	5000
Total Liabilities		**1576**	**120**	**5825**	**2193**	**604**	**6598**	**16917**
Variation of Total Liabilities (In %age)		0.4	79.1	4.7	6.8	6.2	31.8	14.1
Asset								
Loans and Advances	2016	1390	36	5167	365	422	3660	11039
Investments		44	28	114	1302	27	657	2172
Total Assets		**1569**	**67**	**5566**	**2054**	**569**	**5007**	**14832**
Loans and Advances	2017	1325	81	5287	532	400	4771	12396
Investments		104	33	132	1262	61	963	2555
Total Assets		**1576**	**120**	**5825**	**2193**	**604**	**6599**	**16917**
Variation of Total Assets (In %age)		0.4	79.1	4.7	6.8	6.2	31.8	14.1

Source: Reserve Bank of India

Table 07 and Table 08 clearly establishes that The NBFCs- ND- SI are systematically very important as they command a very large asset base and are suppliers of credit to most of the borrowers in the market. The amount of money they have borrowed from the banking system makes them systematically important.

Now moving to the overall picture of NBFCs in India, we can see the vital aggregates of credit supplied to various sectors by NBFCs, both deposit taking and non deposit taking. They have a large market share of total credits.

Table 09: Amount of Credit to Various Sectors by Non-Banking Financial Companies (NBFCs) in India (As on 31st March, 2016 and 2017)

(Amount: Rs. in Billion)

Items	2016	2017	Share in 2017 (In %age)	Variation (In %age)
I. Gross Advances	**13169**	**14846**	100.0	12.7
II. Non-Food Credit (A to E)	13167	14846	100.0	12.8
A. Agriculture and Allied Activities	392	346	2.3	-11.7
B. Industry	**8063**	**8940**	**60.2**	**10.9**
Micro and Small	326	508	3.4	55.8
Medium	154	172	1.2	11.7
Large	3726	4375	29.5	17.4

Others	3857	3885	26.2	0.7
C. Services	**1865**	**2224**	**15.0**	**19.2**
D. Trade	**279**	**230**	**1.6**	**-17.6**
E. Retail Loans	**2047**	**2490**	**16.8**	**21.6**
F. Other Non-Food Credit	801	847	5.7	5.7

Source: Reserve Bank of India

The credit to various sectors can be viewed from Table 09. Gross advances have risen from Rs. 13,169 Billion in 2016 to Rs. 14,846 Billion in 2017. There has been a 12.7% increase in the amount of credit advanced to various sectors. Industry has been the largest borrower from the NBFCs with 60% of the Advances followed by retail loans and Services.

When we analyze select financial parameters of NBFCs across India we get a clear picture of the extent of performance and systemic importance of the NBFCs.

Table 10: Selected Financial Parameters of Non-Banking Financial Companies (NBFCs) in India (As on 31st March, 2014 to 2017)

(Amount: Rs. in Billion)

Items	**2014**	**2015**	**2016**	**2017**
Income	1713	2009	2142	2310
Expenditure	1279	1495	1628	1822
Net Profit	313	365	367	314
Total Assets	14499	17284	17231	19671
Financial Ratios (As %age of Total Assets)				
a. Income	11.8	11.6	12.4	11.7
b. Expenditure	8.8	8.6	9.4	9.3
c. Net Profit	2.2	2.1	2.1	1.6
Cost to Income Ratio	74.6	74.4	76.0	78.9

Source: Reserve Bank of India

From Table 10, we can clearly see the following trends.

1. Total income in absolute terms has constantly risen from Rs. 1,713 in 2013 to Rs. 2,310 Billion in 2017.
2. The income to asset ratio has remained on an average at 11.9. That shows a healthy profitability ratio earned by NBFCs. The ROI at 11.9 year on year is an indicator of strong performance of NBFCs
3. On an average the NBFCs have contained their expenditures. It has remained at around 8.9% year on year. This has led to good profitability.
4. Net profit to Total Assets Ratio has also been healthy at around 2.3%.
5. The Cost to Income Ratio has been around 76%.

This shows very strong performance of the overall NBFCs in India. They are systematically very important. Looking at the level of credits they have advanced, the amount of total assets they command it is clearly evident that the NBFCs have become absolutely indispensable.

The NBFCs also faced the crisis of NPA. The NPAs of NBFCs excluding state run NBFCs registered with RBI for the past three financial years are as under:[11]

Particulars	**March 2015**	**March 2016**	**March 2017**
Gross NPA to Total Advances (%)	4.60	4.60	4.40
Net NPA to Total Advances (%)	2.50	2.50	2.30

Sorce : India State.com

The NPA levels on an average have been much lower than the Public Sector Banks. The levels of 4.50 of Gross NPA and 2.40 of Net NPA are still quite manageable. But the crisis caused by failure of IL & FS draws sharp attention to levels of NPA of NBFCs.

Shadow Banking by Non Banking Financial Companies (NBFCs)

Shadow banking means offering of products and services similar to commercial banks by non banking financial intermediaries outside the purview of banking regulations. Many financial institutions that act like banks are not regulated like banks. This creates a regulatory vacuum in the banking sector. There exists strong interdependence between the players in the financial system. Therefore, regulating every player adequately can only ensure orderly development of the financial system. NBFCs for their shadow banking operations in India are not adequately regulated. Therefore a systemic crisis is imminent. The IL & FS crisis is a warning signal. This paper attempts to study the extent and effect of shadow banking operations by systemically important NBFCs.

Shadow Banking Operations of NBFCs

However, they are not regulated like banks by RBI. This gives them additional flexibility and competitive edge over the banks. The areas where Banks and NBFCs converge in operations but differ in terms of regulations in India are listed below.

Similar Operations	**Regulation for Banks**	**Regulation for NBFCs**
Lending to priority sector	Priority Sector includes the following categories:	NBFCs can jointly lend with Banks with a single blended

	(i)Agriculture (ii) Micro, Small and Medium Enterprises (iii)Export Credit (iv) Education (v) Housing (vi) Social Infrastructure (vii) Renewable Energy (viii) Others Directly applicable to banks.	interest rate.
Borrowing through non convertible debentures	Permitted	Permitted
Prudential norms	Applicable	Not Applicable (except NBFC-D and NBFC-ND-SI)
NPA norms	Applicable	Not Applicable (except NBFC-D and NBFC-ND-SI)
BASEL Norms	Applicable	Not Applicable (except NBFC-D and NBFC-ND-SI)

Conclusion

To conclude, the NBFCs are inevitable for the success of the financial system. Through proper regulation the concerns of misuse of public money, NPA and rising instances of shadow banking could be curbed. The NBFCs are deeply entrenched in the financial system. They are indispensable.

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